

Key risks to investing in I-direct Instinct

- It is a quick pitch note, which captures the essence of an idea in brief
- Instinct idea may be based on management interaction or some immediate triggers that may have a positive impact on the future of the company
- Target price is based on forward estimates, which will be published along with Detailed Coverage Report or Nano Nivesh report as the case may be
- The intent is to capture price action by coming out with a gist, which may or may not be an interim report between management interaction and publication of the final report
- The fair value of I-direct Instinct stocks is subject to expected growth potential in the future. Though due diligence has been done to a fair extent, the actualisation of growth still has a degree of uncertainty attached to it. Customers are advised to allocate a small proportion of their investible income to these stocks and diversify well

Automotive Axles (AUTAXL)

CMP: ₹ 1,050

Target: ₹ 1,260 (20%)

Target Period: 12 months

May 6, 2021

BUY

Efficient, proxy play on cyclical recovery in CV segment

Automotive Axles (AAL), established in 1981, is co-promoted by the Kalyani Group (35.5% stake) and Meritor Inc. (US, 35.5% stake). AAL is the largest independent manufacturer of rear axle drive assemblies in India (primarily for CVs; M&HCV). It is also a prominent brake manufacturer. Rear drive axles comprise ~60% of its topline with brakes share at ~20% and other parts comprising the rest. AAL counts all major CV OEMs as its clients with prominent being Ashok Leyland, M&M, Volvo, Daimler India, Tata Motors among others. It has four manufacturing locations pan India with capacity pegged at ~20,000 units/month for axles, ~120,000 units/month for brakes.

Triggers

Infra push, scrappage policy to propel healthy CV growth

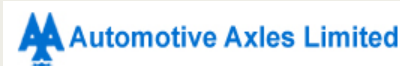
Commercial vehicle (CV) segment is a cyclical industry. Currently, we have seen it turn the corner of its usual two year down cycle. January-March 2021 volume prints by industry majors like Tata Motors, Ashok Leyland and Eicher Motors (VECV arm) reaffirm our thesis with healthy double digit sequential pick up in volumes. FY21 domestic sales volumes in the CV space were at ~5.7 lakh units, down 44% from the peak clocked in FY19 i.e. ~10 lakh units. Within the CV space, M&HCV saw a sharper decline at ~60% over the two-year period with industry volumes being pushed back by ~12 years while decline was limited to ~33% in the LCV space with segmental volumes being pushed back by ~4 years. Going forward, however, given the government's push on infrastructure development amid growth oriented Union Budget 2021-22 and recently announced scrappage policy promoting sales of new fuel efficient vehicles for Indian roads, we feel the CV industry will bounce back sharply and grow in excess of 30-35% in the next two years, withstanding the minor hiccups due to Covid resurgence. With AAL deriving 90%+ of its revenues from the CV segment, especially the M&HCV sub-segment, we expect it to be a natural beneficiary of the same. With this, coupled with its penchant to launch new products as well as break into new OEMs, AAL is well poised to clock ~37% sales CAGR in FY21E-23E.

Capital efficient business model, unlevered balance sheet

AAL, over the years, has demonstrated healthy capital efficiency with FY16-20 average RoE, RoCE, RoIC at ~15%, 23%, 25%, respectively. In normal times, it clocks an asset turnover of ~3x, realises ~10-12% EBITDA margins and has working capital cycle of <=60 days thereby ensuring core RoIC >=20%. On the balance sheet front, AAL had gross debt of ~₹ 35 crore as of FY20, with cash & cash equivalents at ~₹ 74 crore, thereby making it a net debt free company. Over the years, its leverage has been quite minimal. Also, with capex executed in the recent past, the unlevered nature of balance sheet is expected to persist, going forward. On the cash flow front, it has been a consistent cash generator i.e. positive CFO, with cumulative 10 years (FY11-20) CFO at ~₹ 800 crore while FCF in the aforesaid period is at ~₹ 350 crore. Healthy b/s and consistent cash generation bodes well and acts as a good margin of safety to our investment thesis.

Valuation & Outlook

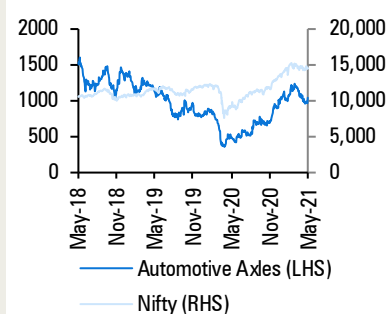
With cyclical recovery envisaged in the CV space, we expect sales to grow at a CAGR of ~37% in FY21E-23E to ~₹ 1500 crore in FY23. PAT in the aforesaid period is expected to grow to ~₹ 95 crore in FY23E with capital efficiency reviving to ~20% levels (RoCE, RoIC). We are also enthused by the Vision 2025 statement at AAL, wherein the management's intent is to grow profitably ahead of industry including exports. With favourable risk-reward at hand, we ascribe **BUY** rating to the stock with a target price of ₹ 1,260 i.e. 20 x P/E on FY23E numbers.



Particulars

Particulars	Amount
Market capitalisation (₹ crore)	1,586
Debt (FY20, ₹ crore)	35
Cash & Inv. (FY20, ₹ crore)	74
EV (₹ crore)	1,547
52 Week High/Low (₹)	1250/ 404
Equity capital (₹ crore)	15.1
Face value (₹)	1.0

Price Performance



Key Highlights

- Cyclical recovery in CV segment to boost demand prospects at ancillaries; AAL to benefit
- Sound technology support from parent Meritor Inc. with capabilities in both gasoline fuelled vehicles and electric vehicles

Risks to our call

- Delay in recovery in volumes at its key OEM clients over FY22E-23E; especially Ashok Leyland
- More than anticipated increase in raw material costs (metals) and the company's inability to pass on the same to its customers

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Key Financial Summary

P&L Account (₹ crore)	FY20	FY21E	FY22E	FY23E
Sales	952.0	790.1	1,185.2	1,481.5
EBITDA	91.3	43.5	124.4	163.0
EBITDA margin (%)	9.6	5.5	10.5	11.0
PAT	41.1	9.2	66.9	95.0
EPS (₹)	27.2	6.1	44.3	62.9
Balance Sheet (₹ crore)				
Equity	15.1	15.1	15.1	15.1
Net Worth	531.9	538.8	589.0	660.2
Gross Debt	35.3	-	-	-
Gross Debt: Equity (x)	0.1	-	-	-
Return Ratios (%)				
RoE	7.7	1.7	11.4	14.4
RoCE	11.0	1.4	14.3	18.3
RoIC	13.2	1.7	18.2	23.7
Valuations (x)				
P/E	38.5	NM	23.7	16.7
EV/EBITDA	16.9	34.2	11.7	8.8
P/B	3.0	2.9	2.7	2.4

Source: Capitaline, ICICI Direct Research

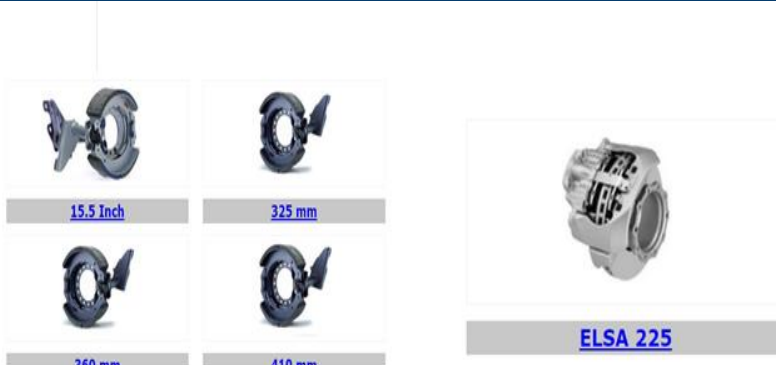
Financial story in charts

Exhibit 1: Real drive axles – AAL (share of revenues at ~60% as of FY20)



Source: Company, ICICI Direct Research

Exhibit 2: Disc & drum brakes – AAL (share of revenues at ~20% as of FY20)

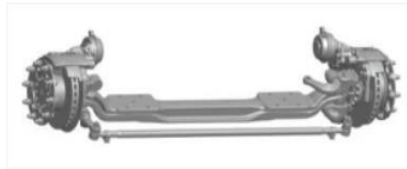


Source: Company, ICICI Direct Research

Exhibit 3: Front steer axles - AAL



FG945



FH941



FH946

Source: Company, ICICI Direct Research

Exhibit 4: End markets & key customers - AAL

Diverse End Markets

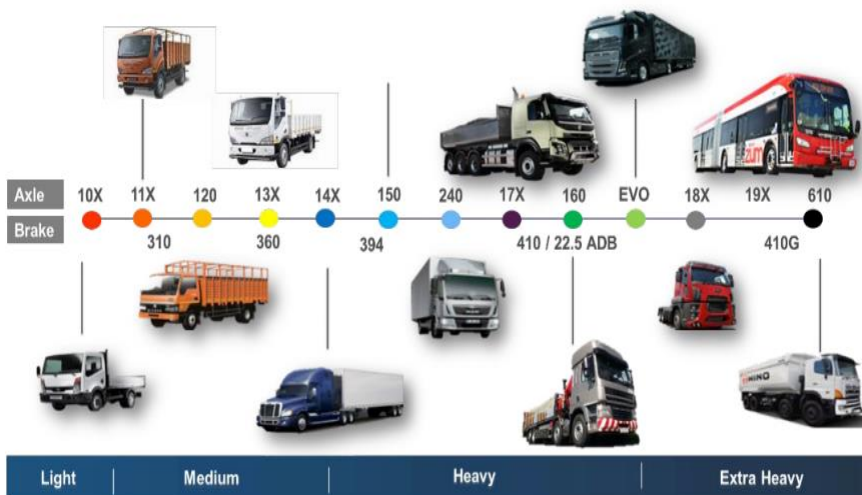


Major Customers



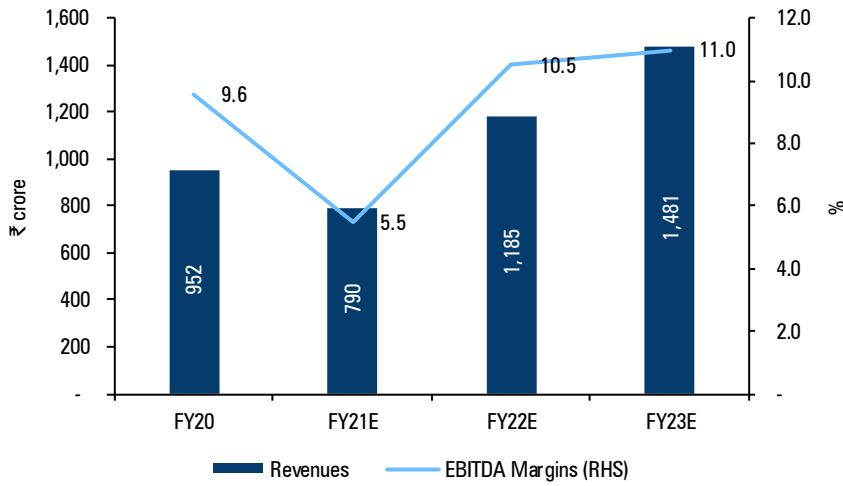
Source: Company, ICICI Direct Research

Exhibit 5: Axle & brake offerings - AAL



Source: Company, ICICI Direct Research

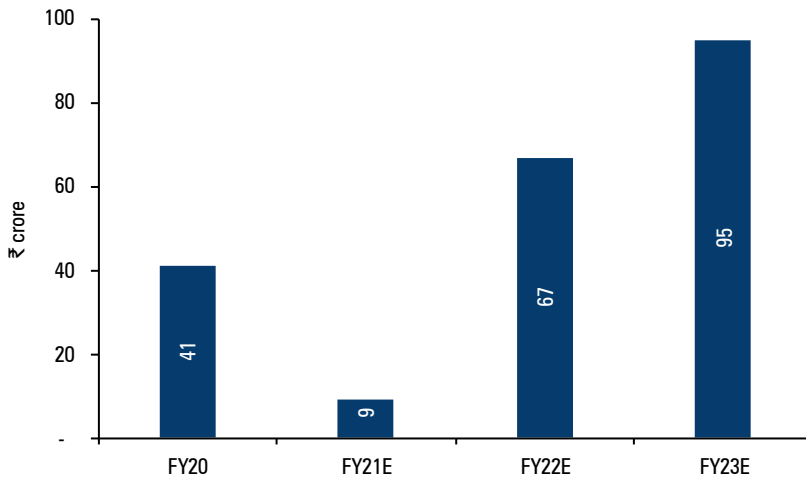
Exhibit 6: Revenue, EBITDA margin trend



We expect revenues to grow at a CAGR of 36.9% over FY21-23E with EBITDA margins seen improving to 11% in that timeframe amid operating leverage benefits and various cost cutting initiatives being undertaken by the company

Source: Capitaline, ICICI Direct Research

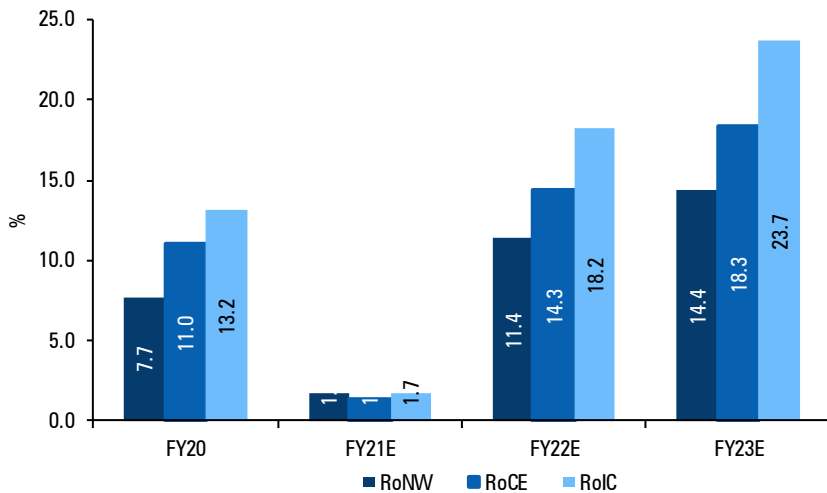
Exhibit 7: Profitability (PAT) trend



Post the cyclical decline in FY20 & FY21E, PAT is seen rebounding to ₹ 67 crore and ₹ 95 crore levels in FY22E and FY23E, respectively

Source: Capitaline, ICICI Direct Research

Exhibit 8: Return ratios trend



With healthy growth prospects, operating leverage at play and near zero debt on b/s, return ratios are seen improving sharply to ~20% levels by FY23E

Source: Capitaline, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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