Initiating Coverage | Auto Ancillary

June 16, 2015

Rane Brake Lining

No Brake to its Ascent

Rane Brake Lining (RBL) is engaged in the manufacture of safety critical friction material products viz brake linings, disc pads and brake shoes. It is the leader in the automobile OEM (Passenger and commercial vehicle) segment with a 38% share, while it has an 18% share in the aftermarket segment.

Recovery in OEM segment coupled with aftermarket focus to drive growth
Passenger vehicle and the MHCV OEM segment, which contribute about 47% to RBL's revenues, are in an uptrend and slated to grow in double digits over the next two years. Improved economic growth, further easing of interest rates, lower fuel prices and low base during the recent slowdown period would lead to an OEM upcycle in FY2016/17. RBL, with its market leadership (38% market share) and well established client base, would reap benefits from an anticipated upsurge in demand. Further, RBL's strategy to enhance its distribution network in underpenetrated Northern and Eastern markets and to introduce new products, is likely to boost its aftermarket revenues. We expect RBL's aftermarket segment (constituting 38% of sales) to grow at 14% CAGR over FY2015-2017. RBL is likely to outpace the industry and further augment its share in the aftermarket segment (current aftermarket share is 18%).

Operating leverage, raw material localization and energy savings to augment margins
RBL would reap benefits of operating leverage given the double digit top-line growth over the next two years. Also, it is working on enhancing the localization levels. Imported raw material currently forms about 48% of the material costs and the company aims to realize 100-200bp cost reduction with increased domestic procurement. Further, RBL is also working towards reducing its energy costs by implementing best practices across manufacturing plants and utilizing power from low cost sources. We expect RBL's margins to improve by 70bp over FY2016/17.

Outlook and valuation: RBL's revenues are estimated to grow at 12% CAGR over the next two years. Upsurge in OEM volumes coupled with focus on the aftermarket segment would drive the top-line. Also, the company's margins are expected to improve on account of operating leverage, enhanced local procurement and energy savings. Given the healthy top-line growth and margin improvement, RBL's earnings are likely to grow at a CAGR of 17% over FY2015-2017. Its return ratios are also estimated to expand due to margin improvement and reduction in leverage. **We initiate coverage on RBL with a Buy recommendation and target price of ₹336 (based on 12x FY2017 earnings).**

Key financials

Y/E March (₹ cr)	FY2014	FY2015	FY2016E	FY2017E
Net sales	384	416	460	520
% chg	*2.0*	*8.4*	*10.5*	*13.0*
Net profit (Adj.)	17	16	19	22
% chg	*89.1*	*(6.4)*	*15.4*	*19.0*
EBITDA margin (%)	10.5	10.9	11.3	11.6
EPS (₹)	21.7	20.4	23.5	28.0
P/E (x)	13.0	13.9	12.0	10.1
P/BV (x)	2.0	1.8	1.7	1.5
RoE (%)	15.3	13.2	14.0	15.2
RoCE (%)	11.9	13.3	15.7	16.7
EV/Sales (x)	0.8	0.7	0.6	0.6
EV/EBITDA (x)	7.5	6.3	5.4	4.9

Source: Company, Angel Research, Note: CMP as of June 15, 2015

BUY

CMP	₹282
Target Price	₹336
Investment Period	12 Months

Stock Info	
Sector	Auto Ancillary
Market Cap (₹ cr)	223
Net Debt (₹ cr)	61
Beta	1.3
52 Week High / Low	387 / 212
Avg. Daily Volume	650
Face Value (₹)	10
BSE Sensex	26,587
Nifty	8,014
Reuters Code	RABL.BO
Bloomberg Code	RABL@IN

Shareholding Pattern (%)	
Promoters	66.5
MF / Banks / Indian FIs	10.9
FII / NRIs / OCBs	-
Indian Public / Others	22.6

Abs. (%)	3m	1yr	3yr
Sensex	(6.7)	5.4	56.9
RBL	(12.5)	27.8	148.2

3-Year Daily price chart

Source: Company, Angel Research

Bharat Gianani
022-39357800 Ext: 6817
bharat.gianani@angelbroking.com

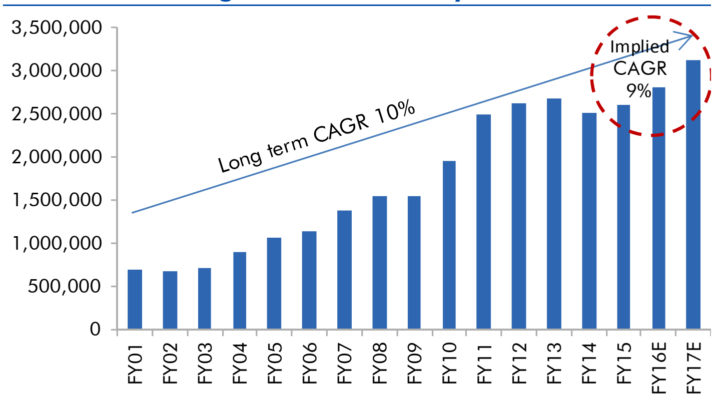
Investment Arguments

Passenger vehicle and HCV OEM to record double digit growth

The passenger and MHCV OEM industry is clearly in an upcycle in the medium term. After three consecutive years of slowdown, the industry showed signs of recovery in FY2015. The passenger vehicle segment grew 4% in FY2015, after flattish volumes over the FY2012-FY2014 period. Similarly, the MHCV segment surged 16% after two consecutive years of double digit decline. We expect the industry growth to accelerate in FY2016/17. Favourable macro economic factors, viz (a) higher economic growth leading to higher income levels, (b) easing of interest rates which would reduce the operating cost and (c) lower fuel prices which reduce the maintenance cost, are likely to boost OEM demand. Further, the slowdown period has created a low base, thus paving way for healthy growth over the medium term. The passenger vehicle and MHCV OEM segments are likely to grow in double digits, ie we estimate a 9% and 16% CAGR respectively over FY2015-2017 period,_in order to retract to long term CAGR trend of 10% and 7% respectively.

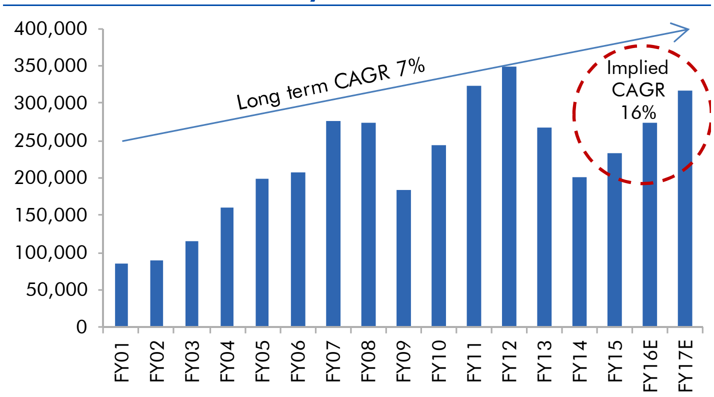
We believe RBL with its leadership position (commanding 38% market share) and well established client base is well poised to benefit from an uptrend in volumes. It derives about 47% revenues from the OEM segment and would be the key beneficiary of an OEM upcycle. We estimate RBL'S OEM segment revenues to grow by 10% CAGR over the next two years.

Exhibit 1: Passenger vehicle industry trend



Source: SIAM, Angel Research

Exhibit 2: MHCV industry trend



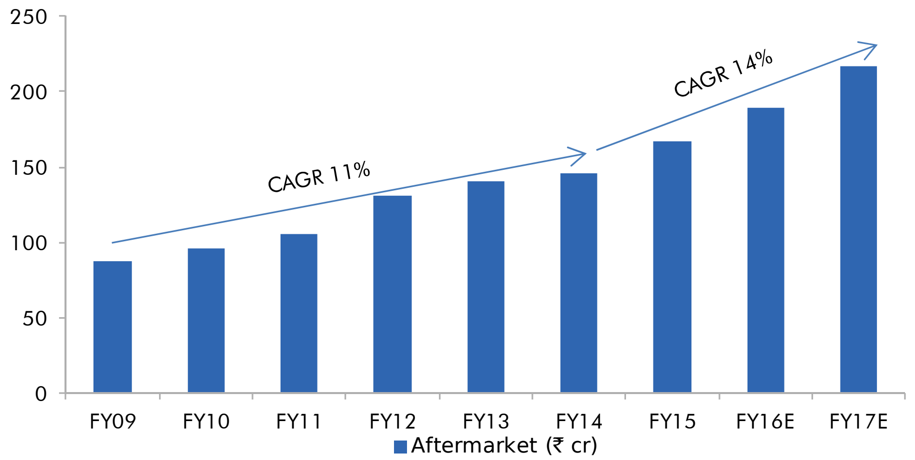
Source: SIAM, Angel Research

Expanding reach in Northern and Eastern markets and new product introduction to drive aftermarket segment

RBL's products have strong acceptance in the aftermarket segment in which it commands 18% market share. In a move to further boost aftermarket revenues, RBL is targeting to strengthen the distribution network in the Northern and the Eastern markets where it has relatively lower dealer penetration. RBL is traditionally strong in the Southern and Western regions which account for about 60-65% of the company's overall aftermarket revenues. With demand potential of Northern and Eastern regions being almost similar to the Southern and Western regions, RBL has immense growth potential. Apart from enhancing the dealer network, RBL is also introducing new related products in the aftermarket space. It recently introduced brake shoes, thereby enhancing product offerings. Further, improvement in the economy along with uptick in OEM volumes would bolster the replacement demand going ahead.

As per the industry estimates, replacement market is almost double the size of the OEM segment. With the dual strategy of enhancing distribution network and introducing new products, RBL is likely to gain market share in the replacement space. We expect RBL's aftermarket division (constituting about 40% of revenues) to grow at a CAGR of 14% over FY2015-17.

Exhibit 3: RBL after market growth trend



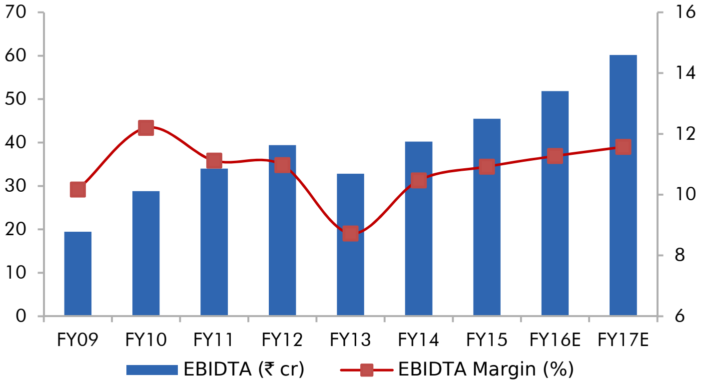
Source: Company, Angel Research

Operating leverage, raw material localization and energy savings to lead to margin improvement

RBL is poised to register double digit top-line growth (12% CAGR) over the next two years. Uptick in the OEM segment coupled with healthy growth in the aftermarket space would boost the top-line. The company is likely to draw benefits of operating leverage on the back of healthy top-line growth. Also it's working on reducing the raw material costs by increasing the local content. It is planning to enhance sourcing domestically and reduce dependence on imports (Imported raw material currently contributes about 50% of the overall raw material costs). RBL aims to curb the material costs by 100-200bp on back of increased localization. Further, it is planning to reduce energy consumption by improving manufacturing processes across its plants and utilizing power from low cost sources. Given the cost reduction initiatives, we expect RBL's margins to improve by 70bp over the next two years.

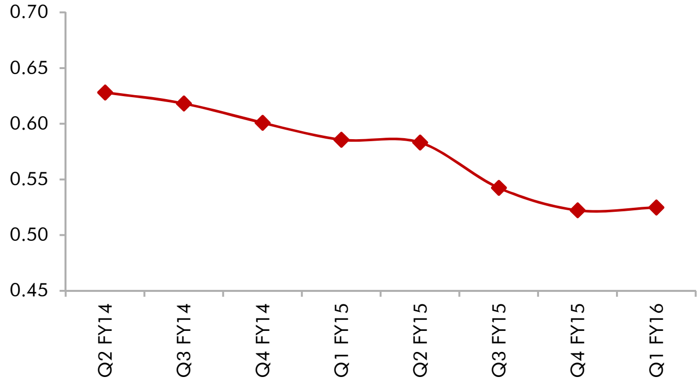
RBL is also likely to realize the benefits of JPY weakening against INR given that the imported raw material constitutes about half of the material costs and is largely JPY denominated. Benefits of weak Yen would accrue from FY2016, given the policy of hedging raw material costs for the next 6 months. (JPY had started to depreciate from 2HFY2015).

Exhibit 4: EBIDTA margin to improve



Source: Company, Angel Research

Exhibit 5: INR-JPY Trend

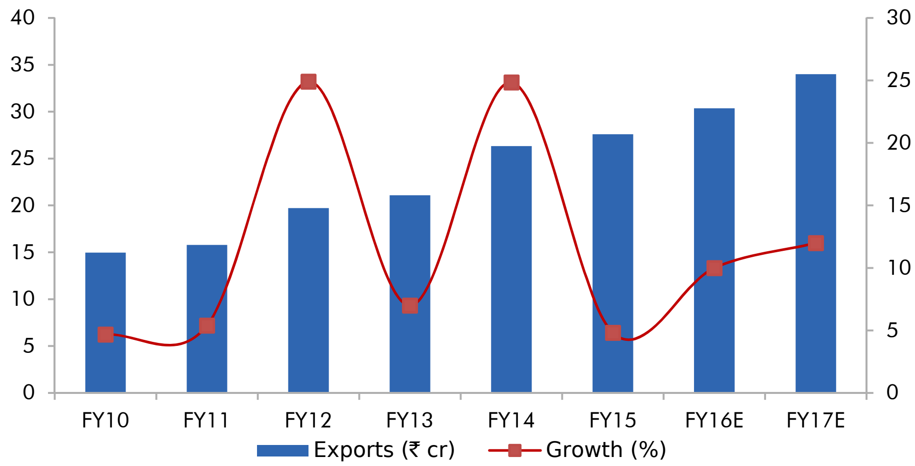


Source: Exchange rates, Angel Research

Exports to provide steady growth

The export segment, constituting about 7% of revenues, is expected to provide steady revenue stream for the company. Apart from boosting the top-line, exports act as a natural hedge given the high level of raw material imports. To enhance exports, RBL aims to strengthen distribution network in the existing markets of SAARC, Middle East and Africa. It is also tapping new markets and has recently commenced supplies to Nigeria, Malawi and Ukraine. Further, RBL has identified Europe as a focus area to enhance export revenues and it also aims to expand product offerings in the market.

Exhibit 6: RBL export growth trend



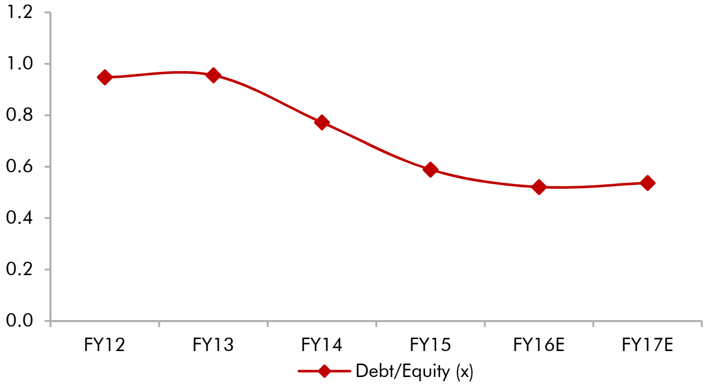
Source: Company, Angel Research

Margin improvement coupled with improvement in leverage to boost return ratios

RBL's margins are estimated to improve by 70bp over FY2016/17. This would be on the back of a double digit top-line growth, increased localization coupled with savings in energy costs. Further, RBL has no major capex plans in the immediate term. We also estimate the leverage metrics of RBL to improve over the next two years, considering the improving profitability and stable debt levels. Consequently, we expect the Debt/Equity ratio to improve marginally. Given the improvement in profitability coupled with improving D/E ratio, we expect the RoCE to improve from

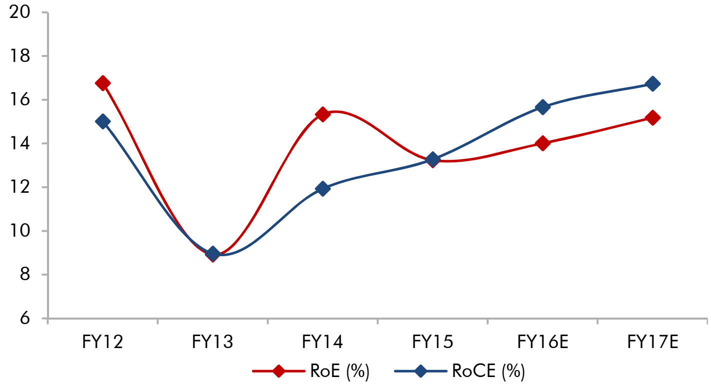
13% in FY2015 to 17% in FY2017. Also, RoE is estimated to improve from 13% currently to 15% in FY2017.

Exhibit 7: Capital Gearing



Source: Company, Angel Research

Exhibit 8: Return ratios



Source: Company, Angel Research

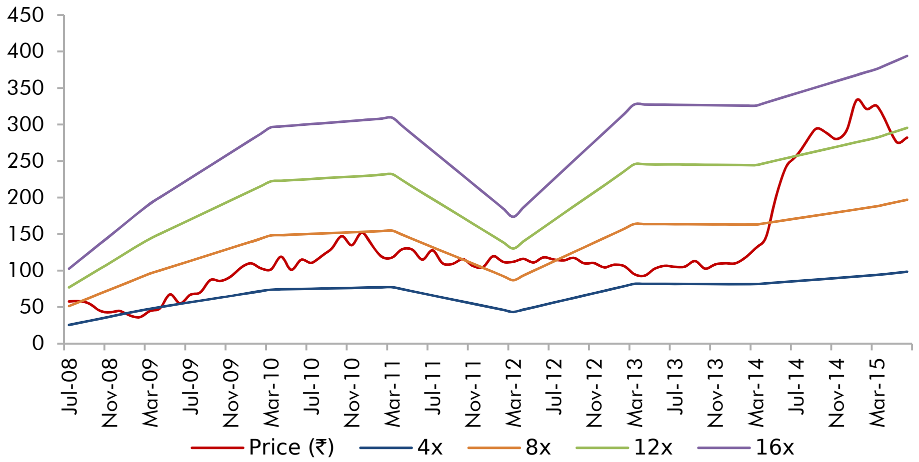
Management targets

- The Management is targeting revenue CAGR of 18% over FY2015-FY2018. As per the Management, uptrend in OEM sales would contribute to the robust growth. Also, the company's efforts of enhancing aftermarket base by increasing dealer network in the underpenetrated Northern and Eastern markets & introducing new products would boost the top-line.
- The Management is aiming to double the RoCE to 25% by FY2018. Margin improvement on back of raw material localization, energy savings, and lowering leverage would be the key drivers to achieve the desired RoCE.
- RBL has guided for a cumulative capex of ₹120cr over the next three years.

Outlook and Valuation

RBL's revenues are estimated to grow at 12% CAGR over the next two years. Upsurge in OEM volumes coupled with focus on the aftermarket segment would drive the top-line. Also, the company's margins are expected to improve on account of operating leverage, enhanced local procurement and energy savings. Given the healthy top-line growth and margin improvement, RBL's earnings are likely to grow at a CAGR of 17% over FY2015-2017. Its return ratios are also estimated to expand due to margin improvement and reduction in leverage. **We initiate coverage on RBL with a Buy recommendation and target price of ₹336 (based on 12x FY2017 earnings).**

Exhibit 9: One-year forward P/E band



Source: Company, Angel Research

Company Background

Rane Brake Lining Ltd (RBL) is a part of diversified ancillary supplier Rane Group. Rane Group has a strong and diversified clientele and supplies various products viz steering and suspension systems, steering columns, hydraulic pumps, friction material, engine components and diecast components. The group through its holding arm (Rane Holdings Ltd) has four subsidiaries viz Rane Madras Ltd, Rane Engine Valves Ltd, Rane Brake Lining Ltd and Rane Holdings America Inc. Rane Group also has three joint ventures namely Rane TRW Steering Systems, Rane NSK Steering Systems and JMA Marketing Ltd.

RBL is the flagship company of the Rane Group engaged in the manufacturing of safety critical components such as brake linings, disc pads, clutch facings, clutch buttons, brake shoes and railway brake blocks. Key braking components ie brake lining and disc pads constitute bulk of the revenues (approximately 87%) for the company. The products are manufactured across four plants based in South India.

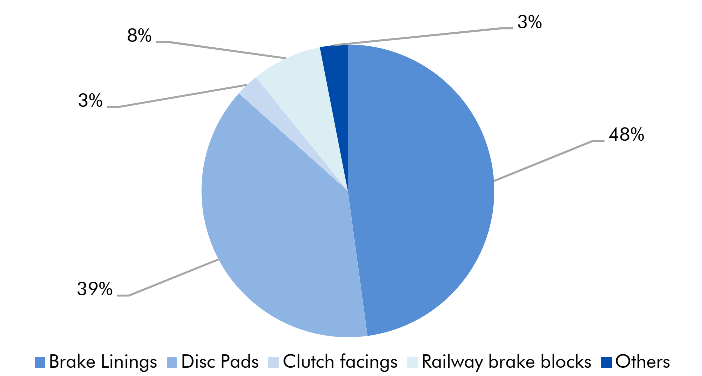
Exhibit 10: RBL manufacturing footprint

Location	Products	User segment
Chennai	Brake linings, disc pads and clutch facings; Composite brake blocks; Organic pads for trainer aircraft	Automotive, Railway, Aerospace
Hyderabad	Brake linings, clutch facings & sintered clutch buttons; Compositive brake blocks	Automotive, Railway
Puducherry	Disc pads, clutch facings & CV brake pads; Composite brake blocks	Automotive, Railway
Trichy	Disc pads & brake linings	Automotive

Source: Company, Angel Research

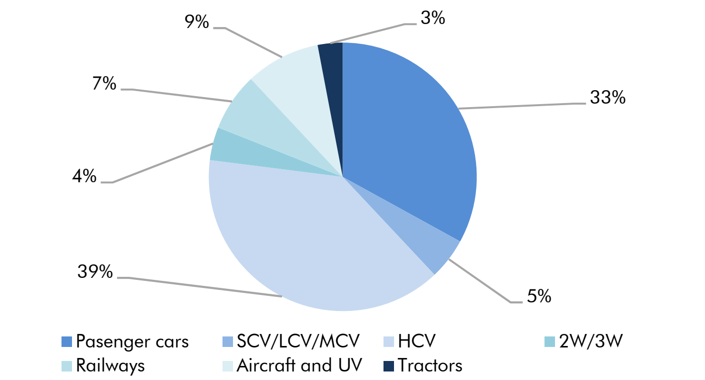
RBL supplies braking and related components across the automotive segments viz passenger vehicles, commercial vehicles, two wheelers and railways. Passenger car and the HCV segment constitute about 33% and 39% revenues for the company. Aircraft and the utility vehicle segment contribute about 9% and 7% respectively.

Exhibit 11: Product breakup



Source: Company, Angel Research

Exhibit 12: Segmentwise breakup



Source: Company, Angel Research

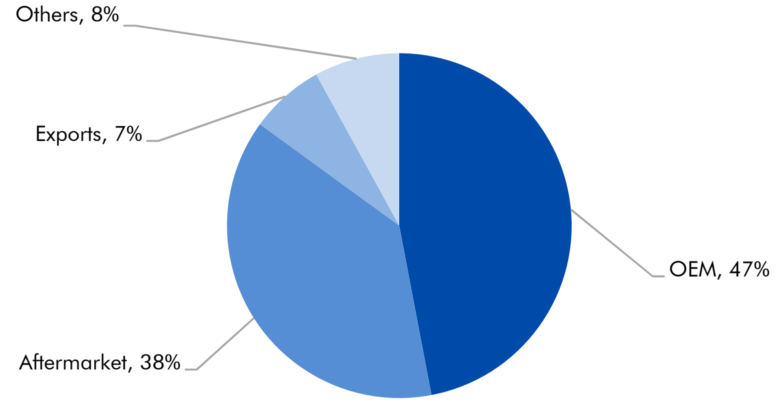
The OEM segment forms about half of the revenues of the company. RBL has leadership position in the domestic market commanding share of 38%. RBL is a Tier 2 supplier catering to leading OEMs such as Maruti Suzuki, Toyota, Honda and Nissan. In the commercial vehicle segment RBL's key clientele includes leading players like Tata Motors, Ashok Leyland and M&M. Apart from the OEM segment, RBL also has strong presence in the aftermarket space, which forms about 40% of the revenues. Given the strong OEM base and a well established dealer network, RBL is a preferred aftermarket supplier commanding a market share of 18%.

Exhibit 13: Client base

Key clientile	End customers	Tier 1 clientle
Passenger vehicle	Maruti Suzuki, Toyota, Honda India, Nissan, Volkswagen India	Brakes India, Brembo, Mando, Endurance, Chassis Brakes International
Commercial Vehicle	Tata Motors, Ashok Leyland, M&M, Bharat Benz	

Source: Company, Angel Research

Exhibit 14: Customer segmentation



Source: Company, Angel Research

Profit & Loss Statement

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	FY2016E	FY2017E
Total operating income	**359**	**376**	**384**	**416**	**460**	**520**
% chg	*17.4*	*4.8*	*2.0*	*8.4*	*10.5*	*13.0*
Total Expenditure	**320**	**344**	**344**	**371**	**408**	**460**
Net Raw Materials	195	204	194	204	224	252
Personnel	46	49	53	61	69	78
Other	79	90	97	106	115	130
EBITDA	**39**	**33**	**40**	**45**	**52**	**60**
% chg	*15.9*	*(16.7)*	*22.5*	*13.1*	*14.0*	*16.0*
(% of Net Sales)	*11.0*	*8.7*	*10.5*	*10.9*	*11.3*	*11.6*
Depreciation & Amortisation	15	18	18	21	22	25
EBIT	**26**	**14**	**19**	**23**	**30**	**36**
% chg	*18.5*	*(46.1)*	*35.1*	*18.6*	*32.1*	*18.8*
(% of Net Sales)	7.3	3.8	5.0	5.4	6.5	6.8
Interest & other Charges	7	7	8	6	6	7
Other Income	4	3	2	2	3	4
PBT (recurring)	**22**	**11**	**17**	**21**	**27**	**32**
% chg	*11.3*	*(50.1)*	*53.2*	*23.2*	*30.9*	*19.0*
Extraordinary Expense/(Inc.)	0	0	0	0	0	0
PBT (reported)	**22**	**11**	**17**	**21**	**27**	**32**
Tax	6	2	0	4	8	10
(% of PBT)	*26.1*	*16.7*	*(2.9)*	*21.8*	*31.0*	*31.0*
PAT (reported)	**16**	**9**	**17**	**16**	**19**	**22**
ADJ. PAT	**16**	**9**	**17**	**16**	**19**	**22**
% chg	*5.9*	*(43.8)*	*89.1*	*(6.4)*	*15.4*	*19.0*
(% of Net Sales)	4.5	2.4	4.5	3.9	4.0	4.3
Basic EPS (₹)	**20.5**	**11.5**	**21.7**	**20.4**	**23.5**	**28.0**
Fully Diluted EPS (₹)	**20.5**	**11.5**	**21.7**	**20.4**	**23.5**	**28.0**
% chg	*5.9*	*(43.8)*	*89.1*	*(6.4)*	*15.4*	*19.0*

Balance sheet statement

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015E	FY2016E	FY2017E
SOURCES OF FUNDS						
Equity Share Capital	8	8	8	8	8	8
Reserves& Surplus	89	94	104	114	125	138
Shareholders Funds	**97**	**102**	**112**	**122**	**133**	**146**
Total Loans	84	90	81	67	65	74
Deferred Tax Liability	9	9	9	9	9	9
Other long term liab.	0	0	0	0	0	0
Long term provisions	1	2	2	2	2	2
Total Liabilities	**191**	**203**	**205**	**200**	**209**	**232**
APPLICATION OF FUNDS						
Gross Block	240	259	286	293	315	356
Less: Acc. Dep.	119	136	153	174	196	221
Net Block	**121**	**123**	**133**	**119**	**119**	**135**
Capital WIP	3	19	0	0	0	0
Investments	**0**	**0**	**0**	**0**	**0**	**0**
Long Loans and adv.	8	7	9	10	11	12
Current Assets	119	113	125	136	151	165
Cash	11	2	3	6	7	3
Short term loan	8	7	7	8	9	10
Other	100	104	114	122	135	153
Current liabilities	61	58	63	66	73	82
Net Current Assets	**58**	**55**	**61**	**70**	**78**	**83**
Total Assets	**191**	**203**	**205**	**200**	**209**	**232**

Cash flow statement

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015E	FY2016E	FY2017E
Profit before tax	22	11	17	21	27	32
Depreciation	15	17	17	21	22	25
Change in Working Capital	(4)	(5)	(6)	(7)	(7)	(10)
Others	1	(0)	(0)	0	0	0
Direct taxes paid	(6)	(2)	0	(4)	(8)	(10)
Cash Flow from Operations	28	21	29	31	34	38
(Inc.)/ Dec. in Fixed Assets	(31)	(35)	(9)	(7)	(22)	(41)
(Inc.)/ Dec. in Investments	0	0	0	0	0	0
(Inc.)/ Dec. in Loans & Adv	-	-	-	-	-	-
Cash Flow from Investing	(31)	(35)	(9)	(7)	(22)	(41)
Issue of Equity	-	-	-	-	-	-
Inc./(Dec.) in loans	20	6	(9)	(14)	(2)	9
Dividend Paid (Incl. Tax)	(6)	(3)	(6)	(7)	(8)	(9)
Others	(3)	2	(3)	(1)	(1)	(1)
Cash Flow from Financing	12	5	(18)	(21)	(11)	(1)
Inc./(Dec.) in Cash	9	(8)	2	2	1	(5)
Opening Cash balances	2	11	2	3	6	7
Closing Cash balances	11	2	3	6	7	3

Key ratios

Y/E March	FY2012	FY2013	FY2014	FY2015E	FY2016E	FY2017E
Valuation Ratio (x)						
P/E (on FDEPS)	13.8	24.5	13.0	13.9	12.0	10.1
P/CEPS	7.1	8.3	6.3	6.0	5.5	4.7
P/BV	2.3	2.2	2.0	1.8	1.7	1.5
Dividend yield (%)	2.0	1.1	2.1	2.0	2.3	2.7
EV/Sales	0.8	0.8	0.8	0.7	0.6	0.6
EV/EBITDA	7.5	9.5	7.5	6.3	5.4	4.9
EV / Total Assets	1.6	1.5	1.5	1.4	1.3	1.3
Per Share Data (₹)						
EPS (Basic)	20.5	11.5	21.7	20.4	23.5	28.0
EPS (fully diluted)	20.5	11.5	21.7	20.4	23.5	28.0
Cash EPS	39.5	34.1	44.8	46.8	51.4	59.5
DPS	5.5	3.2	5.9	5.6	6.5	7.7
Book Value	122.0	128.9	141.8	153.9	167.7	184.3
Dupont Analysis						
EBIT margin	7.3	3.8	5.0	5.4	6.5	6.8
Tax retention ratio	0.7	0.8	1.0	0.8	0.7	0.7
Asset turnover (x)	2.0	1.9	1.9	2.1	2.3	2.3
ROIC (Post-tax)	10.8	5.9	9.8	9.1	10.2	10.7
Cost of Debt (Post Tax)	5.9	6.8	9.8	7.0	6.2	6.2
Leverage (x)	0.8	0.9	0.7	0.5	0.4	0.5
Operating ROE	14.4	5.1	9.8	10.2	12.0	12.9
Returns (%)						
ROCE (Pre-tax)	15.0	9.0	11.9	13.3	15.7	16.7
Angel ROIC (Pre-tax)	14.6	7.0	9.5	11.6	14.8	15.5
ROE	16.8	8.9	15.3	13.2	14.0	15.2
Turnover ratios (x)						
Asset Turnover (Gross Block)	1.50	1.46	1.34	1.42	1.46	1.46
Inventory / Sales (days)	28.7	27.3	26.5	27.0	27.0	27.0
Receivables (days)	70.6	72.9	81.8	80.0	80.0	80.0
Payables (days)	61.8	56.5	60.3	57.6	57.6	57.4
WC cycle (ex-cash) (days)	48.2	50.9	55.2	56.7	56.6	56.8
Solvency ratios (x)						
Net debt to equity	0.8	0.9	0.7	0.5	0.4	0.5
Net debt to EBITDA	1.9	2.7	1.9	1.3	1.1	1.2
Interest Coverage (EBIT / Int.)	3.9	1.9	2.5	3.8	5.1	5.3

Research Team Tel: 022 - 39357800 E-mail: research@angelbroking.com Website: www.angelbroking.com

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Disclosure of Interest Statement	**Rane Brake Lining**
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Based on expected returns over 12 months investment period):	*Buy (> 15%)*	*Accumulate (5% to 15%)* *Reduce (-5% to -15%)*	*Neutral (-5 to 5%)* *Sell (< -15)*