Initiating Coverage on Automobile Components Sector

September 2010

Executive Summary

Sector Outlook	Positive

On cruise mode

We are positive on the automobile component sector driven by continued strong expected OEM volume growth (PVs, CVs and 2-Ws) as well as driven by the latter's significant capacity expansion plans over the ensuing two years. We prefer auto component manufacturers (ACMs) having higher bargaining/ pricing power and accordingly like businesses having high replacement market and high barriers to entry backed by superior technology and R&D. We initiate coverage on Apollo Tyres (APTY, Exide Industries (EIL), Motherson Sumi (MSSL) and Bharat Forge (BFL) apart from continuing our coverage on Amara Raja Batteries (ARBL) and WABCO-TVS (WTVS).

ACM business to hinge on OEM volume growth: ACMs are expected to benefit by way of strong OEM volume growth, backed by significant capacity expansion - PVs OEM capacity is expected to grow by ~60%, CVs and 2-Ws by ~30% between FY10 – FY12. We believe ACMs having high exposure to PVs would benefit the most given the highest capacity expansion. Assuming 75% utilisation rate (as of FY10) on the expanded capacity for PVs, the implied production CAGR stands at 24% for FY10 – FY12. This we expect would be driven by the underlying domestic demand, augmented by strong exports growth.

What we like and dislike: We like businesses which are backed by 1) high R&D and own patents and designs thereby ensuring bargaining power and creation of entry barriers; 2) high exposure to replacement market thereby mitigating cyclicality risk and ensuring high profitability driven by premium pricing vs. OEMs; 3) dominant players in the respective product segments. We dislike businesses with 1) higher customer concentration; 2) low/no pricing power. To augment our view, we have developed a framework comprising of 16 business and financial parameters (Critical Success Factors – CSF) to rank our coverage universe. The matrix ranks WTVS, EIL and MSSL at the top, followed by APTY, ARBL and BFL. The top rankers invariably have high barriers to entry (WTVS, MSSL) or high replacement market exposure (EIL , APTY).

Coverage universe view: We are positive on Apollo Tyres and WABCO-TVS as they are key beneficiaries of robust CV volume growth. Apollo Tyres being a pioneer in MHCV radial segment is expected to capitalize on increasing MHCV 'radialisation'. For WABCO-TVS, the parent's increased commitment to India would lead to strong traction in exports. We like Exide Industries on the back of its expected increase in auto replacement penetration and continued leadership in the OEM space. Margins for Exide are expected to remain at current levels with higher sourcing of recycled lead offset by possible price reduction to capture share from the unorganised replacement market. We like Motherson Sumi for its dominance in PVs wiring harness and mirrors market and its diversified customer and product portfolio.

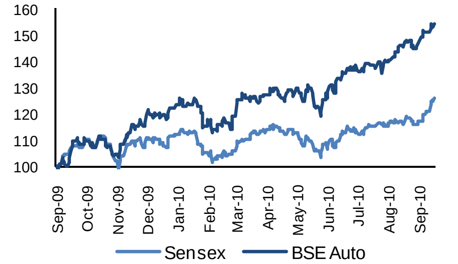
We turn negative on Amara Raja Batteries as we expect volumes and margins to weaken due to the telecom business and pricing pressures in the auto replacement market. Unlike Exide, Amara Raja is more susceptible to lead price fluctuations due to lower recycled lead sourcing and lower scale. For Bharat Forge, we are negative on overseas business (~45% of consolidated revenue) due to low capacity utilization and lower margins, pulling down consolidated earnings.

Stock calls: We have OUTPERFORM rating on Apollo Tyres (TP: Rs. 114), WABCO-TVS (TP: Rs. 1,326), Exide Industries (TP: Rs. 189) and Motherson Sumi (TP: Rs. 197). We have an UNDERPERFORM rating on Amara Raja (TP: Rs. 167) and Bharat Forge (TP: Rs. 344). Key Risks: 1) Slowdown in OEM volume growth 2) Commodity price increase 3) continued slowdown in Europe.

Date	Sep 20, 2010

Market data	
BSE SENSEX	19595
Nifty	5885
BSE Autos	9276

BSE Auto vs. Sensex



Performance (%)

	1m	3m	12m
Sensex	7.3	11.5	17.0
BSE Auto	4.5	14.0	40.5

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Snapshot of Views on Stocks

Sector Outlook	Positive

Company	Business analysis outcome	View	Rating
WABCO-TVS	Rank: 1	▪ We like WABCO-TVS for its leadership position in the braking system and high entry barriers ▪ Pricing power backed by high R&D, own design rights and patents ▪ Expect strong volume growth on the back of its dominance in the domestic CV braking system (80% share) ▪ Exports to post strong growth on the back of parent's (WABCO) increased focus on making India a low cost manufacturing hub	OUTPERFORM TP: Rs. 1,326
Exide Industries	Rank: 2	▪ We like Exide Industries for its leadership position in the auto replacement and OEM battery market (>70% market share in both); ▪ We like its wider distribution network and its better position to capture the unorganised auto replacement market ▪ Stable margins on the back of increased recycled-lead sourcing, thereby offsetting margin decline in the replacement market ▪ Industrial battery business (38% of revenues) growth on the back of 25% exposure to UPS/Inverter segment	OUTPERFORM TP: Rs. 189
Motherson Sumi	Rank: 3	▪ We like Motherson for its leadership position in the domestic wiring harness and mirror segment of the domestic PV segment ▪ Expect it to benefit significantly with the expected domestic PVs capacity expansion ▪ We like the company for its diversified product range and customer base ▪ Strong growth visibility with ~EUR 800mn orders for SMR, over the next few years - SMR has ~25% global market share in PC exterior mirrors ▪ Margin expansion with increasing SMR margins by way of cheaper inputs from group companies post expiry of current sourcing contracts	OUTPERFORM TP: Rs. 197
Apollo Tyres	Rank: 4	▪ We like Apollo Tyres as we expect it to benefit the most from increasing MHCV 'radialisation' . ▪ Key beneficiary of CV OEM volume growth given its dominance in the space (28% market share) ▪ Strong replacement market (~70% of revenue) and pricing power to partially offset margin decline by rubber price surge in FY11E ▪ Overseas subsidiaries showing good traction (Europe at peak capacities, South Africa utilisation increasing)	OUTPERFORM TP: Rs. 114
Bharat Forge	Rank: 5	▪ Expect overseas subsidiaries utilisation to be at 43% by FY12 (against 35% in FY10), much lower than 60% utilization in FY09. ▪ Expect European business to post slow recovery, expect 10% CAGR for FY10-12 against low base. ▪ The delayed recovery in GM's business (accounts for 75% of total Bharat Forge America sales) is expected to drag utilisation rates ▪ Domestic CV segment to aid revenue growth (90% market share) ▪ Expect non-auto business to post 40% CAGR from FY10 - FY12 to Rs. 13.9bn, the co. is expanding capabilities in power equipment ▪ The valuation captures the story (PE multiple of ~20x FY12E earnings)	UNDERPERFORM TP: Rs. 344
Amara Raja Batteries	Rank: 6	▪ Industrial revenue (~50% of total) to see continued pressure from weak telecom sector (26% of total revenue) ▪ Susceptible to lead price increase as sourcing from smelters is very low compared to Exide ▪ Margins to decline 530bps from FY10 - FY12 due to pricing pressure in auto replacement and telecom business ▪ Expect strong auto segment revenues on the back of its OEM demand; ~80% capacity expansion from FY10-12 ▪ Auto replacement volumes to grow, however margins to decline due to pricing pressure from competition	UNDERPERFORM TP: Rs. 167

Valuation Matrix

Sector Outlook	Positive

Company	Sales (Rs. mn)			EBITDA (Rs. mn)			PAT (Rs. mn)			EPS (Rs.)			EBITDA Margin		
	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E
Amara Raja Batteries	14,652	17,711	22,289	2,873	2,588	3,185	1,670	1,431	1,784	19.6	16.8	20.9	19.6%	14.6%	14.3%
Apollo Tyres	81,210	88,265	113,858	11,751	10,543	14,440	5,660	4,469	7,182	11.2	8.9	14.2	14.5%	11.9%	12.7%
Bharat Forge	33,276	42,178	51,368	3,385	7,456	9,603	8	3,154	4,732	0.03	12.2	18.4	10.2%	17.7%	18.7%
Exide Industries	39,789	47,016	57,356	9,772	10,599	12,914	5,619	6,304	7,630	5.8	7.4	9.0	24.6%	22.5%	22.5%
Motherson Sumi	69,240	82,657	96,036	6,301	8,930	10,820	2,283	3,287	4,245	6.1	8.5	11.0	9.1%	10.8%	11.3%
WABCO-TVS	6,021	7,795	9,261	1,283	1,667	1,981	786	1,153	1,398	41.4	60.8	73.7	21.3%	21.4%	21.4%

Company	P/E			EV/EBITDA			EV/Sales			CMP (Rs)	Mkt Cap (Rs. mn)	Target		% absolute return	Rating
	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E			P/E	Price		
Amara Raja Batteries	11.0x	12.9x	10.3x	6.5x	7.2x	5.7x	1.3x	1.1x	0.8x	215	18,400	8.0x	167	-22%	UPF
Apollo Tyres	7.7x	9.7x	6.0x	4.8x	5.9x	3.9x	0.7x	0.7x	0.5x	86	43,402	8.0x	114	32%	OPF
Bharat Forge	NM	29.8x	19.9x	28.9x	12.4x	9.3x	2.9x	2.2x	1.7x	365	81,286	18.0x	344	-6%	UPF
Exide Industries	27.5x	21.5x	17.8x	14.1x	12.9x	10.2x	3.5x	2.9x	2.3x	160	135,745	20.0x	189	19%	OPF
Motherson Sumi	29.9x	21.4x	16.6x	11.6x	8.3x	6.4x	1.1x	0.9x	0.7x	182	70,351	18.0x	197	9%	OPF
WABCO-TVS	26.8x	18.2x	15.0x	16.4x	12.1x	9.6x	3.5x	2.6x	2.1x	1,109	21,027	18.0x	1,326	20%	OPF
Sector Mean	**20.6x**	**18.9x**	**14.3x**	**13.7x**	**9.8x**	**7.5x**	**2.2x**	**1.7x**	**1.4x**			**15.0x**		**8.5%**	

Standalone numbers for Amara Raja & WABCO-TVS, Earnings CAGR for Bharat Forge is for FY09 - FY12

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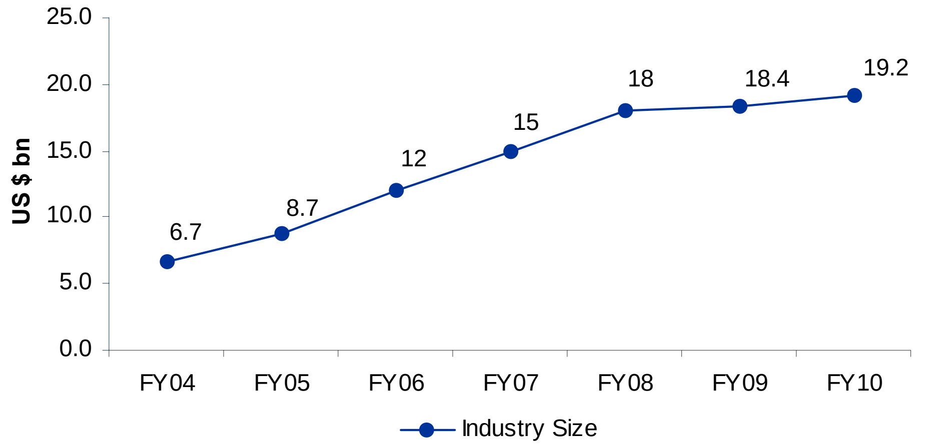
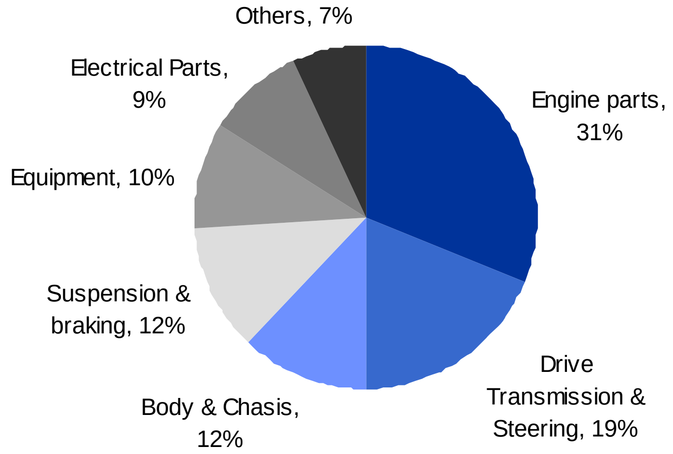
Industry Scenario

Auto component industry CAGR of ~19% from FY04 – FY10



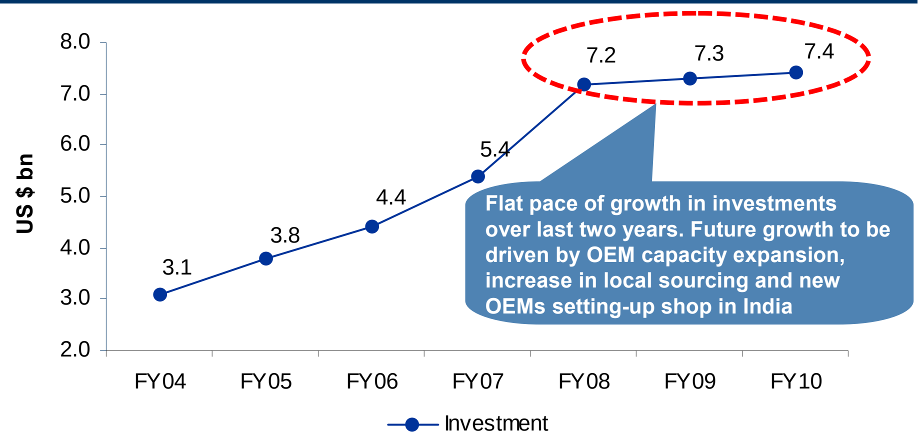
Source: Spark Capital, ACMA

Engine & Transmission components form ~50% of industry



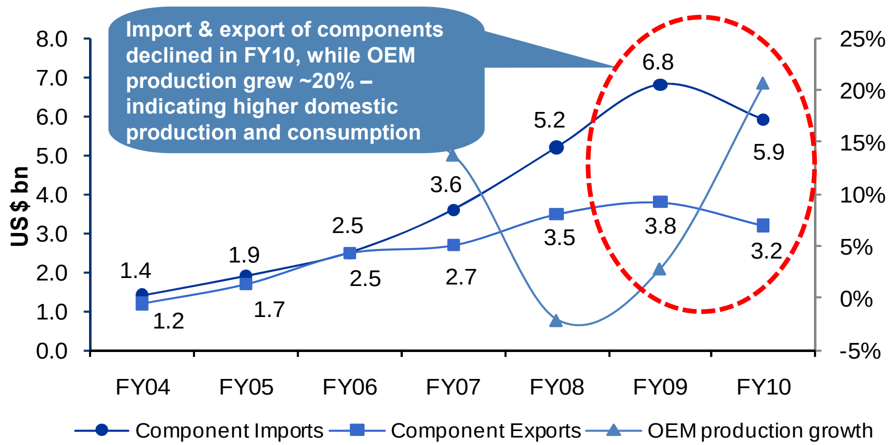
Source: Spark Capital, ACMA

Flat pace of capital investments over the last three years



Source: Spark Capital, ACMA

High domestic production & consumption in FY09 and FY10



Source: Spark Capital, ACMA

Investment in Auto Components is Driven by Expansion/Sourcing Plans of OEMs

Sector Outlook Positive

OEMs capacity addition plan (mn units)

	Capacity			
PVs	**FY10**	**FY12E**	**% growth**	**Key beneficiaries (ACMs)**
Maruti Suzuki	1.00	1.25	25%	MSSL, EIL, ARBL
Hyundai India	0.60	0.68	13%	MSSL, EIL, ARBL, APTY
Tata Motors	0.30	0.60	100%	EIL
M&M	0.16	0.36	123%	MSSL
Ford india	0.10	0.20	100%	ARBL, APTY
Honda Siel	0.12	0.30	150%	
Tata Fiat	0.14	0.20	48%	
GM India	0.23	0.23	0%	
Toyota India	0.07	0.20	186%	
Others	0.30	0.73	141%	
Total PVs	**3.01**	**4.74**	**57%**	
	Capacity			
Two-Wheelers	**FY10**	**FY12E**	**% growth**	**Key beneficiaries (ACMs)**
Hero Honda	5.20	5.70	10%	MSSL, EIL, ARBL
Bajaj Auto	3.60	5.00	39%	EIL
TVS Motors	2.40	2.80	17%	
HMSI	1.55	2.20	42%	MSSL, ARBL
Royal Enfield	0.06	0.06	0%	
Suzuki	0.25	0.54	116%	EIL
Mahindra Scooters	0.45	0.60	33%	
Yamaha Motors	0.45	1.05	133%	
Total 2Ws	**13.96**	**17.95**	**29%**	
	Capacity			
CVs	**FY10**	**FY12E**	**% growth**	**Key beneficiaries (ACMs)**
Tata Motors	0.62	0.69	12%	WTVS, APTY, BFL, EIL
Ashok Leyland	0.10	0.14	40%	WTVS, APTY, BFL, EIL
Daimler India	0.00	0.07	n.a	APTY, BFL, EIL
Mahindra Navistar	0.10	0.20	100%	WTVS, APTY, BFL, EIL
Total CVs	**0.82**	**1.10**	**34%**	

Source: Spark Capital, Industry, Media reports

- **We expect EIL's dominance in the auto segment (>70% market share) to continue. Hence the capacity expansion in PVs, 2-Ws and CVs OEM capacity would benefit EIL the most.**
- **BFL and WTVS to be the key beneficiaries of CV OEMs capacity expansion, given their dominant market share – BFL ~90% and WTVS ~80%**
- **MSSL is expected to benefit from the significant PV capacity expansion, given its dominant market share (~65%)**
- **ARBL would benefit from its MoU with HMSI, while APTY would benefit from CV OEM expansion on the back of increasing preference to radials. (APTY expected to have the largest CV radial capacity by FY12)**

PCs local component sourcing

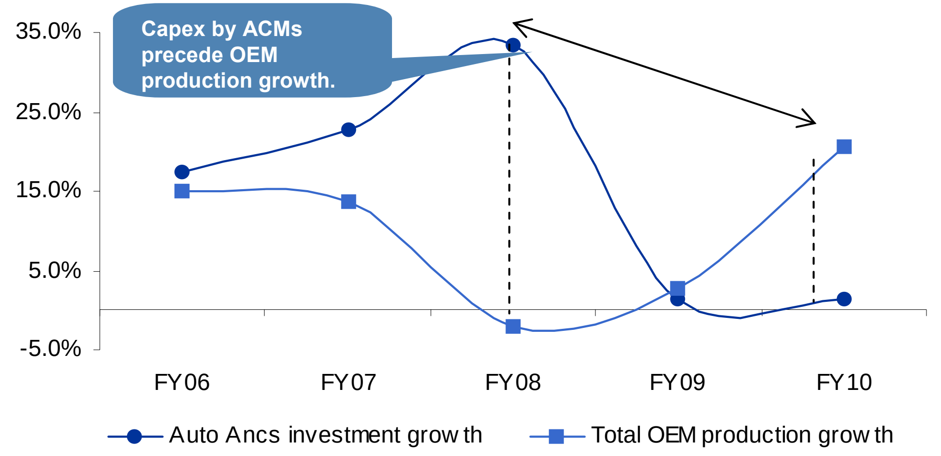
OEM	Model	Localisation*
Fiat India	Linea, Punto	60%
Ford India	Figo, Ikon, Fiesta	80%
GM India	Beat	60%
Honda Siel	Jazz, City, Small car	75%
M&M	Logan	55%
Maruti Suzuki	Eeco, Wagon R	85%
Mitsubishi	Lancer	65%
Nissan	Nissan micra	85%
Toyota India	Etios, small car	60%
Hyundai	Santro, i10, i20	80%
Volkswagen India	Polo	50%
Average		**69%**

*Source: Spark Capital, Industry, Media reports, Note: * avg. localization at launch/currently, of models mentioned*

ACMs supplying to PVs to benefit the most

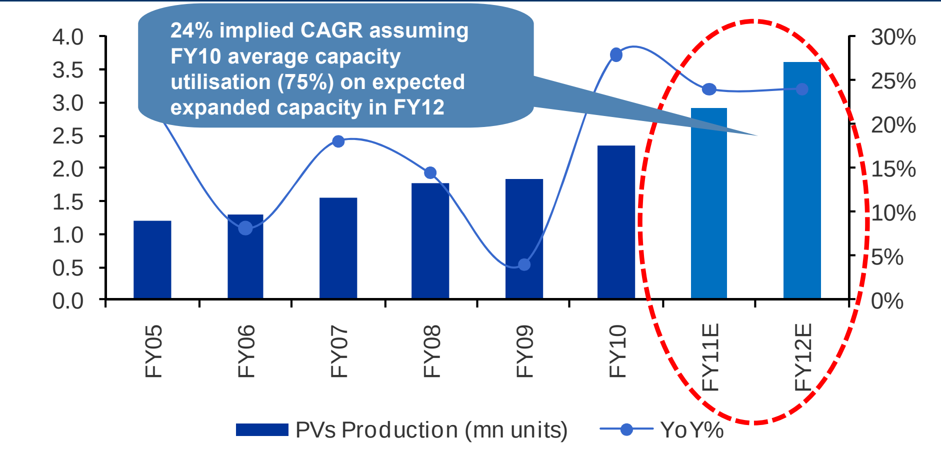
Sector Outlook	Positive

ACM Investment expected to rise driven by OEM production growth



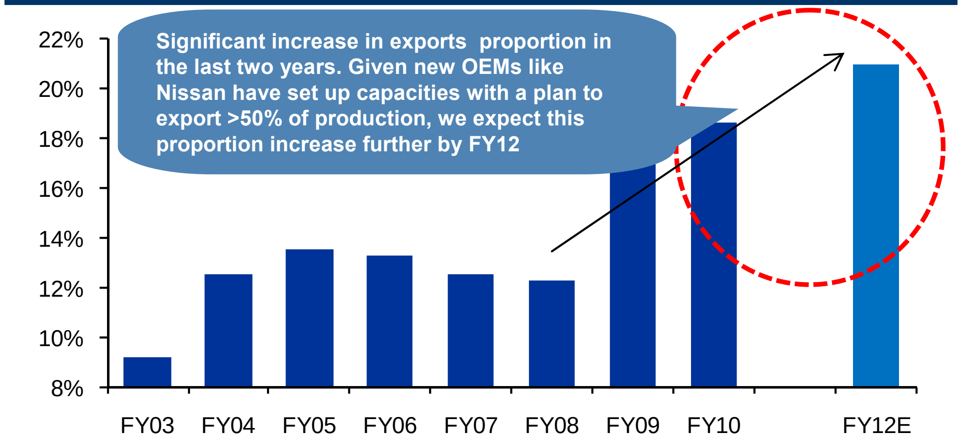
Source: Spark Capital, ACMA, SIAM

Implied PV production CAGR at 24% between FY10 and FY12



Source: Spark Capital, ACMA, SIAM

Proportion of exports to total PV volumes expected to increase



Source: Spark Capital, SIAM

- **PVs are expected to see the largest capacity expansion - which implies a 24% production CAGR assuming similar (75%) capacity utilisation rates as seen in FY10**
- **PVs production grew 28% in FY10 primarily driven by domestic volumes augmented by export growth of ~33% yoy. Hence for the implied 24% production CAGR between FY10-FY12E, exports proportion to total volumes should increase from ~19% in FY10 to ~21% in FY12**
- **PV OEMs such as Nissan and Hyundai have set up capacities to specifically address export opportunities, hence we believe exports proportion increasing in the next two years is likely.**
- **We believe the key beneficiaries on the back of significant PV capacity expansion would be MSSL, EIL, ARBL and APTY in that order**

Business & Financial Analysis

Identifying Critical Success Factors (CSFs)

Our interactions with the industry has helped us identify eight 'Critical Success Factors' for an ACM. We have conceptualized a 'CSF Matrix' to rank the coverage universe based on the eight CSFs and eight financial parameter scoring based on our FY12 estimates.

	Parameters	Definition
Critical success factors	OEM's dependence	Dependence of the OEM, for the components. The relative criticality of a component in the vehicle (for the OEM).
	Technology/R&D/Patents	Technology, R&D barrier created by the company
	Replacement Market/distribution network	Proportion of revenues from replacement market (aftermarket)
	Risk of JV divorce	Dependency on JV partner
	Customer concentration	Large share of revenue coming from few key customers
	Non-Auto exposure	Proportion of revenue from non-automotive business (related diversification)
	Competitive Landscape	Market share, competitive positioning in the industry segment
	Impact of govt. policies/external factors	Favourable/unfavourable implication of changes in govt. policies/external factors
Financial parameters (FY12E)	Revenue growth (CAGR FY10 - 12E)	
	PAT growth (CAGR FY10 - 12E)	
	EBITDA margin (%)	
	Total assets turnover (x)	
	Working Capital turnover (x)	
	RoCE (%)	
	Debt/Equity (x)	
	OCF/Revenue (%)	

Automobile Components

CSF & Financial Parameter Ranking

Scoring of coverage universe: **Scale: 1 – 6 with 6 being the best**

Critical success factors Scoring	Amara Raja Batt.	Apollo Tyres	Bharat Forge	Exide Inds.	Motherson Sumi	WABCO-TVS
OEM's dependence	3	3	5	3	4	6
Technology/R&D/Patents	4	4	5	4	5	6
Replacement market	4	6	2	5	2	3
Risk of JV divorce	4	6	5	4	4	6
Customer concentration	4	6	2	5	4	4
Non-Auto exposure	6	3	4	5	3	2
Competitive Landscape	3	3	6	4	4	5
Impact of govt. policies/external factors	4	6	4	4	4	5
Financial parameters (FY12E) Scoring						
Revenue growth (CAGR FY10 - 12E)	4	2	5	3	1	6
PAT growth (CAGR FY10 - 12E)	1	2	4	3	6	5
EBITDA margin (%)	3	2	4	6	1	5
Total assets turnover (x)	5	2	1	4	6	3
Working Capital turnover (x)	1	6	3	4	5	2
RoCE (%)	4	2	1	5	3	6
Debt/Equity (x)	4	2	1	5	3	6
Operating Cash Flows (OCF)/Revenue (%)	1	3	4	6	2	5
Overall Rank	**6**	**4**	**5**	**2**	**3**	**1**

Wabco-TVS & Exide have high bargaining power backed by high scores in R&D and replacement market exposure respectively

WABCO-TVS and Exide Industries score high on EBITDA margin, OCF generation and RoCE.

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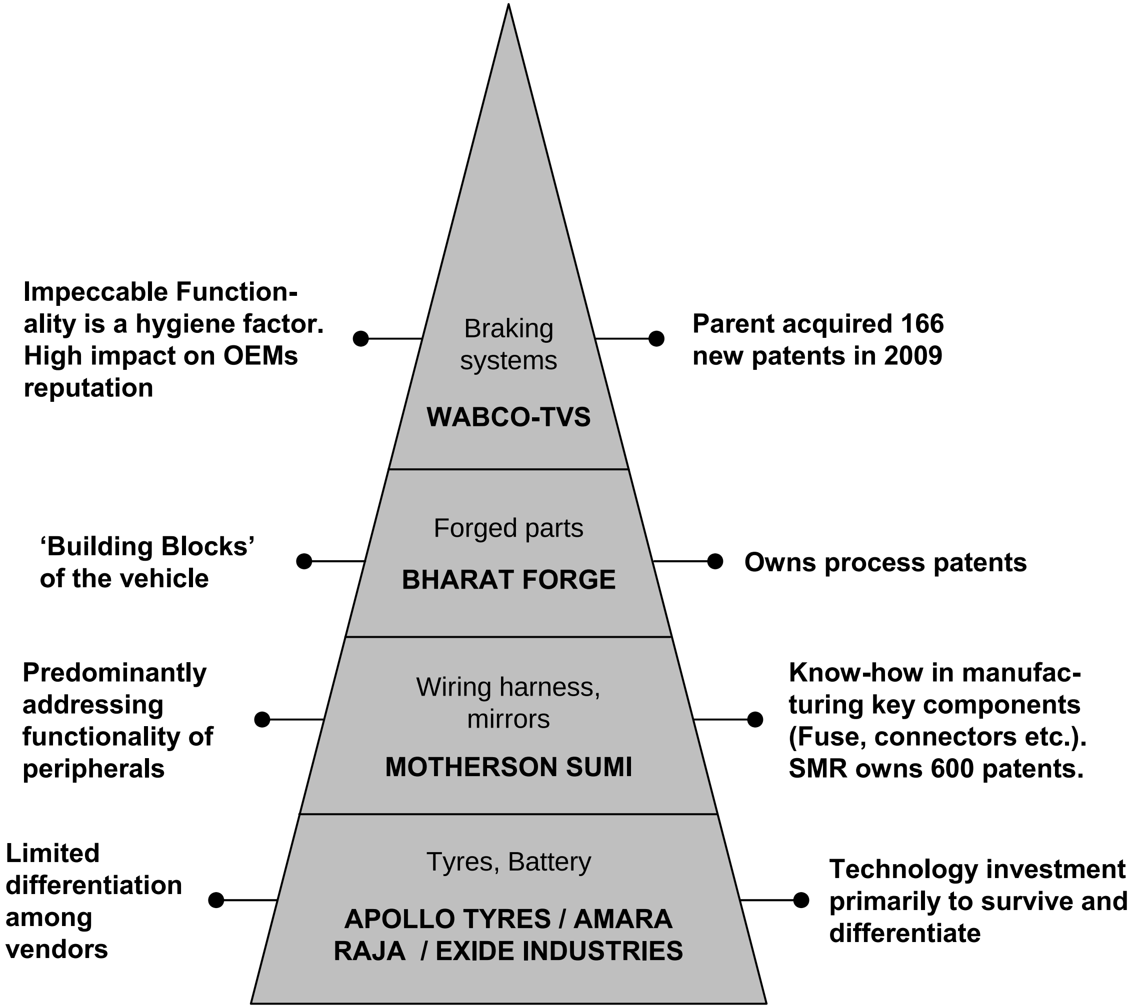
#1 OEM's Dependence

#2 Technology, R&D, Patents

High Component criticality → High technology, R&D, patents → High barriers to entry → High switching costs for OEMs → High bargaining power for ACMs

OEM's dependence	Score
WABCO-TVS	6
Bharat Forge	5
Motherson Sumi	4
Amara Raja	3
Apollo Tyres	3
Exide Industries	3



Technology, R&D, Patents	Score
WABCO-TVS	6
Bharat Forge	5
Motherson Sumi	5
Amara Raja	4
Apollo Tyres	4
Exide Industries	4

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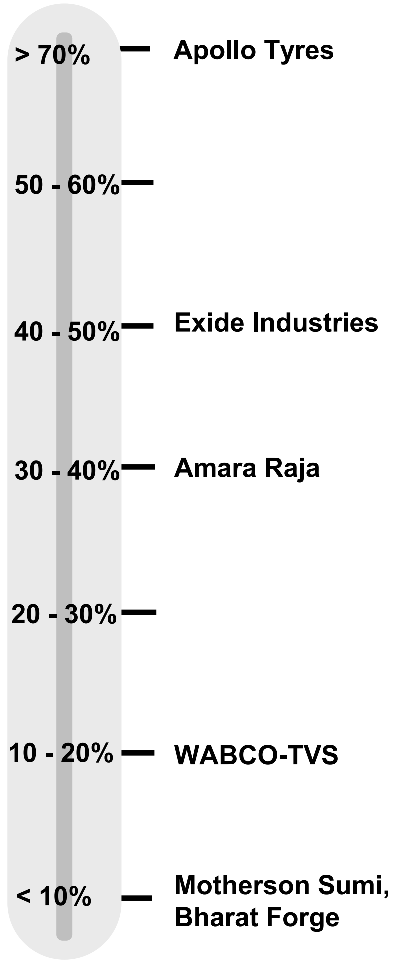
#3 Replacement Market

Replacement market revenues as a % of total revenues



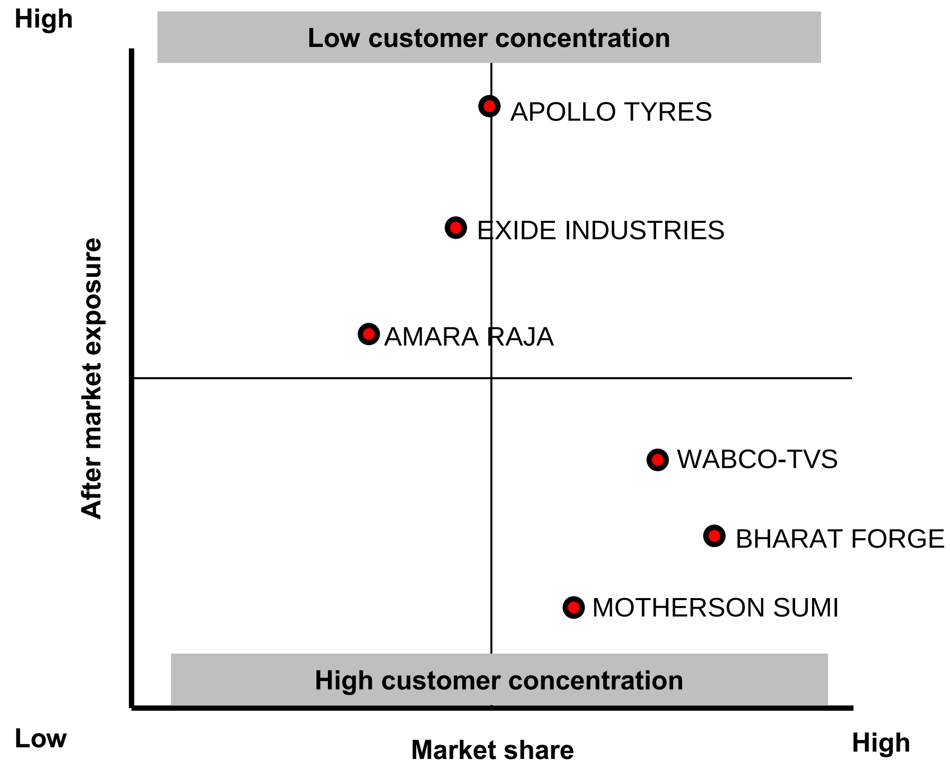
Aftermarket	Score
Apollo Tyres	6
Exide Industries	5
Amara Raja	4
WABCO-TVS	3
Bharat Forge	2
Motherson Sumi	2

Aftermarket exposure ↑

↑ Pricing power

↓ Volume cyclicality

#4 Customer Concentration



High after market exposure + **High market share** = **Low customer concentration**

Customer concentration	Apollo Tyres	Exide Inds.	Amara Raja	Motherson Sumi	WABCO-TVS	Bharat Forge
Score	6	5	4	4	3	2

Automobile Components

#5 Non-auto Exposure

Non-auto revenues as a % of total revenues (related diversification

- **> 50%**
- **40 - 50%** — **Amara Raja**
- **30 - 40%** — **Exide Industries**
- **20 - 30%**
- **10 - 20%** — **Bharat Forge**
- **5 - 10%** — **Motherson Sumi**
- **< 5%** — **WABCO-TVS, Apollo Tyres**

Non-auto exposure	Score
Amara Raja	6
Exide Industries	5
Bharat Forge	4
Motherson-Sumi	3
WABCO-TVS	2
Apollo Tyres	2

↑ **Non-auto exposure** → ↓ **Volume cyclicality**

#6 Risk of JV Divorce

Details of key JVs/technology partners

Company	JV/Technology partner	Details
Amara Raja Batteries	Johnson Controls	Equal equity stake of 26%, Technology provider for auto batteries
Exide Industries	Furukawa Batteries, Shin-Kobe Electric Machinery	Automotive and VRLA Lead Acid Storage Batteries
Motherson Sumi	Sumitomo Wiring	Sumitomo wiring has 25% equity stake (technology provider for wiring harness business), MSSL has six other key JVs
Bharat Forge	NTPC, Alstom	For foray into power equipment business
Apollo Tyres	-	-
WABCO-TVS	-	-

Company	Presence of JV	Impact of divorce	Dependence for technology	Historical issues with partner
Amara Raja Batteries	✓	High	High	×
Exide Industries	✓	High	High	×
Motherson Sumi	✓	High	High	×
Bharat Forge	✓	Low	Low	×
Apollo Tyres	×	-	-	-
WABCO-TVS	×	-	-	-

↓ **Dependence on JV partner** → ↓ **Risk in the event of divorce**

Risk of JV divorce	Apollo Tyres	WABCO-TVS	Bharat Forge	Amara Raja	Exide Inds.	Motherson Sumi
Score	6	6	5	4	4	4

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Automobile Components

#7 Competitive Landscape

Company	Market Share	Competitive Scenario
Bharat Forge	90%	Sole supplier to most CV OEMs
WABCO-TVS	80%	Dominant supplier to CV OEMs. Duopoly (Knorr-Bremse second largest)
Exide Industries	~70%	Dominant share in auto OEM and replacement. Duopoly (Amara Raja second largest)
Motherson Sumi	65%	Dominant supplier to PV segment. Duopoly (Tata Yazaki second largest)
Amara Raja	~30%	#2 player in auto OEM and replacement. Duopoly (Exide Industries is the largest)
Apollo Tyres	~28%	Leader in CV segment. Highly competitive market (top 5 players account for ~90%)

Competitive landscape	Score
Bharat Forge	6
WABCO-TVS	5
Exide Inds.	4
Motherson Sumi	4
Amara Raja Batt.	3
Apollo Tyres	3

#8 Impact of government policies/external factors

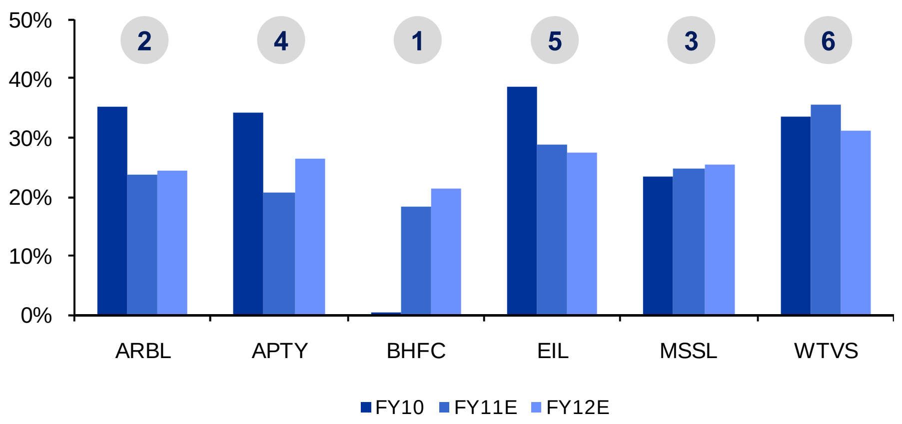
Company	Impact of govt. policies / external factors	Details
Apollo Tyres	High (favourable)	Policy on import of tyres and rubber, movement to radials
WABCO-TVS	Low (favourable)	Policy on mandatory ABS in certain CVs
Amara Raja	Low	Policy on disposal of used batteries, movement to VRLA batteries
Bharat Forge	Nil	-
Exide Industries	Low	Policy on disposal of used batteries, movement to VRLA batteries
Motherson Sumi	Nil	-

Impact of govt. policy	Score
Apollo Tyres	6
WABCO-TVS	5
Amara Raja Batt.	4
Bharat Forge	4
Exide Inds.	4
Motherson Sumi	4

Automobile Components

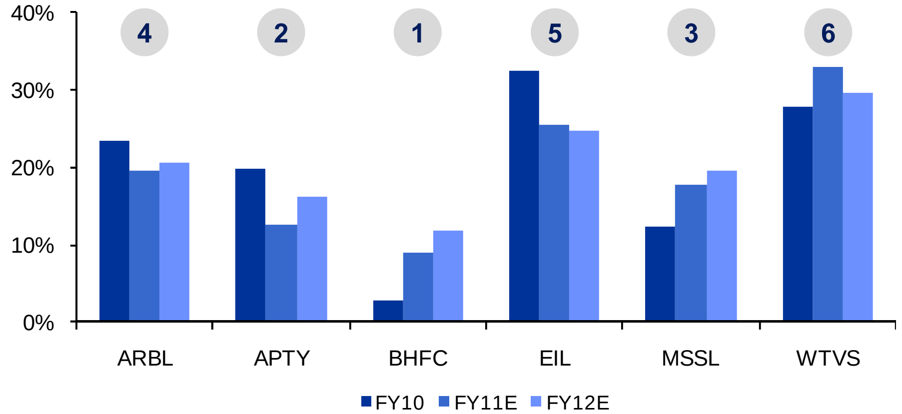
#9 Capital Efficiency

RoE - WTVS scores the highest , while BHFC the lowest



Source: Spark Capital, Company

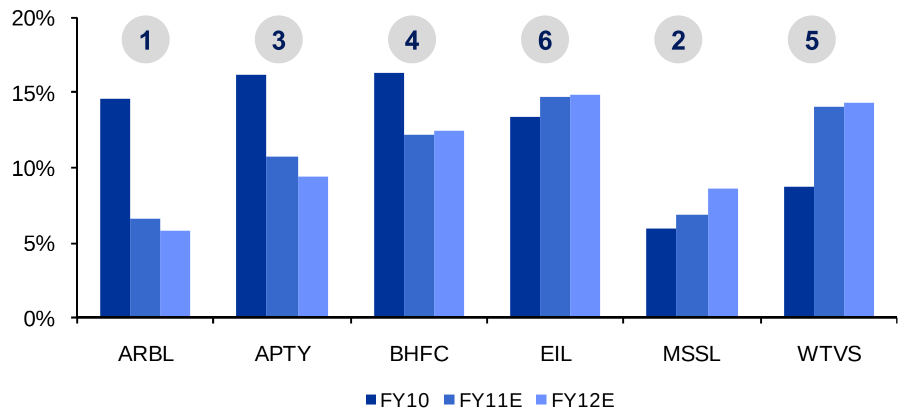
RoACE - WTVS scores the highest , while BHFC the lowest



Source: Spark Capital, Company

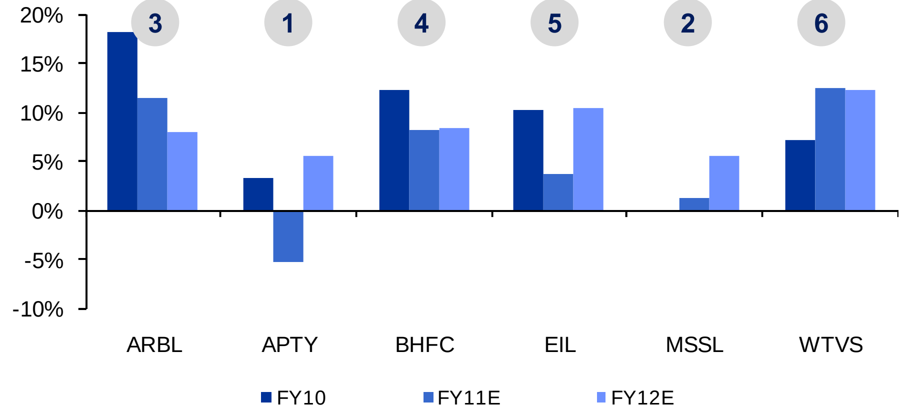
#10 Cash Flow

OCF/sales - EIL scores the highest , while ARBL the lowest



Source: Spark Capital, Company

FCF/sales - EIL scores the highest , while APTY the lowest



Source: Spark Capital, Company

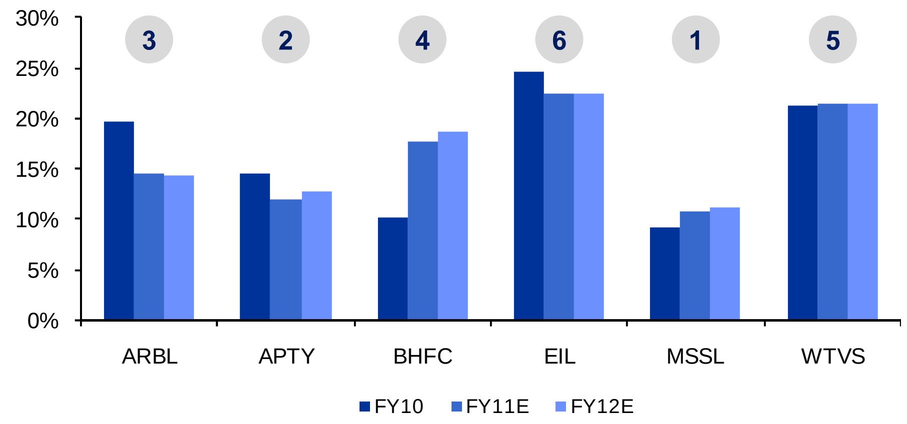
Note: ARBL – Amara Raja Batteries, APTY. Apollo Tyres, BHFC – Bharat Forge, EIL – Exide Industries, MSSL-Motherson Sumi, WTVS-WABCO TVS

Automobile Components

#11 Profitability Ratios

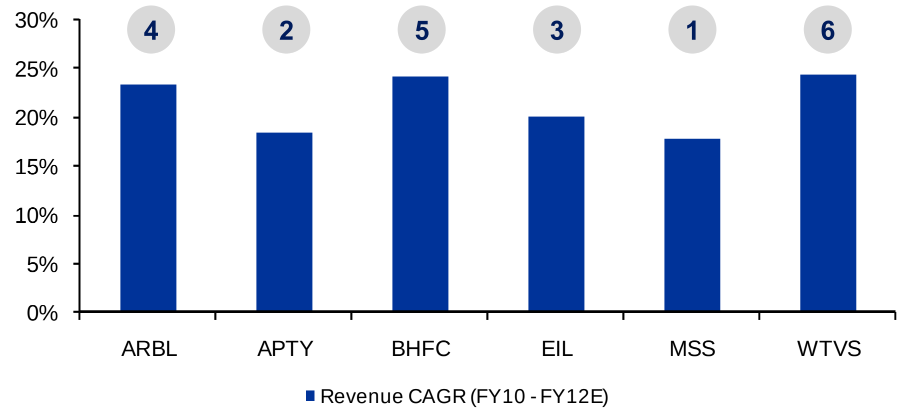
#12 Growth Ratios

EBITDA margin – EIL scores the highest, while MSSL the lowest



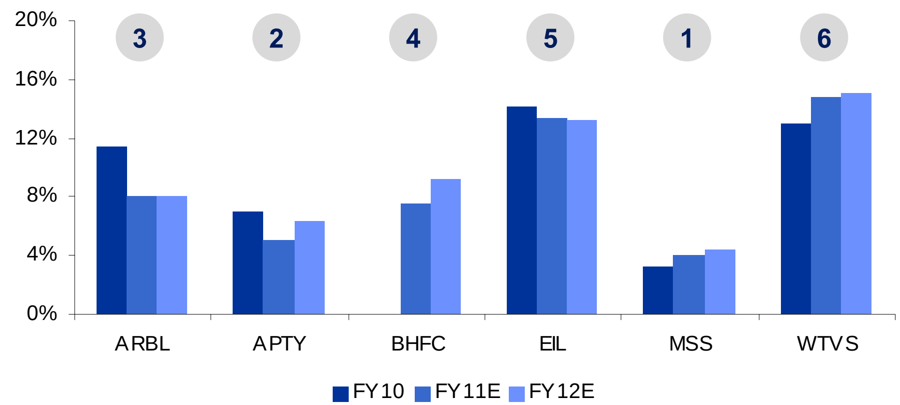
Source: Spark Capital, Company

Revenue CAGR (FY10 – FY12) - WTVS scores the highest, while MSSL the lowest



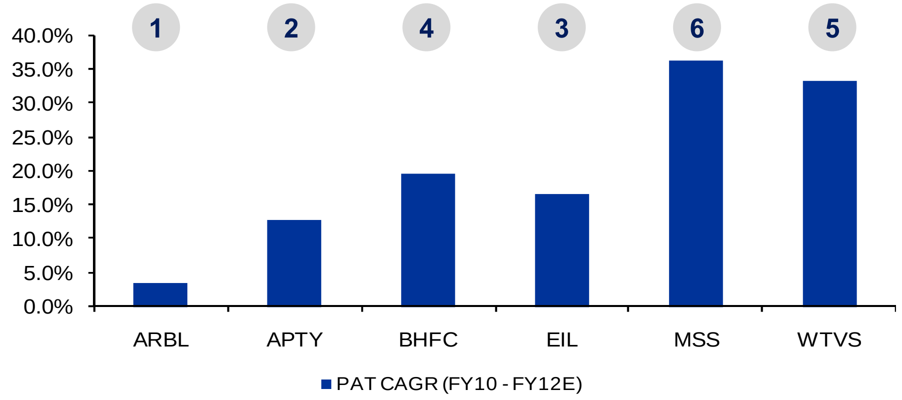
Source: Spark Capital, Company

PAT margin - WTVS scores the highest, while MSSL the lowest



Source: Spark Capital, Company

PAT CAGR (FY10 – FY12) - MSSL scores the highest, while ARBL the lowest

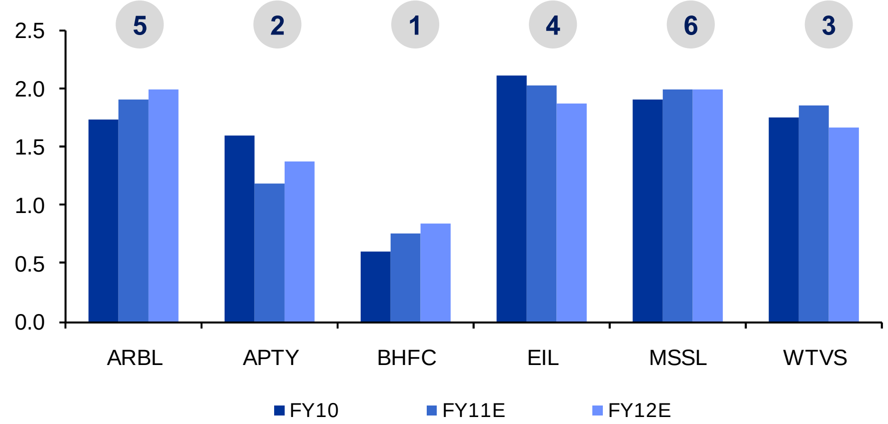


Source: Spark Capital, Company, Note: BHFC earnings CAGR for FY09-12

Automobile Components

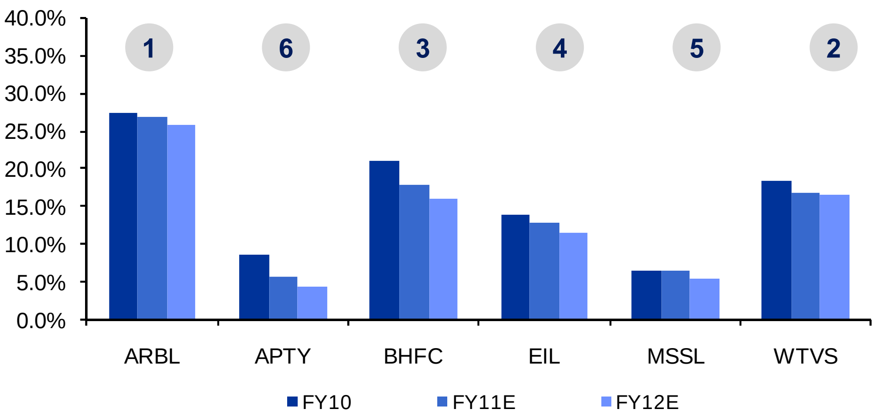
#13 Turnover Ratios

Total asset turnover (x) - MSSL scores the highest, while BHFC the lowest



Source: Spark Capital, Company

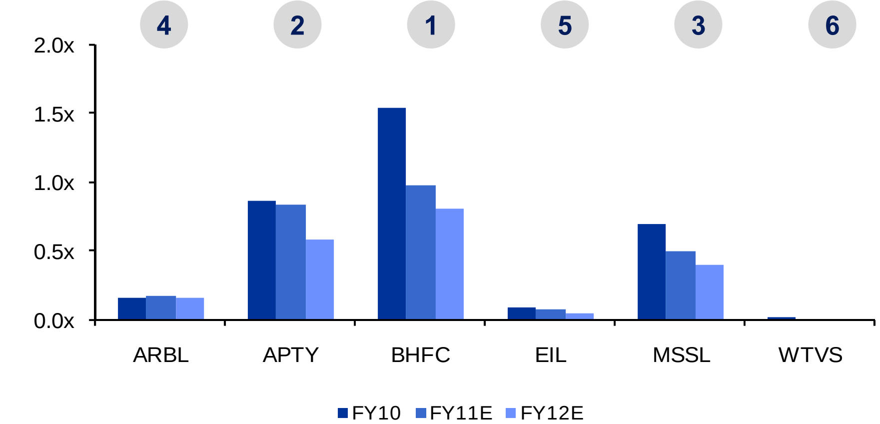
Working capital/sales - APTY scores the highest, while ARBL the lowest



Source: Spark Capital, Company

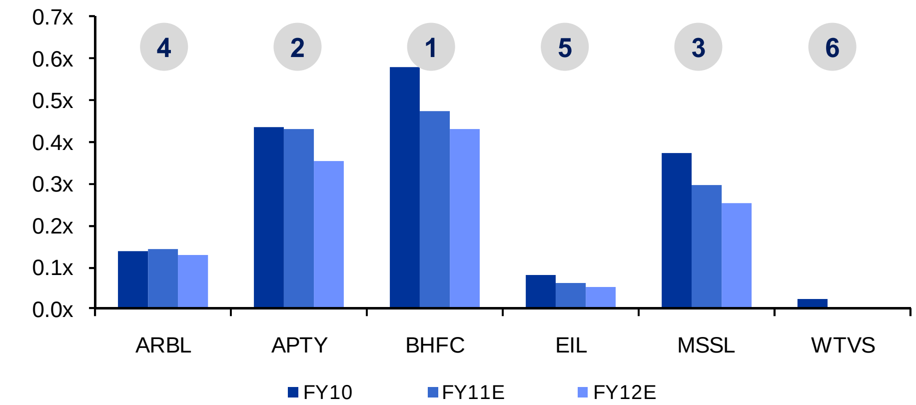
#14 Leverage Ratios

Debt / Equity - WTVS scores the highest, while BHFC the lowest



Source: Spark Capital, Company

Debt / Total assets - WTVS scores the highest, while BHFC the lowest



Source: Spark Capital, Company

Automobile Components

Growth without Fresh External Capital – Apollo Tyres and Exide Industries score high

CAPITAL EMPLOYED (Rs.)

ARBL	100
APTY	100
BHFC	100
EIL	100
MSSL	100
WTVS	100

TOTAL ASSET TURNOVER

REVENUE (Rs.)

ARBL	190
APTY	215
BHFC	111
EIL	218
MSSL	217
WTVS	221

BHFC: Capital intensive business with low utilisation rates

PAT MARGIN

PAT (Rs.)

ARBL	18
APTY	11
BHFC	4
EIL	23
MSSL	13
WTVS	25

EIL and WVTS: Highest EBITDA margin leading to higher PAT

OCF CONVERSION

OPERATING CASH FLOW (Rs.)

ARBL	20
APTY	26
BHFC	11
EIL	25
MSSL	17
WTVS	20

APTY and EIL: Efficient working capital management leading to higher OCF

OCF RE-DEPLOY MENT

Assuming no incremental external capital infusion, Apollo Tyres and Exide Industries are expected to post the highest earnings growth. (26% and 25% respectively)

Automobile Components

Strategic Positioning of ACMs in the entire Value Chain

Positioning the top ranking ACMs of our CSF matrix in the entire value chain; high CSF ranking on R&D, patents and criticality implies a **'system developer,'** while high ranking on replacement market, distribution network implies a **'component specialist within the consumable space'**

Integration, design & development contribution

Specialising in building the overall application beyond component level

Assembly, Integration and R&D contribution

Assembly scope of in-house and vendor sourced components

Scale, consistency and R&D contribution

In depth competence in individual parts and components

VALUE ADDITION

- **We like 'System Developers' for their bargaining power and high entry barrier (Fuel Injection: Bosch is the leader with Delphi being the second player; Braking System: WABCO-TVS is the leader with Knorr-Bremse being the second player)**
- **We like 'Component Specialists' with high exposure to the 'Replacement Market ' as profitability is higher and are non-cyclical in nature. Exide Industries and Apollo Tyres fall in this category**

Exide Industries, Apollo Tyres, Motherson Sumi, Amara Raja and Bharat Forge

Component specialist

Characteristics

- Can be TIER I , II and III
- Traditional supplier with little differentiation in products
- Components with superior R&D; critical standalone components
- Includes sub-segment having products which are **'consumables'**
- Consumables have high replacement market opportunity; require 'Brand' building and distribution network

Typical products

- Batteries, tyres
- Chassis components, Castings/forgings, fasteners

Module assembler

Characteristics

- TIER I supplier
- Assembly work involving integration of in-house and externally sourced components
- In-depth knowledge of components sourced from vendors

Typical products

- Door assembly
- Cockpit assembly
- Bumper-grill-lights assembly

Motherson Sumi

System developer

Characteristics

- TIER I supplier
- Design and development of entire systems with unique functionality
- Significant integration, assembly and high R&D contribution

Typical products

- Braking systems
- Navigation and locking systems
- Fuel injection system

Wabco-TVS

Automobile Components

Component Specialist (CS) vs. Module Assembler (MA) vs. System Developer (SD)

	COMPONENT SPECIALIST	MODULE ASSEMBLER	SYSTEM DEVELOPER
Definition	Specialist in individual components ranging from fasteners to bumpers to steering columns. Most Indian ACMs fall in this category. This segment can be further divided into commodity manufacturer and component manufacturer. Commodity manufacturer would typically involve manufacture of less critical parts like fasteners, plastic handles, door knobs etc. Component manufacturer would include more critical engine and chassis components.	Know-how in assembling a particular section of the automobile. Typically, a component specialist with additional knowledge in assembling various components which it may or may not manufacture. Eg: a dash board manufacturer may specialise in assembling all the components that go into the dashboard viz. switches, AC vents, driver information cluster etc. (cock-pit assembly). Currently very few Indian players exist in this category	Include technology leaders and manufacturers of complete systems in an automobile, viz. fuel injection system, braking systems. Involved with the OEM starting from the design of the vehicle. **Has own R&D and owns the design rights. Product in many cases are patented**. Players involved are generally global players having local partners.
Position in value chain	Tier I, II and III	Tier I	Tier I
Design and R&D	Manufacture based on **design and specifications provided by the OEM**. R&D involved in process, cost and product improvement. Some ACMs own the moulds and dies required in the production	Manufacture based on **design and specifications provided by the OEM.** R&D involved in integration, process, cost and product improvement.	**High R&D facilitating path breaking technology.** Eg. Superior fuel injection system for better fuel efficiency; introduction of Anti-lock braking system etc. In-house design activity
Growth Opportunity	Increasing scale thereby ensuring price leadership as players generally have multiple OEM supply; global sourcing opportunity, **after market opportunity leads to non-cyclical demand**	High opportunity for those who have **high assembly capability.** OEMs increasingly sourcing completely assembled sections of the vehicle as they want to reduce overheads and capital costs leading to higher content per vehicle	New technology to better cater to the needs of OEMs/end-customers and reducing costs could lead to high opportunity. Global OEMs setting-up shops in India is a key driver. **High entry-barries created by high R&D**
Specific capabilities required	Quality, scale, capabilities for concurrent component and product consistency. Leveraging design and engineering, prompt delivery (efficient supply chain)	Product development with sub-suppliers and OEMs. Synergies with sub-suppliers, efficient supply chain, integration of various components, liase with suppliers on-behalf of OEMs	**High R&D, design and integration capabilities. Most products are critical components** and hence superior quality is required
After market	**High after market opportunity for consumables like tyres, batteries**	Aftermarket opportunity for the components manufactured inhouse	Aftermarket opportunity for the individual parts rather than the complete system
Challenges	Strong cost pressures, more competition from global players when they enter Indian market. **No product differentiation** between competitors	Provide value addition apart from simple assembly as OEMs may not see significant contribution. Pricing contracts with sub-suppliers done directly by OEMs	Hign expenditure on R&D which might not result in successful product
Example	Sundaram Fasteners, Apollo Tyres, Amara Raja Batteries, Exide Industries, Bharat Forge, Motherson Sumi	Tata Auto Components (TACO), Behr Group, Mando India Limited, Motherson Sumi	Bosch India, Wabco-TVS

Company Section

Apollo Tyres

OUTPERFORM

Initiating Coverage

CMP	Rs. 86	Target	Rs. 114

Setting the wheel rolling

Apollo Tyres is one of the leading players in the domestic tyre market with a lion's share in the vital MHCV segment. While the current tight demand-supply equation translates into a favourable situation for all tyre manufacturers, we believe Apollo would be a key beneficiary as it is has one of the largest production capacities. Also, with increasing radial penetration in the MHCV segment, we expect Apollo to be the leader as it would constitute major proportion of the industry radial capacity by FY12. This coupled with strong replacement market exposure and relatively strong pricing power will help the company reduce margin impact in the event of rubber price inflation.

Production to grow > 40% yoy in FY12 after a flat FY11 due to plant lock-out for more than two months at Perambara (~33% of total capacity) facility (bias tyres). Apollo's total production is expected to average ~1,268 mt/day in FY12 after a sluggish FY11 at ~893 mt/day (19% FY10-FY12 CAGR). Growth in FY12 is primarily from incremental capacity of average ~380 mt/day from the Chennai radial plant, which is expected to exit FY12 with ~480 mt/day. In FY11 we expect flat overall volumes despite incremental production from Chennai plant (average ~110mt /day). The drop in bias production is expected to reduce MHCV bias tyres sales, offset by an increase in radial PV and MHCV tyres.

Radialisation and strong position in replacement market to aid growth: Radialisation levels in MHCVs are expected to reach 25-30% in the next three years from the current 10-12%. We expect Apollo Tyres to have the largest MHCV radial capacity by FY12 (average ~300 mt/day) and hence cater to a larger portion of the incremental radial demand. The company also has a large proportion of sales in replacement market (>70% of revenue) by way of its strong distribution network. In the replacement market, Apollo enjoys higher margins vs. OEMs. However given the steep yoy rise in rubber prices and the possibility of only a partial pass-through in replacement market, we expect EBITDA margins to slip from its peak of 14.5% in FY10 to 12.7% in FY12.

Overseas subsidiaries are starting to show good traction with European business benefiting from early winter tyre sales and low inventory levels. South African business, which currently is operating at an effective utilisation of ~80% is expected to improve with a pick-up in South African economy. Subsidiaries revenues are expected to grow ~6% CAGR from FY10 – FY12, with an EBITDA margin growth of 80bps in FY12 from 12.7% in FY10.

Valuation and Risks: We expect the company's earnings to grow at 13% CAGR for FY10-12 to Rs. 7.18bn on the back of 18% CAGR in revenues and a 180bps fall in EBITDA margins. We value the company at 8x P/E (in-line with historical multiple) on its consolidated FY12E EPS of Rs. 14.3. We initiate coverage on the stock with OUTPERFORM rating at a target price of Rs. 114. **Key Risks:** Steady rise in natural rubber prices, lesser than expected traction in transition to radialisation and slow ramp-up at Chennai plant.

Financial summary (consolidated)

YEAR	Revenues (Rs. mn)	EBITDA (Rs. mn)	Adj.PAT (Rs. mn)	EPS (Rs.)	P/E (x)	EV/EBITDA (x)
FY10	81,210	11,751	5,660	11.2	7.7	4.8
FY11E	88,265	10,543	4,469	8.9	9.7	5.9
FY12E	113,858	14,440	7,182	14.2	6.0	3.9

Date	Sep 20, 2010

Market data

SENSEX	19595
NIFTY	5885
Bloomberg	APTY IN
Reuters code	APLO.BO
Market cap	Rs. 43.4bn
Shares o/s	504mn
52-week High-Low	Rs. 88.8 – 39.0
3m Avg.Daily Vol	Rs. 457.3mn

Latest shareholding (%)

Promoters	39.7%
Institutions	42.7%
Public	17.6%

Stock Performance (in %)

	1m	3m	12m
Apollo Tyres	24.6	33.7	79.2
BSE Auto	4.5	14.0	40.5
Sensex	7.3	11.5	17.0

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Apollo Tyres

Company Overview

OUTPERFORM

CMP	Rs. 86	Target	Rs. 114

Company Background

- Leading tyre manufacturer with one of the largest CV tyre capacity; leading the MHCV segment with a market share of 28%; third largest PC tyre player with 19% market share
- High exposure to replacement market - MHCV (80%), LCV (60%) and PV (50%)
- Currently has four plants in India, with Chennai, recently coming online, exclusively catering to MHCV and PV radial tyres
- In April 2006, Apollo acquired Dunlop Tyres in South Africa and since then holds the rights of the brand ‘Dunlop’ in Africa. In May 2009, Apollo acquired Nederland based Vredestein Banden . Both the subsidiaries primarily cater to replacement market

Source: Spark Capital, Company

FY10 - Revenue break-up

India			
Segment	**Break-up**	**OEM**	**Replacement**
MHCV	64%	20%	80%
PV	13%	50%	50%
LCV	9%	40%	60%
Others	14%	-	-
Europe		**South Africa**	
Segment	**Share**	**Segment**	**Share**
PV	80%	PV	60%
Agri	15%	MHCV	30%
Bicycles	5%	Mining	10%

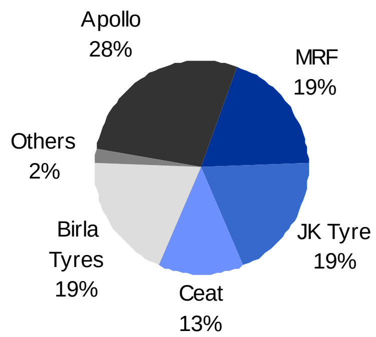
Source: Spark Capital, Company; Europe and South Africa primarily cater to replacement market

Spark Snapshot

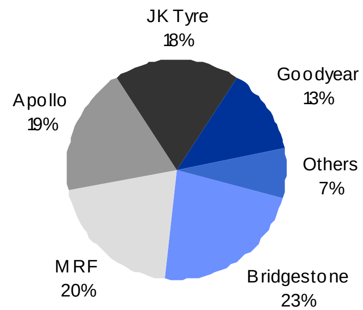
Position in value-chain	Component Specialist (Consumable)
CSF and financial rank	4
Key trends to watch	• Ramp-up at Chennai plant • Natural Rubber prices • Govt. policies on import of tyres and rubber • Radialisation of MHCVs • Pricing actions by tyre manufacturers in replacement market

Source: Spark Capital

Domestic MHCVs Market Share



Domestic PCs Market Share



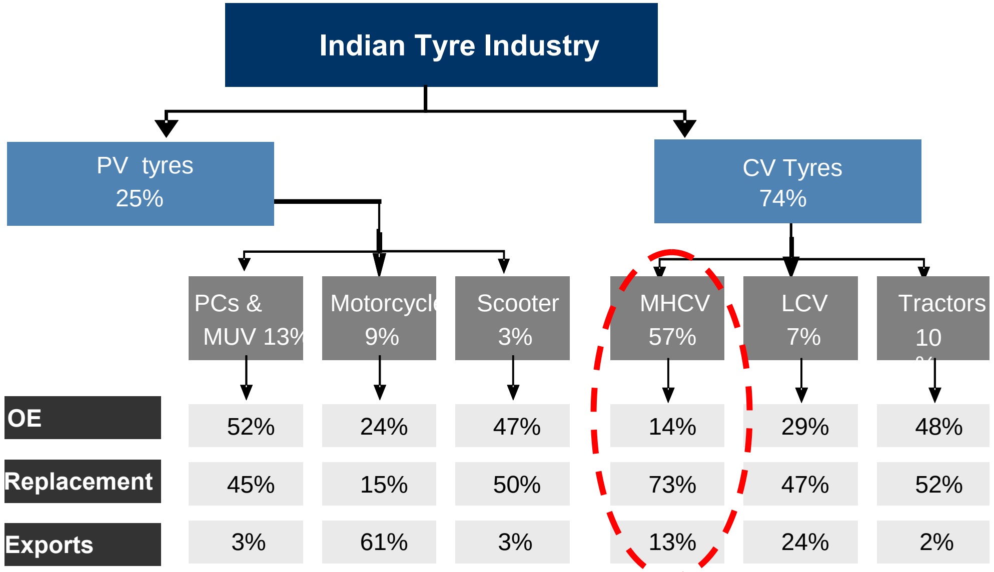
Source: Spark Capital, Company, Industry reports

Apollo Tyres

OUTPERFORM

Apollo Tyres to have one of the Largest Radial Capacities

CMP	Rs. 86	Target	Rs. 114



Remainder of 1% is accounted by 'Off the road tyres, animal drawn vehicles' and industrial tyres
Note : % denotes sales in tonnage in the respective category to total sales in tonnage

Source: CRISIL, Spark Capital

- Indian tyre industry valued at Rs. 290bn, installed capacity of ~87mn tyres operating at 98.5% utilisation
- Apollo Tyres has the largest market share in MHCV segment (28%); In FY10, 64% Apollo's of top-line accounted by MHCVs of which 80% came from aftermarket sales
- Apollo has one of the largest truck & bus (T&B) radial capacities. It is planning to increase T&B radial capacities to ~107,000 tonnes, post which it will be the largest player in the segment.
- On a average, green field expansion costs ~Rs. 70-75mn per tonne for CV and PC radial tyres and Rs. 35mn per tonne for CV bias tyres

Player-wise passenger car radial capacity

(000' tonnes)	FY10	FY11E	FY12E	FY13E
Apollo Tyres	25.0	56.2	64.3	64.3
JK Tyres	30.7	34.1	43.0	51.5
Ceat	20.4	31.8	31.8	31.8
Birla	2.0	27.2	34.0	40.8
Goodyear	13.6	13.6	13.6	13.6
MRF	32.0	37.4	42.9	42.9
Bridgestone	31.1	35.9	35.9	35.9
Industry	**175.1**	**236.3**	**265.4**	**280.7**

Source: CRISIL, Company, Spark Capital, media reports

Player-wise truck & bus radial capacity

(000' tonnes)	2009	2010	2011	2012
Apollo Tyres	10.4	23.4	107.6	107.6
JK Tyres	22.0	44.0	66.0	88.0
MRF	na	33.0	66.0	99.0
Ceat	11.6	11.6	26.1	40.6
Birla	-	43.6	71.3	71.3

Source: CRISIL, Company, Spark Capital, media reports, Apollo numbers are for FY10 onwards

Apollo Tyres is expected to have the largest radial tyre capacity for both PCs and MHCVs by FY12. We expect its MHCV radial dominance to lead to significant growth given the tight demand-supply situation and expected increase in radialisation

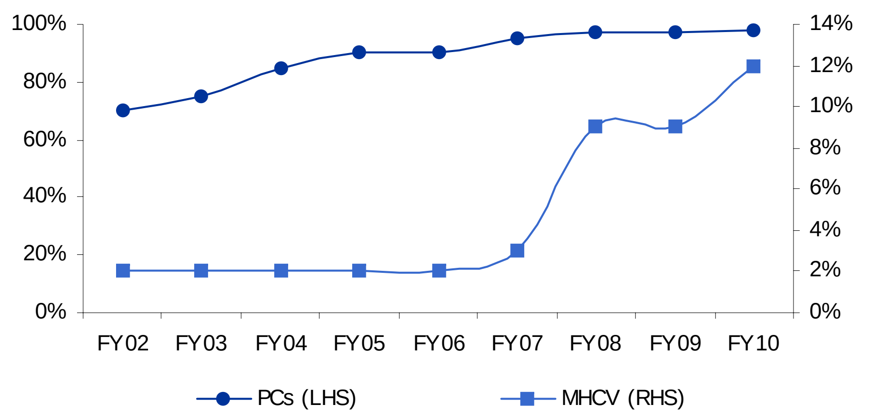
Apollo Tyres

OUTPERFORM

Radialisation – Initially driven by OEMs and Large Fleet Operators

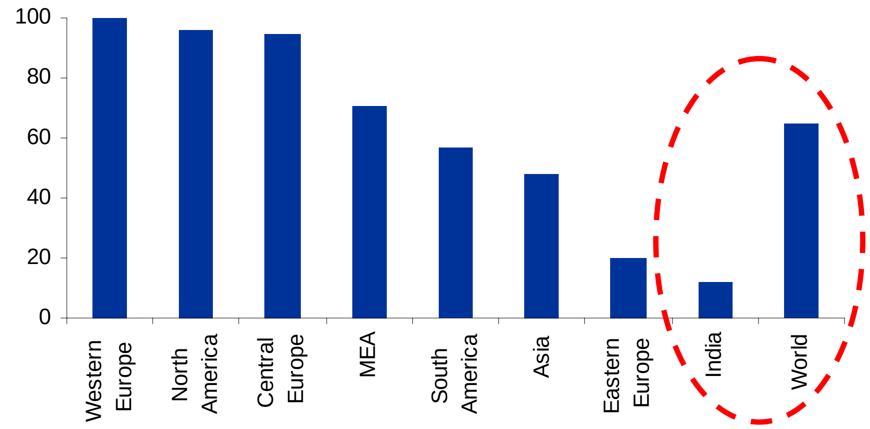
CMP	Rs. 86	Target	Rs. 114

PC & MHCV radialisation trend in India



Source: Spark Capital, Industry

MHCV radialisation in India vs. World



Source: Spark Capital, Industry

- **Cost benefit equation:** While radial tyres costs ~15% higher than the bias tyres they are however cost effective with longer life and aid to better fuel efficiency. On the downside, radials cannot withstand overloading and require better road conditions in order to remain cost effective vis-à-vis bias tyres. Hence, most CV OEMs and tyre manufacturers are in the process of educating fleet operators on the do's and don'ts of radials in order to make them beneficial.
- In our view, radialisation of MHCVs would be the next growth driver for tyre manufacturers as industry estimates suggest ~25-30% MHCV radialisation in the next two years vs. the current ~12%.
- **Drivers:** Although >75% of the MHCV tyres is accounted for by replacement market, we believe one of the key drivers for radialisation is the pace at which OEMs move to radial tyres. OEM's new platforms such as the Tata World truck and Ashok Leyland U-truck use radial tyres extensively. Our interactions suggests that there will be clear increase in off-take of radial tyres in future. Also, large-fleet operators, who generally do not overload trucks use radial tyres extensively and hence could set the pace for radialisation.
- In the replacement market, educating fleet operators on the total cost of ownership of a radial tyre would be a key driver.
- Currently most tyre manufacturers are in the process of setting up radial capacities for MHCVs, as there is a shortage of radial tyres. OEMs are resorting to imports in order to bridge the deficit. We expect this tight domestic demand-supply scenario to remain for the next 12-18 months until the new capacities come on stream

- **In the long term, we believe that the growth in radialisation would be driven by stricter regulation by the government on overloading of trucks and improvement in road infrastructure. The initial growth in radialisation to about 30% could be driven by OEMs moving to radials and education to fleet operators. However to further stimulate growth, government regulations would be the key.**

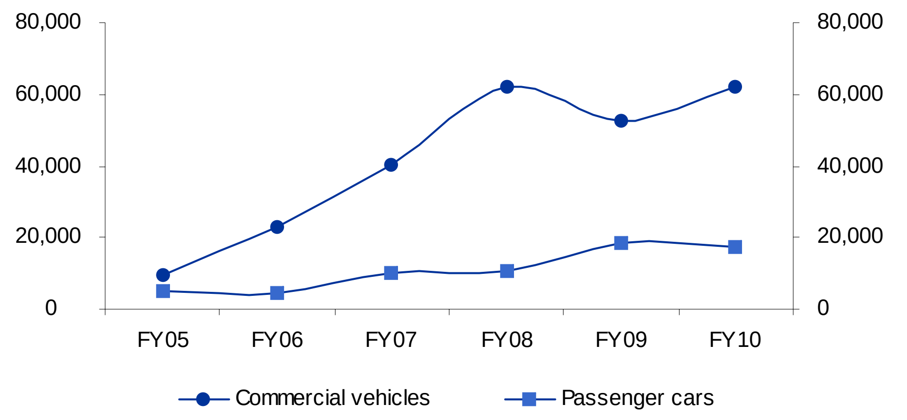
Apollo Tyres

OUTPERFORM

Imports filling-in for Shortage

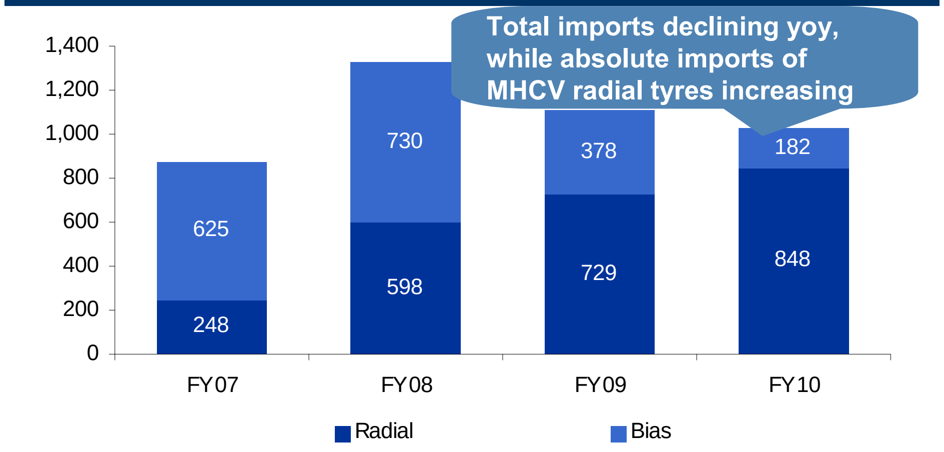
CMP	Rs. 86	Target	Rs. 114

Imports of tyres in tonnage terms



Source: Spark Capital, Industry

MHCV tyre imports



Source: Spark Capital, Industry, FY10 includes nine-month numbers from Apr - Dec

- **Chinese tyres constitute 6% of the market:** Currently there exists an anti-dumping duty on import of tyres from China and Thailand and despite this, the landed costs of these tyres are lesser than the domestic tyre prices. However quality of Chinese and Thai tyres is an issue as it would risk the OEMs reputation. Similarly, in the replacement market dealers are not able to provide any after sales service leading to skepticism to sell imported tyres as it may dent relationship with fleet operators.
- **OEMs however resort to import of radial tyres from global players** (such as Michelin) **to avoid quality issue**. Currently OEM imports are based on filling up the shortage rather than cost benefit of imported tyres. We expect this to continue in the near term, until domestic capacities come on-stream.
- **Cap on import of natural rubber:** Domestic production of natural rubber stood at 8.2mn tonnes in FY10, while consumption was at 9.3mn tonnes, with imports filling-in for the shortage. In the future, there could be a cap on import of natural rubber due to pending exports vis-à-vis the imports. In FY10, imports stood at 0.17mn tonnes against which it should have exported ~0.4mn tonnes of tyres, however exports stood at 0.17mn tonnes of tyres, leading to a cap on imports

Natural Rubber - demand supply (installed capacity)

(tonnes)	FY06	FY07	FY08	FY09	FY10	FY11 YTD
DEMAND						
Consumption	801,110	820,305	861,455	871,720	932,850	311,000
Exports	73,830	56,545	60,288	46,926	20,777	4,335
TOTAL	**874,940**	**876,850**	**921,743**	**918,646**	**953,627**	**315,335**
SUPPLY						
Production	802,625	852,895	825,345	864,500	829,125	222,600
Imports	45,286	89,699	87,415	78,429	170,719	46,524
TOTAL	**847,911**	**942,594**	**912,760**	**942,929**	**999,844**	**269,124**
Demand/ Supply	**103%**	**93%**	**101%**	**97%**	**95%**	**117%**

Source: Spark Capital, Industry

OUTPERFORM

1 – Chennai and Perambara Plant to drive FY12 Volume Growth

CMP	Rs. 86	Target	Rs. 114

Volumes to grow > 40% yoy in FY12 after a flat FY11

- Most tyre manufacturers are operating at peak capacity and this situation is expected to continue in the next 12 – 18 months given that new capacities are yet to come on-stream. In the MHCV segment, OEMs have resorted to import of tyres to bridge the shortage
- We expect Apollo to operate at peak capacities through FY12, given its strong OEM presence (PC and MHCV) and leadership position in MHCV replacement
- Apollo's total production is expected to average ~1,268 mt/day in FY12 (19% CAGR for FY10-12E) after a sluggish FY11 to ~893 mt/day against 898 mt/day in FY10. Growth in FY12 is expected from incremental production of average ~380 mt/day from the Chennai radial plant, which will exit FY12 with ~480 mt/day.
- Perambara plant lockout in June – August 2010 to result in ~85 mt/day fall in bias tyre production in FY11, however we expect flat overall volumes as production from Chennai plant will offset the decline from Perambara.

Drop in MHCV bias production is expected to be offset by increase in PV and MHCV radial capacity.

- Apollo's bias tyre production for MHCVs is expected to take a hit in FY11 as the Perambara plant primarily caters to this segment. We estimate MHCV bias tyre production to fall to ~490 mt/day in FY11 from an estimated ~545 mt/day in FY10. However, in FY12 we expect the production to be ~560 mt/day on the back of complete utilisation of Perambara plant and a slight increase in capacity at Kalamassery and Perambara
- PV capacity of ~125 mt/day in FY10 is expected to increase to 154 mt/day and MHCV radial capacity is expected to rise to 65 mt/day from ~30mt/day in FY10, both driven by Chennai plant. At its peak capacity the plant would have a product mix of 80% for M&HCVs and 20% for PVs

We expect total number of tyres (excluding tractors and others segment) to increase to ~12.4mn tyres (yoy 33%) and ~15.9mn tyres (yoy 28%) in FY11 and FY12 respectively. FY11 growth is solely on the back of PV tyres which is expected to grow to ~7.5mn units from ~4mn in FY10.

Domestic plant-wise production

Metric Tonnes/Day	FY10E	FY11E	FY12E
Limda	**455 mt/day**	**455 mt/day**	**455 mt/day**
Bias	330 mt/day	330 mt/day	330 mt/day
Radial	125 mt/day	125 mt/day	125 mt/day
Perambara	**320 mt/day**	**237 mt/day**	**330 mt/day**
Bias	320 mt/day	237 mt/day	330 mt/day
Radial	-	-	-
Kalamassery	**88 mt/day**	**94 mt/day**	**100 mt/day**
Bias	88 mt/day	94 mt/day	100 mt/day
Radial	-	-	-
Chennai	**35 mt/day**	**108 mt/day**	**383 mt/day**
Bias	-	-	-
Radial	35 mt/day	108 mt/day	383 mt/day
TOTAL DOMESTIC	**898 mt/day**	**893 mt/day**	**1268 mt/day**

Volume in tyres	FY10E	FY11E	FY12E
M&HCV tyres			
Bias	3,840,000	3,227,615	3,712,116
Radial	160,000	396,938	1,816,635
Total	**4,000,000**	**3,624,552**	**5,528,752**
LCV			
Bias	1,169,643	1,050,414	1,208,094
Radial	130,357	226,821	572,702
Total	**1,300,000**	**1,277,236**	**1,780,796**
PC			
Radial	4,000,000	7,504,400	8,561,683
Grand Total	**9,300,000**	**12,406,188**	**15,871,231**

Source: Spark Capital, Company

SPARK CAPITAL enhancing value

2 – Radialisation and Replacement to aid Volume Growth

CMP	Rs. 86	Target	Rs. 114

Radials to account for 33% of Apollo's MHCV volumes in FY12

- Radialisation in TBRs (Truck & Bus radials) is expected to rise to 25 – 30% by FY12 from about 10-12% in FY10. We believe Apollo would be a key beneficiary of this increase given that it would have the highest TBR capacity in the industry by FY12.
- Given the Chennai radial capacity coming on-line and a majority of the capacity being utilised for MHCV tyres, we expect proportion of radials production to total MHCV tyres for Apollo to increase to 11% and 33% in FY11 and FY12, from ~4% in FY10.

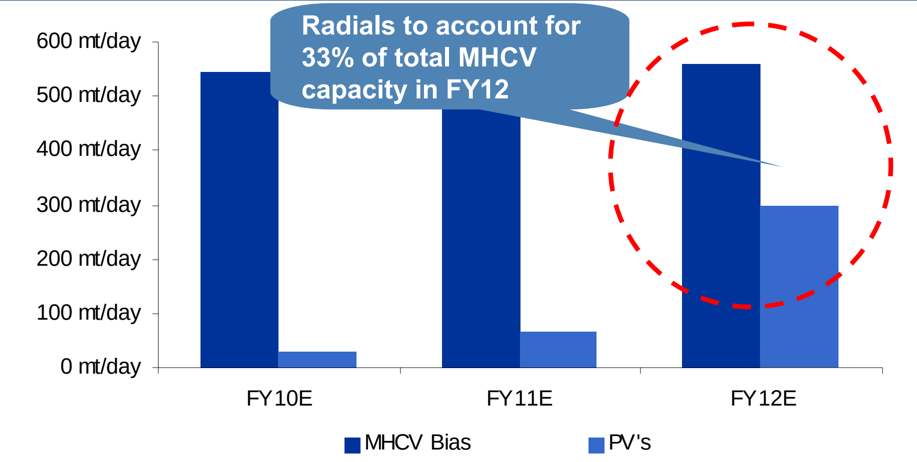
PV tyres (radials) production to grow 42% from FY10 to FY12

- Chennai plant is expected to boost PV radial production by 42% to ~180 mt/day in FY12 from about ~125 mt/day in FY10
- Apollo's PV segment caters equally to OEMs and replacement market. Industry reports suggest that volume growth in PV tyres is expected to be about 13-14% CAGR over the next five years for OEM, replacement and exports.

High exposure to replacement market is a positive

- Apollo's high exposure to replacement market ensures stable volume growth despite volatility in OEM offtake (~70% of revenues from replacement market)
- The company has better pricing power in replacement market as price increases with OEMs require detailed negotiations which may or may not fructify. Moreover, the company earns much higher margins in replacement market – highest in PV replacement
- Focused on increasing its distribution network, currently at 4,000 dealers and 150 sales offices.
- Chinese and Thai tyres are also available in the replacement market and some fleet operators opt for these imported tyres as they are cheaper. However, due to quality issues and unavailability of after sales service, dealers are increasingly wary of selling imported tyres as it spoils the dealers relationship with the fleet operators.

Apollo Tyres MHCV radial vs. bias production



Source: Spark Capital, Company

Industry tonnage growth across end-markets	FY09	FY10
Overall tyre tonnage	-0.10%	18.50%
OEM tonnage	-14.30%	30.10%
Replacement tonnage	9.40%	17.70%
Exports tonnage	-14.30%	2.80%

Replacement demand remained positive despite a 14% drop in OEM tonnage in FY09. Apollo's large exposure to replacement market (MHCVs 80% and PVs 50%) would shield the company's volume growth even in the event of a weak OEM demand scenario

Source: Spark Capital, Industry

OUTPERFORM

CMP	Rs. 86	Target	Rs. 114

3 – Margins to Slip from its Peak Levels in FY10

Natural rubber price inflation to pressurize margins

- Domestic natural rubber production has fallen short of demand, primarily from tyre manufacturers, leading to a very tight demand-supply equation, translating into high domestic prices.
- Natural rubber cost for Apollo was at Rs. 165/kg in 1QFY11, up ~70% yoy and 18% qoq. Industry estimates suggests that natural rubber prices could hit a peak of ~Rs. 180/kg during FY11, and taper off back to 1QFY11 levels. This would imply an average price of Rs. 171/kg for FY11, more than 50% increase vs. FY10 average of Rs. 113/kg
- Industry average suggest that natural rubber costs account for ~52% of total raw material costs for tyre manufacturers. **A sensitivity analysis for Apollo indicates that a 5% increase in natural rubber prices would lead to an EBITDA margin fall of ~160 – 170bps, assuming no pass-through to end customer.**

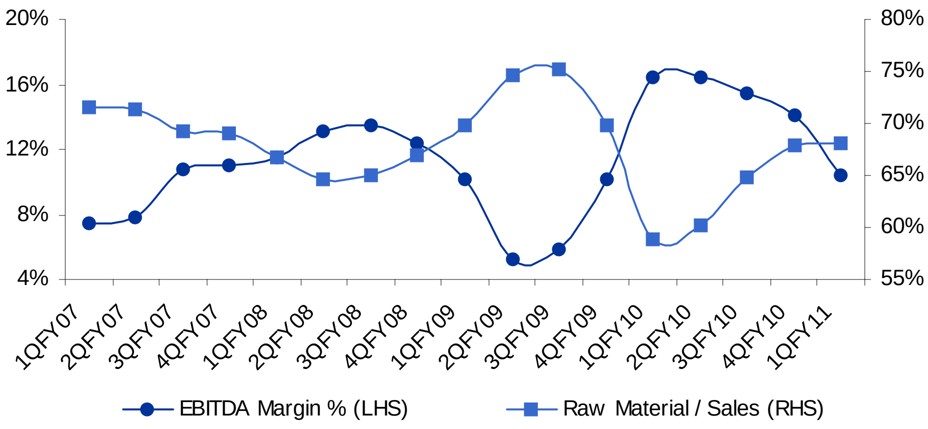
Pricing actions to help partially offset rubber price hike

- Being a price maker, Apollo has hiked prices in the replacement market. In the May – July 2010 period, the company raised tyre prices by ~10% and in April by ~5%, followed by another 5% for PC and 7% for MHCV tyres in July.
- Though the pricing actions have only been partial, the price hikes have ensured lesser impact on margins
- Capacity additions by major players would lead to intense competition and hence the pricing environment might not be as conducive as it is currently

Policy moves on rubber imports could provide relief

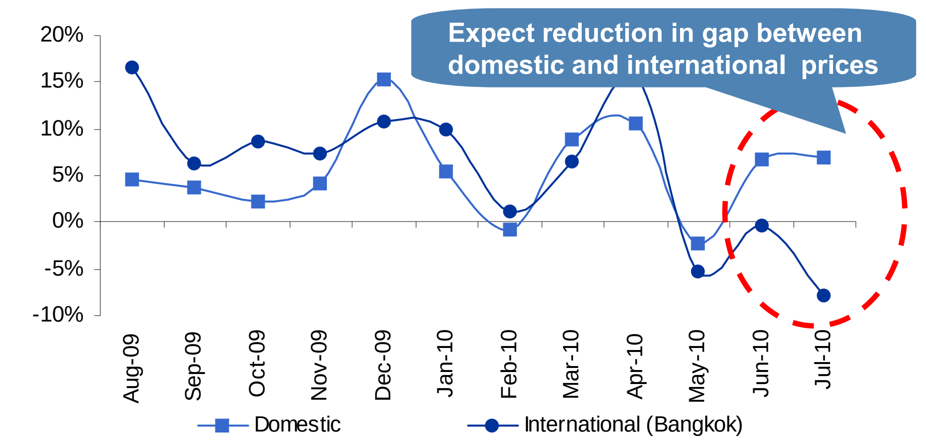
- Recent proposal by the government of setting a cap of ~Rs. 21/kg or 20%, which ever is lower on rubber imports is a welcome relief for tyre manufacturers. The proposal has already had an impact on domestic natural rubber prices, thereby leading to a reduction in the gap between domestic and international prices. The proposal is yet to receive cabinet approval and is being apposed by farmers across Kerala (92% of domestic production is from Kerala). In the event of the proposal being accepted, we could see domestic prices slip closer to international price, which is currently at ~Rs. 155 / kg vs. domestic prices of ~Rs. 170 / kg.

Apollo Tyres – Raw material costs and EBITDA as a % of revenue



Source: Spark Capital, Company

MoM change in natural rubber prices



Source: Spark Capital, Industry

4 – Overseas Subsidiaries showing Good Traction

CMP	Rs. 86	Target	Rs. 114

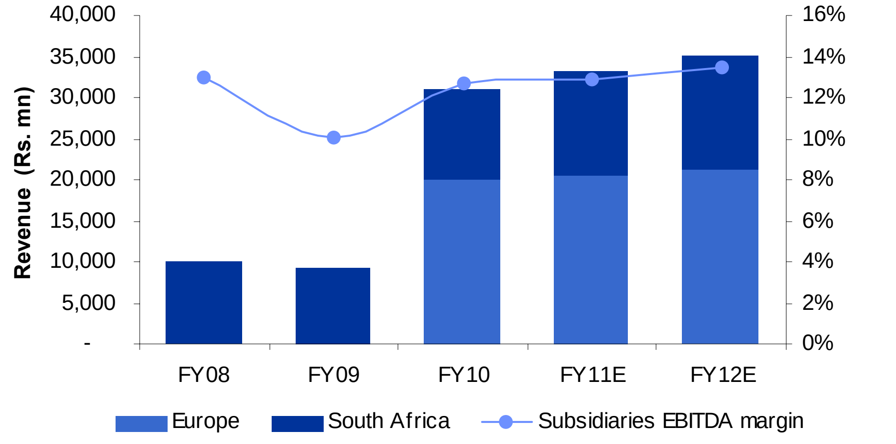
Europe business showing better than expected growth

- Apollo Vredestein (AVBV) has a plant capacity of 150 mt/day primarily catering to (80%) PCs and remaining to agricultural segment and high performance bicycle tyres.
- Strong player in the niche winter tyres segment and the company indicated a strong growth in winter tyres during 1QFY11 on the back of early winter orders and low inventory levels at dealers end.
- The company is operating at peak capacities and plans to increase capacities by ~10%, which would be available next year.
- Raw material costs at AVBV are the least for the group – an average ~30% of sales. AVBV hence makes the highest EBITDA margin for the company – 1QFY11 margin was at 16.5%. Also, AVBV uses lower proportion of natural rubber as winter tyres require larger amount of synthetic rubber. Hence the huge spurt in natural rubber prices affect AVBV the least among Apollo's operations.
- Growth for the company would primarily depend on the extent and duration of the winter season, as the market is typically niche and is not price sensitive. The company has also taken a price hike of 4% in May and further pricing actions could be seen if raw materials prices continue to harden.

South Africa business beginning to show signs of improvement

- Plant capacity of 175 mt/day catering to PVs and light vans (60%), trucks (30%) and the mining segment (10%)
- A port strike during 4QFY10, affected the availability of raw materials during 1QFY11 as raw material was diverted during the strike and hence availability was affected even after the strike was called off.
- Ignoring the plant shut down due to the strike, the business operated at ~80% utilisation during 1QFY11. We expect volumes to grow based on the economic recovery in South Africa.
- The company increased prices by 10% in May due to increase in raw material price. Imports from China account for a large portion of the market, however, the weak currency makes the imports costlier thereby benefiting domestic tyre manufacturers.
- There is currently no clarity on the recent development of the fine (10% of revenues) levied by the South African competition commission due to cartel formation during 2007-2008. The company has appealed against the ruling and our interactions with management suggested that the timelines are not clear.

Subsidiary business (Revenue & EBITDA margin)



Source: Spark Capital, Company

South Africa market share (FY09)	MHCV	LCV	PC
Apollo	19%	16%	22%
Third party imports	30%	15%	26%
Other domestc players	51%	69%	52%

Source: Spark Capital, Industry

OUTPERFORM

Financial Analysis

CMP	Rs. 86	Target	Rs. 114

Topline growth not to percolate to bottomline

- We expect standalone topline to grow at 25% CAGR between FY10 – FY12, offset by a slower growth in subsidiary companies (6.3% CAGR) resulting in a consolidated topline CAGR of 18.4% to Rs. 113.8bn in FY12
- However the topline growth would not percolate to the bottomline due to the expected EBITDA margin fall of 250bps to 11.9% in FY11 followed by an improvement of 70bps in FY12.
- Increase in leverage would lead to a significant drop in PAT margin to 5.1% and 6.3% in FY11 and FY12 respectively at consolidated level. Standalone PAT margins are expected to come in at 4.7% in FY11 and 5.9% in FY12

Capex and leverage on the rise

- Apollo's planned expansion of Chennai plant in FY11 is expect to result in a capex of ~Rs.10bn taking the total capex to ~Rs. 12.7bn for domestic operations. At a consolidated level capex would be ~Rs. 14.1bn including the ~Rs. 1bn investment in Europe
- On the back of this Capex increase, gross debt is expected to increase to Rs. 19.8bn in FY11 at the consolidated level, driven primarily by standalone debt increase of Rs. 4bn
- Net debt in FY11 of Rs. 18bn is expected to push net interest expense up to Rs. 1.5bn at the consolidated level
- Capex is expected to result in negative free cash flow generation of ~Rs. 4bn in FY11 before moving back into the positive territory in FY12
- D/E ratio to fall by FY12 to ~0.6x from 0.9x levels in FY10
- We expect RoACE to dip to ~13% in FY11 on the back of lower utilisation rates and higher capex (funded by debt). However, from FY12 (~16% RoACE) we expect the situation to turn around with higher utilisation of new and existing plant and completion of capex plans

Standalone and subsidiary revenue & margin movement

Standalone (Rs. mn)	FY09	FY10	FY11E	FY12E
Standalone revenue	40,716	50,368	55,379	79,021
Raw material % of revenue	72%	63%	67%	66%
Standalone EBITDA margin %	8.0%	15.6%	11.4%	12.3%
PAT margin %	2.7%	8.2%	4.7%	5.9%
Subsidiary (Rs. mn)	**FY09**	**FY10**	**FY11E**	**FY12E**
Subsidiary revenue	9,136	30,842	32,886	34,837
Raw material % of revenue	51%	46%	45%	43%
Subsidiary EBITDA %	10.0%	12.7%	12.9%	13.5%
PAT margin %	3.4%	7.7%	5.5%	6.3%

Source: Spark Capital, Company

Cash flow and debt movement

Consolidated (Rs. mn)	FY09	FY10	FY11E	FY12E
Operating Cash Flow	4,250	13,125	10,071	11,039
Capex	(5,019)	(10,444)	(14,111)	(4,326)
Free Cash Flow	(769)	2,681	(4,040)	6,713
Net Debt	5,286	13,582	18,063	11,790
D/E	0.7x	0.9x	0.8x	0.6x
Standalone (Rs. mn)	**FY09**	**FY10**	**FY11E**	**FY12E**
Operating Cash Flow	3,246	7,027	4,595	7,252
Capex	(4,663)	(8,585)	(12,725)	(3,943)
Free Cash Flow	(1,417)	(1,559)	(8,130)	3,309
Net Debt	3,549	8,741	17,312	14,444
D/E	0.5x	0.7x	0.8x	0.6x

Source: Spark Capital, Company

Apollo Tyres

OUTPERFORM

Valuations & Risk

CMP	Rs. 86	Target	Rs. 114

Valuations remain at historical levels

- We expect earnings to record a CAGR of ~13% on the back of an ~18% topline CAGR and margins declining to 12.7% in FY12 from FY10 peak levels of 14.5%
- Our consolidated EPS stands at Rs. 8.9 and Rs. 14.2 for FY11 and FY12 respectively.
- We value the stock at a P/E multiple of 8x (last four year average consensus forward P/E of 7.9x) on FY12 EPS, resulting in a target price of Rs. 114, with an OUTPERFORM rating.
- Our multiple is based on the fact that historically tyre companies have been more of a 'play' on rubber prices, however we see a structural shift in the Indian tyre industry by way of radialisation in CV segment. On the back of this, Apollo is expected to be the pioneer as it would have the largest radial capacity with maximum exposure to CVs and the lucrative replacement segment.

Risks to our thesis

- Rubber prices continue to show a sharp rise and competition could lead to reduced pricing power, hence leading to huge margin impact.
- Radialisation levels could continue to remain subdued due to lower awareness among fleet operators.
- Government policies on import of tyres could be lenient leading to flooding of Chinese and Thai tyres in domestic market. On the other hand, import of rubber could be capped with a higher duty.
- Delay in ramp-up at Chennai plant could lead to Apollo Tyres not being able to address the radial demand, hence leading to drop in market share and topline.

Apollo historical forward consensus P/E

Source: Spark Capital, Bloomberg

Apollo forward consensus P/E band and trading days

Fwd P/E band	Days traded	% of Total days
3x - 5x	128	7.7%
6x	135	8.1%
7x	368	22.0%
8x	334	20.0%
9x	182	10.9%
10x	154	9.2%
11x	224	13.4%
12x	121	7.2%
13x - 15x	24	1.4%
Total days	1670	100.0%

Source: Spark Capital, Bloomberg

SPARK CAPITAL enhancing value

Apollo Tyres

Consolidated Financial Summary

OUTPERFORM

CMP	Rs. 86	Target	Rs. 114

Abridged Financial Statements				
Rs. mn	FY09	FY10	FY11E	FY12E
Profit & Loss				
Revenues	49,852	81,210	88,265	113,858
Manufacturing & Other Expenses	45,679	69,459	77,722	99,419
EBITDA	4,173	11,751	10,543	14,440
Depreciation	1,285	2,542	2,991	3,648
EBIT	2,887	9,209	7,551	10,791
Net Interest Exp / (inc)	973	1,154	1,490	1,430
Profit Before Tax	2,134	8,266	6,320	9,868
Tax	742	2,607	1,851	2,686
Adj. Net Profit	1,391	5,660	4,469	7,182
Balance Sheet (Rs. mn)				
Shareholders Equity	13,496	19,678	23,707	30,448
Loan funds	8,907	17,072	19,872	17,872
SOURCES OF FUNDS	**24,345**	**39,264**	**46,093**	**50,834**
Net block	14,019	24,425	35,556	37,600
Investments	48	59	59	59
Capital WIP	2,814	5,360	5,349	3,982
Current assets, loans & advances	14,228	23,704	18,991	25,280
Current liabilities & provisions	6,999	15,459	15,038	17,262
Net Current Assets	7,228	8,245	3,954	8,018
APPLICATION OF FUNDS	**24,345**	**39,264**	**46,093**	**50,834**
Cash Flows (Rs. mn)				
Cash flows from operations	4,250	13,125	9,528	10,710
Capex	5,019	10,444	14,111	4,326
Free cashflow	(769)	2,681	(4,583)	6,384
Cash flows from investments	(5,221)	(12,142)	(14,111)	(4,326)
Cash flows from financing	671	(801)	2,359	(2,441)
Cash generated during the year	251	226	(2,224)	3,943

Key metrics				
	FY09	FY10	FY11E	FY12E
Growth ratios				
Revenues	6.2%	62.9%	8.7%	29.0%
EBITDA	-29.9%	181.6%	-10.3%	37.0%
PAT	-48.4%	306.7%	-21.0%	60.7%
Margins				
EBITDA	8.4%	14.5%	11.9%	12.7%
EBIT	5.8%	11.3%	8.6%	9.5%
PAT	2.8%	7.0%	5.1%	6.3%
Leverage & WC ratios				
Debt to equity (x)	0.7	0.9	0.8	0.6
Current ratio (x)	2.0	1.5	1.3	1.5
Debtor days (Sales)	16	35	25	20
Inventory days (COGS)	68	79	71	67
Creditor Days (COGS)	59	95	80	72
Performance & turnover ratios				
RoACE	8.5%	19.8%	12.5%	16.2%
RoAE	11.0%	34.1%	20.6%	26.5%
Total asset turnover (x)	1.7	1.6	1.2	1.4
Fixed asset turnover (x)	2.4	2.1	1.4	1.6
Valuation metrics				
Current price (Rs.)		86.0		
Shares outstanding (mn)	504	504	504	504
Market capitalisation (Rs. mn)	43,352	43,352	43,352	43,352
Enterprise value (Rs. mn)	48,638	56,933	61,957	56,014
Price-earnings multiple (x)	31.2	7.7	9.7	6.0
EV/EBIDTA (x)	11.7	4.8	5.9	3.9
Adj. Per-share earnings (Rs.)	2.8	11.2	8.9	14.2
Dividend yield (%)	0.5%	0.9%	0.9%	0.9%

WABCO TVS

OUTPERFORM

Rating: ◄►	Target price: ▲	EPS: ▲	Company Update	CMP	Rs. 1,109	Target	Rs.1,326

No speed ‘brake’er ahead

Date	Sep 20, 2010

A system developer, with a dominant 80% in domestic market in braking systems, WABCO TVS is well positioned for continued superior operational performance in future backed by expected strong domestic CV and exports growth. The company’s high R&D capabilities leads to significant bargaining power and dominance in the braking systems business. Moreover, lean manufacturing system enables continuous cost reduction leading to larger share of parent company’s manufacturing moving to WABCO-TVS.

Strong domestic growth on the back of buoyancy in CV market (20% and 15% for FY11E and FY12E respectively) due to its undisputed domination in the braking systems segment. We also expect content per vehicle to increase on the back of new product introduction; test launch of Optidrive (AMT) has already begun for Ashok Leyland.

Export opportunity on the rise as parent firm’s (WABCO) commitment to India is only on the rise with slew of new products active in various stages of R&D. Moreover, WABCO’s keenness is reflective with its recent decision to shift its South American business (6% of global sales) to India, valued at ~$90mn over a period of 4-5 years. The current exports of Rs. 0.55bn (FY10) is expected to grow at 47% CAGR for FY10-12E to Rs. 1.2bn on the back of new export opportunities in the form of Clutch Servo, Brake chambers, Double Diaphragm spring brake adjuster etc. This growth would be driven by fresh capex of Rs. 100-150mn in the second phase of expansion (Phase I capacity at full utilisation).

Competition exist, but not intense: While competition is expected to increase in the domestic market from Knorr-Bremse; we do not expect significant market share pressure in the next two years. However, in the long-term we foresee OEMs to move to dual sourcing of components leading to market share pressure for WABCO-TVS. Moreover, global OEMs setting up shop in India will benefit Knorr-Bremse due to its dominant position globally.

Return ratios and free-cash flow to remain healthy: Technology-based product portfolio with near monopoly resulting in higher bargaining power has been the prime reason for healthy margins and return ratios (EBITDA margins at 22% and RoCE 30% in FY10) over the years. At an expected strong earnings growth of 33% CAGR for FY10-12E to Rs. 1.39bn with limited capex plans, we expect positive FCF to continue. We expect RoE and RoCE to be at 31% and 29% respectively for FY12E.

Valuations and Risks: We value the company using 18x P/E multiple (10% discount to 20x FY12E consensus multiple for Bosch India due to difference in scale and comparative historical track record) on its FY12E EPS of Rs. 73.7 resulting in a target price of Rs. 1,326 with an OUTPERFORM rating. **Key Risk:** 1) Domestic and global CV slowdown.

Market data	
SENSEX	19595
NIFTY	5885
Bloomberg	WTVS IN
Reuters code	WABC.BO
Market cap	Rs. 21.1bn
Shares o/s	19mn
52-week High-Low	Rs. 1316.8–326.0
3m Avg.Daily Vol	Rs. 27.6mn

Latest shareholding (%)	
Promoters	75.00
Institutions	11.98
Public	13.02

Stock Performance (in %)

	1m	3m	12m
WABCO-TVS	12.9	46.5	216.7
BSE Auto	4.5	14.0	40.5
Sensex	7.3	11.5	17.0

Financial summary

YEAR	Revenues (Rs.mn)	EBITDA (Rs. mn)	PAT (Rs. mn)	EPS (Rs.)	P/E (x)	EV/EBITDA (x)
FY10	6,021	1,283	786	41.4	26.8	16.4
FY11E	7,795	1,667	1,153	60.8	18.2	12.1
FY12E	9,261	1,981	1,398	73.7	15.1	9.6

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WABCO TVS

OUTPERFORM

Company Overview

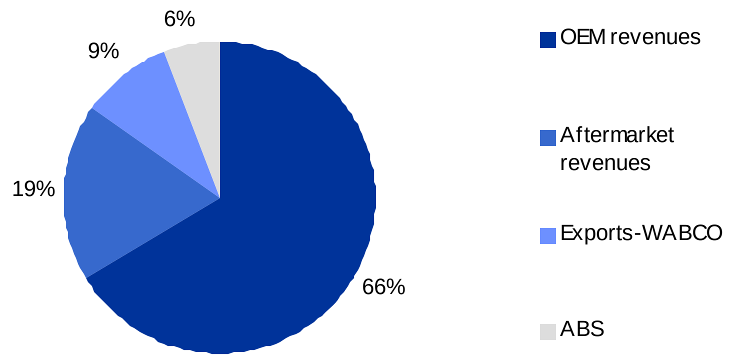
CMP	Rs. 1,109	Target	Rs.1,326

WABCO (parent), a technology oriented company- committed to India

- Possess design rights of its various product portfolios – pioneer in breakthrough electronic, mechanical and mechatronic technologies for braking, stability and transmission auto systems to CVs, bus segment etc.
- WABCO was granted nearly 166 new patents in 2009
- WABCO has strategic objective to outsource 43% of its sourcing requirements to low-cost countries such as India and China
- Very recently WABCO management highlighted that its South American operations be transferred to India. Nearly 6% of global sales is South American operations, valued at USD ~90 mn
- Currently the new products launched in the last three years from WABCO TVS constitute 30% of its sales

Source: Spark Capital, Company

Revenue mix (%) in FY10



Source: Spark Capital. Company

Spark Snapshot

Position in value chain	System developer	
CSF and financial rank	1	
Key trends to watch	• Domestic CV growth	
	• Exports momentum	
	• Competition from Knorr-Bremse	
	• Raw material price escalation	

Source: Spark Capital, Company

WABCO TVS - Future plan of action

- Introduction of Electronically controlled air braking systems for Indian markets
- Value engineered spring brake actuator for Indian market
- Clutch servo for Russian customer and clutch master cylinder for US/Brazilian market
- Fourteen valve devices for North American OEMs
- Door control systems for European market – door cylinder, solenoid control valve and emergency valve.

Source: Company

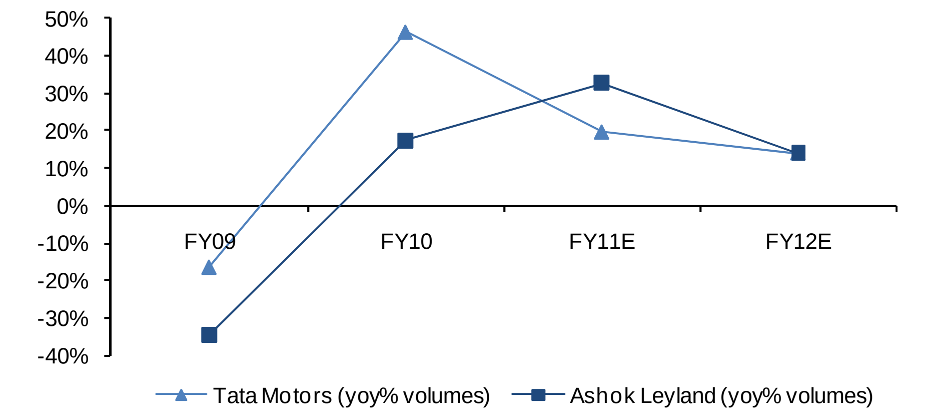
Domestic Sales and Exports on the Growth Trajectory

CMP	Rs. 1,109	Target	Rs.1,326

Strong volume growth driven by domestic CV growth and increasing content per vehicle

- We expect air brake volumes (0.41mn in FY11 and 0.46mn in FY12) to grow by 16% CAGR for FY10-12E on the back of 17% CAGR in domestic CV growth for the same period.
- The growth opportunity would also be driven by increase in content per vehicle in the form of Automated Manual transmission (AMT), Electronically controlled air suspension (ECAS), Clutch actuation systems.
- On the back of higher tractor-trailor and buses sales, we expect ABS volumes to grow by ~14% CAGR for FY10-12E (13,188 kits in FY11E and 14,770 kits in FY12E).
- Current R&D expense as a % of sales stands at 1.6%, by far the highest in our coverage. We expect it to continue to remain at current levels given new product introduction.

Expected strong growth for WABCO TVS's key clients

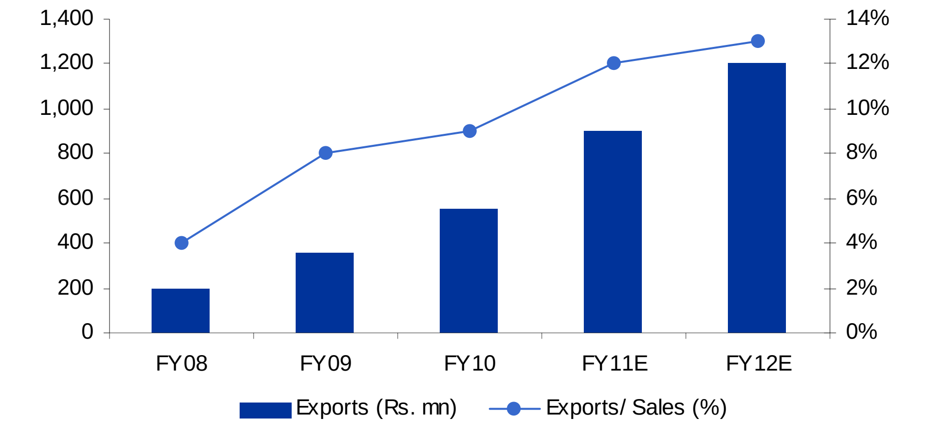


Source: Spark Capital, Company

Exports – strong traction ahead

- Exports growth opportunities are essentially are available through productionising transfer projects and technology transfer. WABCO management highlighted that its South American operations would be transferred to India. Nearly 6% of global sales is South American operations, valued at USD ~90 mn.
- WABCO-TVS is a sourcing hub for WABCO's global operations, as the company provides machining facilities of metals, casting and electrical motors that are used in factories globally to manufacture the end product
- New products for exports markets include DDSBA, D2 governor valve, valves, new Clutch servo for US and European markets, high pressure compressors. Phase 2 expansion is on the anvil for new export opportunities. The likely capex for the same is expected to be Rs. 100-150mn
- Expect strong traction in exports as some of the future plan of exports plan materializes. We expect total exports to grow by 47% CAGR for FY10-12E to Rs. 1.2bn (FY11E at Rs 0.9bn).

Strong traction in exports



Source: Spark Capital, Company

OUTPERFORM

After-market to aid growth, Competition exists; but not intense

CMP	Rs. 1,109	Target	Rs.1,326

Competition exists; but not intense

Our industry interaction suggested that the existing and new OEMs are looking for dual sourcing of components and thus expect increased competition for WABCO-TVS from Knorr-bremse, who is globally the largest. WABCO TVS supplies 80% of Tata Motor's requirement and a sole supplier to Ashok Leyland as on FY10.

Currently, Knorr-bremse with its capacity of 100,000 sets caters to 20% of Tata Motor's requirement and our interaction suggested that they expect the same to reach to 50% in the next three-four years. The company, along with WABCO-TVS, will also supply complete braking system for Tata Motor's World truck. For this purpose, Knorr-bremse has been working on localization of 350 components for the World truck over the last two years.

Similarly, Knorr-bremse has started its supplies to Ashok Leyland from July 2010 and aims to have nearly 40% share in the next three-four years. It has commissioned its supply of compressors for the new generation of Ashok Leyland engines. Component supply for some platform of Mahindra Navistar is also expected from Knorr-bremse.

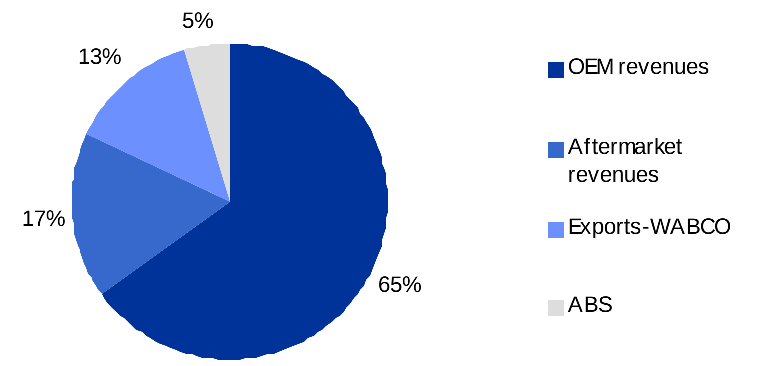
Also, new foreign OEMs have expressed their plans to dual source components. For instance, Daimler who is setting up CV capacity in India may have higher procurement orders from Knorr-bremse India, as its parent is currently associated with Daimler's global requirement.

We believe competition for WABCO exist but not very intense to dilute earnings growth in the next two years. However, foresee market share pressure in the next three-four years with existing OEMs intending to have dual sourcing. In our view, new OEMs having dual sourcing would not materially impact WABCO-TVS until they reach a critical mass.

WABCO TVS's after-market – to aid overall growth

- Currently after-market revenue is at Rs. 1.09bn (19% of total sales) as on FY10; the company has commissioned 156 authorized service centers and 145 certified workshops as on FY10 (increase of 31 authorized service centers and 20 certified workshops over the previous year).
- Whereas, Knorr-bremse has 56 authorized service centers as on 2009. We believe, it has a long way to reach the size of WABCO-TVS's distribution network. However, increase in distribution network would be in-line with Knorr-bremse's ability to penetrate in the OEM market.
- We expect WABCO-TVS's after-market revenue to grow at 19% CAGR for FY10-12E to Rs. 1.55bn on the back of expected increasing service network.

Domestic and exports – strong catalyst for growth (FY12E)



Source: Spark Capital, Company

OUTPERFORM

Superior return Ratios and Free Cash Flows to continue

CMP	Rs. 1,109	Target	Rs.1,326

Strong free cash flow generation expected in the next two years

- Against the backdrop of strong earnings growth 33% CAGR for FY10-12E, we expect WABCO's operating cash flow to increase to Rs. 1.32bn
- The company expects to spend Rs. 100-150mn of capex for FY11E towards Mahindra SEZ Phase 2 expansion for its future export opportunities. Thus, with limited capex and strong growth in operating cash flow, we expect free cash flow to be on the rise for FY11E at Rs.0.96bn and Rs. 1.13bn for FY12E.
- The company, over the years has demonstrated its efficient working capital management with cash conversion cycle improving from 49 days in FY09 to 36 days in FY10. We expect the cash conversion cycle to be well under control at 35 days for FY11E and 40 days for FY12E.

Superior asset turnover , return ratios to continue

- With its ability to pass-on the entire input cost rise with a quarter lag and lean manufacturing we expect stable margin over FY10-12E to 21.4%. However, expect PAT margins to improve to 15.1% by FY12E from 13.1% as on FY10 driven by higher exports from Mahindra SEZ facility (lower effective tax rate at 29% for FY11E and FY12E against 34% in FY10).
- Stable asset turnover ratio at 1.7x by FY12E against 1.8x in FY10 and margins would ensure stable ROCE (%) at 30% by FY12E.
- Strong earnings growth and efficient working capital management would lead to positive free cash flow generation. We expect positive FCFF of Rs728 mn and Rs1.15 bn for FY11E and FY12E respectively.

OCF and FCF trend

Cash flow items	FY09	FY10	FY11E	FY12E
Operating Cash Flow	34	529	1,098	1,332
Capex	-352	-99	-132	-198
Free Cash Flow	-318	430	967	1,134
D/E (x)	0.3	0.0	0.0	0.0

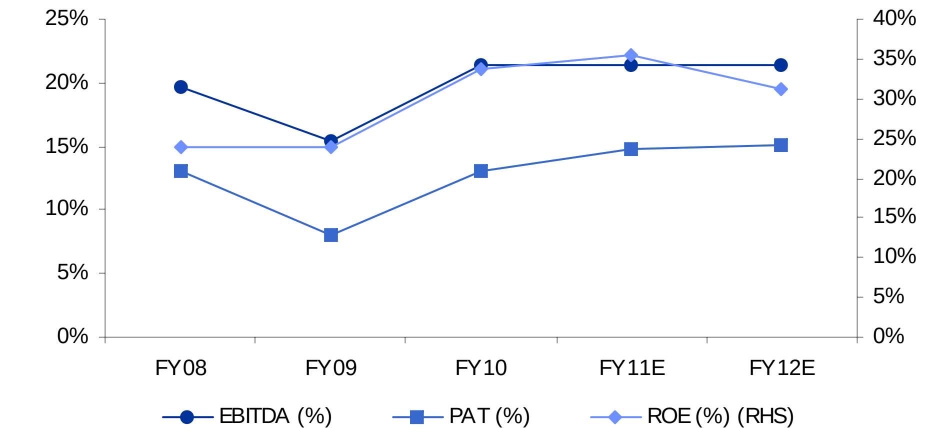
Source: Spark Capital, Company

Efficient working capital management

Working capital cycle	FY09	FY10	FY11E	FY12E
Inventory days	68	50	50	60
Sundry debtors	59	80	75	70
Sundry creditors	78	94	90	90

Source: Spark Capital, Company

Healthy operating margins and higher RoEs to continue



Source: Spark Capital, Company

OUTPERFORM

WABCO TVS – Valuation and Risks

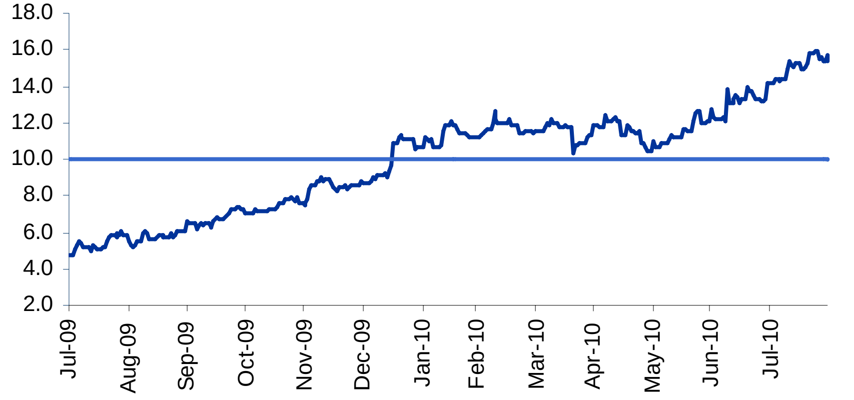
CMP	Rs. 1,109	Target	Rs.1,326

We expect WABCO TVS revenue to grow by CAGR 24% over FY10-12E to Rs. 9.26bn. The growth would be led by strong domestic growth of 23% CAGR for and exports to WABCO by 47% CAGR for the same period. With stable margins and lower effective tax rates, the PAT is expected to outgrow at 33% CAGR for FY10-12E to Rs.1.39bn leading to an EPS of Rs. 73.7

The stock trades at 18.2x FY11E EPS of Rs. 60.8 and 15.1x FY12E EPS of Rs. 73.7. In the last one year (post de-merger) the stock was trading at ~16x one-year forward earnings, with the absence of long historical trading period. For its dominant position in the OEM market with higher bargaining power, we assign 18x to FY12E EPS, (10% discount against 20x FY12E consensus multiple for Bosch India as it is also a system developer) leading to target price of Rs. 1,326 with an Outperform rating.

Risks: 1) Global slowdown affecting exports 2) Slowdown in domestic CV growth 3) Competition from Knorr-bremse

WABCO TVS one-year forward PE Band



Source: Spark Capital, Bloomberg

Key estimate revision

	FY11E			FY12E		
	Old	New	Change	Old	New	Change
Revenue	7,687	7,795	1.4%	9,166	9,261	1.0%
EBITDA	1,604	1,667	3.9%	1,936	1,981	2.3%
Margin (%)	20.9%	21.4%	*52 bps*	21.1%	21.4%	*27 bps*
PAT	1,065	1,153	8.2%	1,301	1,398	7.4%
PAT Margin	13.9%	14.8%	*93 bps*	14.2%	15.1%	*89 bps*
EPS	56.2	60.8	8.2%	68.6	73.7	7.4%

OUTPERFORM

Financial Summary

CMP	Rs. 1,109	Target	Rs.1,326

Abridged Financial Statements				
Rs. mn	FY09	FY10	FY11E	FY12E
Profit & Loss				
Income from operations	4,259	5,913	7,686	9,152
Other operating income	141	109	109	109
Total Income	4,401	6,021	7,795	9,261
Total operating expenses	3,724	4,738	6,127	7,279
EBITDA	677	1,283	1,667	1,981
EBIT	537	1,139	1,517	1,820
Profit before tax	526	1,183	1,597	1,905
Tax	170	397	444	508
Profit after tax	355	786	1,153	1,398
Balance Sheet				
Networth	1,977	2,703	3,801	5,143
Loan funds	602	72	-	-
Sources of funds	**2,619**	**2,808**	**3,833**	**5,175**
Net Block	1,914	1,802	1,849	1,886
Capital WIP	39	66	-	-
Investments	90	22	22	22
Current assets, loans & advances	1,289	1,997	3,266	4,785
Current liabilities & provisions	713	1,079	1,304	1,517
Net Current Assets	576	918	1,962	3,268
Application of funds	**2,619**	**2,808**	**3,833**	**5,175**
Cash Flows (Rs. mn)				
Cash flows from operations	34	529	1,098	1,332
Capex	(352)	(99)	(132)	(198)
Cash flows from investments	(348)	12	(132)	(198)
Free Cash Flow	(318)	430	967	1,134
Cash flows from financing	61	(250)	(127)	(55)
Cash generated during the year	(253)	291	839	1,078

Key metrics				
	FY09	FY10	FY11E	FY12E
Growth ratios				
Revenues	-21%	39%	30%	19%
EBITDA	-36%	90%	30%	19%
PAT	-49%	121%	47%	21%
Margins				
EBITDA	15.4%	21.3%	21.4%	21.4%
EBIT	12.2%	18.9%	19.5%	19.6%
PAT	8.1%	13.1%	14.8%	15.1%
Leverage & WC ratios				
Debt to equity	0.3	0.0	-	-
Current ratio	1.8	1.9	2.5	3.2
Working capital days	41	44	41	45
Performance & turnover ratios				
RoACE	16%	28%	33%	30%
RoAE	19%	34%	35%	31%
Total asset turnover	1.6	1.8	1.8	1.7
Fixed asset turnover	1.8	2.3	2.8	3.1
Valuation metrics				
Current price (Rs.)		1109		
Shares outstanding (mn)	19	19	19	19
Market Capitalisation (Rs.mn)	21,035	21,035	21,035	21,035
Enterprise value (Rs.mn)	21,624	21,083	20,172	19,094
EV/EBITDA (x)	32.0	16.4	12.1	9.6
Per-share earnings (Rs.)	**18.7**	**41.4**	**60.8**	**73.7**
P/E (x)	**59.2**	**26.8**	**18.2**	**15.1**
Price to Sales	4.9	3.6	2.7	2.3
EV/Sales (x)	5.1	3.6	2.6	2.1
Dividend yield	0.5%	0.2%	0.2%	0.2%

Exide Industries

OUTPERFORM

Initiating Coverage

CMP	Rs. 160	Target	Rs. 189

Charged-Up!!

EIL's dominant position in the auto battery market (>70% market share in auto OEM and replacement market) and deeper penetration to capture the unorganised auto replacement market are the key growth drivers ahead. The expected margin leverage derived from increased sourcing of recycled lead, may get compensated for the possible price reduction to capture the unorganised auto replacement market, thus providing margin stability in future. At an expected earnings growth of 16% CAGR for FY10-12E and efficient working capital management, we expect strong free cash flow generation ahead. We initiate with Underperform rating as the stock appears fully valued (17.7x PE FY12E EPS)however, recommend investors to buy on dips as we believe the fundamentals are only growing strength to strength.

Well ahead of competition in the auto battery business: Against the backdrop of robust auto OEM volume growth of ~18-20% across two-wheelers, PVs and CVs (FY10 – FY12) , and strong traction in the replacement market (considering significant OEM volume growth witnessed over the last seven years) is expected to drive auto business growth at 23% CAGR for FY10-12E. The growth is expected from significant capacity expansion plans (FY10-FY12 ~60% in two-wheeler batteries and ~20% four wheeler batteries in FY11) as it currently operates at peak utilisation rates. With wider distribution network, a key competitive strength, of 38,500 touch points, we expect EIL to penetrate deeper in the unorganised side of the replacement market.

Industrial segment to grow on the back of UPS: EILs exposure to inverter/UPS batteries is ~25% of its total business, which is expected to see continued demand on the back of expected power demand-supply deficit (~8 – 10%) till 2015. Currently, the telecom end-market is the weakest and it accounts for a miniscule portion (~7.5%) of its revenues. On the whole we expect industrial revenues to account for ~37% of total revenues in FY11 and FY12 from the current ~38%.

EBITDA margins to remain flat in FY11 and FY12 at 22.5% on the back of price reductions that we expect the company to take in the unorganised auto replacement market (to capture the unorganized market), offset by the gain in margins by increased sourcing of recycled lead from smelters (FY10: 45%, FY11E: 50% and FY12E: 60%). As a result, we expect EIL to garner higher market share in the unorganized side of the auto replacement market.

Valuations and Risks: We initiate the stock with Outperform rating at a target price of Rs.189 on an SOTP basis. The core business is valued at 20x PE (for its continued dominance in the OEM and increasing penetration in unorganized replacement market) on FY12E EPS of Rs. 9.0 and Rs. 10 for its 50% stake in ING Vysya Life Insurance (based on the recent Gujarat Ambuja's stake sale of 12%). While we believe that valuations appear expensive , we recommend investors to buy on dips as we believe the fundamentals are growing strength to strength.

Financial summary (consolidated)

YEAR	Revenues (Rs. mn)	EBITDA (Rs. mn)	Adj. PAT (Rs. mn)	EPS (Rs.)	P/E (x)	EV/EBITDA (x)
FY10	39,789	9,772	5,619	5.8	27.6	14.1
FY11E	47,016	10,599	6,304	7.4	21.6	12.9
FY12E	57,356	12,914	7,630	9.0	17.8	10.2

Date	Sep 20, 2010

Market data

SENSEX	19595
NIFTY	5885
Bloomberg	EXID IN
Reuters code	EXID.BO
Market cap	Rs. 135.7bn
Shares o/s	850mn
52-week High-Low	Rs. 169.0 – 86.6
3m Avg.Daily Vol	Rs. 214.3mn

Latest shareholding (%)

Promoters	46.0
Institutions	31.9
Public	22.1

Stock Performance (in %)

	1m	3m	12m
Exide Industries	10.7	24.4	74.2
BSE Auto	4.5	14.0	40.5
Sensex	7.3	11.5	17.0

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Exide Industries

OUTPERFORM

Company Overview

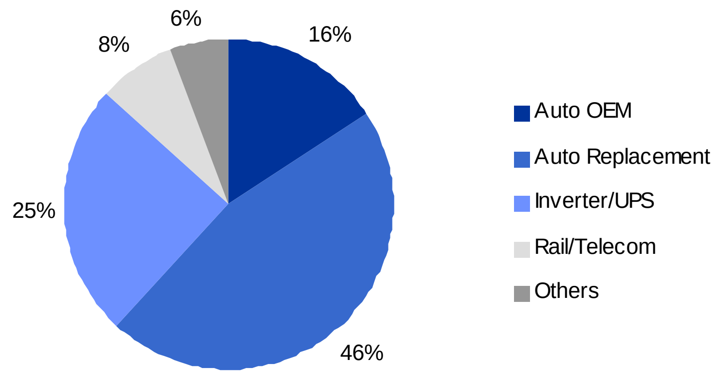
CMP	Rs. 160	Target	Rs. 189

Company Background

- Leading manufacturer of Lead Acid Batteries in India and South Asia, and also reckoned among the first five major companies in the global battery manufacturing industry
- Supplier to most new launches during the year , including Chevrolet Beat, Honda Zazz & Accor V6, Toyota Fortuner, Maruti Suzuki Ritz & EECO, Fiat Grand Punto, Premier RIO, Tata Sumo Grande and Caterpillar Dumpers
- Exide has imported foreign technology in Automotive and VRLA Lead Acid Storage Batteries with Shin-Kobe Electric Machinery Co, Furukawa Battery Co
- Strong distribution network to cater to the auto replacement market as auto replacements account for the largest chunk of the company's top line.

Source: Spark Capital, Company

Revenue Break-up (FY10: Rs. 5,809mn)



Source: Spark Capital, Company

Spark Snapshot

Position in value-chain	**Component Specialist (Consumable)**	
CSF and financial rank	2	
Key trends to watch	• Lead prices	
	• Pricing actions in replacement market	
	• Proportion of lead sourcing from smelters	
	• Investment in ING Vysya Life Insurance Co.	
	• Capacity expansion	

Source: Spark Capital

Subsidiaries & Associates

Subsidiaries	Holding %
ChlorideMetals Limited	100%
Caldyne Automatics Limited	100%
Leadage Alloys India Limited	100%
Chloride International Limited	100%
Chloride Batteries S.E. Asia Pte. Ltd., Singapore	100%
Espex Batteries Limited, UK	51%
Associated Battery Manufacturers, Sri Lanka	61.5%
Associates	
ING Vysya Life Insurance Co.	50%

Source: Spark Capital, Company

SPARK CAPITAL enhancing value

Amara Raja Batteries

UNDERPERFORM

Rating: ▼ Target price: ▼ EPS: ▼

Company Update	CMP	Rs. 215	Target	Rs. 167

Losing charge

While we expect strong traction from automotive battery segment, driven by OEM growth, we foresee slowdown in telecom business which we believe would drag revenue and earnings growth in future. With less margin leverage due to pricing competition in the auto replacement market, insignificant rise in recycled lead sourcing and further pricing pressure in telecom would drag margins and earnings for the next two years. Consequently, we expect operating and free cash flow to decline. The stock appears very expensive at 10x FY12E earnings and hence downgrade the rating to Underperform from Outperform.

Auto OEM volumes to provide a stable platform: Against the backdrop of expected~18-20% CAGR in two-wheelers, PCs and CVs for FY10-12E and strong penetration in replacement market, we expect auto battery volume to grow at 36% CAGR for FY10-12E. The growth would be led by aggressive capacity expansion plans (4.2mn to 6mn; ~20% in FY11 and FY12) for four-wheeler and two-wheeler (1.8mn to 5.0mn; 100% in FY11 and ~40% in FY12) batteries. Between FY10-12E, we expect market share improvement in the four-wheeler battery replacement market (100bps increase) and two-wheeler replacement market (400bps) driven by penetration in the unorganised sector.

Telecom weakness proving to be a key negative for ARBL: ARBLs high exposure (more than 30% of total revenue) to telecom sector is expected to be the key drag on volumes and margins as the market continues to be weak, as seen in latter part of FY10. ARBLs utilisation rates are expected to drop to 65% in FY11 before getting back at 2HFY10 levels of 75% in FY12. We expect proportion of industrial revenues to drop from 50% in FY10 to ~45% in FY12 on the back of decline in telecom business and growth in auto battery revenues.

EBITDA margin expected to decline due to telecom slowdown and replacement market competition: ARBL, being a price taker in the auto replacement market, is expected to follow the pricing actions of EIL as it plans to penetrate deeper in the unorganised sector. This, would impact margins for ARBL significantly than EIL as EIL has greater flexibility in margins by way of higher procurement of recycled lead. Also, the weak telecom market would further put pressure on ARBLs margins as it may have to reduce prices in order to bag orders. As a result, we expect EBITDA margin to decline by 530bps between FY10-12E to 14.3%

Valuations and Risks: We expect earnings to post a 3.3% CAGR (FY10 – FY12) to Rs. 1.78bn, on the back of steep decline in margins to 14.3% from 19.6% in FY10. Our valuation is based on 8x P/E multiple (in-line with historical valuations) on FY12 EPS of Rs. 20.9 leading to a target price of Rs. 167 (earlier target price of Rs. 189). We downgrade the stock to UNDERPERFORM rating with a potential downside of 22%. **Key Risks** include steep rise in lead prices, further decline in telecom end-market and a price war in auto replacement market.

Financial summary

YEAR	Revenues (Rs. mn)	EBITDA (Rs. mn)	Adj. PAT (Rs. mn)	EPS (Rs.)	P/E (x)	EV/EBITDA (x)
FY10	14,652	2,873	1,670	19.6	11.0	6.5
FY11E	17,711	2,588	1,431	16.8	12.8	7.2
FY12E	22,289	3,185	1,784	20.9	10.3	5.7

Date	Sep 20, 2010

Market data	
SENSEX	19595
NIFTY	5885
Bloomberg	AMRJ IN
Reuters code	AMAR.BO
Market cap	Rs. 18.4bn
Shares o/s	85mn
52-week High-Low	Rs. 225.0 – 130.5
3m Avg.Daily Vol	Rs. 62.2mn

Latest shareholding (%)	
Promoters	52.1
Institutions	18.3
Public	29.6

Stock Performance (in %)

	1m	3m	12m
Amara Raja	14.2	23.5	55.6
BSE Auto	4.5	14.0	40.5
Sensex	7.3	11.5	17.0

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Amara Raja Batteries

UNDERPERFORM

Company Overview

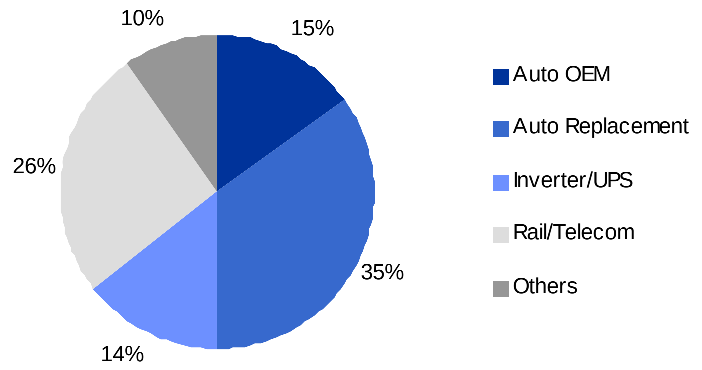
CMP	Rs. 215	Target	Rs. 167

Company Background

- No. 2, next only to Exide, battery manufacturer in India.
- Joint venture with Johnson Controls Inc. (technology provider), the world's largest manufacturer of automotive batteries
- ARBL introduced the VRLA (Valve Regulated Lead Acid) technology, zero-maintenance batteries and pioneered the 60-month warranty battery for the first time in India's automotive battery space
- In the industrial segment, ARBL is one of the largest supplier to all major telecom infrastructure
- Key customers include Maruti, Hyundai, Ford, M&M, Tata Motors and Indus Towers

Source: Spark Capital, Company

Revenue Break-up (FY10: Rs. 1,670mn)



Source: Spark Capital, Company

Spark Snapshot

Position in value-chain	Component Specialist (Consumable)
CSF and financial rank	6
Key trends to watch	• Lead Prices • Capacity ramp-up • Two-wheeler OEM penetration • Pricing actions in replacement market • Telecom sector demand

Source: Spark Capital

Brands and End-markets

Brand	End- Market
PRO	Passenger Car
FLO	Passenger Car
GO	Passenger Car
BLACK	Passenger Car
FRESH	Passenger Car / Utility Vehicles
HI-WAY	Commercial vehicles
HARVEST	Tractors
SHIELD	Inverters
PowerStack	Telecom, Rail, Power station
Quanta	UPS
PowerSleek	Wireless telecom, niche applications

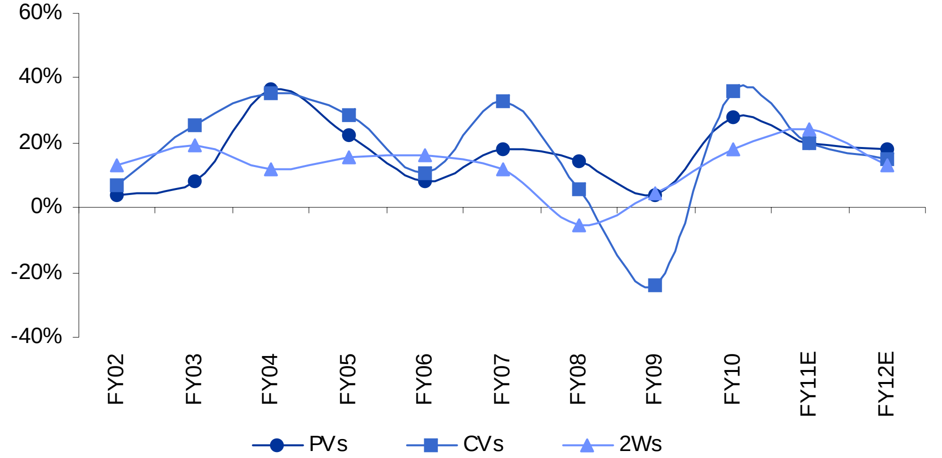
Source: Spark Capital, Company

Comparative analysis of EIL and ARBL

Auto OEM volumes to surge

- We expect a CAGR of ~18-20% across two-wheelers, PVs and CVs from FY10 – FY12. Both **EIL and ARBL are in capacity expansion mode** in order to cater to the derived demand for batteries.
- The companies have a similar break-up (around 30/70) of their auto segment revenues to OEMs and replacement, however **EILs auto revenues account for 62% of its total revenues vs. ARBLs 50%**
- **EIL enjoys a >70% market share of both auto OEM and organized replacement market (~50% of total replacement market).** Hence, we believe it would be in a much better position to benefit from the surge in demand, despite ARBLs expansion plans.
- We expect EIL and ARBL (four wheeler batteries) to record a ~19% CAGR (FY10 – FY12) in auto OEM volumes. Market shares are also expected to remain flat for both the companies in four-wheeler OEMs. ARBL would begin supplies to 2-wheeler OEMs from FY12 and expect its market share to increase.

New vehicle growth



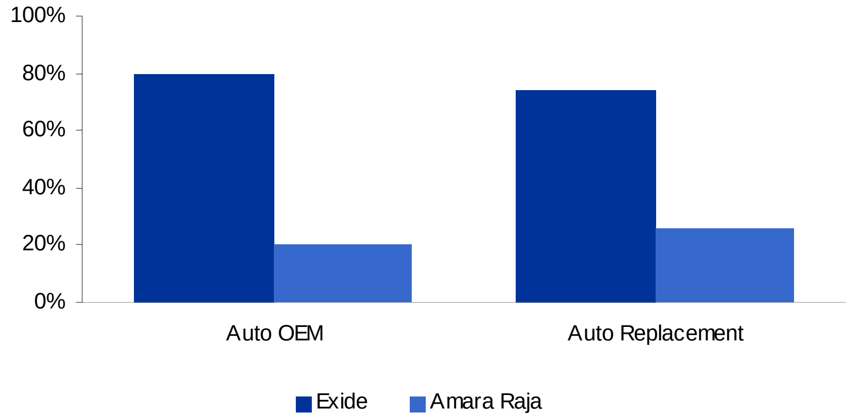
Source: Spark Capital, SIAM

Auto batteries capacity expansion plan

	Current	Target (FY11)	Target (FY12)
Amara Raja (mn units)			
4-Wheeler Capacity	4.2	5.1	6.0
yoy growth (%)		21%	18%
2-Wheeler Capacity	1.8	3.6	5.0
yoy growth (%)		100%	39%
Exide (mn units)			
4-Wheeler Capacity	7.9	9.2	11.2 *
yoy growth (%)		16%	22%
2-Wheeler Capacity	9.6	10.6	15.4
yoy growth (%)		10%	45%

*Source: Spark Capital, Company, * Spark Capital estimate*

Auto segment market share



Source: Spark Capital, Company

Replacement market to grow

- We expect a significant growth in the replacement market given the exceptional growth in OEM production volumes over the last seven years - about 19% in PVs, ~18% in CVs and ~11% in two-wheelers
- Two wheeler replacement battery demand is expected to grow on the back of increase in electric start option in most of the models released over the past four years.

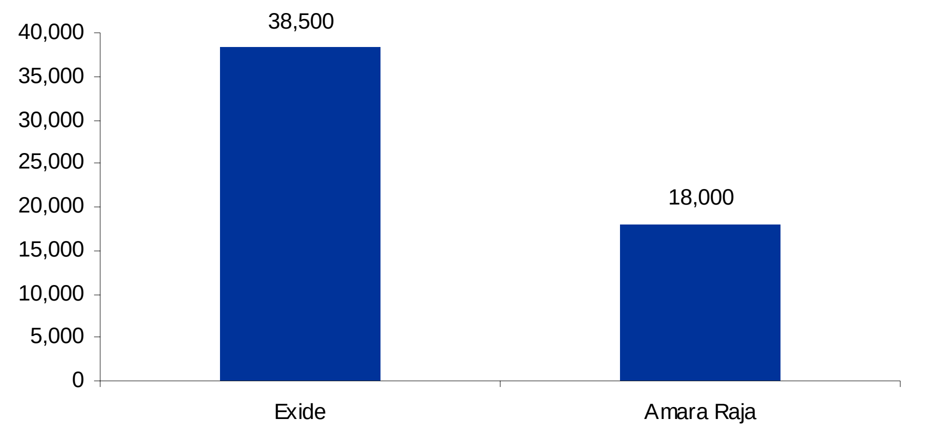
Organized replacement market to grow

- Both EIL and ARBL fight for market share in the organized replacement market, which is only half of the total replacement battery market. We expect the organized replacement market's proportion to increase to ~54% over the next two years, from the current ~50%, primarily on the back of larger penetration of EIL and ARBLs distribution network
- We expect EIL to reduce prices in the replacement market primarily to capture market share from the unorganised players and **expect to sell ~14.9mn units in the auto replacement market as against ~4.9mn units for ARBL in FY12**
- EIL has more than double the retail touch points that ARBL has and is one of the key reasons for strength in the auto replacement market with >70% of organised market share. EIL is currently present in 206 hubs (locations) through which it operates the retail outlets. It plans to increase this to 250 by 3QFY11 and further nearly double this in subsequent three years
- EIL has some specific programs targeting market segments such as 'Project Kissan' targeted towards rural markets and 'Humsafar' module which batteries are sold by dealers through motor garages. All these initiatives are expected to help EIL tap the unorganised segment.

ARBL's auto growth driven by two-wheelers

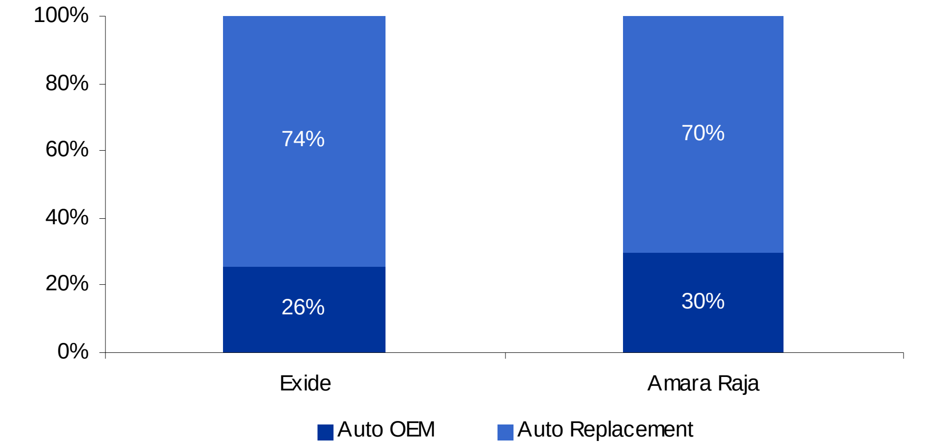
- **We expect EIL's total auto revenues to grow ~20% CAGR from FY10 – FY12, to Rs. 33.7bn vis-à-vis ARBLs CAGR of 29% in the same period to Rs. 12.2bn**.
- We expect ARBLs auto revenues to primarily gain on the back of two-wheelers as the significant ramp-up in capacities is expected to see high utilisation rates driven by OEM penetration in FY12.

Automobile battery - retail touch points



Source: Spark Capital, Company

Auto Segment revenue break-up



Source: Spark Capital, Company

Demand – Supply gap in power to remain

- Our Power & Utilities team expect the power deficit (demand-supply gap) to increase from current levels of ~10% in FY10 to ~12.5% in FY11 before falling to an average ~8% deficit from FY12 to FY15. This is despite an absolute increase of ~50% in supply of power by FY15
- Given the power deficit, we expect demand for back-up systems to be robust, hence leading to increase in demand for batteries used in Inverters/UPS systems

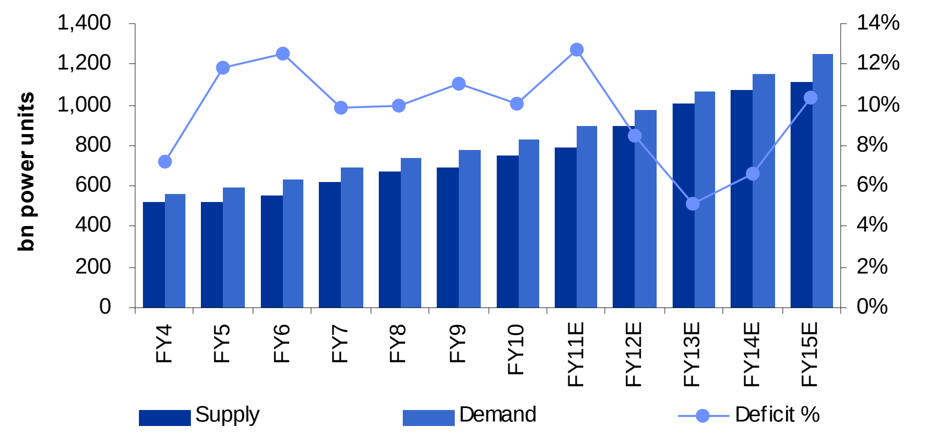
However, exposure to sub-segments is the key

- EIL derives ~65% of its industrial battery sales from inverters and UPS batteries, which is expected to see continued demand given the power deficit, while ARBL's exposure remains below the 30% mark.
- ARBL has a high exposure to rail/telecom (telecom forms major chunk) with ~52% of its industrial segment revenue coming from the segment while for EIL the proportion is ~20%. Telecom end-market is expected to continue to be weak as seen in latter half of FY10

Telecom weakness proving to be a key negative for ARBL

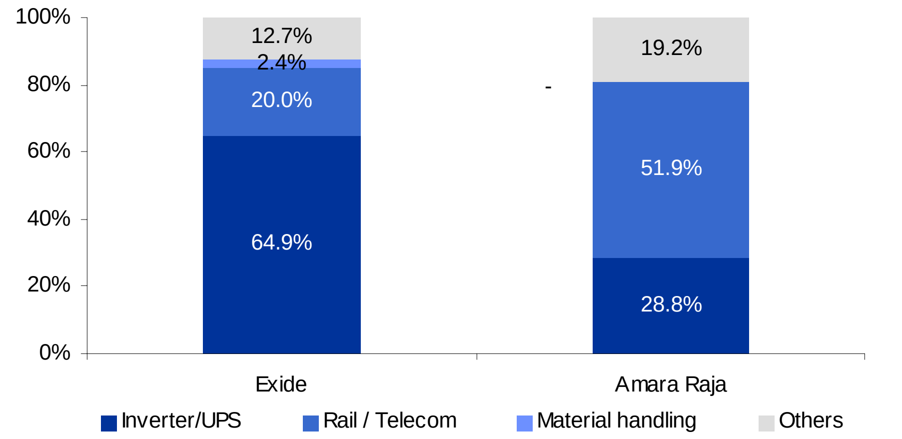
- Setting-up of new telecom towers leads to demand for batteries; however we expect a fall in demand as we see a saturation of the number of players entering the market and increasing tower sharing agreements between service providers
- Moreover, the common perception that the 3G auction would lead to increase in battery demand may not play out, as our industry interaction suggest the 3G license does not require setting-up of additional towers
- ARBLs high exposure to telecom is proving to be a negative given the significant fall in the end-market which is expected to be ~1,500 MAH in FY11 lower than FY10 which was at ~1,600 MAH
- ARBLs has a capacity of ~900 MAH per annum, however in 2HFY10 we estimate ARBL to have operated at ~75% utilisation. In FY11 we expect utilization to further fall to ~65% before picking up again in FY12 to ~75% on the back of replacement demand for new towers set-up in FY09 and FY10
- **For ARBL, we expect proportion of industrial revenues to drop from 50% in FY10 to ~45% in FY12 on the back of telecom business decline and growth in autos. For EIL we expect industrials to remain at ~37 % for the next two years**

Power deficit in India



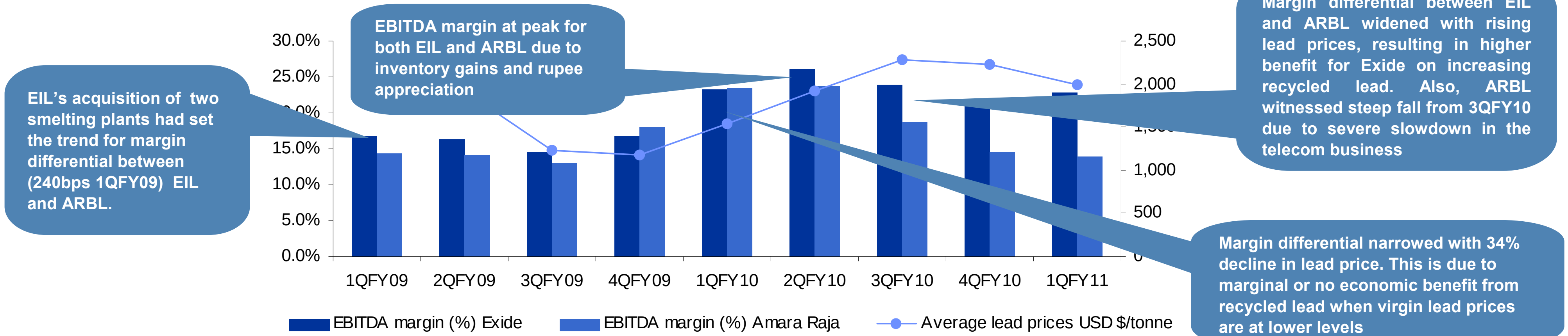
Source: Spark Capital, CEA

Industrial battery segment revenue break-up



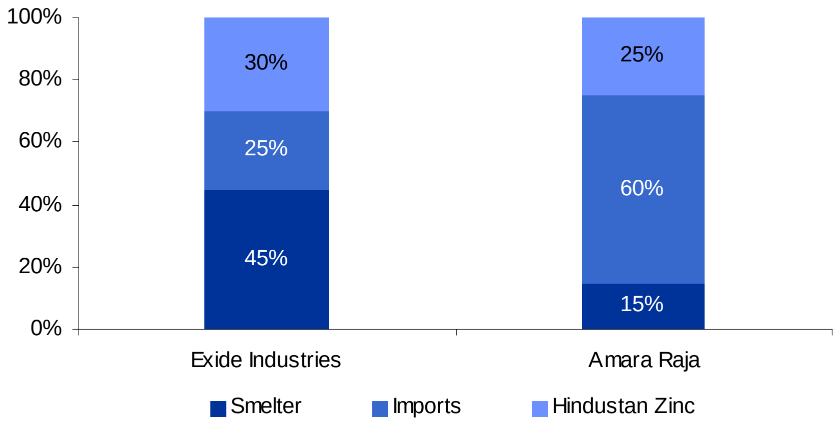
Source: Spark Capital, Company

EBITDA margin comparison with average lead price trend



Source: Spark Capital, Company

Source-wise break-up of Lead (RM) as on FY10



Source: Spark Capital, Company

Sourcing mix – a key reason for margin differential between EIL and ARBL

- Currently recycled lead accounts for ~45% of EIL's total lead requirement. The current cost advantage between recycled lead and virgin lead ranges between 12% and 15%. We expect the company to increase its proportion of recycled lead to 60% by FY12E. Historically, for EIL, lesser proportion of imports reduced the sensitivity of exchange rate and lower inventory carrying costs. Imports constituted 25% of total lead requirement in FY10.
- In comparison, ARBL procures 15% of its total lead requirement from smelting plants; therefore higher imports (60%) primary results in the margin differential between ARBL and EIL (14-15% for ARBL vs. EIL's 22-23%)
- We believe ARBL's proportion of recycled lead sourcing to unlikely increase in future as most of their batteries sold are VRLA (maintenance-free) given that their industrial business segment, which constitutes 50% of total sales, requires VRLA. EIL volume sales is dominated by non-VRLA batteries.
- **In an increasing lead price scenario, higher proportion of recycled lead makes economic sense due to the cost differential as mentioned above**
- **In a decreasing lead price scenario, 1) selling recycled lead batteries to replacement market is more profitable as the level of refinement is relatively less compared to a recycled battery sold to OEMs 2) increased sourcing of recycled lead would also choke the supply of the same to the unorganized players thereby garnering higher market share.**

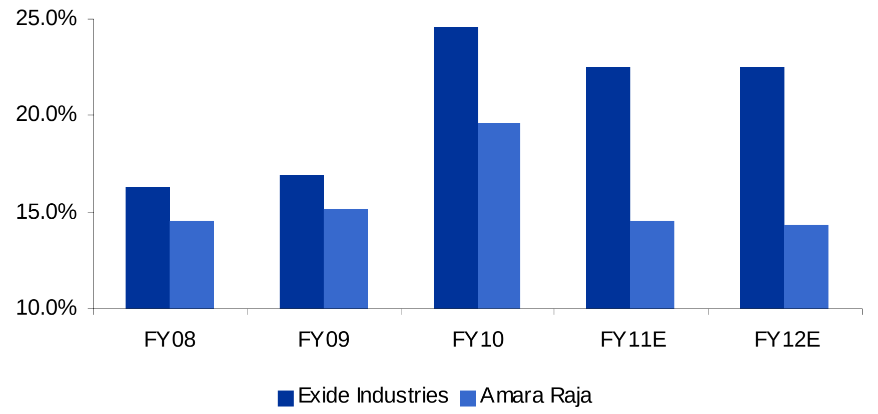
EIL's EBITDA margin expected at 22.5% in FY11E and FY12E against 24.6% in FY10.

- In a rising lead price scenario, battery manufacturers tend to benefit by way of en products priced based on the current spot prices against lower procurement price as they carry 45-60 days of imported lead inventory. Also rupee appreciation from Rs. 48.84/$ in 1QFY10 to Rs. 45.95/$ lead to cheaper imports
- While recycled lead proportion is expected to increase in FY11E and FY12E, we believe that the benefit of the same would get offset by price cuts in the competitive (unorganised market) replacement market. Thus we expect EBITDA margin at 22.5% for FY12E (against 22.8% in 1QFY11).

ARBL's profitability to decline sharply primarily due to continued slowdown in its telecom business

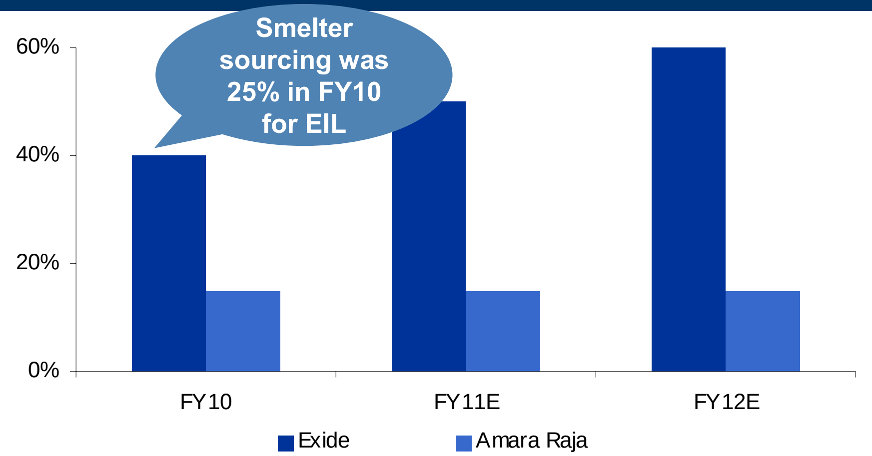
- Similar to EIL, ARBL benefited on inventory gains and rupee appreciation, resulting in EBITDA margin at 19.6% in FY10, However, EBITDA margin declined 520bps sequentially in 3QFY10 with the slowdown coupled with price reduction in its telecom business.
- We expect EBITDA margin for FY11E to be at 14.6% against 19.6% in FY10, due to continued expectation of slowdown in telecom business and competitive pressure in the auto replacement market.

EBITDA margin trend for EIL and ARBL



Source: Spark Capital, Company

Proportion of lead sourcing from smelters



Source: Spark Capital, Company

Revenue, RM and EBITDA per battery comparison

Exide Industries	FY09	FY10	FY11E	FY12E
Revenue per battery	1,776	1,732	1,722	1,728
RM per battery	1,177	996	1,032	1,050
EBITDA per battery	287	408	381	381
Amara Raja				
Revenue per battery	2,620	2,263	2,371	2,137
RM per battery	1,728	1,362	1,573	1,406
EBITDA per battery	397	444	346	305

Source: Spark Capital, Company

EIL scores better on FCF and WC Management over ARBL

Revenue mix to shift towards automotive batteries for ARBL and remain more or less same for EIL in the next two years

- We expect ARBL's revenue mix to shift towards automotive batteries in the next two years on the back of capacity expansion in two-wheeler batteries and four-wheeler batteries from FY10-12 and declining proportion of industrial batteries due to slowdown in telecom business
- We do not expect shift in the revenue mix for EIL given strong traction in both automotive and industrial business. We expect 16% CAGR for FY10-12 in industrial segment primarily driven by higher power back-up (home and commercial) given the power demand-supply gap. We expect automotive business to grow at 20% CAGR for FY10-12, driven by strong OEM growth and replacement market

Strong capex expected in FY11

- We expect both EIL and ARBL to invest in capacity expansion reflecting in capex increasing in FY11 and trending down in FY12
- Drop in FCF is expected to be severe for ARBL vs. EIL due to steep fall in OCF
- The D/E (x) is well under control at 0.1x for EIL and 0.2x for ARBL as on FY10 and expect it to be stable and thus enough borrowing strength. We expect ARBL by repay Rs.180mn in FY11, reducing its FCN loan to Rs. 90.6mn.

EIL scores high again on working capital management

- The cash conversion cycle for EIL is currently at 60 days against ARBL's 91 days in FY10 and we expect it to drop to 49 days for EIL and 89 days for ARBL by FY12. ARBLs working capital requirement is higher than EIL due to the difference in the revenue mix between them. ARBL has higher exposure to Industrial which has higher collection days than auto OEMs

Revenue mix (%) comparison

	FY09	FY10	FY11E	FY12E
EIL				
Automotive	62.0%	62.0%	63.3%	64.3%
Industrial	38.0%	38.0%	36.7%	35.7%
ARBL				
Automotive	48.0%	50.0%	53.3%	54.7%
Industrial	52.0%	50.0%	46.7%	45.3%

Source: Spark Capital, Company

OCF and FCF comparison

EIL (Rs. mn)	FY09	FY10	FY11E	FY12E
Operating Cash Flow	5,005	5,341	6,207	7,475
Capex	-1,790	-1,303	-5,207	-2,401
Free Cash Flow	3214.7	4,038	1,000	5,074
D/E (x)	0.4	0.1	0.1	0.1
ARBL (Rs. mn)	**FY09**	**FY10**	**FY11E**	**FY12E**
Operating Cash Flow	2,364	2,143	1,165	1,290
Capex	-904	-471	-856	-500
Free Cash Flow	1,460	1,672	309	790
D/E (x)	0.7	0.2	0.2	0.2

Source: Spark Capital, Company

Working capital management

EIL (standalone)	FY09	FY10	FY11E	FY12E
Inventory days	70	100	95	95
Sundry debtors	25	24	22	22
Sundry creditors	48	65	66	68
ARBL	**FY09**	**FY10**	**FY11E**	**FY12E**
Inventory days	68	86	90	92
Sundry debtors	57	60	60	62
Sundry creditors	40	54	60	65

Source: Spark Capital, Company

Valuation Differential, Unlikely to Narrow

Valuation differential to remain at current level

In the past, EIL has always been trading at higher multiple than ARBL reflecting higher scalability in its business, superior operational performance over ARBL. Its ability to penetrate in the replacement market, enabling operating margin expansion through increasing proportion of recycled lead sourcing and efficient working capital management would ensure valuation differential remaining status quo.

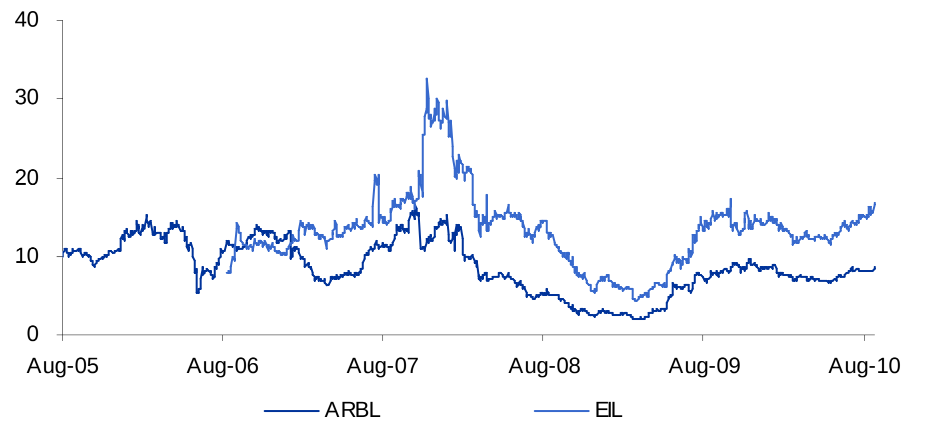
EIL - Valuation captures growth story: We expect EIL's earnings at 16.5% CAGR for FY10-12E to Rs. 7.63bn leading to an EPS of Rs. 9.0. We value EIL at Rs. 189 on an SOTP basis, We value core business at 179.5, 20x P/E of FY12E EPS, on the back of continued dominance in the OEM & replacement battery market and increasing share in unorganized share of replacement market. We value EIL's stake in ING Vysya Life Insurance business at Rs. 10. (based on a recent Gujarat Ambuja deal valuing 12% stake at ~Rs. 2bn). We initiate with OUTPERFORM rating on the stock.

Risks: 1) Slowdown in domestic growth 2) Increasing lead price may result in margin pressure and impact earnings growth

ARBL - Laggard earnings CAGR not reflected in stock price: For ARBL, we expect 3.3% CAGR for FY10-12E to Rs. 1.78bn. We value the stock at 8x PE (in-line with historical trends) to FY12E EPS of Rs. 20.9 and arrive at a target price of Rs. 167 (earlier target price of Rs. 189). We downgrade the stock to Underperform.

Risks: 1) Further pricing pressure in telecom business 2) Competition with respect to pricing in auto replacement market 3) Rising lead prices

EIL and ARBL Forward PE band comparison



Source: Spark Capital, Bloomberg,

Five year forward trading range and number of days traded

EIL			ARBL		
Forward P/E	No of days traded	% of total traded days	Forward P/E	No of days traded	% of total traded days
2-4x	0	0%	2-4x	226	12%
4-7x	167	11%	4-6x	138	7%
7-10x	125	9%	6-8x	489	26%
10-13x	408	28%	8-10x	326	18%
13-16x	563	39%	10-12x	307	17%
16-19x	84	6%	12-14x	291	16%
19-22x	57	4%	14-16x	72	4%
22-25x	9	1%	16-18x	2	0%
25-28x	47	3%			

Source: Spark Capital, Company

Key estimates revision – ARBL

	FY11E		
	Old	New	Change
Revenue	19,076	17,711	-7.2%
EBITDA	3,147	2,588	-17.8%
Margin (%)	16.5%	14.6%	*-188 bps*
PAT	1,790	1,431	-20.0%
PAT Margin	9.4%	8.1%	*-130 bps*
EPS	21.0	16.8	-20.2%

Exide Industries

OUTPERFORM

Consolidated Financial Summary

CMP	Rs. 160	Target	Rs. 189

Abridged Financial Statements				
Rs. mn	FY09	FY10	FY11E	FY12E
Profit & Loss (Rs. mn)				
Revenues	34,049	39,789	47,016	57,356
Manufacturing & Other Expenses	28,278	30,017	36,418	44,442
EBITDA	**5,771**	**9,772**	**10,599**	**12,914**
Depreciation	720	875	1,132	1,424
EBIT	5,052	8,897	9,467	11,491
Net Interest Exp / (inc)	587	161	160	160
Profit Before Tax	4,523	8,817	9,540	11,614
Tax	1,579	3,009	3,205	3,946
Less: Minority interest	33	190	31	38
Adj. Net Profit	**2,911**	**5,619**	**6,304**	**7,630**
Balance Sheet (Rs. mn)				
Shareholders Equity	9,929	19,165	24,478	31,117
Minority interest	178	366	398	435
Loan funds	3,610	1,741	1,741	1,741
SOURCES OF FUNDS	**14,153**	**21,879**	**27,223**	**33,900**
Net block	7,736	7,938	11,510	12,955
Investments	2,759	8,768	8,768	8,768
Capital WIP	198	429	941	574
Current assets, loans & advances	8,760	12,107	15,121	22,890
Current liabilities & provisions	5,304	7,366	9,119	11,290
Net Current Assets	3,456	4,741	6,002	11,600
APPLICATION OF FUNDS	**14,153**	**21,879**	**27,223**	**33,900**
Cash Flows (Rs. mn)				
Cash flows from operations	5,005	5,341	6,937	8,526
Capex	-1,790	-1,303	-5,215	-2,502
Cash flows from investments	-3,241	-7,940	-5,215	-2,502
Cash flows from financing	-1,473	2,483	-991	-991
Free cashflow	3,215	4,038	1,721	6,024
Cash generated during the year	292	-116	731	5,033

Key metrics				
	FY09	FY10	FY11E	FY12E
Growth ratios				
Revenues	14.3%	16.9%	18.2%	22.0%
EBITDA	18.5%	69.3%	8.5%	21.8%
PAT	12.1%	93.0%	12.2%	21.0%
Margins				
EBITDA	16.9%	24.6%	22.5%	22.5%
EBIT	14.8%	22.4%	20.1%	20.0%
PAT	8.5%	14.1%	13.4%	13.3%
Leverage & WC ratios				
Debt to equity (x)	0.4	0.1	0.1	0.1
Current ratio (x)	1.7	1.6	1.7	2.0
Debtor days (Sales)	28	27	29	31
Inventory days (COGS)	89	133	127	120
Creditor Days (COGS)	55	82	85	88
Working Capital days	62	78	71	63
Performance & turnover ratios				
RoACE	24.4%	32.5%	25.6%	24.8%
RoAE	31.6%	38.6%	28.9%	27.4%
Total asset turnover (x)	2.0	2.1	2.0	1.9
Fixed asset turnover (x)	2.7	2.8	2.7	2.7
Working capital turnover (x)	9.9	8.4	7.8	4.9
Valuation metrics				
Current price (Rs.)		160.0		
Shares outstanding (mn)	800	850	850	850
Market capitalisation (Rs. mn)	128,000	136,000	136,000	136,000
Enterprise value (Rs. mn)	131,221	137,440	136,709	131,676
EV/EBIDTA (x)	22.7	14.1	12.9	10.2
Adj. Per-share earnings (Rs.)	2.4	5.8	7.4	9.0
Price-earnings multiple (x)	66.8	27.6	21.6	17.8
Dividend yield (%)	0.4%	0.6%	0.6%	0.6%

Amara Raja Batteries

Financial Summary

UNDERPERFORM

CMP	Rs. 215	Target	Rs. 167

Abridged Financial Statements				
Rs. mn	FY09	FY10	FY11E	FY12E
Profit & Loss				
Revenues	13,177	14,652	17,711	22,289
Manufacturing & Other Expenses	11,180	11,779	15,123	19,105
EBITDA	1,998	2,873	2,588	3,185
Depreciation	346	429	454	509
EBIT	1,652	2,444	2,134	2,676
Net Interest Exp / (inc)	182	68	24	42
Profit Before Tax	1,228	2,546	2,147	2,670
Tax	422	876	715	886
Adj. Net Profit	999	1,670	1,431	1,784
Balance Sheet (Rs. mn)				
Shareholders Equity	4,057	5,436	6,577	7,999
Loan funds	2,858	912	1,128	1,238
SOURCES OF FUNDS	**7,097**	**6,565**	**7,921**	**9,453**
Net block	2,813	3,057	3,460	3,451
Investments	471	161	161	161
Capital WIP	396	227	227	227
Current assets, loans & advances	5,260	6,311	7,848	10,151
Current liabilities & provisions	1,843	3,191	3,774	4,536
Net Current Assets	3,416	3,120	4,074	5,615
APPLICATION OF FUNDS	**7,097**	**6,565**	**7,921**	**9,453**
Cash Flows (Rs. mn)				
Cash flows from operations	2364	2143	1165	1290
Capex	(1029)	(515)	(856)	(500)
Free cashflow	3393	2658	2021	1790
Cash flows from investments	(1321)	(177)	(820)	(464)
Cash flows from financing	(851)	(2044)	(97)	(222)
Cash generated during the year	191	(78)	248	603

Key metrics				
	FY09	FY10	FY11E	FY12E
Growth ratios				
Revenues	21.6%	11.2%	20.9%	25.9%
EBITDA	26.5%	43.8%	-9.9%	23.0%
PAT	5.6%	67.2%	-14.3%	24.6%
Margins				
EBITDA	15.2%	19.6%	14.6%	14.3%
EBIT	12.5%	16.7%	12.1%	12.0%
PAT	7.6%	11.4%	8.1%	8.0%
Leverage & WC ratios				
Debt to equity (x)	0.7	0.2	0.2	0.2
Current ratio (x)	2.9	2.0	2.1	2.2
Debtor days (Sales)	57	60	60	62
Inventory days (COGS)	68	86	90	92
Creditor Days (COGS)	40	54	60	65
Performance & turnover ratios				
RoACE	15.8%	23.5%	19.6%	20.6%
RoAE	27.0%	35.2%	23.8%	24.5%
Total asset turnover (x)	1.6	1.7	1.9	2.0
Fixed asset turnover (x)	3.6	3.2	3.3	3.7
Valuation metrics				
Current price (Rs.)		215.0		
Shares outstanding (mn)	85	85	85	85
Market capitalisation (Rs. mn)	18,362	18,362	18,362	18,362
Enterprise value (Rs. mn)	20,517	18,649	18,617	18,124
Price-earnings multiple (x)	18.4	11.0	12.8	10.3
EV/EBIDTA (x)	10.3	6.5	7.2	5.7
Adj. Per-share earnings (Rs.)	11.7	19.6	16.8	20.9
Dividend yield (%)	0.4%	1.3%	1.4%	1.7%

Motherson Sumi Systems

OUTPERFORM

Initiating Coverage

CMP	Rs. 182	Target	Rs. 197

Harnessing growth

A component specialist, with dominant presence in the domestic market, MSSL is positioned for superior earnings growth for the next two years. While the domestic business is expected to be strong with its sheer dominance in the PV market, the catalyst for our earnings growth is expected from SMR, its subsidiary. The revenue visibility in SMR along with expected margin leverage would drive overall earnings growth, return ratios and free cash flows for the next two years.

Promising domestic growth: MSSL's continued dominance in the wiring harness (65%) and mirror (45%) segment of the domestic PC, would ensure strong domestic revenue growth of 20% CAGR for FY10-12E. Its overseas subsidiary, SMR, accounts for ~25% of global mirrors market and is a supplier to most top OEMs. This we believe will enable MSSL to be a key beneficiary of the expected growth in domestic PC expansion(~60% capacity expansion from FY10 – FY12). In addition to this, MSSL's increasing content per vehicle through polymer and rubber/metal machined components segments would ensure continued dominance

SMR to catapult earnings growth: SMR's business accounts for ~60% of MSSLs top line and we expect this to remain at similar levels. The company has a strong revenue visibility by way of a long term EUR 800mn contract that it has received from European OEMs starting FY11. The overall margin leverage is expected from strong margin expansion in SMR's business by virtue of its low cost sourcing of inputs from MSSL. The benefits are already visible in 1QFY11and expect it to accelerate in the next two years.

Return ratios and free cash generation on the rise': Against the backdrop of strong revenue growth (18% CAGR for FY10-12E) and margin expansion (220 bps increase from FY10-12E), we expect strong RoACE improvement from 12.3% in FY10 to 19.6% in FY12E and generate positive free cash flow of Rs. 5.4bn by FY12E from the negative free cash flow of Rs. 39mn in FY10. On the back of strong cash flow generation, we expect the consolidated D/E(x) to decline to 0.4x in FY12E from 0.7x in FY10

Valuations and Risks: We expect earnings to grow ~34% CAGR from FY10 – FY12, translating into EPS of Rs. 8.4 in FY11 and Rs.11.0 in FY12. At CMP, the stock trades at 16.6x our FY12 EPS. We have assigned a P/E of 18x (for its continued dominance and strong traction in SMR business) on FY12E EPS translating into a target price of Rs. 197. We initiate the stock with an OUTPERFORM rating. **Key Risks**: Delayed turnaround in European PVs could significantly impact SMR; competition from domestic players could increase, impacting pricing power.

Financial summary (consolidated)

YEAR	Revenues (Rs. mn)	EBITDA (Rs. mn)	Adj. PAT (Rs. mn)	EPS (Rs.)	P/E (x)	EV/EBITDA (x)
FY10	69,240	6,301	2,283	6.1	30.0	11.6
FY11E	82,657	8,930	3,287	8.5	21.5	8.3
FY12E	96,036	10,820	4,245	11.0	16.6	6.4

Date	Sep 20, 2010

Market data	
SENSEX	19595
NIFTY	5885
Bloomberg	MSS IN
Reuters code	MOSS.BO
Market cap	Rs. 70.3bn
Shares o/s	388mn
52-week High-Low	Rs. 201.0 – 90.5
3m Avg.Daily Vol	Rs. 64.4mn

Latest shareholding (%)	
Promoters	65.2
Institutions	18.4
Public	16.4

Stock Performance (in %)

	1m	3m	12m
Motherson Sumi	-1.9	25.2	73.7
BSE Auto	4.5	14.0	40.5
Sensex	7.3	11.5	17.0

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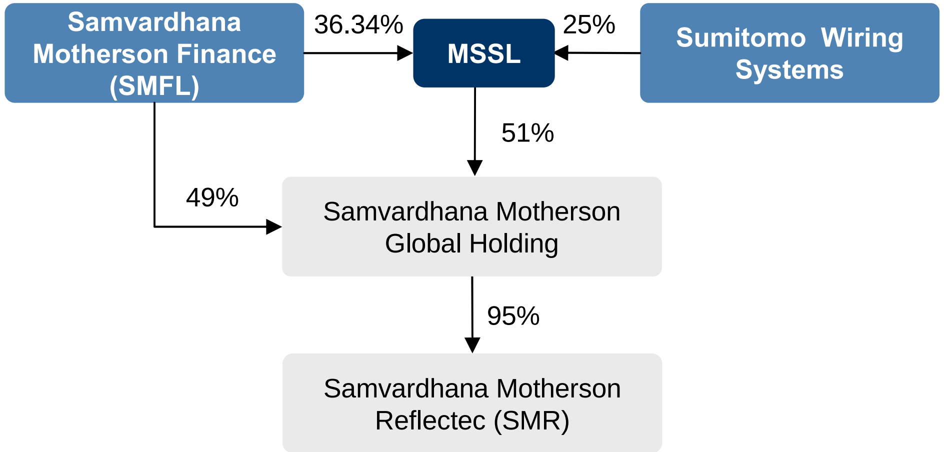
Company Overview

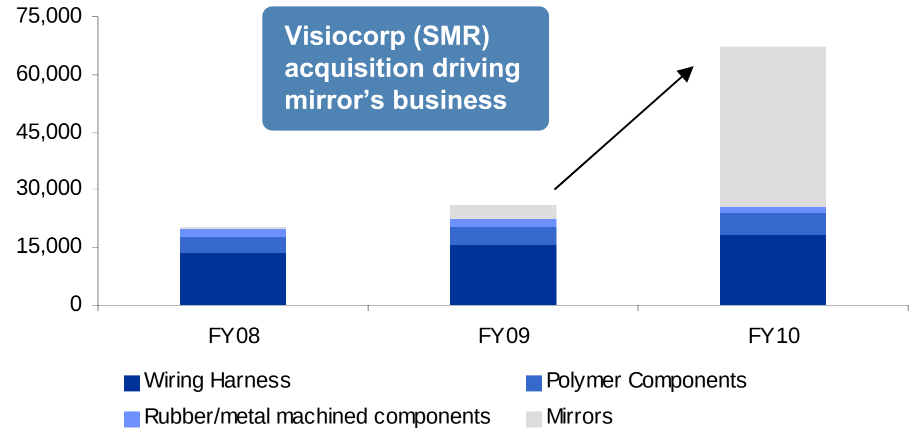
CMP	Rs. 182	Target	Rs. 197

Samvardhana Group



Source: Spark Capital, Company

Consolidated Revenue Break-up



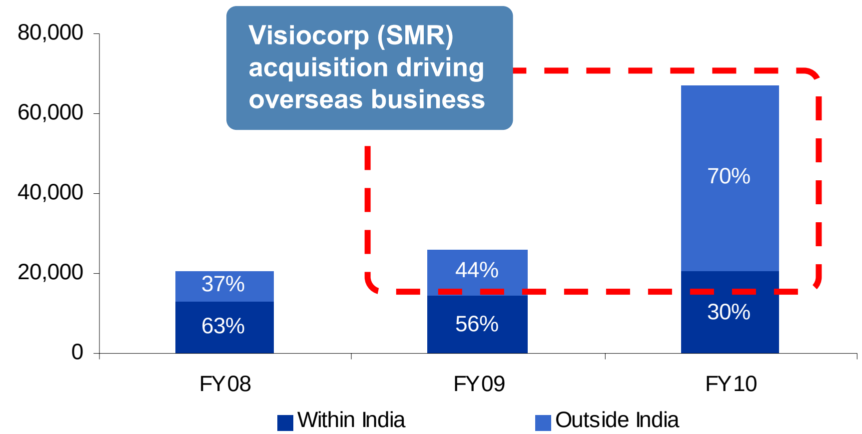
Source: Spark Capital, Company

Spark Snapshot

Position in value-chain	Component Specialist / Module assembler	
CSF and financial rank	3	
Key trends to watch	• SMR margin trend	
	• Capex for EUR 800mn order at SMR	
	• Backward integration of components	
	• New OEMs following dual sourcing	
	• Acquisitions to increase content per vehicle	

Source: Spark Capital

Revenue break-up (within and outside India)



Source: Spark Capital, Company

Segments Snapshot

CMP	Rs. 182	Target	Rs. 197

Automotive mirrors

- Acquired Visiocorp (now SMR), manufacturer of automotive rear view mirrors, in March 2009
- Key global competitors include Magna, Ficosa and Murakami
- Supplier to the top ten global OEMs totaling more than 360 individual programs
- High R&D with over 300 patents; introduced the first 'Camera based blind spot detection system'
- 13 manufacturing locations across the world; 62% of consolidated top line in FY10

Wiring harness

- Key partners include Sumitomo Wiring Systems (Japan) and Kyungshin industrial Co. (S. Korea)
- 65% market share of passenger car wiring harnesses in India. Key domestic competitor includes Tata Yazaki
- Full Service Supplier with complete in-house design capability. Vertical backward integration for critical inputs for wiring harnesses such as wires, connectors, terminals, fuses and fuse boxes
- Direct exports to the customers as well as exporting back to collaborators
- More than 25 Manufacturing Facilities; 27% of consolidated top line in FY10

Polymer components

- Key partners include Sumitomo Wiring Systems (Japan), Calsonic Kansei (Japan), Roki mfg. (Japan) and Tokyo Printing Ink Mfg (Japan)
- One of the largest molded parts, assemblies & module supplier to the domestic market
- Also undertakes module assembly (cock pit, dash board, HVAC systems etc), Comprehensive post molding & assembly processes along with Polymer compounding
- 30 manufacturing facilities; 8% of consolidated top line in FY10

Rubber/metal machined components

- Key partners in elastomer (rubber) processing include Woco Industrietechnik GmbH (Germany)
- Manufacturing parts for the Automotive, Measuring and Control, Medical, White Goods and for other Industrial applications
- Key partners in metal working include DREMOTEC GmbH & Co (Germany)
- Specialist in machining of high precision, critical application metal components
- Three percent of consolidated top line in FY10

Source: Spark Capital, Company

Motherson Sumi Systems

OUTPERFORM

#1 – Leader with a diversified Business and Customer Base

CMP	Rs. 182	Target	Rs. 197

Top of the table in domestic market, leading player globally

- MSSL is the largest manufacturer of wiring harness and rear view mirrors in India (followed by TATA Yazaki) and enjoys a 65% market share in the wiring harnesses and 48% market share in the mirrors business (PCs & UVs). SMR has a ~25% global market share of exterior mirrors for PCs
- MSSL has an extremely diversified customer base with the top five customers accounting for less than 50% of the consolidated top line.
- Apart from PCs, MSSL has also received new orders for harnesses in CVs, two-wheelers, material handling & earth moving equipment and in farm equipment

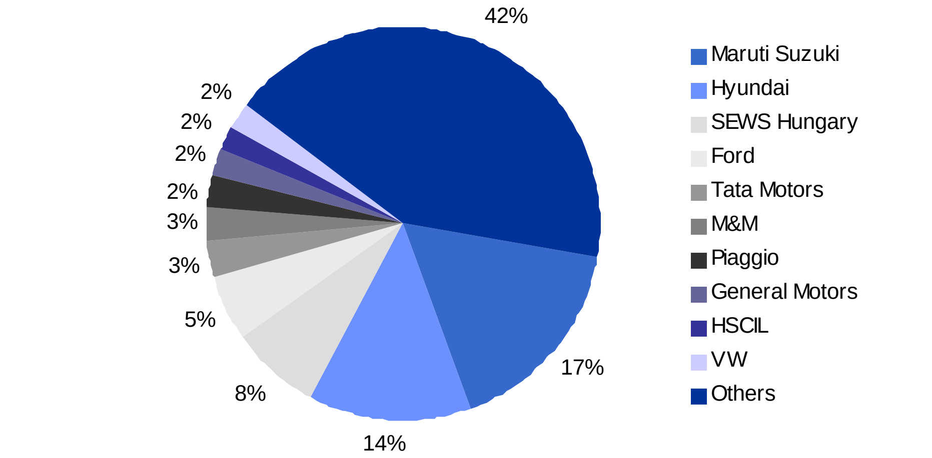
Domestic growth to be led by PV OEMs expansion plans

- The expected capacity expansion by most of the OEMs in the domestic market is expected to be the key driver for the standalone business. We expect total PCs production CAGR of 18-20% (FY10-FY12); however on the basis of capacity increase plans of OEMs the implied growth is ~26% from ~3mn in FY10
- MSSL is already a supplier for global OEMs such as VW, hence with a 'big-bang' entry of these global OEMs in India, MSSL would be the supplier of first choice
- We expect standalone revenue to increase by ~20% CAGR for FY10-12E to Rs. 24.2bn
- The growth would also be driven by increase in the content per vehicle in the form of polymer components such as injection molded parts; modules such as dash boards, bumpers, cockpits; and rubber and machined components.
- We estimate MSSL's total product/component offering for a mid-sized car could total anywhere between 4-6% of the cost of the vehicle

PV growth in India and Europe

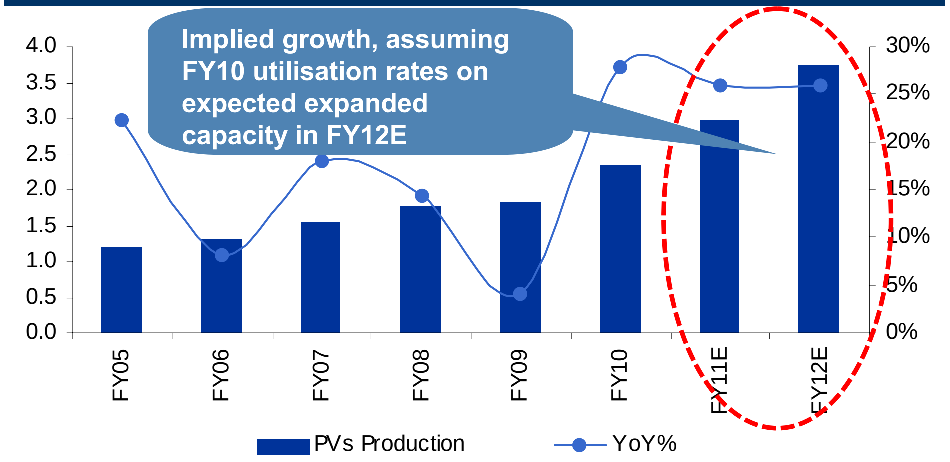
- Currently most OEMs in the domestic market are operating at peak capacities; significant expansion plans are in place for the next two years and we believe MSSL being a top supplier would in-turn see a surge in demand
- MSSL has also announced plans for a Rs. 4 – 5bn capex including ~Rs. 3bn in India for expansion in plants located in Chennai, Uttarakhand and Bangalore.
- European PCs production is up 20.6% yoy and 33.7% yoy in 4QCY09 and 1QCY10.

Consolidated - OEM wise revenue break-up (FY09)



Source: Spark Capital, Company

Domestic PVs production



Source: Spark Capital, Company

#2 – SMR to lead Overseas Growth

CMP	Rs. 182	Target	Rs. 197

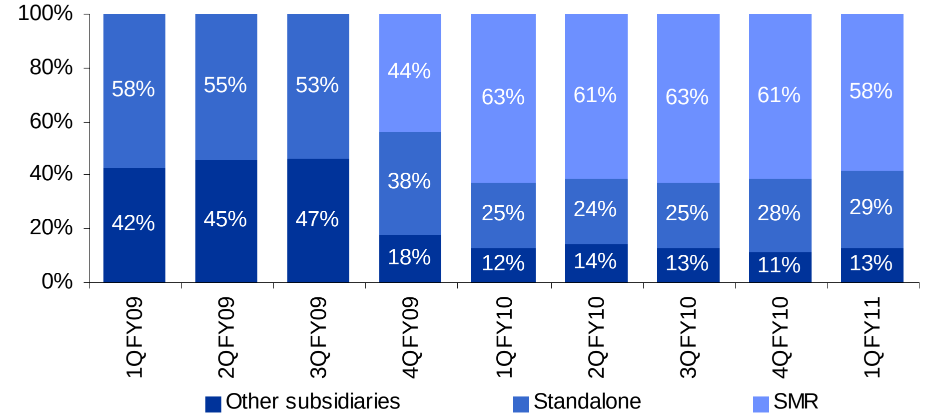
Visiocorp (SMR) deal was a 'steal'

- MSSL, along with SMFL acquired 95% of Visiocorp in March 2009 and created a new entity Samvardhana Motherson Reflectec (SMR)
- At the time of sale, Visiocorp was owned by private equity holders and hedge funds and had heavy debt. Media reports suggests that heavy operating losses and management issues led to the company virtually running out of cash in November 2008
- However, Visiocorp remained a key supplier to majority of global OEMs including BMW, Daimler, Ford among others. We believe, OEMs had a big role to play in the acquisition and supported the sale as they did not want to see Magna and Ficosa to gain duopolistic dominance in the mirror systems market in Europe
- The acquisition also made business sense for MSSL as mirrors need capabilities in tooling, designing, wiring harnesses etc which MSSL already had. The acquisition also gave MSSL access to 17 manufacturing plants of Visiocorp and customers spread over a wide geography
- The acquisition was for a cash consideration of EUR 25mn and after acquisition the debt in SMR stood at ~EUR 60mn. Considering Visiocorp's top line of EUR 660mn in 2008, we believe the deal was a real 'steal'. The deal was structured such that all the assets (including subsidiaries) were acquired without the debt
- SMR has over 300 patents; currently R&D is going on for developing driver assist system - Mirror with camera based Blind Spot Detection System was the first product in this series

Turned around to positive PAT within third quarter of acquisition

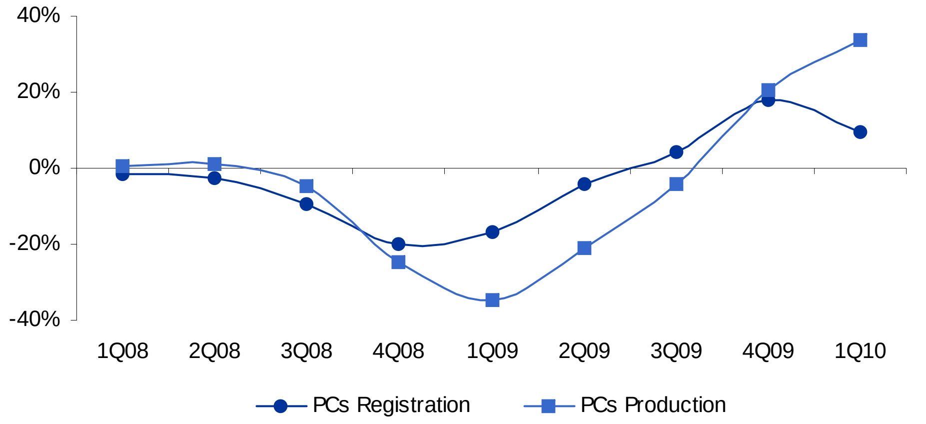
- MSSL spent ~Rs. 500mn in restructuring expenses, which we believe as paid dividends as SMR posted a positive PAT in 3QFY10 after first two quarters of losses
- SMR has received orders to supply mirrors for the value of ~EUR 800mn to be supplied over the life of a model, which is expected to be launched by an European OEM in FY11. The company will undertake capex of EUR 50-60mn in FY11, to cater to the order
- We believe that such revenue visibility gives the company great advantage in capex planning and generating higher ROCEs

Revenue break-up



Source: Spark Capital, Company

European Union passenger car registration & production (yoy %)



Source: Spark Capital, ACEA

#3 – Margin Improvement driven by SMR

Internal sourcing of inputs to aid margin growth

- Post the expiry of legacy contracts that erstwhile Visiocorp had, SMR would be sourcing most of its components and inputs at low cost from the Motherson group companies itself, thereby leading to significant margin push
- The company has also completed its restructuring activity and the benefit of these is expected to reflect in FY11
- We expect SMR's EBITDA margins to increase to 8% in FY11 and 8.6% in FY12, from FY10 levels of 5.7%. In 1QFY11 SMR reported EBITDA margin of 7.2% as we believe benefit of internal sourcing of inputs has already started reflecting in margins

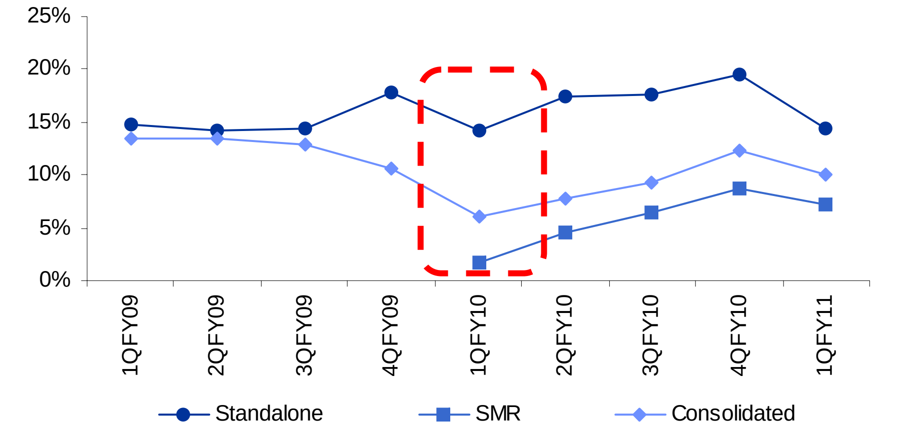
Drivers for pricing power to stay

- We believe MSSL enjoys significant pricing power given its leading position and diversified customer base
- MSSL has in-house capabilities of the design/manufacturing and know-how for critical inputs for all its major product ranges including tooling, electronics, wiring harnesses, actuators and control cables for mirrors; wires, connectors, terminals and fuse boxes for wiring harnesses; compounding and tooling support for polymer processing and compounding and mixing for molded rubber products
- MSSL also provides complete end-to-end solutions right from product design to analysis, prototyping, tooling, molding, manufacture, assembly to supply of Integrated Modules
- MSSL has a high degree of backward integration which enables it to maintain quality and facilitates consistent just-in-time product supply.
- The key raw material for wiring harness is copper and MSSL has arrangements with most OEMs for passing on the price increase, therefore it does not have major impact on its earnings

Consol margins to grow 170bps and 50bps in FY11 and FY12

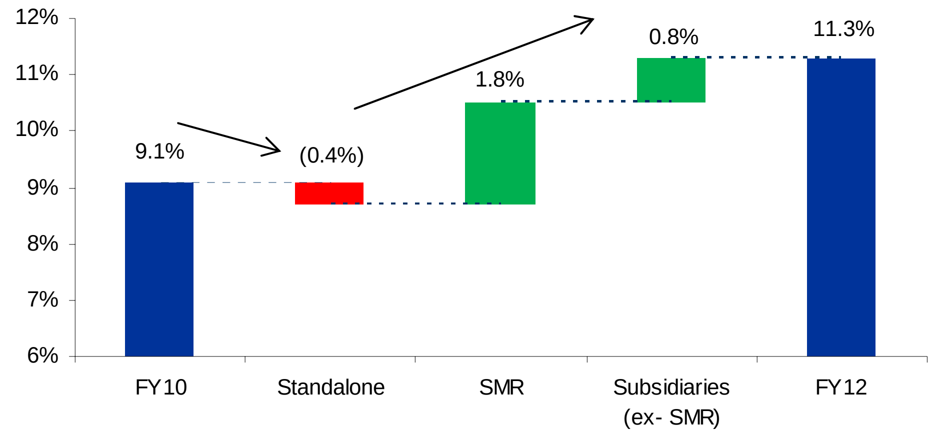
- Consolidated margins expected to increase 170bps to 10.8% in FY11 and 50bps to 11.3% in FY12 . The growth in margins is primarily driven by growth in SMR margins from 5.7% in FY10 to 8.0% and 8.6% in FY11 and FY12 respectively
- On the standalone business, we expect margins to come-off its peak 17.4% in FY10, to 15.2% and 15.6% in FY11 and FY12 respectively

MSSL margin trend



Source: Spark Capital, Company

EBITDA Margin FY10 – FY12



Source: Spark Capital, Company

#4 – JV specialist and Turnaround of Acquisitions

CMP	Rs. 182	Target	Rs. 197

- Most of MSSLs acquisitions have been at low valuations as they have typically been under distressed condition. MSSL has a record of turning around these acquisitions into profitable businesses
- The acquisitions have also been done keeping in mind its customers who have backed MSSLs deals. The most recent acquisition, Visiocorp has been by far the largest till date and in the short span, the business generated profits highlighting MSSLs prowess in seamlessly turning sick businesses
- MSSL has six key JVs which are primarily centered around bringing technology or manufacturing capabilities for specific customers

Acquisition	Business segment	Year	Location	Highlights
Wexford Electronics	Engineering design and logistics centre	2002	Ireland	First overseas wiring harness facility
Reiner Prazision GmbH	Machining Business	2005	Germany	Acquisition added capabilities in precision metal machining and the company started supplying in Europe
G&S Kunststofftechnik GmbH	Plastic injection moulding	2005	Germany	Added capabilities in plastic injection molding including 2K molding and enabled in setting up a window for customer support and logistics
ASL Systems	Wiring harness	2006	UK	Consolidating MSSLs position in wiring harness business in niche markets
Huon Corporation	Door Trims	2006	Australia	-
FP Formagrau s.r.o.	Plastic injection moulding	2006	Czech Republic	-
Empire Rubber	Rubber components	2007	Australia	Access for supply of rubber extruded components to automotive OEM 's and Tier 1 suppliers as well as non-automotive customers
Visiocorp	Automotive Mirrors	2009	UK	~25% global mirrors market share for PCs

Joint Ventures	MSSL Holding	FY10 PAT (Rs. mn)	Details of Business
Kyungshin Industrial Motherson Ltd.	50.0%	589.97	Located in Chennai. Caters exclusively to Hyundai Motors. It is a single source of procuring wiring harness for Hyundai Motor India for its complete range of cars manufactured in India.
Woco Motherson Ltd.	33.3%	58.83	Located in Sharjah, UAE. Specializes in liquid silicone rubber injection Molding
Woco Motherson Elastomer Ltd.	33.3%	43.7	Located in Noida, India. Manufactures and exports injection molded rubber components back to the Joint Venture Partner
Woco Motherson Advanced Rubber Technologies	33.3%	127.6	Located in Kandla (SEZ). Focuses on European automotive and auto component manufacturing. The range includes pedal parts and solid silicon articles for acoustic applications besides manufacturing and exporting rubber, rubber to metal and rubber to plastic bonded parts.
Calsonic Kansei Motherson Auto Products Ltd.	49.0%	13.87	Located in Manesar & Chennai. Primarily caters to Maruti Suzuki & Nissan Motors. New facility is coming up in Ahmedabad for supply of compressors to Tata Nano. Specializes in the manufacture of climate- control systems including HVAC modules, compressors, body control modules and meters clusters.
Ningbo SMR Huaxiang Automotive Mirrors	50.0%	32.32	Located in China. Produces exterior mirrors, fuel filler modules and other component.

Source: Spark Capital, Company, Bloomberg

Motherson Sumi Systems

OUTPERFORM

Financial Analysis

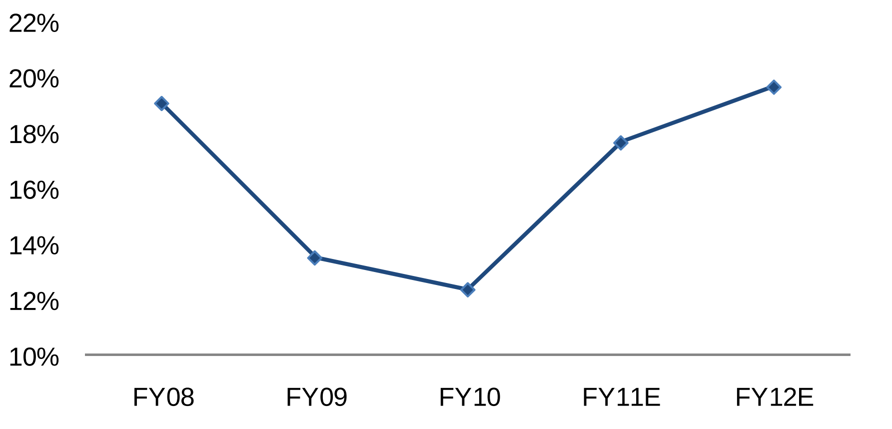
CMP	Rs. 182	Target	Rs. 197

- MSSL plans for a capex of Rs. 4 – 5bn in FY11, of which about Rs. 3bn is expected to be spent in India for expansion in Chennai and Bangalore. The remaining expenditure for capacity addition in Hungary plant. The Hungary addition is a part of capex required to cater to EUR 800mn long term contract received at SMR
- MSSL has completed the conversion of zero coupon FCCBs in 1QFY11, by issuing 12.95mn equity shares
- We expect the net debt at consolidated level to fall significantly in FY12, on the back of cash generated by the business. Gross debt is expected to be constant at ~Rs. 7.5bn in FY11 and FY12
- D/E ratio is expected to fall to 0.4x in FY12 from 0.7x in FY10.
- We expect RoACE to significantly improve from FY10 levels of ~12% (due to SMR acquisition) to ~20% in FY12

Standalone (Rs. mn)	FY09	FY10	FY11E	FY12E
Operating Cash Flow	3,206	2,147	3,221	2,920
Capex	(1,598)	(2,048)	(2,937)	(1,684)
Free Cash Flow	1,067	100	284	1,236
Net Debt	5,202	3,764	3,304	2,853
D/E	1.3x	0.6x	0.4x	0.4x
Consolidated (Rs. mn)	**FY09**	**FY10**	**FY11E**	**FY12E**
Operating Cash Flow	3,008	5,373	7,607	8,694
Capex	(2,756)	(4,129)	(4,649)	(2,795)
Free Cash Flow	(257)	(39)	427	2,694
Net Debt	6,185	4,749	4,191	2,398
D/E	1.1x	0.7x	0.5x	0.4x

Source: Spark Capital, Company

RoACE



*Source: Spark Capital, Company * Calculated after adjusting for tax*

Revenues (Rs. mn)	FY09	FY10	FY11E	FY12E
Standalone	13,229	17,581	21,737	24,998
SMR	-	41,587	49,401	57,805
Other Subsidiaries (ex-SMR)	13,169	10,072	11,519	13,232
Consolidated	26,398	69,240	82,657	96,036
EBITDA (Rs. mn)	**FY09**	**FY10**	**FY11**	**FY12**
Standalone	2,023	3,066	3,307	3,900
SMR	-	2,362	3,975	4,989
Other Subsidiaries (ex-SMR)	1,255	874	1,649	1,931
Consolidated	3,278	6,301	8,930	10,820

Source: Spark Capital, Company

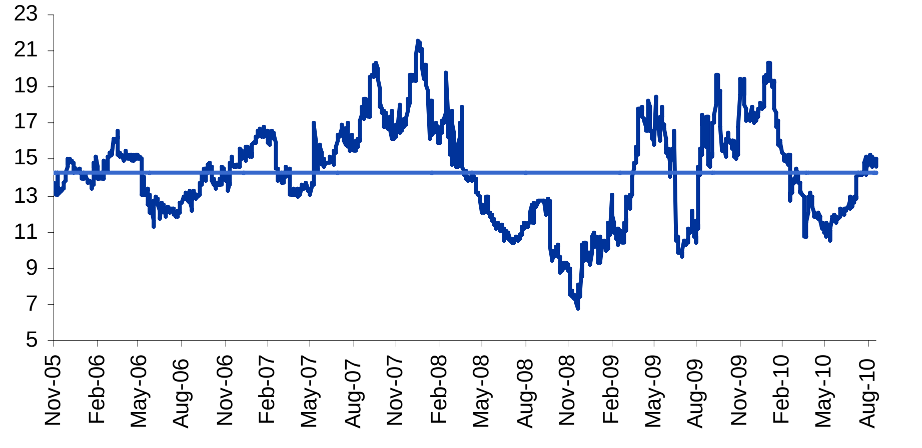
Valuation and Risks

CMP	Rs. 182	Target	Rs. 197

Valuation based on historic P/E band

- We expect earnings to grow ~34% CAGR from FY10 – FY12, on the back of ~18% CAGR in top line and a 220bps increase in EBITDA margins during the two year period
- We estimate an EPS of Rs. 8.4 in FY11 and Rs.11.0 in FY12. At CMP the stock trades at 16.6x our FY12 EPS
- Historic average P/E multiple range suggest that the stock has traded at 14x – 16x for ~30% of the days in the last five years
- We have assigned a P/E of 18x, for its continued dominance and strong traction in SMR business, on FY12E EPS translating into a target price of Rs. 197 We initiate the stock with an OUTPERFORM rating.
- Based on our target price, the stock will trade at an EV of 6.5x FY12 EBITDA

MSSL historical forward consensus P/E (Last five years)



Source: Spark Capital, Bloomberg

Risks

- Delayed turnaround in European passenger vehicles demand could significantly impact SMR, which accounts for a major portion of consolidated revenues
- Increase in competition in domestic market as globally Yazaki is a bigger player in the wiring harness market than Motherson Sumi. Hence, when global OEMs set-up shop in India, they may want to extend their relationship with Tata Yazaki

MSSL Forward consensus P/E band and trading days

Fwd P/E band	Days traded	% of Total days
6x	0	0.0%
6x - 8x	19	1.1%
8x - 10x	80	4.6%
10x - 12x	273	15.6%
12x - 14x	426	24.3%
14x - 16x	487	27.8%
16x - 18x	335	19.1%
18x - 20x	102	5.8%
20x - 22x	30	1.7%
Total days	1752	100.0%

Source: Spark Capital, Bloomberg

Motherson Sumi Systems

Consolidated Financial Summary

OUTPERFORM

CMP	Rs. 182	Target	Rs. 197

Abridged Financial Statements				
Rs. mn	FY09	FY10	FY11E	FY12E
Profit & Loss				
Revenues	26,398	69,240	82,657	96,036
Manufacturing & Other Expenses	23,120	62,939	73,727	85,216
EBITDA	**3,278**	**6,301**	**8,930**	**10,820**
Depreciation	979	2,601	2,735	3,007
EBIT	2,299	3,700	6,195	7,813
Net Interest Exp / (inc)	354	620	493	512
Profit Before Tax	2,560	3,428	5,793	7,451
Tax	349	1,094	1,907	2,318
Minority Interest	450	-91	628	891
Adj. Net Profit	**1,279**	**2,283**	**3,287**	**4,245**
Balance Sheet (Rs. mn)				
Shareholders Equity	7,831	11,649	15,071	18,514
Minority Interest	2,000	2,027	2,654	3,545
Loan funds	8,951	8,179	7,467	7,467
SOURCES OF FUNDS	**18,927**	**21,896**	**25,233**	**29,567**
Net block	13,487	14,548	16,458	16,243
Investments	547	471	500	600
Capital WIP	1,764	1,808	1,812	1,815
Current assets, loans & advances	18,835	20,971	24,292	29,685
Current liabilities & provisions	-15,971	-15,921	-17,846	-18,793
Net Current Assets	2,865	5,051	6,446	10,892
APPLICATION OF FUNDS	**18,927**	**21,896**	**25,233**	**29,567**
Cash Flows (Rs. mn)				
Cash flows from operations	2,498	4,090	5,703	8,225
Capex	(2,756)	(4,129)	(4,649)	(2,795)
Cash flows from investments	(4,312)	(3,758)	(4,678)	(2,895)
Cash flows from financing	2,948	305	(551)	(802)
Free cashflow	-257	-39	1,054	5,431
Cash generated during the year	1,134	637	474	4,529

Key metrics				
	FY09	FY10	FY11E	FY12E
Growth ratios				
Revenues	28.9%	162.3%	19.4%	16.2%
EBITDA	2.3%	92.2%	41.7%	21.2%
PAT	-32.8%	78.5%	43.9%	29.1%
Margins				
EBITDA	12.4%	9.1%	10.8%	11.3%
EBIT	8.7%	5.3%	7.5%	8.1%
PAT	4.8%	3.3%	4.0%	4.4%
Leverage & WC ratios				
Debt to equity (x)	1.1	0.7	0.5	0.4
Current ratio (x)	1.2	1.3	1.4	1.6
Debtor days (Sales)	66	38	38	36
Inventory days (COGS)	106	56	55	54
Creditor Days (COGS)	165	93	88	85
Working Capital days	7	1	5	5
Performance & turnover ratios				
RoACE	13.5%	12.3%	17.6%	19.6%
RoAE	19.4%	23.4%	24.6%	25.3%
Total asset turnover (x)	1.1	1.9	2.0	2.0
Fixed asset turnover (x)	1.4	2.3	2.4	2.5
Working Capital turnover (x)	9.2	13.7	12.8	8.8
Valuation metrics				
Current price (Rs.)		182.00		
Shares outstanding (mn)	356	375	388	388
Market capitalisation (Rs. mn)	64,701	68,177	70,525	70,525
Enterprise value (Rs. mn)	70,886	72,926	74,088	69,559
EV/EBIDTA (x)	21.6	11.6	8.3	6.4
Adj. Per-share earnings (Rs.)	3.6	6.1	8.5	11.0
Price-earnings multiple (x)	50.6	30.0	21.5	16.6
Dividend yield (%)	0.7%	1.0%	1.0%	1.0%

Bharat Forge

UNDERPERFORM

Initiating Coverage

CMP	Rs. 365	Target	Rs. 344

Overseas business to play 'spoil-sport'

A component specialist, with dominant share (~90% in domestic CV market) in the forging business, Bharat Forge (BFL) is well placed for improving operational performance on the back of strong domestic CV growth. While the short term cost reduction measures in Europe have ensured lower break-even volumes and expect the overseas subsidiaries to be profitable, we do not expect, for the next two years, the capacity utilization to be anywhere near CY09 levels. However, with most of the capex already completed for the next two years, we expect positive free cash flow generation. The company's foray in power equipment through JVs is set to diversify its business model and earnings profile beyond FY12.

Domestic CV, export and non-auto business growth would drive volume (MT) growth by 20% for FY11 and FY12 on the back of its continued domination in the domestic CV market which is expected to grow at 17% CAGR for the next two years. We expect the forging utilization to increase from 43% in FY10 to 63% in FY12. Also, with replacement of ageing class-8 trucks in North American exports, we expect exports to increase. The company's design expertise in forging is expected to drive non-automotive business from Rs. 6.7bn in FY10 to Rs. 13.9bn by FY12E.

Cost reduction, a short term measure, in overseas subsidiaries – has led to lower break-even volumes. Reduction in headcount in Europe, post slowdown, has led to 33% decline in staff costs (Rs.1.9bn) in FY10, resulting in lower breakeven volumes. While, we expect the subsidiaries to become profitable in FY11, we do not expect the utilisation levels to be anywhere near to CY08 and CY09 levels and believe OEM volume growth is critical

Overseas subsidiaries capacity utilisation not to reach FY09 levels: On the back of slow recovery in the European and US business, we do not expect capacity utilizations across subsidiaries to reach FY09 levels. We expect the overseas capacity utilization levels to increase from 36% in FY10 to 44% by FY12 (against 60% in FY09). We expect 10% revenue CAGR (FY10-12) for Europe and US business; Europe utilisation is expected to be at 43% by FY12 (35% for FY10), while US utilisation is expected to increase to 35% in FY12 (30% in FY10). In the US business, we do not expect great turnaround due to its high concentration to General Motor (key customer), and expect a delayed in 'pick-ups' segment.

Valuation reflects the story: We value the company based on SOTP of its core business and JV with Alstom and NTPC. Our valuation of core business at 18x P/E multiple (in-line with historical average) on its consolidated EPS (ex-JVs) of Rs. 18.4 leads to value per share of Rs. 331. We value the JV business (BFL-Alstom and BFL-NTPC) at its estimated BVPS of Rs. 14 (FY12E cumulative book value of Rs. 3,500mn for both JVs) and thus arrive at our target price of Rs. 344. We initiate with UNDERPERFORM rating on the stock. **Key Risk: 1) Swift recovery in European and US slowdown 2) slower ramp-up of non-auto business**

Financial summary (consolidated)

YEAR	SALES (Rs. mn)	EBITDA (Rs. mn)	Adj. PAT (Rs. mn)	EPS (Rs.)	P/E (x)	EV/EBITDA (x)
FY10	33,276	3,385	8	0.0	NA	28.9
FY11E	42,178	7,456	3,154	12.2	29.8	12.4
FY12E	51,368	9,603	4,732	18.4	19.9	9.3

Date	Sep 20, 2010

Market data	
SENSEX	19595
NIFTY	5885
Bloomberg	BHFC IN
Reuters code	BFRG.BO
Market cap	Rs. 81.3n
Free float (%)	232mn
52-week High-Low	Rs. 374.5 – 232.0
3m Avg.Daily Vol	Rs. 239.3mn

Latest shareholding (%)	
Promoters	42.06
Institutions	32.01
Public	25.93

Stock Performance (in %)

	1m	3m	12m
Bharat Forge	5.7	29.5	27.3
BSE Auto	4.5	14.0	40.5
Sensex	7.3	11.5	17.0

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Bharat Forge

UNDERPERFORM

Company Overview

CMP	Rs. 365	Target	Rs. 344

Forging capacity

Geography	Tonnes per annum
India	365,000
Europe	200,000
US	60,000
China	135,000

Source: Spark Capital, Company

Consolidated revenue mix among segments

Segments	FY08	% age	FY09	% age	FY10	% age
CV	27,807	58%	26,489	55%	17,164	51%
PC	10,615	22%	10,630	22%	8,839	26%
Pick-up	1,143	2%	1,052	2%	789	2%
Non Auto	8,684	18%	10,147	21%	6,745	20%
TOTAL	**48,249**		**48,318**		**33,537**	

Source: Spark Capital, Company

Spark Snapshot

Position in the value chain	Component Specialist
CSF and financial rank	5
Key trends to watch	• Europe and US CV volume rebound • Non-auto ramp-up • Domestic CV growth

Source: Spark Capital

Geography-wise consolidated revenue mix

Segments	FY08	% age	FY09	% age	FY10	% age
India	13,129	27%	11,129	23%	11,903	35%
Europe	25,470	53%	25,125	52%	13,827	41%
US (North America)	6,272	13%	7,731	16%	5,059	15%
Asia-Pacific	3,378	13%	4,333	16%	2,748	15%
TOTAL	**48,249**		**48,318**		**33,537**	

Source: Spark Capital, Company

UNDERPERFORM

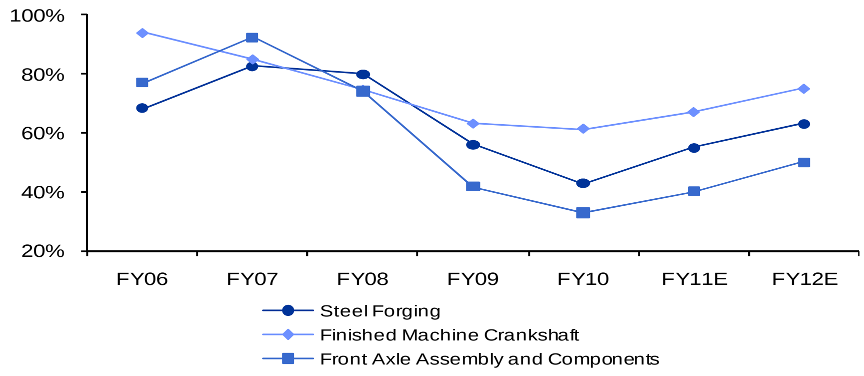
#1 Domestic CV growth, Non-auto and Exports to drive Utilisations

CMP	Rs. 365	Target	Rs. 344

Strength in domestic operations to sustain on strong CV growth

- On the back of expected buoyant domestic M&HCV segment growth and increase in non-auto business we expect BFL's forging capacity utilisation to increase from 43% in FY10 to 63% in FY12E.
- Nearly 56% of domestic revenues come from CV market; we expect this segment revenue to grow by 25% CAGR for FY10-12 on the back of ~90% dominant market share
- As per the company, the North American heavy truck market is expected to recover in 2010 after four years of slump. The company supplies engine and chassis components to the Class 8 trucks. ACT research says that the Class 8 trucks demand is on the cusp of cyclical upswing driven by replacement demand as the average age of those trucks are currently at seven years. It expects 26% growth in production of Class 8 trucks for 2010.

Forging, machining and front axle beam capacity utilisation (%)



Source: Spark Capital, Company

Non-auto business - Only player in the heavy forging and machining components

- The company intends to double its proportion of non-auto revenues to 40% by FY12E. For this purpose, it has set up an 80 MT Hammer (40,000 TPA capacity) and a ring rolling facility (25,000 TPA capacity) in Baramati. This facility is in addition to the existing non-auto facility in Mundhwa (Heavy Forging Division -2)
- Company's non-auto business consists of forging parts supply to power sector (wind, thermal, nuclear and hydro), Oil & gas and transportation (railways and marine) etc. As on 1QFY11 non-auto business contributed nearly 33% of its sales.
- The company has large orders from power sector, railways, Oil & gas and thus expect the non-auto business to be at Rs. 9.7bn in FY11E and Rs. 13.93bn in FY12E against Rs. 6.74bn in FY10.

Segment-wise consolidated break up

Segment	FY08	FY09	FY10	FY11E	FY12E
CV	58%	55%	51%	53%	50%
PC	22%	22%	26%	23%	21%
Pick-up	2%	2%	2%	2%	2%
Non - auto	18%	21%	20%	23%	27%

Source: Spark Capital, Company

#2 Overseas Business expected to have Slow Recovery

UNDERPERFORM

CMP	Rs. 365	Target	Rs. 344

Revenues of BFL;s overseas subsidiaries contributed nearly 45% of the consolidated revenues but had negative contribution to the bottom line to the extent of Rs. 2.03bn. This was primarily led by steep reduction in OEM vehicle production in US and Europe. New truck registration in Europe was down by 44% in CY09. This resulted in capacity utilisation declining to ~40% levels for all subsidiaries (40% in CDP BFL, 35% in BFL Kilsta, Sweden) against 65-70% in previous years.

European CV (>16 tonnes) on the cusp of recovery

European CV production (>16 Tonne which is the relevant market for BFL) declined by 64% in CY09. Key markets like Germany, France, Italy , Spain declined between 52-66% in CY09. However in 1QCY10, the yoy decline in CV was only 4% against 56% yoy decline in 4QCY09 and 64% yoy decline in 3QCY09. Bharat Forge in its outlook expressed its expectation of single digit growth in European CV market for CY10 and expects inventory build up to begin in middle of 2010 as customers expect demand revival in the beginning of CY11.

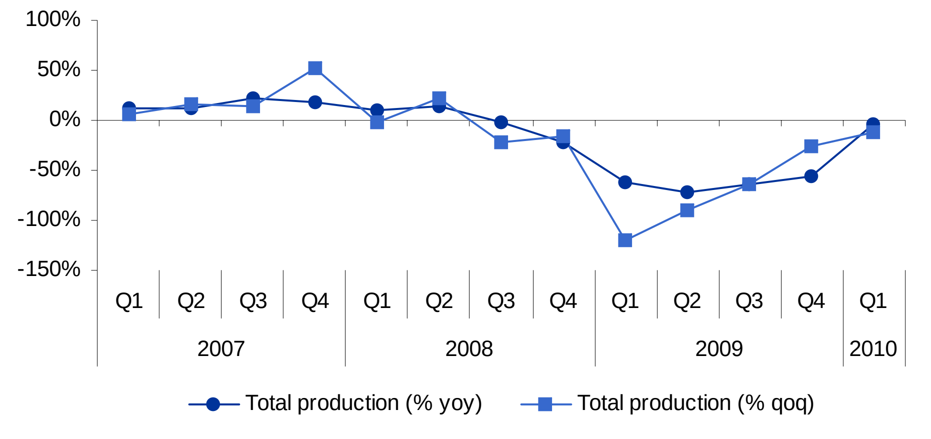
US trucks (North America)– to grow with replacement demand kicking in

US trucks witnessed 28% production decline in CY08 and 30% in CY09. In this market, BFL exports to M&HCV segment with a specific focus on chassis and engine components in Class 8 CVs. The production of Class 8 vehicles fell by 43% in FY10 to 0.11mn units.

The recent pick up in the production from 3QCY09 according to the company, is driven by the replacement of fleet whose age is at all time high, around 7 years. This is expected to continue and thus expect strong exports for BFL as highlighted earlier. ACT research, in its North American Commercial Vehicle Outlook, projects full-year production of Class 8 trucks to be up by 26% for CY10 against CY09.

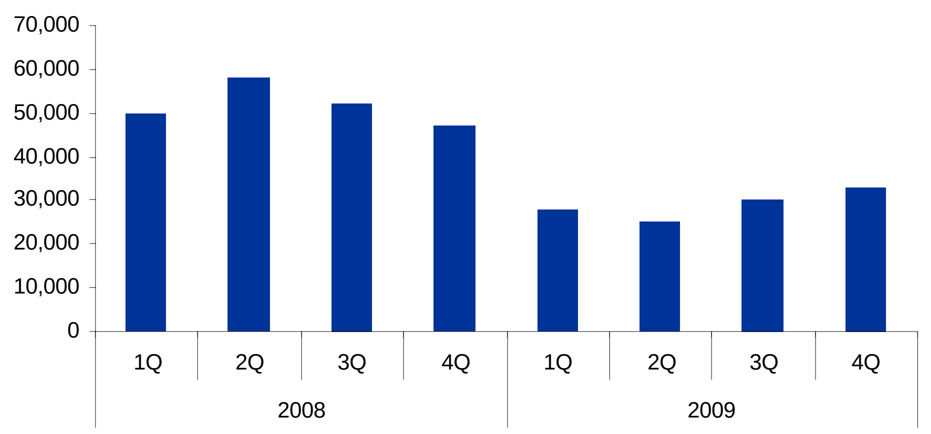
BFL address LCV market in North America through BFA and do not expect a great turnaround in that business as its key customer GM (accounts for 75% of sales) sold off or stopped production of the platforms catered by BFA. However CSM estimates 26% growth in pick-up production for 2010. In such a scenario, BFA can reduce its losses in future

Europe CV (>16 tonne) production trend



Source: Spark Capital, Company

US class 8 trucks production trend



Source: Spark Capital, Company

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#2 Overseas Business Utilisation to be lower than FY09 (Cont'd)

CMP	Rs. 365	Target	Rs. 344

Cost reduction measures to address profitability in the short–term

Reacting to slowdown, the company had reduced the manpower by 30% in Europe and offered severance package to the extent of Rs. 750mn, thereby ensuring the manned capacity is in-line with the demand. The staff cost in the overseas subsidiaries reduced by Rs. 1.89bn in FY10. This has led to lower break-even volumes and thus expect subsidiaries to report profit in FY11E with volume growth. We expect capacity utilization in overall subsidiaries to increase from 35% in FY10 to 44% in FY12, however is still lower than FY09 levels of 60%.

Subsidiaries at brief

- BFA (North America) – Revenue exposure to the extent of 75% from GM for pick-ups. We believe this subsidiary would take longer time to turnaround. The company plans to diversify through its entry in passenger cars
- European subsidiaries (CDP Bharat Forge Germany, BF Aluminiumteck and Bharat Forge Scottish) are expected to become profitable with the expected recovery in CV and PVs
- FAW-BFL JV (China): BFL indicated that the JV would have PAT breakeven next year against FY10 loss of Rs. 315mn
- The first quarter of 2010, witnessed 5% yoy drop in heavy trucks in Europe but showed a muted recovery from March 2010. Between 1Q CY10 and 2QCY10, the registrations have doubled in Germany and UK. BFL's capacity utilisation have also shown improvement during the period
- BFL's subsidiaries posted 6.4% EBITDA margin in 1QFY11 against 5.5% in 4QFY10. We expect 7% growth in European business for FY11E and 12% growth in FY12E. For US business, we expect 9% growth for FY11E and ~12% growth for FY12E

Overseas subsidiaries capacity utilisation (%)

Geography	FY10	FY11E	FY12E
Europe	35%	39%	43%
US	30%	32%	35%
China	40%	45%	50%

Source: Spark Capital, Company

Recovering business and margins (%)

Figures in Rs. mn	FY08	FY09	FY10	FY11E	FY12E
Revenue	24,558	27,165	14,712	16,453	18,683
EBITDA	1,823	1,116	(985)	1,366	1,270
EBITDA margin (%)	*7.4%*	*4.1%*	*-6.7%*	*8.3%*	*6.8%*
PBT	527.8	(469.8)	(2,452.5)	560.5	682.7
PAT	172.3	(621.8)	(2,034.8)	465.0	567.0

Source: Spark Capital, Company

Extending Forging Capabilities to other Businesses

CMP	Rs. 365	Target	Rs. 344

Key players in the BTG space

Companies	Capacity	Tie ups	Products		In house capability		
	(Announced)		Boiler	TG	Designing	BOP	EPC
BHEL	20,000	Alstom/ Siemens	✓	✓	✓	✓	✓
L&T	4,000	Mitsubishi	✓	✓	✓	✓	✓
BGR Energy	4,000	Hitachi	✓	✓	✓	✓	✓
Thermax	3,000	Wilcox & Babcock	✓	×	✓	×	×
JSW-Toshiba	3,000	Toshiba	×	✓	✓	×	×
Bharat forge - Alstom	5,000	Alstom	×	✓	✓	×	×
GB engineering- Ansaldo	2,000	Ansaldo	✓	×	✓	×	×
Total Capacity (MW)			33,000	36,000			

Source: Spark Capital, Company

BFL – Alstom JV – 49:51

The above JV is setting up super critical turbine manufacturing facility with a capacity of 5,000 MW (Turbine and generator) at a cost of Rs. 15bn. The plant will manufacture 300-800 MW sub-critical and super-critical equipments. This JV is one of the bidder for NTPC's order of 11x660MW. We expect BFL-Alstom JV to win atleast 3 of the 11 orders. The company would start producing equipments from FY13E.

Alstom is the global leader in terms of installed capacity at 1150 GW and GE next at 828 GW. It is believed that this JV facility would be the largest facility outside Europe. The JV would also address the export opportunities in future and thus chose Mundra for setting up this facility

Competition to intensify

The total BTG capacity is expected to increase to more than 36GW respectively over the next 3-4years. With expectation of power capacity addition of 20GW annually, we expect the competition in the BTG space to intensify going forward. Players like BHEL, L&T & BGRL will be able to target the overall market as they not only have BTG capability but also have EPC capabilities.

Players like Bharat Forge and JSW will have a limited scope, (unless they tie up with Boiler manufacturers and put in combine bids) as their target customers will be predominantly players like NTPC who give out separate contracts for Boilers and Turbine generators.

BFL – NTPC JV - 51:4

The JV will manufacture Balance of Plant (BOP) equipment for power sector (thermal, hydro and nuclear). The products include advanced class pumps, high pressure piping, castings and forgings etc. The JV expects revenue generation from FY13E.

BFL – Areva JV

BFL has entered into preliminary JV with Areva NP, France to set up a JV to build a manufacturing facility for heavy forgings especially stainless steel forgings. The JV would meet domestic requirements for power generation, and will include the manufacture of turbines, generator rotors and steel plant rolls.

EPC entry

The company is also addressing the EPC space as it is a natural extension to its TG and BOP. The company has won a contract for a 450 MW power plant.

BFL – KPIT Cummins JV

KPIT Cummins and BFL have formed a 50:50 JV that will provide hybrid solutions (kits) for PVs and LCVs to significantly increase fuel efficiency and reduce cost of travel. The proposed equity is Rs.1bn to be built over a period of time and the JV expects Rs. 3bn – 5bn of revenues from FY12. Our interaction with the management suggests a PBT margin of ~10%. However, we lack clarity as the JV is currently in the initial phase of the project and have not factored it in our estimates

Bharat Forge

UNDERPERFORM

Improvement in Utilisation Levels, Low Capex to drive FCF Generation

CMP	Rs. 365	Target	Rs. 344

Higher utilisation and low capex to drive return rations and free cash flow in future

- With expected higher operating margin expansion from 10.2% in FY10 to 18.7% by FY12 and higher earnings growth, we expect RoACE to improve from 2.8% in FY10 to 11.8% in FY12 and RoAE from 0.1% in FY10 to 21.3% in FY12.
- The company's working capital cycle was at 30 days in FY10 and expect it to be well under control with expected working capital days of 33 by FY12E.
- On the back of conversion of FCCBs, the D/E (x) is expected to reduce from 1.5x to 1.0x (factoring the NCD raised worth Rs.1.7bn by FY11)
- With recent capacity addition for non-auto and adequate capacity to address the growing demand, we expect only maintenance capex for the next two years. With improvement in operational cash flow and limited capex budget, we expect free cash generation to continue for the next two years. (Rs. 4.47bn by FY12 against Rs. 4.0bn in FY10)

Reduction in debt and equity dilution of 16%

- In 1Q FY11, BFL redeemed USD $131.5mn worth of FCCBs, leading to addition of 12.8 mn shares. The remaining USD $79.9mn - Tranche A of USD $40mn (conversion price at Rs. 604.03) and Tranche B of USD $39.90mn (conversion price of Rs. 690.32) has conversion deadline on 18th April 2012 and 18th April 2013 respectively. The total diluted shares on these FCCBs is at 5.6mn shares.
- During 1QFY11, the company raised capital of around Rs. 6.26bn including warrants through QIP. This leads to an additional 16.5mn shares
- We do not expect major capex to be incurred for the next two years and thus do not foresee further dilution

Return ratios to improve

Particulars	FY09	FY10	FY11E	FY12E
RoACE	3,219	2.8%	8.9%	11.8%
RoAE	25,316	0.1%	18.2%	21.5%
Total Asset turnover	28,535	0.6	0.8	0.8

Source: Spark Capital, Company

Working capital cycle

Particulars	FY09	FY10	FY11E	FY12E
Inventory days	120	147	150	155
Sundry debtors	41	56	55	58
Sundry creditors	104	173	175	180

Source: Spark Capital, Company

OCF and FCF trend

Particulars	FY09	FY10	FY11E	FY12E
Operating Cash Flow	2,835	5,422	5,174	6,413
Capex	-5,355	-1,350	-1,687	-2,055
Free Cash Flow	-2,520	4,072	3,487	4,359
D/E (x)	1.3	1.5	1.0	0.8

Source: Spark Capital, Company

Nearly 16% dilution (QIP and two tranche of FCCBs)

Total outstanding shares (as on FY10) in mn	222.7
Add: QIP shares (mn)	10
Add: Warrants (mn)	6.5
Total shares (excl FCCB) in mn	239.2
Existing FCCB (mn)	5.6
Total Shares (Diluted) in mn	257.6

Source: Spark Capital, Company

Bharat Forge

UNDERPERFORM

Valuations and Risks

CMP	Rs. 365	Target	Rs. 344

We expect Bharat Forge revenue to grow by CAGR 23% over FY10-12E to Rs. 51.3bn. The growth would be led by strong domestic and exports growth of 33% CAGR for FY10-12E to Rs. 32bn. With improvement in margins and limited capex, we expect consolidated earnings to be at Rs. 4.73bn in FY12E leading to an EPS of Rs. 18.6. The stock has traded nearly 16-18x for 22% of the last five years.

With expected earnings CAGR of ~20% for FY09 – FY12, we assign a target multiple at 18x (in-line with historical multiples) on FY12 consolidated (ex-JV) EPS of Rs. 18.4. Our SOTP based target price of Rs. 344 reflects value per share of Rs. 331 for the core-business (ex-JV) and Rs. 14 per share on FY12E book value of cumulative investments of Rs. 3,500mn in BFL-Alstom JV and BFL-NTPC JV. We initiate the stock with an UNDERPERFORM rating.

Risks: 1) Global slowdown affecting overseas subsidiaries and exports, 2) Slow ramp-up of non-auto business 3) Slowdown in domestic CV business

Five-year forward trading range and number of days traded

Forward P/E	No. of days traded	% of total traded days
2x - 4x	0	0%
4x - 6x	104	6%
6x - 8x	66	4%
8x -10x	68	4%
10x - 12x	288	16%
12x - 14x	178	10%
14x - 16x	209	11%
16x-18x	410	22%
18x - 20x	224	12%
20x - 22x	174	10%
22x-24x	84	5%
24x- 26x	26	1%

Source: Spark Capital, Bloomberg

Bharat Forge one-year forward PE Band

Source: Spark Capital, Bloomberg

Bharat Forge

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Financial Summary (Consolidated)

CMP	Rs. 365	Target	Rs. 344

Abridged Financial Statements (Consolidated)				
Rs. mn	FY09	FY10	FY11E	FY12E
Profit & Loss				
Revenues	47,751	33,276	42,178	51,368
Manufacturing & Other Expenses	42,174	29,891	34,722	41,765
EBITDA	**5,577**	**3,385**	**7,456**	**9,603**
Depreciation	2,517	2,451	2,492	2,430
EBIT	3,060	934	4,965	7,173
Net Interest Exp / (inc)	1,291	1,303	1,178	1,178
Profit Before Tax	1,107	-645	4,366	6,754
Tax	696	119	1,210	1,916
Less: Minority interest	(176)	(132)	0	104
Adj. Net Profit	**2,759**	**8**	**3,154**	**4,732**
Balance Sheet (Rs. mn)				
Shareholders Equity	16,435	14,642	19,981	24,140
Loan funds	21,908	22,527	19,628	19,628
Minority interest	954	783	783	783
SOURCES OF FUNDS	**41,140**	**38,911**	**41,352**	**45,510**
Net block	24,676	24,073	23,269	22,894
Investments	2	2,737	2,737	2,737
Capital WIP	3,219	1,987	2,446	2,979
Current assets, loans & advances	25,316	24,171	29,931	37,278
Current liabilities & provisions	12,081	14,062	17,036	20,383
Net Current Assets	13,236	10,109	12,895	16,895
APPLICATION OF FUNDS	**41,140**	**38,911**	**41,352**	**45,510**
Cash Flows (Rs. mn)				
Cash flows from operations	2,835	5,422	5,174	6,413
Capex	(5,355)	(1,350)	(1,687)	(2,055)
Cash flows from investments	(1,978)	(4,161)	(2,146)	(2,588)
Cash flows from financing	843	(168)	(411)	(574)
Free cashflow	-2,520	4,072	3,487	4,359
Cash generated during the year	1,700	1,093	2,617	3,252

Key metrics				
	FY09	FY10	FY11E	FY12E
Growth ratios				
Revenues	2.6%	-30.3%	26.8%	21.8%
EBITDA	-20.8%	-39.3%	120.3%	28.8%
PAT	1.1%	-99.7%	39945.1%	50.0%
Margins				
EBITDA	11.7%	10.2%	17.7%	18.7%
EBIT	6.4%	2.8%	11.8%	14.0%
PAT	5.8%	0.0%	7.5%	9.2%
Leverage & WC ratios				
Debt to equity (x)	1.3	1.5	1.0	0.8
Current ratio (x)	2.1	1.7	1.8	1.8
Debtor days (Sales)	41	56	55	58
Inventory days (COGS)	120	147	150	155
Creditor Days (COGS)	104	173	175	180
Working capital days	57	30	30	33
Performance & turnover ratios				
RoACE	3.0%	2.8%	8.9%	11.8%
RoAE	16.7%	0.1%	18.2%	21.5%
Total asset turnover (x)	0.9	0.6	0.8	0.8
Fixed asset turnover (x)	1.3	0.8	1.0	1.2
Working capital turnover (x)	4.4	2.9	3.7	3.4
Valuation metrics				
Current price (Rs.)		365		
Shares outstanding (mn)	223	223	223	223
Market capitalisation (Rs. mn)	81,286	81,286	81,286	81,286
Enterprise value (Rs. mn)	98,310	97,836	92,321	89,069
EV/EBIDTA (x)	17.6	28.9	12.4	9.3
Adj. Per-share earnings (Rs.)	10.7	0.0	12.2	18.4
Price-earnings multiple (x)	34.1	na	29.8	19.9
Dividend yield (%)	0.27%	0.29%	0.60%	0.60%

Rating Interpretation	
BUY	More than 100% absolute return over a maximum of three years
OUTPERFORM	Expect the stock to outperform peers/ relevant sector index but is not a Buy
UNDERPERFORM	Expect the stock to underperform peers/ relevant sector index but is not a Sell
SELL	More than 25% downside to the stock price

Analyst Certification

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