



TM

23 May 2022

Auto Sector

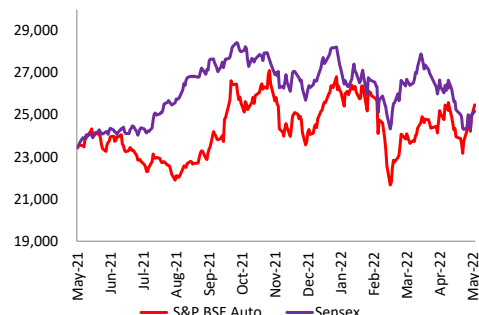
RM inflation – Worst is behind?

FLASH NOTE

Industry

Automobile

Auto sector v/s Sensex



Sector rating

Company	TP (Rs)	Reco.
Ashok Leyland	185	Buy
Bajaj Auto	3,655	Hold
Balkrishna Industries	1,690	Sell
Bharat Forge	875	Buy
Eicher Motors	2,605	Hold
Endurance Tech	1,728	Buy
Hero MotoCorp	2,750	Buy
M&M	873	Hold
Maruti Suzuki	7,740	Hold
Minda Industries	1,210	Buy
Minda Corporation	285	Buy
Motherson Sumi Wiring	85	Buy
Sona BLW	725	Buy
TVS Motor	695	Hold
Varroc Engineering	350	Hold

Source: Systematix Institutional Research

Gross margin to benefit: A 40-100% rise in key commodity prices over last 2 years led to OEMs' operating margins contracting 200-350bps, despite the several price hikes taken by all players. Once the export duties and other measures announced by the central government to lower commodity prices come into effect, we believe, the worst of RM pressures would be behind us. We believe, a 10% correction in steel prices (~45% of the total commodity cost for OEMs) would enable 125-175bps expansion in gross margins of OEM players (See Exhibit 1). Major auto ancillaries too would benefit from the anticipated cooling off in commodity prices.

Demand scenario positive for MHCVs & PVs: MHCVs are seeing robust retail sales momentum, especially in the bus and large haulage segments, as the industry recovers from a deep cyclical downturn (industry volumes have declined ~60% from the FY19 peak). Channel inventory remains low and consequently, discounts are at the lowest level in the last 3 years. The recent fuel price cut should aid the replacement cycle (currently at 8-9 years vs. 4-5 years historically). The demand momentum for passenger vehicles (PVs) remains healthy and with improving availability of semiconductors, OEMs should be able to ramp up production to service their strong order books. SUVs continue to outperform the overall growth in PVs. ICE two-wheeler (2W) demand has improved sequentially, but remains much below FY19 peak level, given frequent price hikes by original equipment manufacturers (OEMs), all-time high fuel prices, and increased traction for EVs.

Sector view: We remain positive on the CV space, as the industry recovers from deep cyclical downturn and would further benefit from the correction in commodity costs and fuel prices. We recommend BUY on Ashok Leyland (TP: Rs 185). Maruti (HOLD; TP: Rs 7,740), Hero (BUY; TP: Rs 2,750) & Tata Motors (NR) should also benefit given their high sensitivity to RM costs. We also see major auto ancillaries benefiting from cool off in commodity inflation. We remain positive on Minda Ind (BUY; TP: Rs 1,210), Sona Comstar (BUY; TP: Rs 725), Endurance Tech (BUY; TP: Rs 1,728), and Bharat Forge (BUY; TP: Rs 875).

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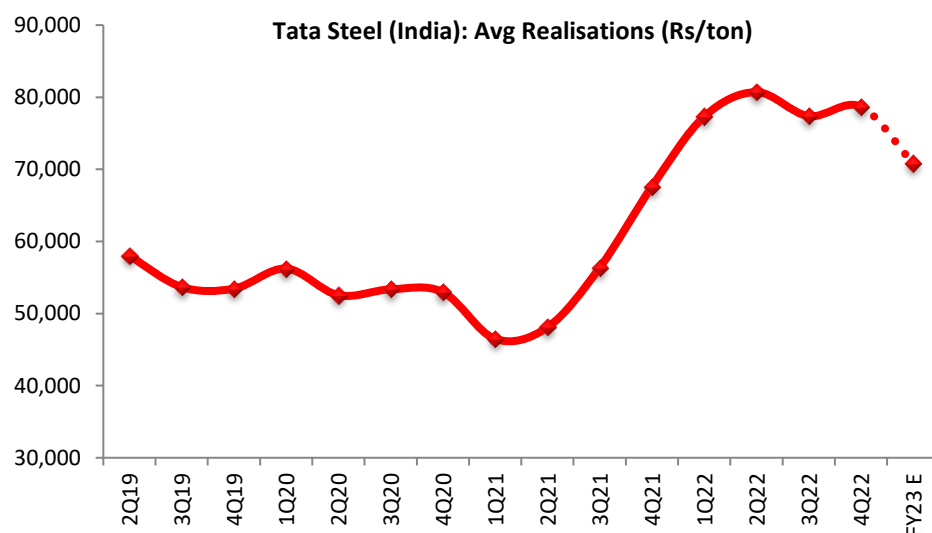
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Exhibit 1: A 10% fall in steel prices should expand gross margins by 125-175bps

Ashok Leyland	FY21	FY22
RM as % of sales	75	77
of which is commodities	50%	50%
of which is steel	45%	45%
Steel price fall expected	10%	10%
Gross margin expansion (bps)	168	174
Maruti Suzuki	FY21	FY22
RM as % of sales	72	75
of which is commodities	45%	45%
of which is steel	40%	40%
Steel price fall expected	10%	10%
Gross margin expansion (bps)	130	135
Hero Motocorp	FY21	FY22
RM as % of sales	71	71
of which is commodities	45%	45%
of which is steel	40%	40%
Steel price fall expected	10%	10%
Gross margin expansion (bps)	127	128

Source: Company, Systematix Institutional Research

Exhibit 2: Domestic Steel price trend; expect prices to cool off

Source: Company, Systematix Institutional Research

Assuming a 10% correction in steel prices on the back of the export duty announced and other government measures, domestic steel prices will be back to 4Q FY21 levels.

Exhibit 3: Global commodity prices have cooled off vs. 4QFY22; Steel spot prices near 4QFY21 levels (lower 16% / 7% vs. 1Q/4QFY22)

	4QFY21	1QFY22	2QFY22	3QFY22	4QFY22	Spot prices	vs. 1QFY22	vs. 4QFY22
HRC Steel (US\$/ton)	730	877	887	804	786	734	-16%	-7%
Aluminium (US\$/ton)	2,094	2,397	2,644	2,755	3,250	2,964	24%	-9%
Lead (US\$/ton)	2,011	2,127	2,331	2,322	2,325	2,160	2%	-7%
Copper (US\$/ton)	8,480	9,682	9,382	9,692	9,992	9,477	-2%	-5%
Palladium (US\$/ounce)	2,400	2,785	2,478	1,944	2,330	1,987	-29%	-15%
Platinum (US\$/ounce)	1,156	1,182	1,026	1,000	1,029	956	-19%	-7%

Source: Company, Systematix Institutional Research

Exhibit 4: Valuation summary

Companies	CMP (Rs)	Reco	FDEPS (Rs)		PE (x)		EV/ E (x)		RoCE (%)	
			FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Ashok Leyland	137	BUY	4	7	26	16	17	12	16	23
Bajaj Auto	3,843	HOLD	165	186	23	21	17	15	23	26
Balkrishna	2,153	SELL	70	77	31	28	20	17	18	18
Bharat Forge	685	BUY	31	38	22	18	15	12	15	17
Eicher Motors	2,742	HOLD	87	104	31	26	26	22	23	25
Endurance	1,288	BUY	49	66	26	20	13	10	20	23
Hero MotoCorp	2,662	BUY	143	166	19	16	11	10	23	25
Mah & Mah	930	HOLD	42	42	14	14	14	12	14	13
Maruti Suzuki	7,900	HOLD	232	289	34	27	20	15	15	18
Minda Corp	206	BUY	10	14	20	15	10	8	19	21
Minda Ind	865	BUY	21	28	41	31	21	16	23	30
MSWIL	63	BUY	2	2	32	28	22	18	52	42
Sona Comstar	562	BUY	9	13	66	43	42	28	27	33
TVS Motor	703	HOLD	25	31	28	23	15	13	23	23
Varroc	361	HOLD	8	13	46	27	9	7	4	8

Source: Company, Systematix Institutional Research

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