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Top Sector Ideas: Auto & Auto Ancillaries

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Auto Sector: Q3FY24 Review

Q3FY24 Auto OEM Review – Recovery in 2W OEMs Led by Rural Demand Pull

✓ *Financial Performance*

- The companies under our coverage reported Revenue/EBITDA/PAT growth of 16.5%/38.9%/40.6% YoY against expectations of 17%/34%/33%. This was driven by higher ASPs, sales volumes, and operating leverage. On a QoQ basis, the aggregate Revenue/EBITDA/PAT degrew by 2.5%/3.6%/2.8%, against expectations of a 2%/7%/8% decline. The QoQ degrowth in EBITDA and PAT was largely limited by operational outperformance led by Escorts Kubota Ltd and 2W OEMs such as Bajaj Auto, TVS Motors, and Hero Motocorp.
- EBITDA margins expanded by 227bps YoY (marginally down 17 bps QoQ). The margin expansion YoY was driven by higher ASPs (due to product premiumization) and increased operating leverage, resulting from higher sales volumes and softer RM input costs.
- The topline for all companies under our coverage was largely in line with our revenue estimates, while bottom-line results exceeded estimates. This outperformance was attributed to improved price absorption, operating leverage, and stable raw material costs.

Q3FY24 Auto Ancillaries Review – Near-term Hiccups; Long-term Growth Drivers Intact

✓ *Financial Performance*

- The companies under our coverage reported Revenue/EBITDA/PAT growth of 13.1%/13.9%/12.3% YoY against expectations of 14%/22%/20%. However, Revenue/EBITDA/PAT posted degrowth of 1.6%/4.9%/6.2% QoQ, falling short of largely flat Revenue/EBITDA/PAT expectations. This decline was primarily due to a sequential decline in production volumes in the PV/MHCV/Tractor/2W segment by ~11%/8.3%/28.7%/1.5%.
- While Sansera Engineering, Minda Corp, and UNO Minda reported in-line EBITDA, there was a miss for Endurance Technologies, CIE Automotive (poor performance in the EU business), and Automotive Axles (decline in MHCV production volumes).

Auto Sector: Outlook

Encouraging 2W Demand Scenario: In FY24, PV/2W/CV segments YTD domestic sales volumes grew by 7.3%/10%/2.4% YoY, driven by healthy demand despite the high base of FY23. In the near term, demand momentum in PV/CV is expected to grow in low single digits, while 2W is anticipated to grow in high single digits (with volumes still below Pre-Covid levels). However, the tractor segment is expected to witness a single-digit decline.

- **PV:** The PV industry growth (as per SIAM) is expected to be in low-single digits YoY in FY25, attributed to a high base. MSIL management also foresees the industry to record ~~4.18/4.3 Mn vehicles respectively in FY24/25E. The domestic industry sales mix is expected to be largely skewed towards UV in the segment sales mix, with higher export volumes and an increasing share of CNG/Hybrid/EV in the fuel mix.
- **2W:** In the 2W domestic industry, we anticipate the 125cc and above segment to grow faster than the entry-level segment. Despite this, the current total industry volumes in FY24E are projected to remain ~14-18% below the industry peak of around ~2.45 Cr units in FY2018-19 (pre-COVID). This suggests significant potential for growth in the 2W industry, primarily driven by the expected revival in the rural economy and the trend towards premiumization. OEMs anticipate continued momentum in Q4FY24, propelled by a recovery in the rural sector and positive growth in international markets.
- **CV:** We anticipate the domestic CV industry growth outlook to remain subdued in the near term due to the high base of last year and some impact from union elections. However, the long-term demand appears favorable, supported by a strong macroeconomic environment, healthy replacement demand (particularly in buses), significant progress on infrastructure projects (higher allocation in the interim budget), and an improvement in freight demand.
- **Tractors**: We anticipate a single-digit decline in FY24 and flat growth for the domestic industry in FY25E, primarily due to the high base of FY23, a slowdown observed in the brick and mining sectors, and the impact of the election year (with high involvement of the farming community). In the short term, the tractor industry in the US and EU is experiencing a downward trend, coupled with increased competition from Korean manufacturers. However, with India being utilized as a sourcing hub, OEMs expect exports to achieve double-digit annual growth in the long term.

Outlook – Long Term Growth Drivers Visible

Stable Margin Outlook

- We anticipate EBITDA margins to remain stable or even improve going forward. This improvement will be driven by a richer product mix, higher realization, and positive operating leverage. However, the raw material tailwind could have a neutral to slightly negative impact, as price benefits have already been accrued in H1FY24 for some companies.
- RM input costs have remained largely benign over the last few months. Spot Steel HRC prices in Q3FY24 were up marginally by 2% YoY/QoQ. Spot LME Zn (up 3% QoQ), Cu (down 2% QoQ), and Al was up by 2% QoQ while Platinum and Palladium are down 2% and 13% QoQ respectively.

We continue with a Long Term positive outlook on the sector as macro economic drivers remain intact. However, due to the recent rally in some stocks, valuations are not very attractive. Against this backdrop, we recommend the “Buy on Dips” strategy for Quality stocks.

- We anticipate 2W sales volumes to sustain in FY24/25, driven by new vehicle launches, especially in the premium category, an elongated replacement demand buoyed by the Indian growth story, and an expected revival in exports in FY25. Furthermore, we expect the trend of premiumization to continue in FY25.
- PV sales will be primarily driven by strong UV launches. However, we anticipate the overall growth rate to be in low single digits following a robust growth of 27% YoY in FY23.
- While moderation in overall domestic CV volume growth is expected over the next few quarters, OEMs remain confident in the long-term megatrends for the Indian economy. These include having the second-largest road network, a focus on policy continuity to reduce supply chain costs, and higher infrastructure capex by the government following the union elections.
- Tractor volumes may see marginal low single-digit de-growth on the high base of FY23 and high involvement of farming community in an Election Year.
- We remain selective and for OEMs under our coverage, our **top picks are TVS Motors** and **Hero Motocorp.**

Auto Ancillaries

- Premiumization, robust order books, exports, and a focus on EVs will drive higher content per vehicle, thereby enhancing profitability. Our top sector ideas in the ancillary space are CIE Automotive Ltd, Steel Strips Wheels, and Sansera Engineering Ltd.

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Short & Medium-Term Outlook

Short to Medium term

PV demand led by New SUV launches

2W Demand – Shift towards e-2Ws, Premium scooters and bikes

Premiumisation across segments to drive ASPs higher

Export focus companies to benefit.

Increasing share of EV/Hybrids/CNG in the fuel mix

Entry Level PV may continue to see weakness.

Slashing of FAME subsidy likely to consolidate the 2W EV market.

Demand momentum in CV/Tractor may witness near-term volume weakness.

Long Term

Key monitorables – *Rural Recovery, Pick up in Exports and Price Realizations*

Top Sector Ideas: Auto

Stock	Reco.	TP	Recommendation Rationale
TVS Motor Company	BUY	Rs 2,350*	✓ **2W-EV business:** The management informed that the TVS iQube is currently available at 400 touchpoints as of Dec'23 and is expected to double over Q4FY24. Additionally, export of the TVS iQube has commenced in Q3, and sufficient capacity is being built in the Chennai plant over the next few years to meet the demand for 2W EVs. The EV market share of TVS in Q3FY24 stands at ~20%, surpassing ICE market share levels (~18 ✓ **Investments in Products, People, and Technology:** In Q3FY24, TVS Motor Company deployed an additional Rs 300 Cr in investments for R&D expenditures, building a robust global engineering team, and making investments in subsidiaries such as Norton Motorcycles, SEMG, and Killwatt GmbH. The forthcoming portfolio resulting from these investments is expected to complement the existing TVS Motor product range, with multiple new launches anticipated in FY25 and beyond. ✓ **EBITDA growth outlook:** TVS Motor Company's EBITDA margins have improved from 10.1% in Q3FY23 to 11.2% in Q3FY24, driven by sustained material cost reduction efforts, commodity softening, opportunistic price hikes taken during the year, and an overall improvement in the product mix. We anticipate EBITDA to grow at a 21% CAGR over FY24E-26E. ✓ **TVS Credit Services:** The book size has surpassed Rs 25,000 Cr, with a GNPA (Gross Non-Performing Assets) ratio at 3.1% and a Capital Adequacy Ratio at 8.6%. The Profit Before Tax (PBT) for Q3FY24 is Rs 239 Cr, compared to Rs 179 Cr in Q3FY23. Additionally, the business disbursement for the quarter is ~Rs 7,000 Cr, up from Rs 6,000 Cr in Q3FY23.

** Note: Target Price is based on our Q3FY24 Result Update Report*

Top Sector Ideas: Auto

Stock	Reco.	TP	Recommendation Rationale
Hero Motocorp Ltd	BUY	Rs 5,550*	✓ **New Products Rollout, Execution Strategy to be in Spotlight:** With the launch of differentiated products offering multiple industry-first features, Hero has a clear strategy to capture market share in the premium category of 2W, while also focusing on growing its EV business, expanding Premia stores, upgrading existing stores to Hero 2.0, and investing in marketing through both traditional and digital channels. While the change in top management has accelerated the pace, all eyes are now on volume growth in the coming quarters. ✓ **2W Business:** In the 2W domestic industry – we expect the 125cc and above segment to grow faster than the entry-level segment. With the increase of models in Heros' stable we expect it to grow at par with the industry (earlier below industry). As the execution strategy plays out in FY25 we conservatively build in a 7% CAGR volume growth over FY23-26E for Hero. ✓ **Strong EBITDA Margins:** The company's EBITDA margin in Q3 came in at 14%, with ~a 200 bps impact due to EV-related expenses. It is expected to improve further on the back of new product launches in the premium category and management's focus on exports in key geographies. With commodity prices expected to largely remain stable, operational efficiency in EVs, and higher ASP led by product premiumization, we factor in a conservative 14.5% EBITDA margin in FY26E.

** Note: Target Price is based on our Q3FY24 Result Update Report*

Top Sector Ideas: Auto Ancillaries

Stock	Reco.	TP	Recommendation Rationale
CIE Automotive Ltd	BUY	Rs 565*	✓ **Indian operations likely to outperform underlying industry growth in the medium term:** The management indicated improvement across segments and customers in CY24, as well as demand-backed Capex. We anticipate the company to report revenue growth of 9.6% CAGR over CY23-26E in its Indian operations. ✓ **Europe Business:** While the EU market forecast is muted in the medium term, we remain optimistic about the CIE Automotive operations, which demonstrate higher margins, higher returns, and strong cash flow generation capabilities. We estimate a 5.7% CAGR revenue growth over CY23-26E in the EU business. ✓ **EV business:** Light-weighting and safety concerns are expected to drive the industry towards aluminum castings and composites, which are key focus areas for the management. The management reported that within the total new orders in CY23, electric vehicles (EVs) constituted 73% of the EU Forgings business, 51% in Metalcastello, and 15% in the Indian operation. The transition to EVs necessitates components with higher precision, closer tolerances, and better quality, thereby creating greater opportunities in India. Companies like Bill Forge, AEL castings, and the Gears division are expected to benefit from export demand.

** Note: Target Price is based on our Q4CY23 Result Update Report*

Top Sector Ideas: Auto Ancillaries

Stock	Reco.	TP	Recommendation Rationale
Steel Strips Wheels Ltd	BUY	Rs 325*	✓ **Outlook on EBITDA per wheel:** SSWL has improved EBITDA per wheel to ~Rs 254 in Q3FY24 from around Rs 248 in Q2FY24. The management is confident of further enhancing margins through product premiumization, driven by increased alloy wheel business, exports, electric motor hub wheels, and aluminum knuckles in the sales mix. The management aims to maintain medium-term EBITDA per wheel margin between ~Rs 250-260 levels, supported by operational efficiencies, albeit partially offset by startup costs at the AMW facility. ✓ **Incremental Capex for AMW (Steel) and Alloy Wheel Capacity:** The company plans to increase alloy wheel capacity to 4.8 Mn wheels by Q3FY25, up from 3 Mn in FY23 and 3.6 Mn in FY24. The total Capex for FY24 amounts to ~Rs 470 Cr, including ~Rs 138 Cr for the AMW plant and ~Rs 190 Cr for brownfield Capex to expand the alloy wheel business in Mehsana, Gujarat. The AMW plant will operate as a wholly-owned subsidiary of SSWL, with commercial production expected to commence in H2FY25, producing 25,000-30,000 CV wheels per month and generating additional revenue of ~Rs 60 Cr in FY25. ✓ **EV Business:** According to the management, the company currently holds a 60% market share for electric hub-motor supplies to 2W EV OEMs and commands a 60-65% wallet share of business from Tata Motors and Mahindra & Mahindra (MnM) each for its EV portfolio. The management anticipates that the EV business will grow at a rate of 25-30% in FY25, supported by the continuation of the FAME subsidy.

** Note: Target Price is based on our Q3FY24 Result Update Report*

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