

Automotive Axles

Established in 1981, Automotive Axles Limited (AAL) is a joint venture of Kalyani Group and Meritor Inc., USA. With manufacturing facilities located at Mysore and Jamshedpur, the company manufactures drive axles, non-drive axles, front steer axles, specialty & defense axles and drum & disc brakes.

Increasing share of higher tonnage vehicles in CV segment to aid realizations:

Given the improving infrastructure and implementation of GST, logistics sector is witnessing a consolidation of warehouses, which in turn is building the Hub and Spoke model to fulfil distribution solution. Further, improvement of road infra is picking pace, which is expected to boost the demand for higher haulage tonne vehicles (especially for categories viz. ≥ 44 tns & ≤ 49 tns and above ≥ 49 tns).

Marquee client base

AAL supplies axles and brakes to most of the OEMs and the company's client base includes AMW, Ashok Leyland, Daimler, Escort, Mahindra & Mahindra, Sonalika, TATA Motors and Volvo. Ashok Leyland contributes significant part of AAL's revenue (65% in FY18); TATA Motors contributed 15% in FY18.

Capacity expansion to cater to increasing demand

AAL intends to increase its axle and breaks capacity by 40-45% over FY2019-20E in order to meet rising industry demand. Interestingly, the company's current order book itself requires addition of 20-25% to the existing capacity. Currently, AAL has an axle capacity of 16,500/month and brakes capacity of 85,000/month.

Healthy revenue growth with improving product mix

AAL's revenue has grown at CAGR of 20% over FY2014-18, which is above the industry growth due to increasing client base and improving content per vehicle along with introduction of new products. The company's ROE/ROCE has also improved significantly from 9%/7% in FY2014 to 28%/19% in FY18 respectively.

Outlook & Valuation: We believe AAL is comfortably placed to tap the upcoming opportunity in the industry owing to improving road infra, BS-VI pre-buying and foray into new segment coupled with expansion of capacity by 35-40%. At the CMP of Rs1,250, the stock is available at 12.3x its FY2020E EPS of Rs96. We have assigned a multiple of 15x and recommend BUY on AAL with a target price of Rs1,450, implying an upside of 16% over the next 9-12 months.

Key Financial

Y/E March (₹ cr)	FY17	FY18	FY19E	FY20E
Net Sales	1,172	1,519	2,095	2,618
% chg	8	30	38	25
Net Profit	49	84	111	146
% chg	42	70	69	6
EBITDA (%)	9.7%	11.0%	10.7%	10.7%
EPS (Rs)	33	56	74	97
P/E (x)	38	23	17	13
P/BV (x)	5.0	4.3	3.5	2.9
RoE (%)	13.1	18.9	20.7	22.2
RoCE (%)	19.7	27.9	28.8	29.7
EV/EBITDA	16.3	11.0	8.0	6.2

Source: Company, Angel Research

BUY

CMP	₹1250
Target Price	₹1450

Investment Period	12 Months
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Stock Info

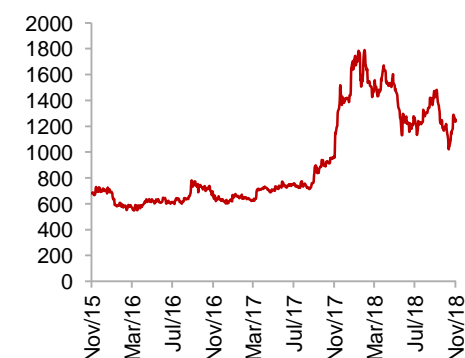
Sector	Auto Ancillary
Market Cap (₹ cr)	1,926
Beta	1.2
52 Week High / Low	1826/945
Avg. Daily Volume	2,614
Face Value (₹)	10
BSE Sensex	35,142
Nifty	10,577
Reuters Code	ATOABO
Bloomberg Code	ATXL IN

Shareholding Pattern (%)

Promoters	71.1
MF / Banks / Indian FIs	6.6
FII / NRIs / OCBs	1.7
Indian Public / Others	20.6

Abs.(%)	3m	1yr	3yr
Sensex	(6.7)	12.6	37.2
Automotive Axles	(2.1)	30.6	83.7

3-year price chart



Source: Capitaline, Angel Research

Company Background

Established in 1981, Automotive Axles Limited (AAL) is a joint venture of Kalyani Group and Meritor Inc., USA. With manufacturing facilities located at Mysore (Karnataka) and Jamshedpur (Jharkhand), the company manufactures drive axles, non-drive axles, front steer axles, specialty & defence axles and drum & disc brakes. It provides these products to major domestic and global manufacturers of trucks & buses pertaining to segments such as light, medium & heavy commercial vehicles, military & off-highway vehicles, aftermarket and exports. As a continuous process, the company believes in introducing new products regularly in order to meet the emerging needs of the commercial vehicle market.

About JV with Meritor

The products manufactured by AAL are based on technology provided by the parent Meritor Inc., USA. The technology transfer by Meritor Inc. is routed through its 51% subsidiary in India – Meritor HVS (India) Limited (MHVSIL). MHVSIL is also responsible for customer sourcing, interaction and marketing for AAL, with almost the entire sales of AAL routed through MHVSIL. MHVSIL is 51:49 JV between Meritor International, USA and Bharat Forge with Meritor holding majority stake. AAL manufactures and sells axles, components, brake components and subassemblies to MHVSIL, which in turn sells it to the end customer.

Management details**Dr. N Muthukumar - President & Whole Time Director**

Dr. Muthukumar is the President and Whole Time Director of Automotive Axles Limited, Mysuru. He joined AAL in 2008 as GM operations and currently heads India Operations & Exports and Off-highway Military business. He has rich experience of more than 28 years in the Automobile and Pharmaceutical sectors. He commenced his career with TVS Srichakra Tyres as Management Trainee in 1987 and became Head of Manufacturing Systems in the same organization by 1994. In 1998 he headed the Business Process Re-engineering in TVS group and post successful completion became Head Operations for Sundaram Industries Limited. He then moved to the TTK Group, running their International Business for about 6 years before joining Automotive Axles Limited.

Mr. Ranganathan S - Chief Financial Officer

Mr. Ranganathan Sankaran is a qualified Chartered Accountant and Cost & Works Accountant. Ranganathan has around 21 years of work experience and joined Automotive Axles Limited from Circor Flow Technologies India Pvt Ltd., Coimbatore, where he was designated as Country Controller and Director - Finance. Earlier to this he worked with Brady Company India Pvt. Ltd. as General Manager - Finance, Makino India Private Ltd as General Manager – Finance and Director, Faurecia Automotive Seating India Ltd, and Motorola India Ltd.

Industry outlook

The Indian automotive industry has been able to create a strong domestic and international market, with policy support from the Government. The Indian Government aims to develop India as a global manufacturing centre coupled with

building an innovative R&D hub and its Automotive Mission Plan: 2016-26 are a boost for the industry. We expect demand growth to pick-up due to favorable demographics, rising disposable incomes, thrust on Make in India initiative, abundance of skilled labor and improved access to finance. A series of reforms, including demonetization, implementation of Bharat Stage-IV (BS-IV) emission norms, implementation of GST and enforcement of overloading norms, have resulted in significant volatility in the purchase considerations of fleet operators, influencing the demand for Commercial Vehicles (CVs). Industry is witnessing progress with new products and advanced technologies entering India through joint ventures, partnerships and acquisitions, due to which the quality and cost competitiveness of Indian auto components is improving steadily. Moreover, automobile exports from India are also on the rise. Lower production costs and significant cost advantages are making India an attractive outsourcing hub, leading to domestic companies' significantly increasing production capacities.

Further, execution of GOI's ambitious umbrella programme "Bhartmala Pariyojana" which will improve connectivity of major economic corridors may help to move 80% of freight traffic to national highways from 40% currently.

Manufacturing capabilities

With manufacturing facilities located at Mysore, AAL is currently one of the largest independent manufacturers of Rear Drive Axle Assemblies. With more than 30 years of axle producing experience and advanced gearing technology from Meritor HVS (India) Ltd., it has been manufacturing reliable & long-life light, medium & heavy duty drive axles, front steer axles, non-drive axles, axles for defence & off-highway applications and drum & disc brakes. The marketing & field service support is provided by Meritor HVS (India) Ltd.

Product offerings

Axles

Axles are used to transmit the driving torque to the wheel and help maintain the position of the wheels. Axles also bear the weight of the vehicle as well as the cargo. There are three types of axles viz. (a) beam axle (front axle), (b) drive axle (mostly rear), (c) front axles.

Exhibit 1: Defence & off-highway axle



Source: Company, Angel Research

Exhibit 2: Drive axle



Source: Company, Angel Research

Exhibit 3: Front axle



Source: Company, Angel Research

Exhibit 4: Brakes



Source: Company, Angel Research

Brakes

A brake is a mechanical device that inhibits motion by absorbing energy from a moving system. It is used for slowing or stopping a moving vehicle, wheel, axle, or to prevent its motion, most often accomplished by means of friction.

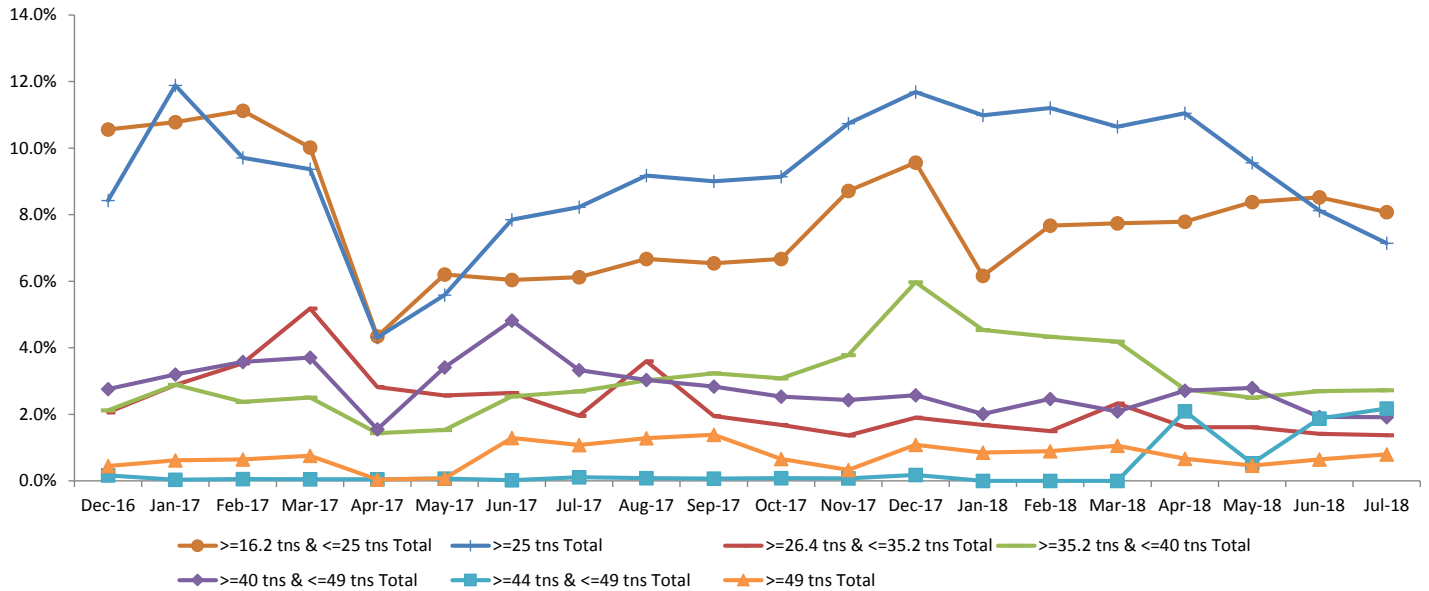
Investment Argument

Increasing share of higher tonnage vehicles in CV segment to aid realizations:

Given the improving infrastructure and implementation of GST, logistics sector is witnessing a consolidation of warehouses, which in turn is building the Hub and Spoke

model to fulfill distribution solution. Further, improvement of road infra is picking pace, which is expected to boost the demand for higher haulage tonne vehicles, especially for categories viz. ≥ 44 tns & ≤ 49 tns and above ≥ 49 tns (refer exhibit 5). The increased share of higher tonnage vehicle i.e. ≥ 44 tns & ≤ 49 tns and above ≥ 49 tns categories is visible from March 2018.

Exhibit 5: Vehicle share in MH&CV segments

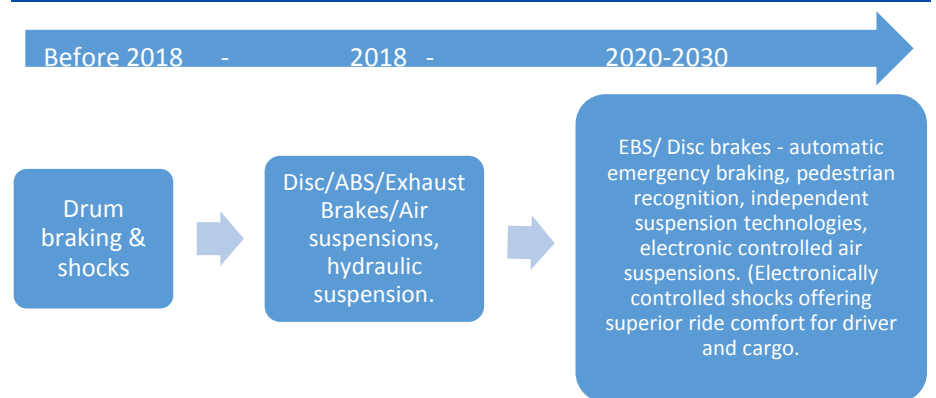


Source: Company, Angel Research

Changing industry dynamics

Indian auto industry is anticipated to change significantly from current levels considering the increasing parameters of safety, emission norms, load carrying capacity, GPS navigation, etc. We believe these changes will require immediate adoption of technological shift, and hence, OEMs will prefer to work with suppliers who have global standard technological edge like Automotive Axles. Introduction of new technologies like automatic emergency braking, pedestrian recognition, independent suspension technologies and electronic controlled air.

Exhibit 6: Changing industry dynamics



Source: Angel Research

Old vehicle scrap policy and Pre-Buying before BS-VI

We believe implementation of BS-VI norms which is expected to be kick in from April 2020 will trigger pre buying of BS-IV vehicles owing to costlier BS-VI vehicle post implementation of said norms. Furthermore, Vehicle scrap policy which is under consultation with stakeholders, if implemented from April 2020 then these will support additional demand for vehicles.

Foray in to suspension segments

AAL looking to increase content per vehicle going forward, in order to achieve the same AAL has launched new slip suspension system with technical collaboration from Brazilian firm. The new suspension is in advance stage to supply the same to Ashok Leyland. As per the management, slip suspension will increase life of tyres by up to 20-25% and also improve ride quality.

Marquee client base

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Capacity expansion to cater to increasing demand

AAL intends to increase its axle and breaks capacity by 40-45% over FY2019-20E in order to meet rising industry demand. Moreover, the company's current order book itself requires addition of 20-25% to the existing capacity. Currently, AAL has an axle capacity of 16,500/month, which it intends to increase to 24,000/month in a phased manner over 12-18 months. Moreover, in brakes it is already running at full capacity and intends to increase the capacity from 85,000/month to 1,25,000/month units during the same period. The part of expansion will be done in its existing Mysore plant and upcoming plant in Pitampura, for which AAL has already acquired the land.

Healthy revenue growth with improving product mix

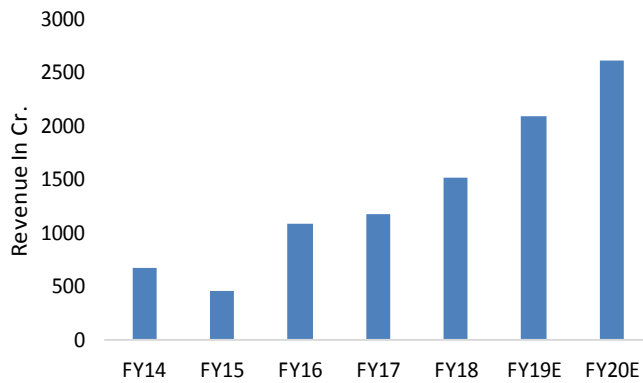
AAL has registered revenue CAGR of 20% over FY2014-18, which is above the industry growth due to increasing client base and improving content per vehicle along with introduction of new products. AAL's ROE/ROCE has also improved significantly from 9%/7% in FY2014 to 28%/19% in FY2018 respectively. We believe introduction of suspension products and increasing presence in after market segments will help AAL maintain industry revenue growth going forward.

Outlook & Valuation: We believe AAL is comfortably placed to tap the upcoming opportunity in the industry owing to improving road infra, BS-VI pre-buying and foray into new segment coupled with expansion of capacity by 35-40%. At the CMP of Rs1,250, the stock is available at 12.3x its FY2020E EPS of Rs96. We have assigned a multiple of 15x and recommend BUY on AAL with a target price of Rs1,450, implying an upside of 16% over the next 9-12 months..

Risk Factor:

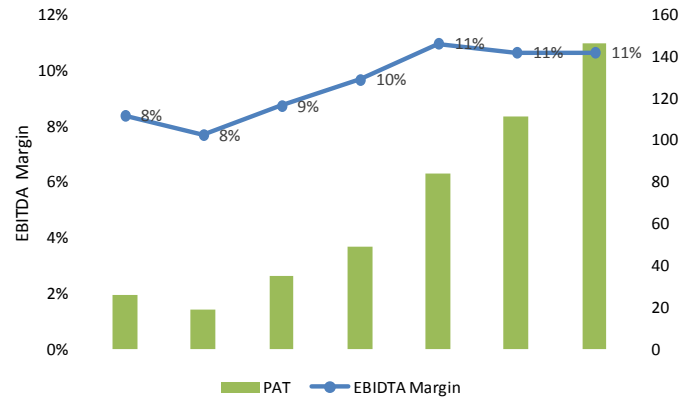
Slowdown in CV segments may impact profitability.

Exhibit 7: Revenue grown at 22% over FY14 to FY18



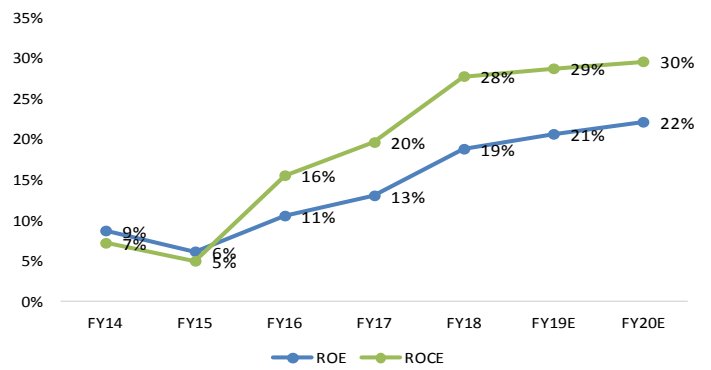
Source: Company, Angel Research

Exhibit 8: PAT and Margin trend



Source: Company, Angel Research

Exhibit 9: Return Ratio



Source: Company, Angel Research

Income Statement

Y/E March (₹ cr)	FY17	FY18	FY19E	FY20E
Total operating income	1,172	1,519	2,095	2,618
% chg	8	30	38	25
Total Expenditure	1,059	1,352	1,872	2,339
Raw Material	826	1,079	1,467	1,833
Personnel	81	99	126	157
Selling and Administration Expenses	21	23	34	42
Others Expenses	130	151	246	307
EBITDA	114	167	224	279
% chg	20	47	34	25
(% of Net Sales)	9.7%	11.0%	10.7%	10.7%
Depreciation & Amortisation	39	43	54	51
EBIT	74	124	169	228
% chg	33	67	37	35
(% of Net Sales)	6	8	8	9
Interest & other Charges	1	1	5	11
Other Income	2	5	5	5
Recurring PBT	75	128	169	223
% chg	46	70	33	32
Tax	26	44	58	77
PAT (reported)	49	84	111	146
% chg	42	70	33	32
(% of Net Sales)	4.2	5.5	5.3	5.6
Basic & Fully Diluted EPS (Rs)	33	56	74	97
% chg	42	70	33	32

Source: Company, Angel Research

Balance Sheet

Y/E March (₹cr)	FY17	FY18	FY19E	FY20E
SOURCES OF FUNDS				
Equity Share Capital	15.1	15.1	15.1	15.1
Reserves & Surplus	361	429	522	644
Shareholders Funds	377	444	537	659
Total Loans	-	-	51	111
Other Liabilities	3	2	0	0
Total Liabilities	379	446	588	769
APPLICATION OF FUNDS				
Net Block	146	118	125	116
Capital Work-in-Progress	7	17	17	10
Investments	-	6	8	10
Long Term Loans & Advances	15	21	21	20
Current Assets	393	570	801	1,090
Inventories	99	137	172	201
Sundry Debtors	231	350	476	574
Cash	35	44	150	260
Loans & Advances	1	1	1	1
Investments & Others	27	37	2	55
Current liabilities	182	285	384	478
Net Current Assets	211	285	417	613
Other Non Current Asset	-	-	-	-
Total Assets	379	446	588	769

Source: Company, Angel Research

Cash flow

Y/E March (₹cr)	FY17	FY18	FY19E	FY20E
Profit before tax	75	128	169	223
Depreciation	39	43	54	51
Change in Working Capital	(35)	81	4	(33)
Interest / Dividend (Net)	1	1	5	11
Direct taxes paid	26	44	58	77
Others	(9)	(245)	(138)	(86)
Cash Flow from Operations	97	51	153	242
(Inc.)/ Dec. in Fixed Assets	(23)	(30)	(49)	(39)
(Inc.)/ Dec. in Investments	1	3	(2)	(2)
Cash Flow from Investing	(23)	(27)	(51)	(41)
Issue of Equity	-	-	-	-
Inc./(Dec.) in loans	-29	-	51	60
Others	(11)	(15)	(47)	(151)
Cash Flow from Financing	(40)	(15)	4	(91)
Inc./(Dec.) in Cash	35	9	106	110
Opening Cash balances	0	35	44	150
Closing Cash balances	35	44	150	260

Source: Company, Angel Research

Key Ratios

Y/E March	FY17	FY18	FY19E	FY20E
P/E (on FDEPS)	38	23	17	13
P/CEPS	17	11	8	7
P/BV	5	4	4	3
EV/Sales	2	1	1	1
EV/EBITDA	16	11	8	6
EV / Total Assets	3	3	2	1
Per Share Data (Rs)				
EPS (Basic)	33	56	74	97
EPS (fully diluted)	33	56	74	97
Cash EPS	75	113	147	180
DPS	8	14	14	14
Book Value	249	294	355	436
Returns (%)				
ROCE	20	28	29	30
Angel ROIC (Pre-tax)	22	33	41	47
ROE	13	19	21	22
Turnover ratios (x)				
Inventory / Sales (days)	31	33	30	28
Receivables (days)	72	84	83	80
Payables (days)	53	62	60	60
Working capital cycle (ex-cash) (days)	50	55	53	48

Source: Company, Angel Research

Research Team Tel: 022 - 39357800

E-mail: research@angelbroking.com

Website: www.angelbroking.com

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4. Broking relationship with company covered under Research	No