

Auto Component Sector

Set to Zoom

Indian auto sector after witnessing tough times in the past couple of years is set to see strong revival from H2 FY15. The key drivers for this growth include 1) improvement in consumer sentiment, 2) pause in diesel price hikes, 3) peaking out of interest rates, 4) pick up in industrial and infrastructure activity and finally 5) partial lifting of ban on mining activities. Internationally too, while developing economies in Africa, Middle East and rest of Asia continue to see strong growth, US is showing robust recovery and Europe is showing signs of stability.

Such scenario, we believe, provides large business opportunities for Indian Auto Component manufacturers, which over the years have built a strong reputation with domestic OEMs and also globally. The large caps auto component players, on this premise, have seen a strong re-rating in the past few months leading to widening of valuation discount for small players. Here we pick three such stocks viz Banco Products, MM Forgings and Phoenix Lamps.

Banco Products

A leading supplier of engine cooling products and gaskets, Banco Products is well placed to ride on both domestic and global demand recovery for automobiles. Domestic CVs particularly will drive standalone revenues while its subsidiaries which account for 61% of the consolidated revenues gain from global recovery. Exit from non core business of cement in Tanzania has not only improved the balance sheet but will also help improving management's focus on the core business.

MM Forgings

A direct play on the demand recovery for CV both domestic and global, MM Forgings with expanded capacity will see strong revenue growth in the ensuing two years. The company is implementing cost cutting measures wherein it plans to cut down its power and fuel costs by 100bps and modify dies to bring down raw material costs resulting in expansion of operating margins. Compared to the largest forging player Bharat Forge, MMFL is trading at a steep valuation discount, which we believe should narrow down.

Phoenix Lamps

With approximately 50% market share in passenger vehicle, 70% in commercial vehicles and 70% in two wheeler OEMs lighting business, Phoenix Lamps will be a major beneficiary of auto demand revival. Exports which account for more than one-third of the total revenues would see strong momentum as the company enters new markets and gains share in existing markets. Exit from general lighting lamps business has improved overall profitability and will put the company on a strong earnings growth trajectory.

Sector view: **Positive**
 Nifty: **8,086**
 Sensex: **27,027**

Banco Products - BUY

CMP: Rs155 Target: Rs190
 Upside: 22.6% Exit trigger*: Rs130

MM Forgings - BUY

CMP: Rs447 Target: Rs550
 Upside: 23.0% Exit trigger*: Rs375

Phoenix Lamps - BUY

CMP: Rs133 Target: Rs160
 Upside: 20.3% Exit trigger*: Rs110

Horizon: 1-3 months

Price as on September 05, 2014

* Exit trigger is the price level below which investor should exit position

Research Analyst:

Prayesh Jain

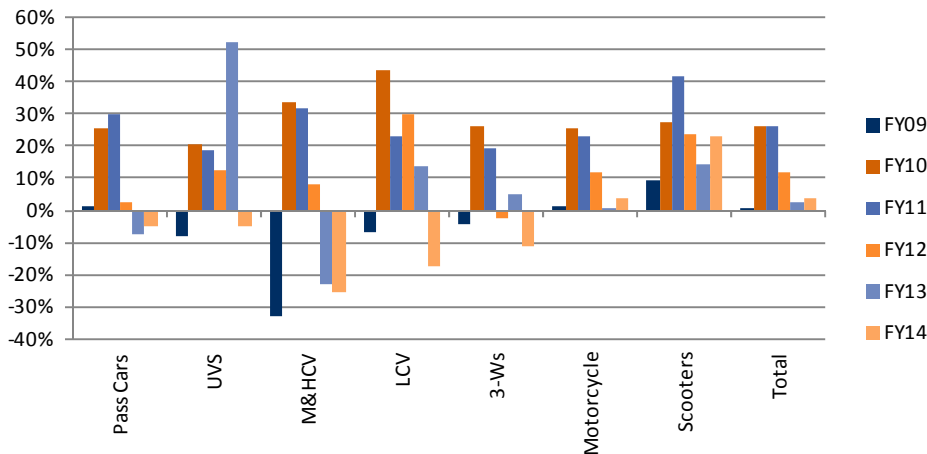
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Auto demand set to recover in India

Past couple of years has been weak for the domestic automobile OEMs with total volumes growing by just 2.5% in FY13 and 3.5% in FY14. Weakness was seen across all segments except two wheelers. This is all set to change and we expect a strong revival in auto sales from H2 FY15 for the following reasons:

Past couple of years has been tough for the Indian automobile industry

Trend in domestic auto demand across segments



Source: SIAM, India Infoline Research

- 1) Improvement in consumer sentiment:** With weak economic environment in the country, new employment opportunities were limited and wage hikes too were below inflation for many industries in the past couple of years. With GDP growth moving from 4.5-4.7% range in FY14 to 5.7% in Q1 FY15, new job opportunities are expected to come up and wage hikes are also likely to be higher creating a strong consumer sentiment. This should translate into increased discretionary spend wherein auto demand plays a major role.
- 2) Interest rates have peaked out:** Interest rates are a key factor influencing automobile demand as 70%+ passenger car purchases, 50%+ two-wheeler purchases and 90%+ CV purchases are financed. Past couple of years has seen steady increase in interest rates to counter rising inflation. With inflation now under control, interest rates are not expected to increase from here on and should see a downward trajectory from Q4 FY15.
- 3) Fuel prices not expected to surge:** With firm crude oil prices and rupee depreciation domestic fuel prices headed north in the past two years. While petrol prices have come down in recent times, diesel prices were raised on sustained basis to eliminate subsidy. Negligible subsidy left on diesel makes us believe that diesel prices too will now be market linked. Thus ownership costs which saw sustained rise should now decelerate.

Improvement in GDP growth, better employment opportunities and higher than inflation wage hikes should drive discretionary spend

Interest rates should start heading down from Q4 FY15 as inflation seems to be under control for now

Fuel prices are not expected to surge from here on as diesel is now close to be market linked while crude oil prices are likely to be soft

4) Recovery in industrial and industrial activity: One of the key reasons for slump in CV sales was poor investments in infrastructure and weak industrial activity. Both are set to change under the new government. Given the track record of previous NDA government and Modi government in Gujarat, infrastructure investments should attain top priority. Also industrial activity would gather pace with improved consumer demand and infrastructure investments.

Under the new government both infrastructure investments and industrial activity are expected to recover

5) Partial lifting of mining ban: Mining activity is a key driver for CV demand. With ban on mining in many belts such as Karnataka and Goa, tipper demand slumped in the past two years. Recently, bans were partially lifted giving way for a rise in demand for tippers.

Lifting of mining ban although partially should help tipper demand

Approximately 60% of the production by auto component manufacturers is to service the demand of domestic OEM players. With the aforementioned factors set to drive automotive sales in India, OEM demand for components is set to surge.

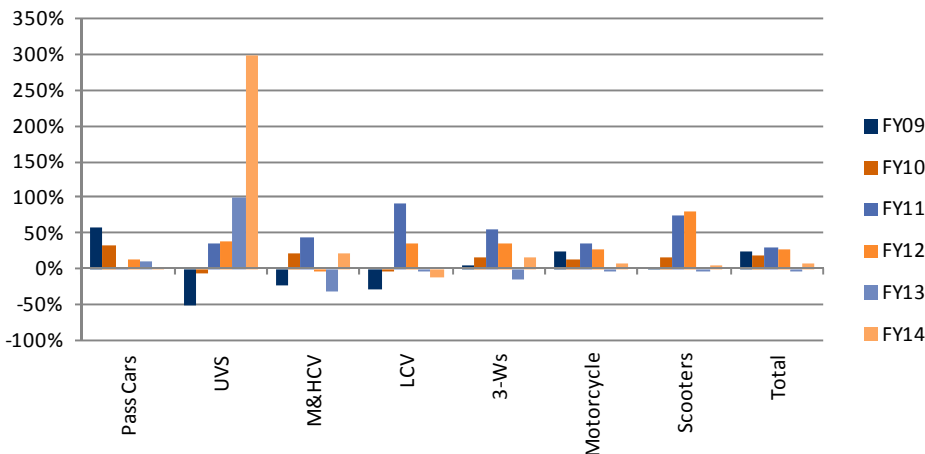
60% of production of auto component players is for OEM customers

Auto exports from India also rising

With cost of manufacturing lower in India, auto manufacturers have made India as their manufacturing hub particularly for small cars. Also demand for Indian made automobiles is on a rise in developing nations where quality of Chinese manufacturers is doubted, while affordability for western countries made vehicles is low. Consequently, exports from India have seen steady rise even in past two years when global auto demand was weak. We believe the trend would sustain as US is recovering at a fast pace while Europe is seeing some stability. This would create additional business opportunities for Indian auto component manufacturers.

Auto exports from India would continue to rise given low cost of production and improving quality products

Trend in auto exports from India



Source: SIAM, India Infoline Research

Rising auto component exports from India

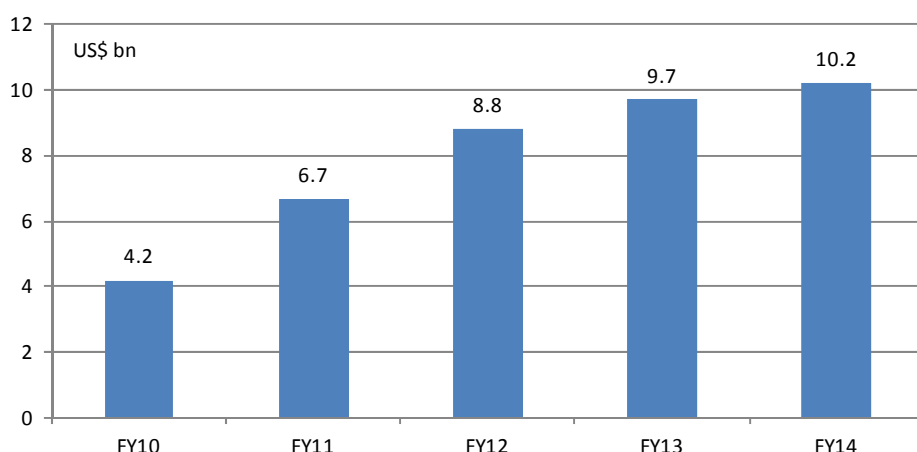
During the recent downturn, global auto manufacturers' financial performance was impacted on account of their high cost structure. This has caused these players to increase their sourcing (automobiles and components) from low cost countries. High skilled labour, improving quality standards and lower manufacturing costs improve India's prospects as a sourcing destination vis-à-vis countries such as Indonesia, Korea, Brazil, etc. Further, Indian players have formed JVs with global leaders, which have resulted in transfer of technology thereby putting them high on the global landscape. Around 38% of the total exports are made to Europe.

High skilled labour, improving quality standards and lower manufacturing costs improve India's prospects as a sourcing destination vis-à-vis countries

Quality is a key consideration for global OEMs and tier-I players, for their outsourcing decision. Over the years, Indian auto component manufacturers have laid stress on meeting global standards for their products. According to JD Power Survey, the problems per 100 vehicles have decreased to 218 in 2014 from 572 in 1997. We believe the outsourcing trend will only increase as Indian manufacturers establish their global footprint.

We believe the outsourcing trend will only increase as Indian manufacturers establish their global footprint

Trend in auto component exports from India



Source: ACMA, India Infoline Research

India's competitive advantage over peers

	Design & Engineering skills	Manufacturing skills	Manpower costs	Supplier base	Raw Materials
Korea					
China					
Thailand					
Indonesia					
Vietnam					
Czech Republic					
Romania					
Poland					
Slovakia					
Russia					
Hungary					
Turkey					
Brazil					
Mexico					

Source: IBEF, India Infoline Research

Profitability matrix to improve further

While revenues for Indian auto component players should see strong traction, profitability will improve at a faster clip due to 1) benefits of operating leverage as the companies have expanded capacities in the past few years and utilization of these capacities will improve in the years to come, 2) cost cutting initiatives implemented by the companies to bring down the costs, 3) limited capex requirements and 4) soft commodity price environment.

Valuation gap between large caps and quality small caps to narrow

While the auto components exciting story is known to the markets, it is yet discounted (only partially) in the large caps. Quality midcaps have rallied too but are trading at much steeper discounts to their larger counterparts. We believe the catch up should happen in a very short period and see 20%+ rally in these stocks in the next 1-3 months. We have handpicked three such stocks viz Banco Products, MM Forgings and Phoenix Lamps.

Banco Products

Domestic CV recovery to be a force for standalone revenues

80% of Banco Products domestic standalone revenues arise from CV segment. Its key customers here include Tata Motors, Ashok Leyland and M&M. Expected recovery in industrial activity, return of infrastructure investments, recommencement of mining activities and pause in diesel price hikes are expected to result in strong CV demand creating large business opportunities for component suppliers such as Banco Products.

Global economic recovery to drive subsidiary performance

61% of Banco Products FY14 revenues were from its subsidiaries which include Nederlandse Radiateurs Fabriek and Banco Gaskets (India) Ltd. Majority of the revenues of these subsidiaries arises from the international markets. With US on recovery track and Europe now stabilizing, outlook for automotive demand remains strong from these regions. This provides large business opportunities for Banco Products subsidiaries. We see 20% revenue CAGR for these companies in the next two years.

Exit from non-core business of Cement

One of the key investor concerns was non-related investments in the cement business (Lake Cement in Tanzania). However, the company in the current fiscal has exited out of that venture for a sum of US\$17.7mn at a premium of 52% over the original investment. This will now allow the company to focus on the core business of heat exchanger and automotive component activities in Europe and North America. The proceeds are expected to be invested for organic or inorganic growth opportunities in the core business.

Robust financials and attractive valuations

Standalone revenue traction was weak during FY13 and FY14 on the back of weak CV demand in India, which we expect to recover in the next couple of years. Subsidiary revenues, however, witnessed a strong 24% CAGR between FY12-14 driven by rupee depreciation and gains in market share. We expect the momentum to sustain in subsidiary revenues driven by new business wins and growth in existing business. Overall we expect 19% CAGR in consolidated revenues in next two years. Margin expansion will result in higher earnings CAGR. Return ratios should head north and company should be debt free in two years. Valuations at 7x FY16E P/E is attractive.

Financial summary

Y/e 31 Mar (Rs m)	FY13	FY14	FY15E	FY16E
Revenues	10,241	11,618	13,718	16,358
yoy growth (%)	(0.0)	13.4	18.1	19.3
OPM (%)	11.4	14.2	14.7	15.2
Reported PAT	613	898	1,209	1,578
yoy growth (%)	(19.9)	46.5	34.6	30.5
EPS (Rs)	8.6	12.6	16.9	22.1
P/E (x)	18.1	12.3	9.2	7.0
Price/Book (x)	2.3	1.9	1.6	1.4
EV/EBITDA (x)	10.9	7.4	6.0	4.7
Debt/Equity (x)	0.4	0.2	0.2	0.1
RoE (%)	13.7	16.9	19.0	21.0
RoCE (%)	15.4	19.8	22.9	25.6

Source: Company, India Infoline Research

Rating: BUY

Target (1-3 months): Rs190

CMP: Rs155

Upside: 22.6%

Exit Trigger*: Rs130

* Exit trigger is the price level below which investor should exit position

Sector: Auto Component

Sector view: Positive

Sensex: 27,027

52 Week h/l (Rs): 33/158

Market cap (Rscr) : 1,120

6m Avg vol ('000Nos): 214

Bloomberg code: BNCO IB

BSE code: 500039

NSE code: BANCOINDIA

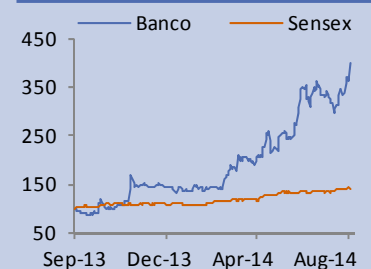
FV (Rs): 2

Prices as on September 05, 2014

Company rating grid

	Low → High				
	1	2	3	4	5
Earnings Growth				4	
Cash Flow				4	
B/S Strength				4	
Valuation appeal				4	
Risk					

Share price trend



Share holding pattern

(%)	Dec-13	Mar-14	Jun-14
Promoter	67.9	67.9	67.9
Insti	5.7	5.0	4.6
Others	26.4	27.1	27.5

MM Forgings

Global CV demand expected to recover

MM Forgings is a key supplier of forged and machined products to the CV industry. In FY14, CV segment accounted for 63% of its revenues. With exports accounting for 73% of its total revenues, it is a proxy play on global CV demand recovery theme. US, particularly, is expected to see strong growth in its CV volumes on the back of 1) broad based economic recovery and 2) replacement demand from aging fleet. Europe is likely to see a stable demand environment as it still battles out the impact of financial crisis.

Domestic CV demand to bounce back

Domestic CV demand has been weak over the past couple of years due to 1) paucity in infrastructure investments, 2) ban on mining, 3) poor industrial activity and 4) rising diesel prices. Infrastructure investments are expected to revive under the new government which has a track record of pro-infrastructure policies. While ban on mining activities have been partially lifted, industrial activity has slowly started picking up. Diesel price hikes should end in the near term as under recoveries are now close to nil. These factors should translate into strong demand for CVs from H2 FY15 creating large demand for forged and machined products.

Margin expansion on the cards

Power and fuel costs accounted for 10.6% in FY14 for MMFL. The company is currently implementing energy conservation methods whereby it expects a reduction of 100bps in power costs. Also it is in the process to improve its dies which shall enable reduction in raw material costs. These along with benefits of operating leverage will result in margin expansion.

MMFL well placed to see robust topline and bottomline growth

While MMFL's existing capacities have been underutilized, it has expanded capacities to service the ensuing surge in demand. We expect the topline to grow at a healthy CAGR of 18%+ during the next couple of years. Margin expansion should result in superior earnings CAGR of 35% in the next two years. 1-year forward P/E of 9.9x looks attractive with healthy balance sheet (D/E of 0.6x), robust return ratios (RoE & RoCE for FY16E 20%+) and strong cash flows (FCF of Rs280mn). Also MMFL's valuation discount to large forging players is very large and we expect it to narrow down in the near term.

Financial summary

Y/e 31 Mar (Rs m)	FY13	FY14	FY15E	FY16E
Revenues	3,611	4,114	4,941	5,905
yoy growth (%)	3.1	13.9	20.1	19.5
OPM (%)	16.0	19.2	19.7	20.5
Reported PAT	244	293	389	543
yoy growth (%)	(8.7)	20.0	32.8	39.3
EPS (Rs)	20.2	23.0	32.3	45.0
P/E (x)	22.1	19.5	13.9	9.9
Price/Book (x)	3.1	2.8	2.4	2.0
EV/EBITDA (x)	11.3	8.6	6.9	5.4
Debt/Equity (x)	0.7	0.7	0.6	0.5
RoE (%)	15.1	15.1	18.6	22.3
RoCE (%)	12.5	13.8	16.6	20.3

Source: Company, India Infoline Research

Rating:	BUY
Target (1-3 months):	Rs540
CMP:	Rs447
Upside:	20.8%
Exit Trigger*:	Rs375

* Exit trigger is the price level below which investor should exit position

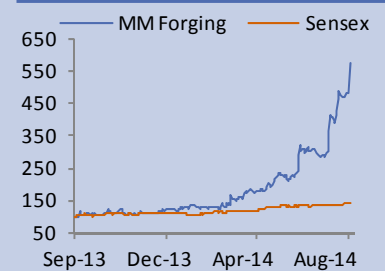
Sector:	Auto Components
Sector view:	Positive
Sensex:	27,027
52 Week h/l (Rs):	72/446
Market cap (Rscr) :	538
6m Avg vol ('000Nos):	96
Bloomberg code:	MMFG IB
BSE code:	522241
NSE code:	MMFL
FV (Rs):	10

Prices as on September 05, 2014

Company rating grid

	Low → High				
	1	2	3	4	5
Earnings Growth				■	
Cash Flow				■	
B/S Strength				■	
Valuation appeal					■
Risk	■				

Share price trend



Share holding pattern

(%)	Dec-13	Mar-14	Jun-14
Promoter	59.5	59.5	58.7
Insti	10.4	8.3	7.7
Others	30.1	32.2	33.6

Phoenix Lamps

Proxy play on recovery in overall auto sales

Phoenix Lamps is the market leader in automotive halogen bulbs in India with approximately 50% market share in passenger vehicle, 70% in commercial vehicles and 70% in two wheeler OEMs. The company is the largest manufacturer in India controlling 50-60% of total manufacturing capacity in the country and among the top 5 globally. With domestic auto demand set to recover on the back of various macro factors, Phoenix Lamps with utilization of ~70% is well placed to garner large business from OEMs with whom it has long lasting relationships.

Exports provide larger opportunities

In FY14, export revenues witnessed a jump of 35% and accounted for 32% of total revenues for Phoenix Lamps. Majority of the exports are to Europe, Central Asia and Latin America mainly for aftermarket. Its brands have established a strong presence in these markets and have seen steady increase in market share. The margins in export aftermarket are better than the overall margins for the company. We expect strong growth here as the company enters new markets and sees increasing share in existing markets.

Restructured operations look much better

In August, 2013, Phoenix Lamps completed sale of its General Lighting Lamps business, on slump sale basis to Halonix Technologies Limited for a sum of Rs1,600mn. This was a loss making segment and served the non-automotive demand. The exit will now improve overall profitability and will allow the company to focus on growing its automotive foothold.

Financials to gain further strength, valuations cheap

The automotive segment of Phoenix Lamps registered 48% yoy jump in spite of a weak environment for the auto industry both domestic and international. The growth was owing to 1) entry into new markets, 2) market share gains in existing markets and 3) rupee depreciation. While rupee might not depreciate substantially from current levels, other two factors will keep momentum intact. Profitability improvement will drive stronger PAT growth and add strength to already strong balance sheet. Valuations are attractive at 1-year forward P/E of 7.8x.

Financial summary

Y/e 31 Mar (Rs m)	FY13	FY14	FY15E	FY16E
Revenues	4,828	4,940	4,387	5,352
yoy growth (%)	6.5	2.3	(11.2)	22.0
OPM (%)	1.6	9.5	11.5	12.3
Reported PAT	(241)	664	353	475
yoy growth (%)	-	-	(46.9)	34.8
EPS (Rs)	(8.6)	8.6	12.6	17.0
P/E (x)	-	15.4	10.6	7.8
Price/Book (x)	4.0	3.6	3.4	2.9
EV/EBITDA (x)	66.2	8.7	8.0	6.2
Debt/Equity (x)	1.7	0.6	0.6	0.5
RoE (%)	(22.8)	24.7	33.2	39.7
RoCE (%)	(1.1)	24.3	31.9	37.9

Source: Company, India Infoline Research

Rating: BUY

Target (1-3 months): Rs160

CMP: Rs133

Upside: 20.3%

Exit Trigger*: Rs110

* Exit trigger is the price level below which investor should exit position

Sector: Auto Components

Sector view: Positive

Sensex: 27,027

52 Week h/l (Rs): 51/177

Market cap (Rscr): 372

6m Avg vol ('000Nos): 38

Bloomberg code: PHLL IB

BSE code: 517296

NSE code: PHOENIXLL

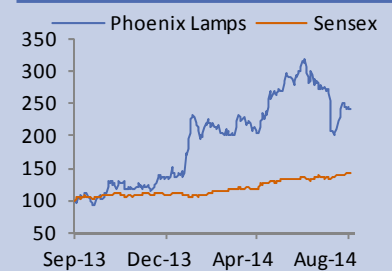
FV (Rs): 10

Prices as on September 05, 2014

Company rating grid

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	1	2	3	4	5
Earnings Growth				4	
Cash Flow				4	
B/S Strength				4	
Valuation appeal				4	
Risk			3		

Share price trend



Share holding pattern

(%)	Dec-13	Mar-14	Jun-14
Promoter	71.0	71.0	71.0
Insti	3.0	3.3	2.4
Others	26.1	25.8	26.7

IIFL Research won 3 awards at India's Best Market Analyst Awards 2013 by Zee Business for Banking, Oil & Gas and Pharma.

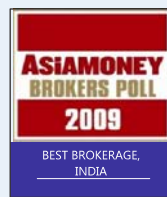
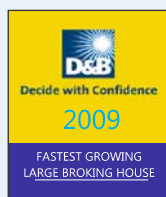
'Best Equity Broker of the Year' – Bloomberg UTV, 2011

IIFL was awarded the 'Best Equity Broker of the Year' at the recently held Bloomberg UTV Financial Leadership Award, 2011. The award presented by the Hon'ble Finance Minister of India, Shri Pranab Mukherjee. The Bloomberg UTV Financial Leadership Awards acknowledge the extraordinary contribution of India's financial leaders and visionaries from January 2010 to January 2011.

'Best Broker in India' – Finance Asia, 2011

IIFL has been awarded the 'Best Broker in India' by Finance Asia. The award is the result of Finance Asia's annual quest for the best financial services firms across Asia, which culminated in the Country Awards 2011.

Other awards



An Express Idea is a recommendation based on our view on the sector and / or stock from a near to medium term perspective, typically less than three months. The view can be based on fundamentals and / or technical parameters for the stock and / or our view on the sector on the whole.

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