

Established in 1981, Automotive Axles Limited (AAL) is a joint venture of Kalyani Group and Meritor Inc., USA (formally the automotive division of Rockwell International Corporation), 35.52% stake each. With manufacturing facilities located at Mysore (Karnataka), Pantnagar (Uttarakhand) 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 the 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.

Investment Rationale

Proxy to the domestic CV cycle up move

Post a lull observed after the DeMon, BS IV and GST implementations, CV industry took a U turn and bounced back with healthy growth rates close to 25-30%. The year FY 18 ended at a growth rate of 19.4% for the trucks segment. In the first quarter too, the sector reported 51% growth rate and is expected to end the year with at least 15-20% growth. The macro drivers for the CV space to grow are in place. With infrastructure activities gathering steam across India, especially in the states/cities like UP, Delhi and Mumbai the demand for trucks is expected to remain buoyant. Post the easing up of mining ban in Karnataka, tipper demand is on an up move. Improvement in freight rates and good monsoon may also assist in CV cycle growth. The recent floods in Kerala may require the government bodies to rebuild infrastructure in major part of the state. This may lead to truck demand going up in the state in the coming months. With elections scheduled in 2019, there will be a rush to complete many infrastructure projects that is expected to improve the CV sales in India. It is likely to drive higher volumes for AAL and the changing product mix would result in margin expansion. The company has a strong customer base in the domestic market catering to all major OEMs in Indian CV industry and continues to retain its position as the largest independent manufacturer of rear drive axles for medium and heavy commercial vehicles (M&HCV) in India. The company has a strong customer base in the domestic market catering to all major OEMs in Indian CV industry and continues to retain its position as the largest independent manufacturer of rear drive axles for medium and heavy commercial vehicles (M&HCV) in India.

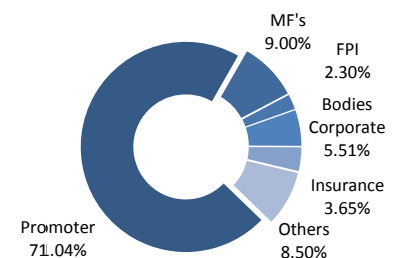
Strong clientele and management provides comfort level and steady performance during tough macro environment

AAL being a JV between Arvin Meritor Inc., USA (formerly the automotive division of Rockwell International Corporation), a Fortune 500 company, and the Kalyani Group ensures sound management support. Products manufactured at AAL are based on technology provided by Meritor through its subsidiary Meritor HVS India Ltd, and more than 90% of the sales are routed through it. AAL's domestic OEM customers include Ashok Leyland, Daimler India, Man Trucks, Mahindra & Mahindra, Tata Motors, Volvo Eicher, Asia Motor Works and Indian Army, among others. AAL also exports its products indirectly through Meritor HVS India Ltd. to various countries including the US, France, Italy, China and Brazil. Ashok Leyland is the largest customer of AAL accounting for ~65% of revenues followed by Tata Motors contributing ~15% of sales. Being in strong collaboration with such big names, AAL has been able to weather the macroeconomic and sectoral ups and downs over the past several years, which can be justified by the fact that the topline has grown three fold in the period between FY14-18, while the bottomline has grown at a CAGR of 45% in the same period.

Stock Data

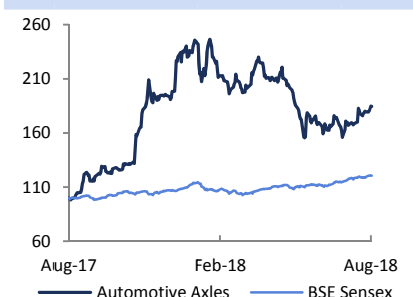
Current Market Price (₹)	1,389
12M Price Target (₹)	1,883
Potential upside (%)	36
BSE / NSE Symbol	505010 / AUTOAXLES
Reuters / Bloomberg	ATO.A.BO / AXTL IN
FV (₹)	10
Market Cap Full (₹ bn)	20.8
52-Week Range (₹)	1,849 / 704

Shareholding Pattern



YE Mar	FY 15	FY 16	FY 17	FY 18
Revenues (₹ mn)	4,592	10,860	11,723	15,194
EBITDA (%)	7.7%	8.8%	9.7%	11.0%
PAT (%)	2.1%	2.9%	3.8%	5.4%
EPS (₹)	7.0	23.0	32.7	55.6
P/E (x)	198.4	60.1	42.3	24.9
P/B(x)	6.9	6.4	5.6	4.7
EV/EBITDA (x)	592.1	220.3	184.2	125.1
ROE (%)	3.5%	10.6%	13.1%	18.9%
ROCE (%)	5.4%	16.2%	19.4%	27.9%

Relative Price Performance



Structural drivers to drive demand till FY 20

The new axle norms introduced for MHCVs by the government in July may drive truck demand in the short to medium term. Under this norm, trucks can carry loads higher by 16.7% of their loading capacities. However, there is a lack of clarity whether these norms are applicable to the existing fleet or the new registrations. In case the latter holds true, then demand for MHCVs shall see a good pick up above the current rate. As it is overloading ban is still prevalent in some of the northern states which is currently driving demand for MHCVs and in turn the ancillaries. Furthermore, the government leap frogging on the BS VI emission norms from 2023 to 2020 will certainly drive huge demand in Q4 of FY20 as the vehicle prices will jump by about 10% post April 20. Hence pre-buying of MHCVs is expected to add significantly to the growth in FY 20E.

Improved product mix to trigger margin growth

Meritor India, the JV partner of AAL has entered the suspension market. It is a type of leaf spring suspension which has some clear benefits over the conventional Bellcrank suspension currently used in India. A study done by fitting the suspension in customer vehicles revealed maintenance cost reduction from 15 to 20 paise per km to 3-5 paise per km. Weighing 80-100kg less, it enables the operator to carry extra load. Tyre wear was found to be 30% after 60,000km whereas in Bellcrank suspension tyre has to be replaced after 40,000km. With just 10% increase in cost over the Bellcrank suspension, operators would derive significant savings in the long run. As more and more OEMs adopt this technology in India, revenues of AAL could see a sharp jump. Further AAL has introduced new products that combine suspension system with axle assembly and is looking forward to introduce integrated system combining suspension, axles and brakes in the near future. All these will create a differentiated product and push sales and margins upwards over the next few years.

Drive Axles



Front Steer Axles



Non-Drive Axles



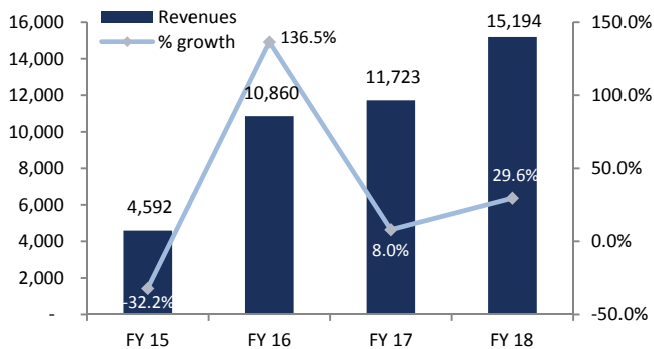
Drum Brake



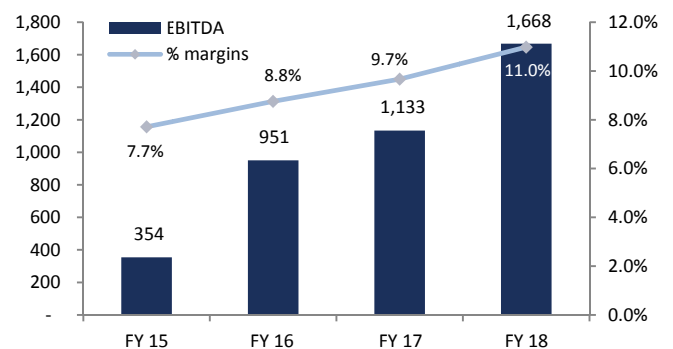
Valuation and Outlook

Being the one stop shop and market leader for all the axle and axle related equipment supplying to both domestic and international OEM players and aftermarkets, AAL is one of the biggest beneficiary of the MHCV cycle excelling in the super positive territory. The company is blessed with a strong parent lineage of the Kalyani and Meritor Groups. Sound financials and an exponential growth in both topline and bottomline despite macro headwinds historically make a clear case of investment. The company's initiative in diversifying its portfolio would lead to better margin performance. A debt free company with ROE and ROCE of 19% and 28% respectively in FY18, clean balance sheet and aggressive expansion plans (in line with the MHCV growth) to be internally funded are the additional positives. On FY20E earnings the stock is trading at 15x, which we believe can easily expand considering the positives of the CV industry. We recommend a BUY with a 12 month target of ₹1,883.

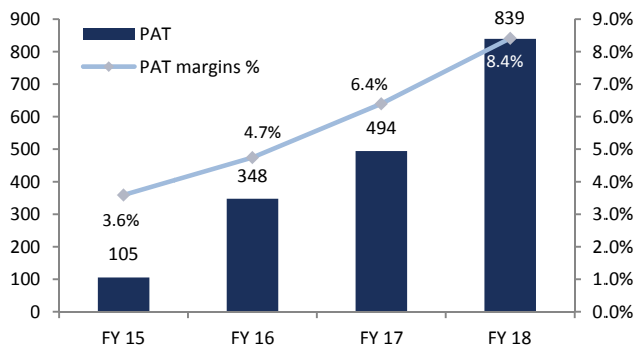
Revenues (₹ mn) v/s growth trend (%)



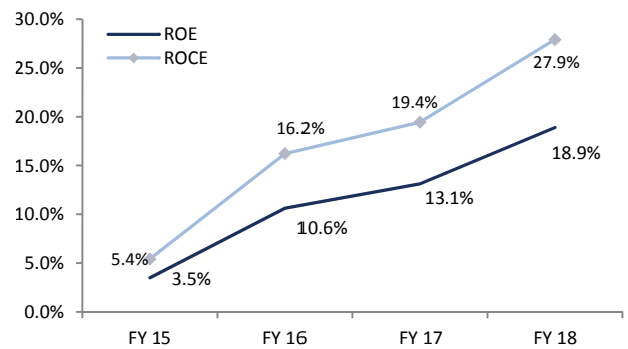
EBITDA (₹ mn) v/s EBITDA margins (%) trend



PAT (₹ mn) v/s growth trend (%)



ROE v/s ROCE



Source: Company, LKP Research

Financials

Income statement

YE Mar (₹ mn)	FY 15	FY 16	FY 17	FY 18
Total Revenues	4,592	10,860	11,723	15,194
Raw Material Cost	3,273	7,812	8,257	10,622
Employee Cost	370	798	814	993
Other Exp	595	1,299	1,518	1,911
EBITDA	354	951	1,133	1,668
EBITDA Margin(%)	7.7%	8.8%	9.7%	11.0%
Other income	25	16	20	45
Depreciation	173	394	391	429
Interest	41	57	12	5
PBT	165	515	750	1,278
PBT Margin (%)	3.6%	4.7%	6.4%	8.4%
Exceptional items	0	0	0	0
Tax	59	168	256	439
APAT	105	348	494	839
APAT Margins (%)	2.3%	3.2%	4.2%	5.5%
PAT	105	348	494	839
PAT Margin (%)	2.1%	2.9%	3.8%	5.4%

Key Ratios

YE Mar	FY 15	FY 16	FY 17	FY 18
Per Share Data (Rs)				
Adj. EPS	7.0	23.0	32.7	55.6
CEPS	18.5	49.1	58.6	84.0
BVPS	200.3	216.7	249.4	294.3
DPS	3.0	1.2	5.5	8.0
Growth Ratios (%)				
Total revenues	-32.4%	137.1%	8.0%	19.3%
EBITDA	-37.8%	168.4%	19.2%	47.2%
PAT	-36.3%	212.6%	45.6%	70.4%
EPS Growth	-36.3%	212.6%	45.6%	70.4%
Valuation Ratios (x)				
PE	198.4	60.1	42.3	24.9
P/CEPS	75.1	28.2	23.6	16.5
P/BV	6.9	6.4	5.6	4.7
EV/Sales	45.7	19.3	17.8	13.7
EV/EBITDA	592.1	220.3	184.2	125.1
Operating Ratios (Days)				
Inventory days	129.2	51.7	43.7	47.1
Receivable Days	139.5	66.6	72.0	84.1
Payables day	106.4	46.1	52.6	61.5
Net Debt/Equity (x)	0.18	0.09	-0.09	-0.10
Profitability Ratios (%)				
ROE	3.5%	10.6%	13.1%	18.9%
ROCE	5.4%	16.2%	19.4%	27.9%

Source: Company, LKP Research

Balance sheet

YE Mar (₹ mn)	FY 15	FY 16	FY 17	FY 18
Equity and Liabilities				
Equity Share Capital	151	151	151	151
Reserves & Surplus	2,873	3,121	3,615	4,292
Total Networth	3,024	3,272	3,766	4,443
Total debt	25	0	0	0
Net Deferred Tax	112	67	11	-59
Other long term liabilities	0	0	6	7
Long term provisions	175	89	34	46
Current Liab & Prov	312	156	52	-6
Short term borrowings	541	288	0	0
Other current liabilities	130	61	75	205
Trade payables	1,338	1,371	1,688	2,562
Total provisions	79	436	56	79
Total Equity & Liabilities	5,424	5,585	5,636	7,283
Assets				
Net block	1,768	1,684	1,458	1,176
Capital WIP	169	89	73	167
Other non current assets	239	140	152	209
Total fixed assets	2,175	1,913	1,683	1,552
Cash and Bank	36	3	351	445
Inventories	1,158	1,106	988	1,371
Trade receivables	1,755	1,980	2,314	3,500
Loan, Advances & others	259	556	288	401
Other current assets	40	28	14	14
Total current Assets	3,249	3,673	3,954	5,731
Total Assets	5,424	5,585	5,636	7,283

Cash Flow

YE Mar (₹ mn)	FY 15	FY 16	FY 17	FY 18
PBT	165	515	750	1,278
Depreciation	173	394	391	429
Interest	0	54	12	5
Chng in working capital	606	-269	85	-720
Tax paid	67	178	313	508
Other operating activities	-94	-302	-581	-988
Cash flow from operations (a)	917	569	971	512
Capital expenditure	-193	-283	-244	-308
Chng in investments	0	0	0	0
Other investing activities	8	6	9	28
Cash flow from investing (b)	-185	-253	-225	-272
Inc/dec in borrowings	-614	-276	-288	0
Dividend paid (incl. tax)	-45	-18	-83	-121
Other financing activities	-44	-55	-26	-25
Cash flow from financing (c)	-703	-349	-398	-146
Net chng in cash (a+b+c)	29	-33	348	94
Closing cash & cash equivalents	34	1	348	442

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