

AUTOMOBILES

18 January 2021

Spiking RM costs to puncture earnings

Input costs make up 65-70% of revenues for most auto manufacturers. Since the Q2FY21 results were announced, prices have spiked abruptly for steel (97%), aluminium (17%), lead (7%), natural rubber (15%) and crude derivatives (29%). We have been flagging the rich valuations of the auto pack and are now doubly concerned given the corrosive impact of commodity price inflation on auto margins. We expect sharp downgrades to consensus margin estimates and recommend a strong SELL on all auto OEM and tyre companies.

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Steel: Steel forms ~60% of the raw material used in a car. Since Sep'20, steel prices have surged >90% (from ~US\$ 540 to >US\$ 1,000), which can have a devastating impact on margins. Even if steel averages at US\$ 750-800, auto companies will need to hike prices by over 15% to maintain Q2FY21 margins.

Natural rubber and crude derivatives: Natural rubber and crude derivatives are the key components in tyres. Combined input costs are at ~70% of revenue. With a 15% jump in natural rubber and ~29% spike in crude derivative prices, we estimate that input costs will get dearer by 23% over Q2FY21 levels. To mitigate this impact, tyre companies will have to effect price hikes of over 15%.

Our estimates vs. consensus: Aggregate estimates for our auto coverage are marginally higher than consensus on revenue (by 5%/2% for FY22/FY23) but lower on EBITDA (by 9%/14%). We believe this is a function of our lower gross margin assumptions. Aggregate adj. PAT estimates for our coverage companies are thus 17%/19% below consensus. (refer Fig. 1)

Consensus margins at high risk of downgrade – SELL OEM and tyre stocks:

Our revenue forecasts are higher than the street, limiting any positive surprise on volume growth. After the steep >10% price hike taken by most automakers due to BSVI transition, we see little scope for further hikes, implying the RM cost burden will erode margins in the near-to-medium term. The street's view of gross margin expansion in FY22 and FY23 looks overstated, leaving us skeptical of current valuations which are running much ahead of long-term averages. We expect sharp downgrades to consensus estimates as commodity prices stabilise.

We thus recommend a strong SELL on all auto OEM and tyre companies. Our top SELLS are Ashok Leyland, Maruti Suzuki, Hero Moto, TVS Motor, Escorts, Apollo Tyres, MRF, JK Tyre, Balkrishna Industries, CEAT and TVS Srichakra.

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
AL IN	114	60	SELL
BJAUT IN	3,565	2,800	SELL
EIM IN	2,860	2,200	SELL
ESC IN	1,268	1,150	SELL
HMCL IN	3,155	2,900	SELL
MSIL IN	7,768	6,900	SELL
MM IN	800	630	SELL
TVSL IN	498	350	SELL
VSTT IN	1,849	2,300	BUY
APTY IN	177	140	SELL
BIL IN	1,607	1,340	SELL
CEAT IN	1,199	780	SELL
JKI IN	87	70	SELL
MDA IN	86	110	BUY
MRF IN	85,598	67,000	SELL
SWE IN	1,350	1,300	SELL
SRTY IN	1,791	1,200	SELL

Price & Target in Rupees

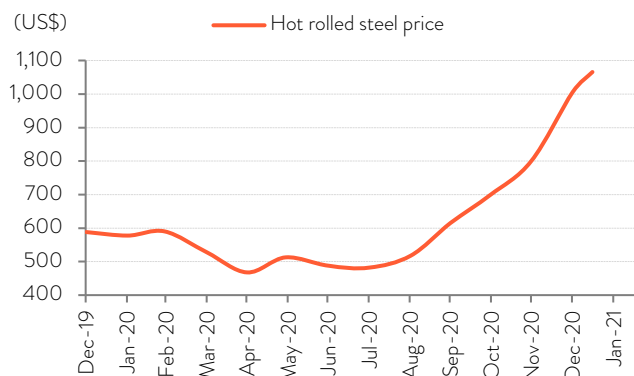


FIG 1 – BOBCAPS ESTIMATES VS. BLOOMBERG CONSENSUS

(%)	Revenues	EBITDA	Adj. PAT
FY22E	5	(9)	(17)
FY23E	2	(14)	(19)

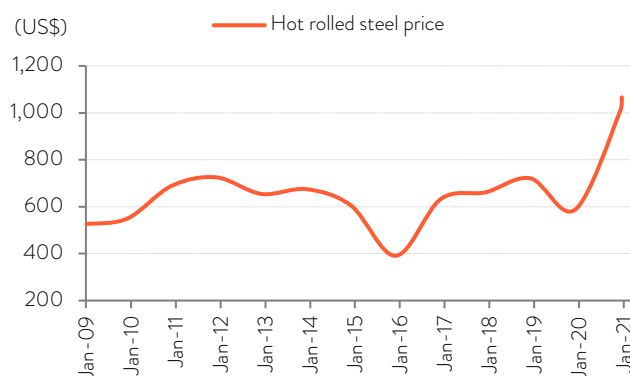
Source: Company, BOBCAPS Research, Bloomberg

FIG 2 – SHARP >2X RISE IN HRC STEEL PRICES OVER LAST SIX MONTHS...



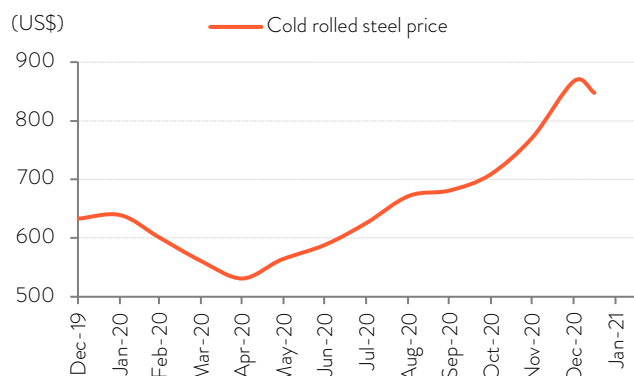
Source: Company, BOBCAPS Research, Bloomberg

FIG 3 – ...AND CURRENTLY AT HISTORICAL HIGHS



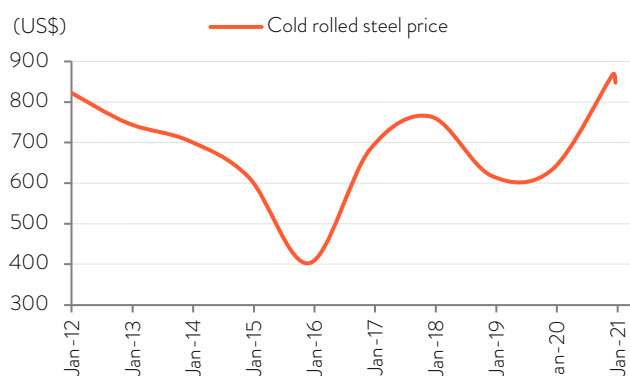
Source: Company, BOBCAPS Research, Bloomberg

FIG 4 – ~60% RISE IN CRC STEEL PRICES OVER LAST NINE MONTHS...



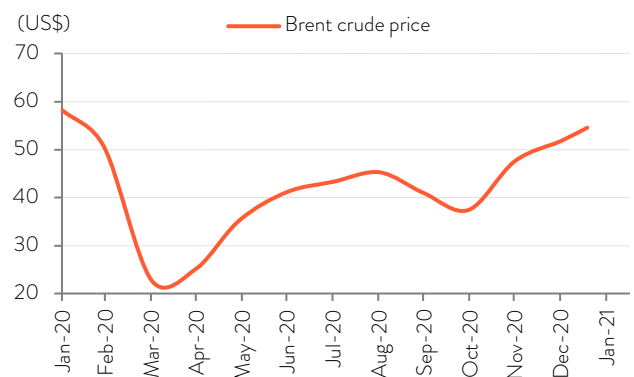
Source: Company, BOBCAPS Research, Bloomberg

FIG 5 – ...AND CURRENTLY AT HISTORICAL HIGHS



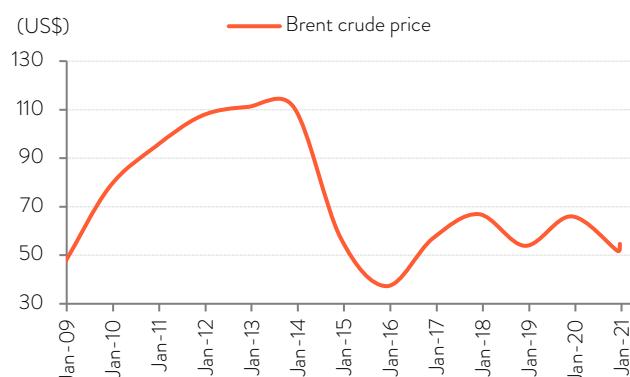
Source: Company, BOBCAPS Research, Bloomberg

FIG 6 – BRENT CRUDE PRICES UP 1.4X IN LAST NINE MONTHS...



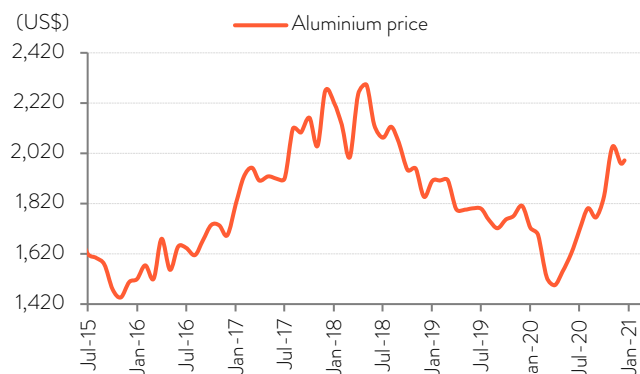
Source: Company, BOBCAPS Research, Bloomberg

FIG 7 – ...AND NOW RANGEBOUND AT LAST 3Y AVERAGE



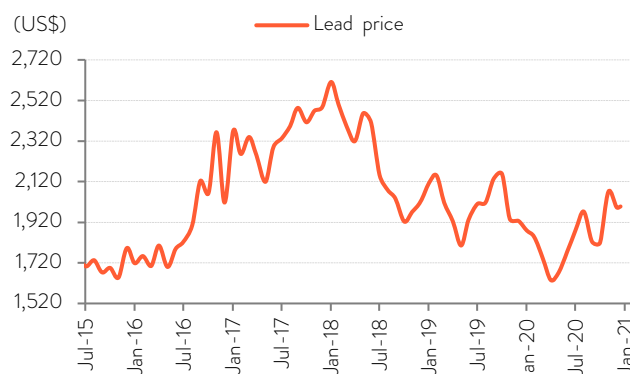
Source: Company, BOBCAPS Research, Bloomberg

FIG 8 – ALUMINIUM PRICES UP ~33% IN LAST NINE MONTHS



Source: Company, BOBCAPS Research, Bloomberg

FIG 9 – LEAD PRICES UP ~22% IN LAST NINE MONTHS



Source: Company, BOBCAPS Research, Bloomberg

So far this year, commodity prices were at their lowest during Q2FY21

Consensus FY22-FY23 gross margin estimates for most auto companies are far above those reported in Q2FY21

With the current steep jump in input prices, it is highly unlikely that auto companies will achieve these estimates

FIG 10 – GROSS MARGIN ESTIMATES: BOBCAPS VS. BLOOMBERG CONSENSUS

Company	Q2FY21A	Gross margins			
		BOBCAPS		BBG Consensus	
		FY22E	FY23E	FY22E	FY23E
Four-wheelers					
MSIL IN	30.0	28.4	28.4	30.1	30.4
AL IN	28.8	28.0	28.0	NA	29.0
Two-wheelers					
HMCL IN	28.9	28.7	28.8	31.4	30.1
BJAUT IN	29.3	29.3	29.3	29.5	29.6
TVSL IN	23.5	24.0	24.0	24.3	24.4
EIM IN	42.3	41.5	42.0	41.5	41.6
Agri					
ESC IN	36.4	32.5	32.5	36.2	33.0
VSTT IN	34.4	32.4	32.4	NA	NA
SWE IN	21.6	22.0	22.0	26.0	26.0
Tyres					
APTY IN	46.3	43.0	43.0	43.5	43.3
BIL IN	61.3	57.0	57.0	52.1	58.6
CEAT IN	46.6	40.7	40.7	43.4	42.9
MRF IN	44.3	40.1	40.0	NA	NA
JKI IN	41.4	36.0	36.0	NA	NA
SRTY IN	42.2	38.3	38.3	NA	NA

Source: BOBCAPS Research, Company, Bloomberg

FIG 11 – BOBCAPS VS. BLOOMBERG CONSENSUS ESTIMATES (AS ON 15 JAN 2021)

FY22E												
Company	Revenue (Rs mn)			EBITDA (Rs mn)			EBITDA margin (%)			EPS (Rs)		
	Consensus	BOBCAPS	Diff (%)	Consensus	BOBCAPS	Diff (%)	Consensus	BOBCAPS	Diff (bps)	Consensus	BOBCAPS	Diff (%)
Four-wheelers												
MSIL IN	838,179	927,746	11	97,511	88,099	(10)	11.6	9.5	(214)	247.3	227.0	(8)
AL IN	213,712	257,272	20	19,812	19,972	1	9.3	7.8	(151)	3.1	2.5	(19)
Two-wheelers												
HMCL IN	345,623	348,982	1	47,628	44,742	(6)	13.8	12.8	(96)	175.1	170.0	(3)
BJAUT IN	324,977	315,247	(3)	57,005	51,912	(9)	17.5	16.5	(107)	184.1	169.8	(8)
TVSL IN	186,808	185,461	(1)	16,557	14,657	(11)	8.9	7.9	(96)	16.2	12.4	(23)
EIM IN	118,438	104,103	(12)	27,688	22,806	(18)	23.4	21.9	(147)	87.4	72.6	(17)
Agri												
ESC IN	70,711	69,485	(2)	9,991	9,398	(6)	14.1	13.5	(60)	75.7	59.8	(21)
VSTT IN	9,150	8,721	(5)	1,244	1,071	(14)	13.6	12.3	(131)	112.1	101.7	(9)
SWE IN	8,901	9,765	10	1,201	1,238	3	13.5	12.7	(81)	70.2	68.6	(2)
Tyres												
APTY IN	184,392	193,924	5	25,058	23,602	(6)	13.6	12.2	(142)	11.1	7.5	(32)
BIL IN	62,038	61,115	(1)	18,970	16,937	(11)	30.6	27.7	(287)	62.7	52.9	(16)
CEAT IN	77,901	84,906	9	9,383	8,473	(10)	12.0	10.0	(206)	82.3	48.1	(42)
MRF IN	184,559	192,002	4	30,100	28,384	(6)	16.3	14.8	(153)	3,391.8	2,766.0	(18)
JKI IN	98,443	103,309	5	11,474	10,452	(9)	11.7	10.1	(154)	9.2	5.7	(38)
SRTY IN	22,417	22,135	(1)	2,660	2,177	(18)	11.9	9.8	(203)	119.7	75.0	(37)

FY23E												
Company	Revenue (Rs mn)			EBITDA (Rs mn)			EBITDA margin (%)			EPS (Rs)		
	Consensus	BOBCAPS	Diff (%)	Consensus	BOBCAPS	Diff (%)	Consensus	BOBCAPS	Diff (bps)	Consensus	BOBCAPS	Diff (%)
Four-wheelers												
MSIL IN	961,557	1,027,015	7	121,907	101,657	(17)	12.7	9.9	(278)	310.0	264.9	(15)
AL IN	271,467	286,035	5	29,465	22,678	(23)	10.9	7.9	(293)	5.5	3.1	(44)
Two-wheelers												
HMCL IN	390,173	384,439	(1)	54,449	50,103	(8)	14.0	13.0	(92)	198.5	191.8	(3)
BJAUT IN	365,331	350,681	(4)	65,184	58,811	(10)	17.8	16.8	(107)	210.3	188.0	(11)
TVSL IN	213,442	203,829	(5)	19,987	16,201	(19)	9.4	7.9	(142)	21.4	14.4	(33)
EIM IN	137,905	113,873	(17)	33,507	25,829	(23)	24.3	22.7	(161)	106.7	86.1	(19)
Agri												
ESC IN	80,207	75,139	(6)	11,566	10,146	(12)	14.4	13.5	(92)	88.6	67.8	(23)
VSTT IN	10,919	9,790	(10)	1,528	1,238	(19)	14.0	12.6	(135)	135.5	116.7	(14)
SWE IN	9,722	10,486	8	1,376	1,321	(4)	14.2	12.6	(156)	80.8	72.2	(11)
Tyres												
APTY IN	204,097	212,529	4	28,596	25,889	(9)	14.0	12.2	(183)	14.6	8.6	(41)
BIL IN	69,710	67,655	(3)	21,862	18,811	(14)	31.4	27.8	(356)	73.7	60.9	(17)
CEAT IN	87,401	93,560	7	10,759	9,841	(9)	12.3	10.5	(179)	99.8	55.5	(44)
MRF IN	200,834	212,354	6	33,299	31,752	(5)	16.6	15.0	(163)	3,800.1	3,060.0	(19)
JKI IN	108,397	114,359	6	13,361	11,832	(11)	12.3	10.3	(198)	13.3	9.8	(26)
SRTY IN	24,694	25,620	4	2,965	1,651	(44)	12.0	6.4	(556)	134.6	85.9	(36)

Source: Company, BOBCAPS Research, Bloomberg

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

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