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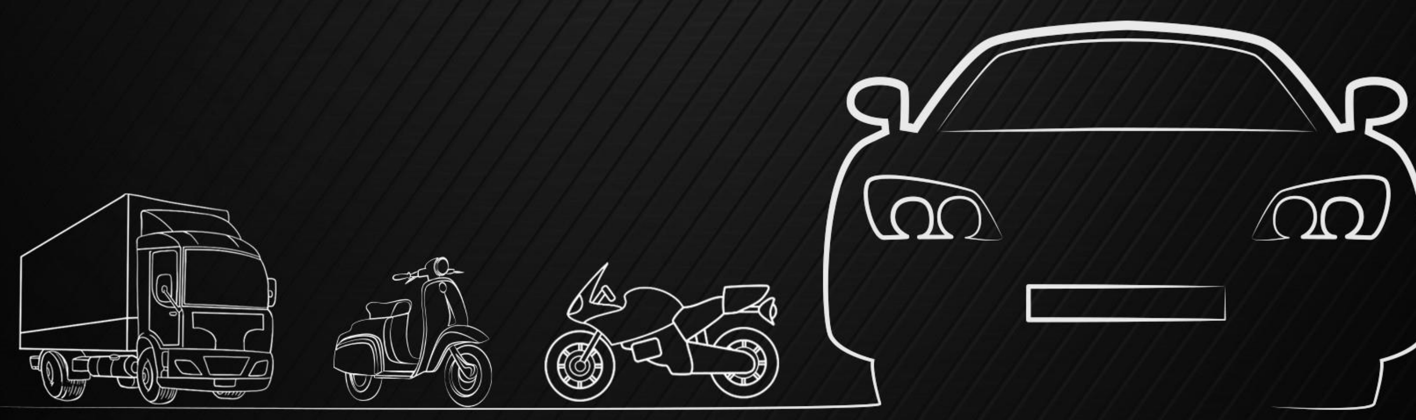
Q2FY24E Auto Sector Preview



17th October 2023

Auto & Ancillary Sector

Sequential improvement in volumes and margins

MARKET DATA

	Close	1D (%)	1M (%)	YTD (%)
Nifty 50	19,811	0.40%	-1.89%	9.42%
Sensex	66,428	0.39%	-2.08%	9.18%
Nifty Auto Index	16,523	0.02%	0.59%	31.01%
USD/INR	83.23	0.02%	0.17%	0.60%

COVERAGE STOCKS

Company	Current Price (INR)	Target Price* (INR)	Upside (%)	Market Cap. (INR Mn)	Fwd PE 2025E (x)	Recommendation*
Ashok Leyland (AL)	176	221	26%	5,10,152	14.2x	BUY
Bajaj Auto (BJAUT)	5140	5,321	4%	14,23,827	17.5x	ACCUMULATE
Maruti Suzuki (MSIL)	10,706	11,170	4%	31,26,514	24.1x	BUY
Tata Motors (TTMT)	655	743	13%	20,95,053	NA	BUY
Balkrishna Industries (BIL)	2,624	2,443	TA	4,95,279	28.0x	HOLD
Minda Corporation (MDA)	338	351	4%	79,853	20.9x	BUY
UNO Minda (UNOMINDA)	597	680	14%	3,41,068	28.9x	BUY

**Note: Target price and recommendation will be reviewed post detailed Q2FY24E result analysis and conference call of the said companies.*
Source: NSE, Data as of 17th October 2023.

SECTOR OVERVIEW

- **Domestic industry wholesale volumes:** As per data released by the Society of Indian Automobile Manufacturers (SIAM) for the months of July and August 2023, the 2-wheeler (2W) segment saw a decline of 3.1% YoY while 3-wheelers (3W) and Passenger Vehicles (PV) grew by 73.3%/ 5.9% YoY, respectively in the 2-month period. The industry data for the month of September 2023 is not available as of the date of the report.
    - **Within domestic 2W,** BJAUT's volumes for the quarter declined by 18.6% YoY due to the base effect as BJAUT undertook channel inventory replenishment in a big way in Q2FY23. As a result, BJAUT underperformed in terms of YoY growth vs. the domestic 2W industry volume growth for the comparative 2-month period.
    - **In the domestic 3W segment,** BJAUT's sales volumes grew by 80.5% YoY/ 34.1% QoQ in Q2FY24. BJAUT strengthened its market leadership as its growth in the segment for the 2-month period of July-August 2023 was at 96.6% YoY vs. industry growth of 73.3% YoY for the comparable period.
    - **Within domestic PVs,** MSIL's segmental volumes for Q2FY24 grew by 7.9% YoY/ 10.9% QoQ. TTMT's sales volumes for the segment declined by 3.1% YoY/ 1.5% QoQ. Compared with the industry growth of 5.9% YoY for July-August 2023, MSIL outperformed with a comparable period growth of 11.3% YoY while TTMT underperformed with a decline of 0.2% YoY.
    - **Within domestic CVs,** TTMT's segmental volumes grew by 5.8% YoY/ 20.6% QoQ. AL's segmental volumes grew by 10.4% YoY/ 20.0% QoQ. Both the key CV players saw a revival in volumes sequentially due to seasonality and as the impact of the BS6-II transition seen in Q1FY24 went away.

- **Domestic industry retail volumes:** Combining the monthly data released by the Federation of Automobile Dealers Associations (FADA), total retail sales for Q2FY24 saw a growth of 12.9% YoY but were lower by 2.4% QoQ. All sub-segments were in the green on a YoY basis. 2W/ 3W/ PV/ Tractors/ CV grew by 11.8%/ 62.0%/ 9.8%/ 9.4%/ 3.4% YoY, respectively for the quarter. Compared to the pre-COVID period, 2W volumes turned positive for the first time with a growth of 2% in the month of September 2023.

- **High inventory levels:** Retail inventory for PVs has significantly increased to 60 to 65 days in September 2023 vs. 37 to 39 days in March 2023. Even for 2W, the inventory has gone up to 33 to 35 days in September 2023 from 15 to 20 days in March 2023. With the catch-up of rainfall in the month of September and the upcoming festive season, OEMs and dealers are expecting strong sales traction in the coming months which has led to heightened inventory levels. Additionally, the improvement in vehicle availability due to the easing of electronic components availability has contributed to higher channel filling.

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- **Green shoots in domestic demand for 2-wheelers, sustainability remains to be seen:** With the festive exuberance nearing, consumer walk-ins and sentiments have improved. Rainfall in September has made up for the deficit in August and India received 94% of the expected rain in the monsoon this year. This is slightly below the forecast of 96% but has alleviated concerns of drought and may be a factor in improving rural demand. Additionally, new product launches and promotional offers are likely to boost sales in the coming months. Rural demand for 2-wheelers has seen some improvement in August 2023 but needs to sustain improvement in the coming months. Inflation could play a spoil-sport in the timeline and quantum of rural recovery. Factoring in the skewed southwest monsoon outturn, the growing likelihood of an El Niño event and the worsening global food prices outlook, RBI in its August 2023 Monetary Policy Committee meeting revised its inflation projection for FY24E upwards by 30 bps to 5.4% and maintained it at the same levels in October 2023.

- **Exports remain lower but are likely to see gradual improvements:** Due to uncertainties and slowdowns in several export markets such as Africa and Europe, OEMS and ancillaries have seen lower export sales. The trend is likely to continue in Q2FY24E despite some sequential improvement. Management commentary regarding the trajectory in H2FY24E will be important.

- **Gross margin improvement to continue:** Key commodity costs including steel, aluminium and rubber have continued to decline sequentially and may see stability from here on. Q2FY24E stands to benefit from the input cost softening, contributing to sequential gross margin improvement.

- **Operating leverage at play for most companies under coverage:** Almost all OEMs under coverage have seen a sequential improvement in volumes due to multiple factors including better availability of electronic components, anticipation of a robust festive season and gradual improvement in exports. As a result, operating leverage will aid margins in Q2FY24E.

- **Mix improvement to aid margins:** Across 2W and PV, the entry-level segments are under pressure while the more premium segments are seeing traction. This has led to continued improvement in the product mix for OEMs, thus contributing to ASPs and margins on a QoQ basis.

- **CV industry sees margin improvement:** The key OEMs in the CV segment- TTMT and AL have continued to see price discipline leading to better ASPs and margins. The trend is expected to continue in the face of strong demand and the OEMs shoring up margins to make way for future investments in higher-order technologies.

- **Our view:** For OEMs under coverage (ex. JLR), we expect the combined revenue to grow by 20.0% YoY/ 14.7% QoQ. We expect EBITDA margins to improve by 334 bps YoY/ 159 bps QoQ. For auto ancillaries under coverage, we expect combined revenue to grow at 3.8% YoY/ 9.7% QoQ and EBITDA margins to expand by 224 bps YoY/ 29 bps QoQ.

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Auto & Ancillary Sector

Exhibit.1: Quarterly result expectation for auto and auto ancillary companies under coverage

INR Mn	Q2FY24E	Q2FY23A	YoY	Q1FY24A	QoQ	Remarks
Ashok Leyland (AL)						
Sales	99,799	82,660	20.7%	81,893	21.9%	AL's sales volumes for the quarter grew by 10.0% YoY/ 20.6% QoQ. We expect ASP to improve by 1.0% QoQ as the price retention across the industry improves. We expect revenue growth of 20.7% YoY/ 21.9% QoQ. We expect a sequential improvement in EBITDA margins of 98 bps on account of better volumes in the quarter. We expect Net profit to grow by 198.7% YoY on a low base and 3.3% QoQ as Q1FY24 had a one-time tax credit benefit. **Key Parameters:** (1) Traction in the bus segment (2) Performance trends of the non-vehicle business (3) Market share movement across segments and geographies (4) Traction in green mobility
EBITDA	10,978	5,373	104.3%	8,208	33.8%	
Net Profit	5,954	1,993	198.7%	5,764	3.3%	
EBITDA Margin (%)	11.0%	6.5%	450 bps	10.0%	98 bps	
NPM (%)	6.0%	2.4%	355 bps	7.0%	-107 bps	
Bajaj Auto (BJAUT)						
Sales	1,06,248	1,02,027	4.1%	1,03,119	3.0%	BJAUT's sales volumes for Q2FY24 grew by 2.6% QoQ but were lower by 8.4% YoY, due to high base of last year when the company replenished its channel inventory. We expect ASPs to remain flattish QoQ as the positive effect of a higher share of 3W and premium motorcycles in domestic sales is likely to offset the negative impact on ASPs of improvement in the share of export 2-wheelers. We expect revenue to grow by 4.1% YoY/ 3.0% QoQ. We expect the EBITDA margin to expand by 205 bps YoY/ 46 bps QoQ due to price hikes YoY, and lower commodity costs QoQ. Net Profit is not comparable to the previous quarter due to the Share of profits of JV recorded half-yearly only in September and March. On a YoY basis, we expect Net Profit to grow by 13.9%. **Key Parameters:** (1) Gradual recovery in exports (2) Effect of currency devaluation in Nigeria (3) Ramp up of Chetak EV sales (4) Comments of retail growth rates in domestic and exports (5) Trajectory of Triumph sales and commencement of exports
EBITDA	20,393	17,496	16.6%	19,323	5.5%	
Net Profit	19,578	17,194	13.9%	16,441	19.1%	
EBITDA Margin (%)	19.2%	17.1%	205 bps	18.7%	46 bps	
NPM (%)	18.4%	16.9%	157 bps	15.9%	248 bps	
Maruti Suzuki (MSIL)						
Sales	3,64,479	2,99,425	21.7%	3,23,385	12.7%	MSIL's total sales volumes for Q2FY24 grew by 6.7% YoY/ 10.8% QoQ. Due to better availability of electronic components, MSIL has managed to sell a higher number of Utility vehicles, which will lead to an improvement in the mix. We expect ASP to improve by 14.1% YoY/ 1.7% QoQ and revenue growth of 21.7% YoY/ 12.7% QoQ. EBITDA margins are likely to be higher by 233 bps YoY/ 236 bps QoQ due to better mix, lower commodity costs and operating leverage. We expect Net Profit to grow by 57.0% YoY/ 31.3% QoQ. **Key Parameters:** (1) Favourable product mix (2) Strong margin improvement (3) Market share movement (4) View on commodity costs and FX movement
EBITDA	42,231	27,709	52.4%	29,851	41.5%	
Net Profit	33,162	21,125	57.0%	25,252	31.3%	
EBITDA Margin (%)	11.6%	9.3%	233 bps	9.2%	236 bps	
NPM (%)	9.1%	7.1%	204 bps	7.8%	129 bps	

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Exhibit.1: Quarterly result expectation for auto and auto ancillary companies under coverage

INR Mn	Q2FY24E	Q2FY23A	YoY	Q1FY24A	QoQ	Remarks
Tata Motors (TTMT)						
Sales	10,91,388	7,96,114	37.1%	10,22,361	6.8%	JLR ex. CJLR volumes grew by 28.6% YoY/ 3.8% QoQ. TTML-CV volumes grew by 3.5% YoY/ 21.3% QoQ. TTML-PV volumes declined by 2.7% YoY/ 1.1% QoQ. We expect consol. revenue to grow by 37.1% YoY/ 6.8% QoQ. We expect EBITDA margin to expand by 623 bps YoY/ 75 bps QoQ. At JLR, we expect the softening of input costs and mix improvement to be offset by higher marketing costs. For TML-CV we expect QoQ EBITDA margin improvement of 167 bps due to operating leverage and better price retention. TML-PV is likely to see only a gradual improvement in margins as the negative impact due to EV business remains. **Key Parameters:** (1) Maintenance shutdown at JLR to impact cash flows (2) Higher marketing spends at JLR (3) Trajectory of TML-PV EV margins (4) TML-CV realization improvement (5) Comments of Reimagine targets
EBITDA	1,52,895	61,962	146.8%	1,35,595	12.8%	
Net Profit	48,343	-9,446	611.8%	32,028	50.9%	
EBITDA Margin (%)	14.0%	7.8%	623 bps	13.3%	75 bps	
NPM (%)	4.4%	-1.2%	562 bps	3.1%	130 bps	
Balkrishna Industries (BIL)						
Sales	22,465	26,575	-15.5%	21,594	4.0%	We expect BIL's volumes to decline by 10.0% YoY but grow by 5.6% QoQ. Q1FY24 saw lower dispatches on account of the disruption caused by cyclone Biparjoy, which will lead to QoQ growth in Q2FY24E despite it being a weak season. ASP will continue to decline QoQ as the benefit of lower input costs is passed on to the customers. We expect revenue to decline by 15.5% YoY but improve by 4.0% QoQ. EBITDA margin is likely to improve by 780 bps YoY/ 64 bps QoQ aided by operating leverage. We expect Net profit to be -10.2% YoY/ +3.4% QoQ. **Key Parameters:** (1) Unwinding of channel inventory (2) End-user demand in Europe (3) Strength of India business (4) Margin trajectory (5) Any operating guidance for the year
EBIDTA	5,354	4,263	25.6%	5,009	6.9%	
Net Profit	3,432	3,823	-10.2%	3,319	3.4%	
EBIDTA Margin (%)	23.8%	16.0%	780 bps	23.2%	64 bps	
NPM (%)	15.3%	14.4%	89 bps	15.4%	(9 bps)	
Minda Corporation (MDA)						
Sales	12,388	11,471	8.0%	10,745	15.3%	We expect sales to grow by 8.0% YoY/ 15.3% QoQ. Exports are expected to be under pressure and likely to recover only from Q3FY24E. We expect the EBITDA margin to expand by 49 bps YoY/ 62 bps QoQ due to softening of input costs. We expect Net Profit to grow by 20.4% YoY/ 53.9% QoQ. **Key Parameters:** (1) Exports performance trajectory (2) Order wins (3) Share of localization (4) Ramp up of new facilities (5) Share of EV in order book
EBIDTA	1,399	1,238	12.9%	1,147	22.0%	
Net Profit	633	578	9.6%	452	40.1%	
EBIDTA Margin (%)	11.3%	10.8%	49 bps	10.7%	62 bps	
NPM (%)	5.1%	5.0%	7 bps	4.2%	91 bps	
UNO Minda (UNOMINDA)						
Sales	34,522	28,768	20.0%	30,927	11.6%	We expect strong revenue momentum to continue for UNOMINDA with a growth of 20.0% YoY/ 11.6% QoQ in Q2FY24E. We expect EBITDA margin to remain flattish YoY but improve by 39 bps QoQ as the operating leverage is partly offset by higher fixed expense from new capacities. We expect the Net Profit growth to be at 22.2% YoY/ 20.4% QoQ. **Key Parameters:** (1) Market share gains (2) Performance of JVs (3) Order wins (4) Update on commissioning and ramp-up of capex (5) Update on timeline for getting PLI benefit
EBITDA	3,818	3,184	19.9%	3,301	15.7%	
Net Profit	2,079	1,701	22.2%	1,728	20.4%	
EBITDA Margin (%)	11.1%	11.1%	(1 bps)	10.7%	39 bps	
NPM (%)	6.0%	5.9%	11 bps	5.6%	44 bps	

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Rating Legend (Expected over a 12-month period)	
Our Rating	**Upside**
Buy	More than 15%
Accumulate	5% – 15%
Hold	0 – 5%
Reduce	-5% – 0
Sell	Less than – 5%

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