

25 September 2023

India | Equity Research | Sector Update

Auto Ancillaries

Options galore; which ones to choose from the lot

We have analysed various auto ancillary businesses based on valuation multiples, likely earnings growth, RoE and several business risks. We believe there are some outliers in the list, on either side, in terms of valuation vs business fundamentals/risk led by fears of EV-led business disruption or EV-led opportunity driving higher growth. For long-term investment purpose, we prefer businesses with minimal exposure to CV cyclicity, minimal EV penetration led business risk, ability to manage capital structure/efficiency, and ability to innovate. **Going by data analysis, our top picks in the space for long-term investment are CIE, Sansera, Sona, SAMIL, Craftsman and Balkrishna. We believe within our coverage universe Asahi India, CEAT, Bharat Forge and Bosch are trading higher than their fair value.**

Avoid cyclical businesses with elevated multiples

Business cyclicity for India auto ancillary businesses is driven by either domestic CV cycle or input commodity cycle with rest growth and margin drivers being largely stable in nature. Thus, post domestic M&HCV market likely regaining FY19 highs by FY24 end in volume terms (~20% higher in tonnage carried terms), we see high probability of the cycle peaking out by FY25E. Thus, businesses dependent on domestic CVs can face ~15-20% segmental revenue decline in FY26E driven by market decline. Therefore, it would be better to avoid companies with higher exposure to this segment. Rising input commodity risk is another key risk that can swing earnings massively by impacting business profitability. Thus, avoid automotive tyre businesses with relatively low pricing power and high capital intensity, currently operating at elevated EBITDAM and trading at the higher end of valuation multiple trajectory.

EV exposure is good, but needs to have sustainable + profitable growth rather than the risk of getting commoditised soon

With present EV penetration in 2Ws at ~5-6% and ~1% in PVs, the rising need for localisation of components is giving scope for ancillary makers to address the rising size of opportunity. We believe ~INR 30-40k/unit of e-2W is the addressable market size exclusively, other than parts common to both ICE/E-2Ws. Components/systems like hub motors (BLDC/PMSM), controllers, ECUs, BMS, chargers, converters etc. would drive this demand. But we believe the entry barrier for any manufacturer to tap this opportunity is becoming lower with time, as access to M&As, JV formation and tech tie ups are allowing competition building up in the space, impacting the profitability potentially.

Avoid companies with volatile margin/cashflow + elevated valuation

We would recommend staying away from players with higher element of cyclicity in profitability, operating at higher end of margin currently along with trading at higher end of valuation multiple band. Thus, automotive tyre stocks, operating more than one standard deviation above long-term mean levels along with trading above long-term average forward P/E multiples should be avoided. We would rather prefer businesses that have the capability to execute and sustain operating margin across OEM cycles and withstand input commodity cost volatility seamlessly, thus, giving visibility to cashflow ahead. Therefore, we like CIE, Sona, Craftsman and Sansera.

Basudeb Banerjee

basudeb.banerjee@icicisecurities.com
+91 22 6807 7260

Vishakha Maliwal

vishakha.maliwal@icicisecurities.com

Exhibit 1: Auto ancillary companies with RoE of 20%+

BBG ticker	Market Cap (INR bn)	ROE FY25E	EPS CAGR FY23-25E	Net debt/Equity FY25E	P/E FY25E	EV/EBITDA FY25E	Comments
TIINDIA IN	618.5	24%	23%	-0.4	47.7	22.8	
BHFC IN	507.9	20%	53%	0.5	29.9	16.7	Set to face CV downcycle by FY26, at elevated valuation on FY25
SCHFL IN	487.6	22%	16%	-0.4	42.4	27.6	
BIL IN	492.4	21%	34%	0.1	28.3	17.4	Less cyclical business going through a bad phase
SONACOMS IN	339.6	27%	46%	-0.1	40.7	25.7	High growth+ ROCE coupled with rising global EV demand
MSWIL IN	281.8	46%	26%	-0.1	34.0	22.6	
SF IN	258.0	22%	30%	0.1	30.7	19.8	Good and less cyclical business at elevated valuations
RMKF IN	103.3	21%	33%	0.5	24.8	12.1	Set to face CV downcycle by FY26, at elevated valuation on FY25
CRAFTSMA IN	100.7	24%	41%	0.4	21.0	9.8	Reducing CV exposure and improving ROCE with growth
VARROC IN	73.7	24%	125%	0.5	20.7	8.7	Benefitting from restructuring and 2W revival
JMNA IN	47.2	23%	17%	-0.0	19.1	12.5	
ATXL IN	33.2	22%	13%	-0.2	15.6	9.8	
LMAX IN	24.6	20%	26%	0.0	15.1	6.9	Catering less cyclical categories of PVs and 2Ws

Source: Bloomberg, I-Sec research

Exhibit 2: Auto ancillary companies with ROE <20%

BBG ticker	Market Cap (INR bn)	ROE FY25E	EPS CAGR FY23-25E	Net debt/Equity FY25E	P/E FY25E	EV/EBITDA FY25E	Comments
MOTHERSO IN	651.6	14%	54%	0.1	16.3	7.1	Optimally valued vs. strong growth execution
BOS IN	563.8	17%	18%	-0.3	28.5	20.2	Weak execution in terms of growth and margin and elevated valuation
MRF IN	460.8	12%	72%	-0.2	22.1	9.8	
UNOMINDA IN	342.7	19%	28%	0.1	31.8	18.6	Diversified growing business with elevated valuation
APTY IN	236.1	11%	27%	0.1	12.5	5.8	Facing mean reversion of margin post making recent highs
ENDU IN	225.5	17%	38%	-0.2	24.0	12.6	
EXID IN	217.8	10%	13%	0.0	17.8	10.5	
CIEINDIA IN	179.7	17%	25%	-0.1	16.8	9.8	Well diversified and less cyclical business at attractive valuation
AISG IN	149.9	19%	22%	0.4	27.2	14.2	Undergoing margin cuts, capex cycle and trading at elevated valuations
CEAT IN	86.4	12%	63%	0.4	14.0	6.5	Margin set to see reversion from recent highs amidst high valuation
MDA IN	79.0	17%	23%	-0.1	23.0	12.0	Limited cyclical and clean balance sheet to drive inorganic growth
JKI IN	68.6	16%	47%	1.0	9.8	5.6	Relatively valued much lower within the tyre peers
SEL IN	56.2	19%	27%	-0.1	20.1	11.7	
SANSERA IN	50.2	18%	36%	0.4	17.3	9.4	2W derivative with diversification towards non-auto; valuation attractive
GABR IN	45.0	18%	24%	-0.2	21.1	12.9	Decent execution, clean balance sheet and optimal multiple
JTEKT IN	35.1	14%	24%	-0.2	28.4	13.4	
LGBB IN	32.8	18%	9%	-0.3	10.8	5.7	Low growth and low multiple. 2W revival the key.
SANDHAR IN	23.5	15%	60%	0.0	14.5	6.0	2W revival to drive re-rating with strong growth execution

Source: Bloomberg, I-Sec research

Exhibit 3: Risk assessment of auto ancillary companies

	EV risk	CV cycle risk	B/S risk	Competitive risk	Margin risk	Growth risk	Global risk
Balkrishna							
Craftsman							
Sonacoms							
Varroc							
SAMIL							
CIE							
Minda Corp							
JK Tyres							
Sansera							
Gabriel							
Sandhar							

 low risk  high risk

Source: Company data, I-Sec research

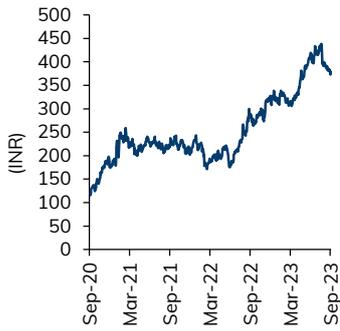
Exhibit 4: Summary of auto ancillary companies in I-Sec coverage

BBG Ticker	Market Cap (INR bn)	Price Target	Rating
MOTHERSO IN	651.4	114	BUY
BOS IN	566.4	17,599	REDUCE
BHFC IN	507.9	899	REDUCE
BIL IN	492.6	2,669	ADD
SONACOMS IN	339.5	630	ADD
ZFCVCS IN	293.8	12,810	HOLD
MSUMI IN	282.8	62	ADD
APTY IN	235.6	424	ADD
CIEINDIA IN	179.8	598	BUY
AISG IN	150.0	503	REDUCE
CRAFTSMA IN	100.4	5,557	BUY
CEAT IN	86.4	1,669	SELL
VARROC IN	73.5	406	BUY
SANSERA IN	50.1	1,133	BUY

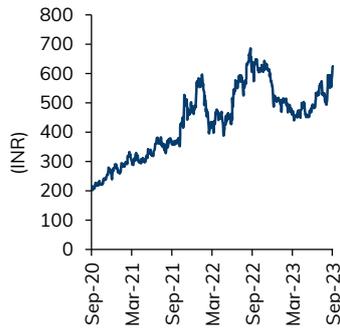
Source: Bloomberg, I-Sec research

Price charts

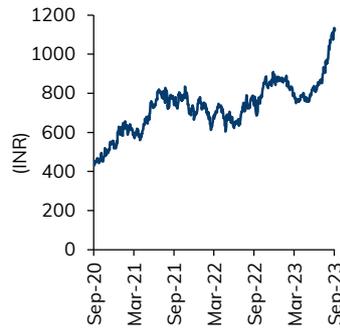
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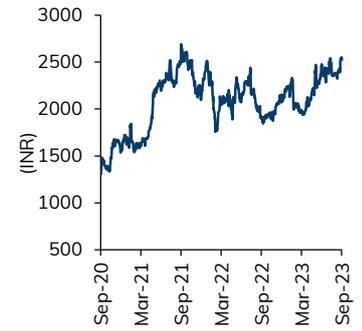
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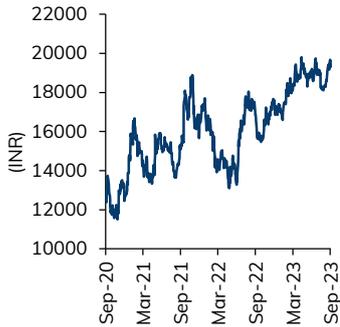
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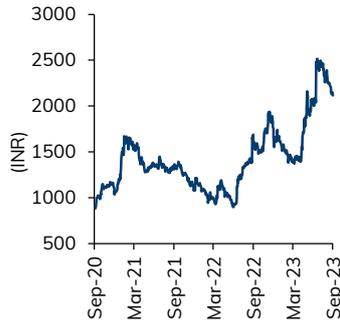
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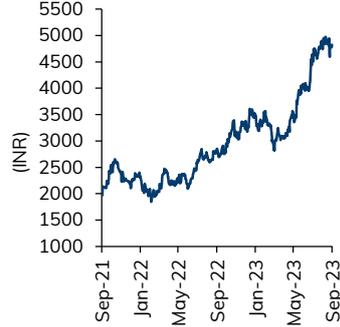
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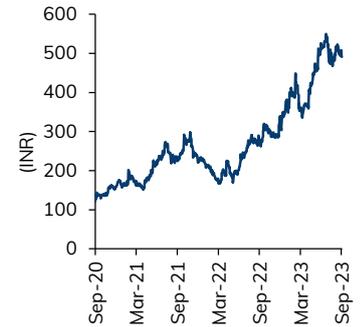
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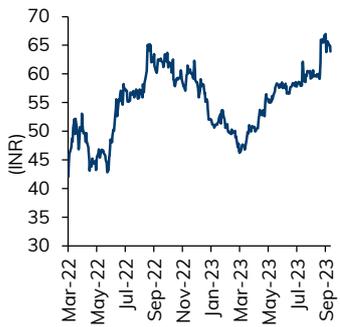
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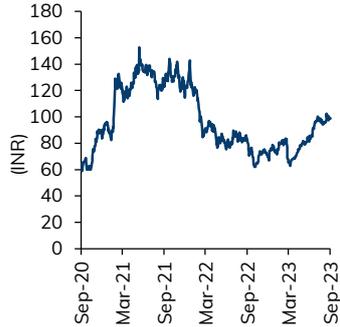
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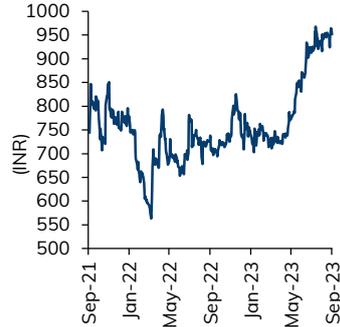
MSUMI



MOTHERSO



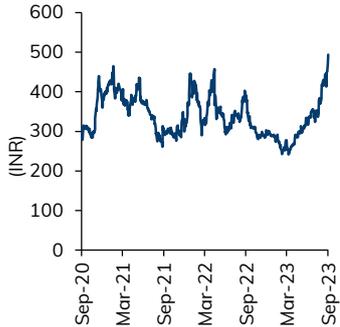
SANSERA



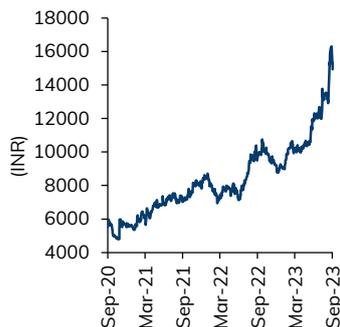
SONACOMS



VARROC



ZCVCS



Source: Bloomberg

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Name of the Compliance officer (Research Analyst): Mr. Atul Agrawal, Contact number: 022-40701000, E-mail Address : complianceofficer@icicisecurities.com

For any queries or grievances: [Mr. Prabodh Avadhoot](mailto:Mr.Prabodh.Avadhoot) Email address: headservicequality@icicidirect.com Contact Number: 18601231122
