Prabhudas Lilladher
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Automobiles

Sector Update

June 11, 2018

Input cost pressure leads to margins missing estimates

Q4FY18 performance for most companies in the Auto and Auto Ancillary sectors somewhat missed our expectations. Despite OEMs across segments registering strong volume growth (particularly the M&HCV segment, even with the high base of last year), margins slightly disappointed owing to commodity inflationary pressures. Delay in the pass-through of commodity price rise hampered the margin performance of Ancillaries. While margin pressure for companies is expected to continue over the near term, growth drivers like predictions of normal monsoon, pick up in infrastructure activities and rural demand scenario looking up, provide optimism for robust volume growth to prevail over the current fiscal. Given the aforesaid factors, ***our preferred picks are M&M, Tata Motors and Ashok Leyland. Also, we remain positive on Maruti Suzuki and Motherson Sumi from a longer-term perspective.***

- **Strong volume growth despite high base:** Q4FY18 was a strong quarter in terms of volume for automobile companies across segments despite the high base of last year on account of the BS IV related pre-buying, particularly in the two/three wheeler segment and the CV segment. Four-wheelers as well as two-wheelers in our coverage universe both saw good growth, up 20% and 28%, respectively. While PVs continued to record decent growth (MSIL volumes up ~10% YoY), CVs again posted a robust performance in the quarter (AL/TTMT/VECV reported CV volume growth of 23%/37%/36% YoY respectively). Two-wheelers were up ~25% YoY, whereas three-wheelers surged ~108% YoY over Q4FY18 on the back of new permits that had opened in the domestic market, coupled with sustained revival in key export markets. *TVS Motors* led two-wheeler growth, growing ~30% YoY, while *Royal Enfield* followed with 27% YoY growth over Q4. Tractors reported robust performance recording a volume growth of ~44% YoY (*M&M* and *Escorts*).

- **Operating margins disappoint:** With commodity prices being higher ~15% YoY and ~2% QoQ, operating margins for most companies failed to meet our expectations despite significant operating leverage, given the strong volume growth. While *TVS Motors* recorded the highest volume growth amongst two-wheelers, it disappointed hugely on the margins front with ~7% operating margins against our expectations of 8.5%. *Ashok Leyland* margins too were slightly below estimates owing to an unfavourable product mix and bunching up of costs in Q4 in addition to the input cost pressure. Consolidated EBITDA margin for TTMT too met expectations, while margins for JLR missed PLe. Among ancillaries, *Exide* margins surpassed estimates, barring which, operating performance of all companies was marginally below our expectations (MSS margins too were 20bps higher than PLe). Overall, the operating margin for the Auto & Auto ancillary sector over Q4FY18 was lower ~60bps YoY (~30bps lower than PLe), while excluding TTMT, the operating margin for the sector stands higher 110bps YoY (50bps below PLe).

- **Adjusted profit too misses estimates:** Net Profit for most companies under coverage missed estimates on account of higher-than-expected tax rate over the quarter.

Change in Target Price

	Old TP (Rs)	New TP (Rs)	*Chg (%)*
Ashok Leyland	143	169	*18.1*
Atul Auto	453	453	-
Bajaj Auto	3,026	2,709	*(10.5)*
Eicher Motors	32,727	33,516	*2.4*
Hero Motocorp	4,104	3,980	*(3.0)*
M&M	890	1,041	*17.0*
Maruti Suzuki	11,237	10,706	*(4.7)*
Tata Motors	438	378	*(13.6)*
TVS Motors	768	678	*(11.8)*
Bharat Forge	837	760	*(9.3)*
CEAT	1,954	1,711	*(12.5)*
Exide Industries	239	281	*17.5*
Motherson Sumi	406	373	*(8.3)*
Wabco India	8,820	8,086	*(8.3)*

Source: PL Research

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Exhibit 1: Q4FY18 Results Snapshot

	Revenue			EBITDA			OPM		Adj. Profit		
	Q4'18	Q4'17	*% Chng.*	Q4'18	Q4'17	*% Chng.*	Q4'18	Q4'17	Q4'18	Q4'17	*% Chng.*
Ashok Leyland	87,725	66,179	*32.6*	10,327	7,299	*41.5*	11.8	11.0	6,615	4,788	*38.1*
Atul Auto	1,506	1,041	*44.7*	181	103	*75.4*	12.0	9.9	117	62	*88.5*
Bajaj Auto	67,733	48,973	*38.3*	13,152	9,060	*45.2*	19.4	18.5	10,703	8,018	*33.5*
Eicher Motors	25,280	18,881	*33.9*	7,972	5,848	*36.3*	31.5	31.0	6,486	4,696	*38.1*
Hero Motocorp	85,640	69,152	*23.8*	13,706	9,576	*43.1*	16.0	13.8	9,674	7,178	*34.8*
Mahindra & Mahindra	1,33,079	1,11,252	*19.6*	17,542	9,385	*86.9*	13.2	8.4	10,232	6,549	*56.2*
Maruti Suzuki	2,11,656	1,83,334	*15.4*	30,150	25,595	*17.8*	14.2	14.0	18,821	17,105	*10.0*
Tata Motors	9,12,791	7,72,172	*18.2*	1,19,252	1,17,875	*1.2*	13.1	15.3	30,244	43,192	*(30.0)*
TVS Motors	39,928	28,445	*40.4*	2,807	1,615	*73.8*	7.0	5.7	1,656	1,268	*30.7*
Bharat Forge	14,666	11,257	*30.3*	4,177	3,200	*30.5*	28.5	28.4	1,936	1,809	*7.0*
CEAT	16,739	14,718	*13.7*	1,976	1,325	*49.1*	11.8	9.0	938	741	*26.5*
Exide Industries	24,594	19,546	*25.8*	3,380	2,519	*34.2*	13.7	12.9	1,896	1,643	*15.4*
Motherson Sumi Systems	1,54,078	1,12,839	*36.5*	15,001	12,543	*19.6*	9.7	11.1	5,328	5,526	*(3.6)*
Wabco India	7,849	5,769	*36.1*	1,122	776	*44.6*	14.3	13.4	772	496	*55.7*

Source: Company, PL

Exhibit 2: Change in Estimates

	Old EPS (Rs)		New EPS (Rs)		*Chg (%)*	
	FY19E	FY20E	FY19E	FY20E	*FY18E*	*FY19E*
Ashok Leyland	5.9	7.8	7.6	9.2	*28.6*	*17.8*
Atul Auto	21.3	23.9	21.3	23.9	*0.2*	*(0.2)*
Bajaj Auto	151.4	168.4	145.2	153.6	*(4.1)*	*(8.8)*
Eicher Motors	933.6	1105.1	996.5	1,145.6	*6.7*	*3.7*
Hero Motocorp	187.1	205.2	178.3	199.0	*(4.7)*	*(3.0)*
Mahindra & Mahindra	40.9	46.6	41.7	49.6	*2.0*	*6.5*
Maruti Suzuki	333.3	403	357.3	411.6	*7.2*	*2.1*
Tata Motors	45	60.2	38.1	49.7	*(15.3)*	*(17.5)*
TVS Motors	23.5	30.7	20.1	27.1	*(14.4)*	*(11.7)*
Bharat Forge	22.4	27.9	20.2	25.3	*(9.9)*	*(9.2)*
CEAT	111.7	148.9	91.7	114.1	*(17.9)*	*(23.4)*
Exide Industries	9.2	10.7	10.5	12.5	*14.6*	*17.0*
Motherson Sumi Systems	11.9	16.9	10.5	15.5	*(12.1)*	*(8.1)*
Wabco India	189.7	245	184.1	224.6	*(2.9)*	*(8.3)*

Source: Company, PL

Exhibit 3: Two & Three wheelers volume

Volume (units)	Q4FY18	*YoY gr. (%)*	*QoQ gr. (%)*
Total	**41,74,748**	***27.6***	***11.2***
Hero Motocorp	20,01,571	*23.4*	*17.1*
Bajaj Auto	10,45,378	*32.7*	*4.4*
TVS Motors	8,89,133	*31.7*	*7.6*
Royal Enfield	2,27,042	*27.4*	*9.9*
Atul Auto	11,624	*38.6*	*17.2*

Source: Company, PL

Exhibit 4: Four wheelers volume

Volume (units)	Q4FY18	*YoY gr. (%)*	*QoQ gr. (%)*
Total	**11,66,238**	***17.4***	***12.7***
Tata Motors (Standalone)	2,03,985	*35*	*19.1*
Jaguar Land Rover (incl. CJLR)	1,82,757	*4.5*	*14.9*
Maruti Suzuki	4,61,773	*11.4*	*7.1*
M&M	2,35,887	*25.3*	*12.2*
Ashok Leyland	58,735	*23.3*	*26.0*
VECV	23,101	*35.6*	*42.3*

Source: Company, PL

Exhibit 5: Snapshot of performance by various companies

Company	Commentary
Ashok Leyland	AL's Q4FY18 operating performance slightly missed estimates with EBITDA margin at 11.8%, up 80bps YoY and 110bps QoQ but below PLe of 12.5%. Margins for Q4FY18 were impacted by an unfavourable product mix, rise in commodity prices and bunching up of costs in the last quarter. The company reported a decent 33% YoY growth in revenues (on a high base) to Rs87.7bn (PLe: Rs92.6bn) on the back of a strong 23% YoY growth in volumes. EBITDA surged 41.5% YoY to Rs10.3bn, while adjusted net profit for the company was up 38% YoY at Rs6.6bn (PLe: Rs6.9bn). With favourable demand drivers, we upgrade to 'BUY' from an 'Accumulate' rating on the stock with a target price of Rs169 (earlier Rs149), based on an 12x Mar'20E EV/EBITDA.
Bajaj Auto	BJAUT reported an operationally in-line performance over Q4FY18, with EBITDA margin at 19.4%, higher 90bps YoY/10bps QoQ and in-line with our expectation of 19.5%. BJAUT's total income was higher ~38% YoY at Rs67.7bn (PLe: Rs66.7bn), with EBITDA growing 45% YoY to Rs13.15bn (PLe: Rs13.02bn). net profit grew 35% YoY to Rs10.8bn (PLe: Rs10.5bn). BJAUT's domestic portfolio continues to be under stress with new launches/brands (V, Avenger, Dominar) failing to make a mark (apart from Pulsar, BJAUT has been unable to create a brand in the motorcycle segment). With the upsurge in the domestic three-wheeler market demand behind us, sustained growth in key exports market would be crucial for BJAUT to drive volumes.
Eicher Motors	EIM's Q4FY18 consolidated operating performance was on expected lines, wherein revenue growth was at ~34% YoY to Rs25.3bn (PLe: Rs25.5bn) and EBITDA margin came in at 31.5% (PLe: 31.6%). With non-operating income higher ~54% YoY as well as share of profit from its VECV joint venture growing ~53% YoY at Rs963mn, consolidated net profit for the company over Q4FY18 surged ~38% YoY to Rs6.5bn, marginally ahead of our expectations at Rs6.3bn. Expansion of network for RE, especially in the underpenetrated smaller markets, will further augment volumes for the company. With the surge in CV demand expected to continue, FY19 should see additional positives for VECV. Introduction of premium variants in the 350cc segment, coupled with increase in spare part revenue would increase profitability and boost margins. We increase our EBITDA margin estimates by 120/130bps for FY19/20E and maintain 'Accumulate' with a target price of Rs33,516.
Hero MotoCorp	HMCL's Q4FY18 performance was slightly below expected lines, with operating margins at 16%, higher 220bps YoY and 20bps QoQ, but below our expectations of 16.8%. Revenue growth for the quarter was good at ~24% YoY to Rs85.6bn (PLe: Rs87.5bn), with EBITDA growth of 43% YoY to Rs13.7bn (PLe: Rs14.7bn). Higher-than-expected non-operating income helped boost Q4FY18 net profit for the company to Rs9.7bn, up 35% YoY (PLe: Rs10.4bn). With sustained recovery in rural demand, entry in the premium segments and increase in overall market share, the medium term outlook for HMCL looks promising. However, rising input costs adding to the impact of the Haridwar plant benefits expiring, management has guided margins could be under pressure, going forward.
M&M	M&M's Q4FY18 revenue was at ~Rs133bn, up 20% YoY v/s PLe of Rs130.3bn and operating margin was at 13.2% (up 470bps YoY / 30bps QoQ) v/s PLe of 13.1%. Absolute EBITDA surged 87% YoY to Rs17.5bn. Adjusted profit for the quarter was at Rs10.2bn, up ~56% YoY, but marginally below PLe of Rs10.7bn. Auto EBIT margins for M&M + MVML came in at 10.7% (up 350bps YoY, all time high) on the back of a favourable product mix. EBIT margins for the FES segment continue the upward trajectory at 19.5% (up 400bps YoY). Management expects the tractor industry to grow 8-10% YoY over FY19E, while M&M is expected to slightly outgrow the industry over FY19E. As for the automotive segment, the management expects PVs to grow over 10% (where UVs are expected to grow ~15% on the back of new launches) and CVs to be higher by 10-12%. We maintain 'BUY' with a price target of Rs1,041, based on a core PE of 17x Mar'20E and value of subsidiaries at Rs281.
Maruti Suzuki	MSIL's Q4FY18 EBITDA grew by ~18% YoY to Rs30.2bn (below PLe) and EBITDA margin came in at 14.2%, up 20bp YoY but lower 160bps QoQ (PLe 15.8%). Operating margins for the quarter were impacted by higher freight expenses to the tune of Rs1.8bn, royalty charges being higher by ~Rs1bn on account of unfavourable Yen movement (royalty rates for Q4FY18 stood at 5.7% as against 5.4% for FY18) and higher advertisement costs owing to Auto Expo'18 held in Jan'18 as well as new Swift launch costs. Accounting for the freight adjustment, margins stand at 15.1%. Despite management's stated production constraints, we expect MSIL not to miss out on demand due to supply constraints and overproduce from its stated production capacity (as achieved historically) on the back of operational efficiency. We marginally increase our volume estimate by 2%/1.4% for FY19/20. However, we slightly cut our EBITDA margins by ~70bps for FY19/20 to factor in commodity costs pressure and ramp-up related costs for the Gujarat plant.
Tata Motors	TTMT's Q4FY18 performance was below PLe with consolidated adjusted profit at Rs30.9bn, lower 29% YoY but up ~179% QoQ (below PLe: Rs45bn). Consolidated revenues grew a decent 18.2% YoY to Rs912.8bn (in-line with PLe), while operating margins too met expectations at 13.1%, lower 220bps YoY, up 30bps QoQ. JLR EBIT margins for the quarter came in at 5.5%, down 330bps YoY. Q4 EBIT margins for JLR were impacted by (1) Higher D&A (2) higher sales incentives (3) Restructuring of the company's capitalisation programme which impacted EBIT margins to the tune of ~100bps. Standalone performance again saw significant improvement this quarter with operating margins coming in at 10.1%, up 160bps QoQ. The near-term outlook for JLR remains muted both for volumes and profitability, EBIT margin target of ~7-9% (earlier 8-10%) mainly due to accelerated product development expenses. With JLR's full product range available in EV/Hybrid variants from 2020 gives us further confidence. Management's focus on improving the performance of the standalone entity is now clearly visible and we expect the same to continue. Given the attractive valuations and buoyant management guidance, we upgrade to "BUY" (earlier Accumulate) with a target price of Rs378.

TVS Motors	For Q4FY18, TVS motor's EBITDA margins stood at 7% (up 130bps YoY/down 80bps QoQ) v/s our expectations of 8.6%. Q4FY18 operating margins were impacted by (1) increase in RM cost (owing to commodity cost pressure as well as import duty rise), (2) higher marketing expenses as a % of sales due to product launch expenses (launch of three new products around the quarter) as well as Auto expo expenses (held in Jan'18) and (3) minimum wage rise in Karnataka. However, revenue growth continues to be robust, up 40.4% YoY to Rs39.9bn (PLe: ~Rs40.8bn). While the management continues to reiterate their target of double-digit margins, they shied away from giving a time frame unlike earlier. We believe this would be an up-hill task given the current upswing in commodity cycle, coupled with the implementation of BSVI norms. Resultantly, we reduce our EBITDA margin assumptions by 125bps/119bps for FY19/20E, respectively. Despite margins pressure, we expect TVS to continue to outperform the industry and increase our volumes estimates by 4%/4.4% for FY19/20E.
Bharat Forge	BHFC delivered good performance in Q4FY18 yet again registering strong growth across all major segments as well as geographies. Overall revenue growth for the quarter was at ~30% YoY to Rs14.7bn (PLe: Rs14.5bn), on the back of 24.5% YoY surge in sales tonnage (highest quarterly tonnage at 68,706MT) and 10% improvement in per ton realisations. Operating performance was slightly below PLe with OPM at 28.6% (PLe: 29.5%), inching up 10bps YoY. Adjusted profit stood at Rs1.9bn, below PLe of Rs2.3bn. With all the major segments as well as markets for BHFC looking up, medium-term and long-term outlook for BHFC remains healthy. The management expects North America Class 8 truck segment to grow a strong 20% YoY over the current fiscal. Domestic automotive segment too is seeing strong growth which is expected to further improve on the back of higher CV demand expected over FY19/20E. Rising commodity prices are providing additional support to the industrial segment, both domestic and overseas.
Ceat	CEAT's Q4FY18 consolidated operating margin at 11.8%, higher 280bps YoY but down 10bps QoQ, marginally missed our expectations of 12.5%. While consolidated revenue growth for the quarter at 13.7% YoY to Rs16.7bn was in-line with our estimates, EBITDA was slightly below our expectations at ~Rs2bn, up 49% YoY. Consolidated adjusted net profit, stood at Rs936mn against PLe of ~Rs1bn. Given the uncertainty regarding crude as well as rubber prices going ahead, coupled with expected ramp-up of new capacities, we remain cautious on the stock. We maintain "Accumulate", with a price target of Rs1,711 (earlier Rs1,954), based upon 15x Mar'19e EPS.
Exide Industries	Exide Industries reported a strong operating performance over Q4FY18, with operating margins at 13.7%, higher 80bps YoY/130bps QoQ, slightly ahead of our expectations of 13%. This was on account of significant reduction of other operating costs leading to a 220bps YoY/60bps QoQ decline in other expenses as a % of sales. Revenue growth was robust at 26% YoY (up 8% QoQ) to Rs24.6bn (in-line with PLe: Rs24.6bn). The company has stated that over Q4FY18, there has been strong growth across segments. Continued growth in the automotive and industrial segment has been impressive and further gains in the unorganized and replacement market post GST implementation has helped Exide lower its dependence on the declining inverter/UPS segment. Introduction of the cheaper brand Dynex has helped increase market share in the LCV and Tractor segment. Increased traction in the e-Rickshaw and solar batteries will further aid revenues. Management's focus on cost control and technology upgradation, coupled with now softening lead prices (down 7% in Q1FY19TD over Q4FY18) will boost margins in the near term.
Motherson Sumi Systems	MSS's Q4FY18 revenues came in at Rs154bn, up 36.5% YoY/7% QoQ (highest quarterly revenues), in-line with our estimates. Operating performance too met our expectations wherein EBITDA grew ~20% YoY to Rs15bn and operating margins came in at 9.7%, up 100bps QoQ but lower 140bps YoY (PLe: 9.5%). With lower share of profit from JVs (down 43% YoY) offset by higher other income and lower tax rate, adjusted profit for the company stood at Rs5.3bn, above PLe of Rs4.9bn. The management commented that SMR revenues for the quarter were somewhat impacted by the slowdown for Hyundai and Kia Motors, while PKC performance during the quarter was affected by some supply-side constraints. MSSL is also in the process of acquiring Reydel Automotive and bulk of the new orders won by MSSL over H2FY18 are towards Reydel's business. The easing up of start-up costs (commissioning of the Hungary and other plants in 1Q/Q3FY19) will partially offset the impact of lower PKC margins.
Wabco India	For Q4FY18, WIL reported net profit of Rs772mn, up 56% YoY and 21% QoQ, but below PLe of Rs822mn. While overall revenue for the quarter was ahead of our expectations at Rs7.85bn (~9% above PLe), growing 36% YoY/21% QoQ (where other operating income was higher 45% YoY), operating performance missed estimates with EBITDA margin lowering to 110bps QoQ (higher 90bps YoY) to 14.3% (PLe: 17%). We remain optimistic about the company as it will be a key beneficiary of the ongoing surge in CV demand. Management is targeting 17-18% margins over the next two years, while we have reduced our margin expectations for FY19/20E by ~100bps each to 16.4%/17.1% respectively, given commodity cost pressures and the difficulty/delay in full pass through of the same.

Source: Company, PL

Exhibit 6: Actual results v/s Expectation

	Revenue			EBITDA			OPM		Adj. Profit		
	Exp	**Actual**	***Dev (%)***	**Exp**	**Actual**	***Dev (%)***	**Exp**	**Act**	**Exp**	**Actual**	***Dev (%)***
Ashok Leyland	92,643	87,725	*(5.3)*	11,590	10,327	*(10.9)*	12.5	11.8	6,936	6,615	*(4.6)*
Atul Auto	1,511	1,506	*(0.3)*	196	181	*(7.9)*	13.0	12.0	127	117	*(8.0)*
Bajaj Auto	66,685	67,733	*1.6*	13,016	13,152	*1.0*	19.5	19.4	10,523	10,703	*1.7*
Eicher Motors	25,457	25,280	*(0.7)*	8,033	7,972	*(0.8)*	31.6	31.5	6,329	6,486	*2.5*
Hero Motocorp	87,552	85,640	*(2.2)*	14,706	13,706	*(6.8)*	16.8	16.0	10,138	9,674	*(4.6)*
Mahindra & Mahindra	1,30,307	1,33,079	*2.1*	17,042	17,542	*2.9*	13.1	13.2	10,707	10,232	*(4.4)*
Maruti Suzuki	2,09,581	2,11,656	*1.0*	33,057	30,150	*(8.8)*	15.8	14.2	21,080	18,821	*(10.7)*
Tata Motors	9,25,062	9,12,791	*(1.3)*	1,21,296	1,19,252	*(1.7)*	13.1	13.1	45,362	30,244	*(33.3)*
TVS Motors	40,793	39,928	*(2.1)*	3,509	2,807	*(20.0)*	8.6	7.0	2,209	1,656	*(25.0)*
Bharat Forge	14,475	14,666	*1.3*	4,290	4,177	*(2.6)*	29.6	28.5	2,345	1,936	*(17.5)*
CEAT	16,765	16,739	*(0.2)*	2,098	1,976	*(5.8)*	12.5	11.8	1,009	938	*(7.0)*
Exide Industries	24,646	24,594	*(0.2)*	3,193	3,380	*5.9*	13.0	13.7	1,949	1,896	*(2.7)*
Motherson Sumi Systems	1,56,313	1,54,078	*(1.4)*	14,799	15,001	*1.4*	9.5	9.7	4,961	5,328	*7.4*
Wabco India	7,174	7,849	*9.4*	1218	1,122	*(7.9)*	17.0	14.3	822	772	*(6.1)*

Source: Company, PL

Analyst Coverage Universe

Sr. No.	CompanyName	Rating	TP (Rs)	Share Price (Rs)
1	Ashok Leyland	Accumulate	169	141
2	Atul Auto	Accumulate	453	428
3	Bajaj Auto	Reduce	2709	2720
4	Bharat Forge	Accumulate	760	680
5	CEAT	Accumulate	1711	1596
6	Eicher Motors	Accumulate	33516	30305
7	Exide Industries	Accumulate	281	268
8	Hero Motocorp	Accumulate	3980	3662
9	Mahindra & Mahindra	BUY	1041	869
10	Maruti Suzuki	BUY	10706	8559
11	Motherson Sumi Systems	Accumulate	373	302
12	Ramkrishna Forgings	BUY	648	638
13	Tata Motors	BUY	378	296
14	TVS Motors	Accumulate	678	610
15	Wabco India	Accumulate	8086	7545

PL's Recommendation Nomenclature (Absolute Performance)

BUY	:	> 15%
Accumulate	:	5% to 15%
Hold	:	+5% to -5%
Reduce	:	-5% to -15%
Sell	:	< -15%
Not Rated (NR)	:	No specific call on the stock
Under Review (UR)	:	Rating likely to change shortly

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