

Demand drivers remain in place

Reiterate our positive outlook on CVs; prefer PV stocks over 2Ws

- **Favorable 4QFY24, though margin appears to have peaked:** The automobile industry in 4QFY24 witnessed a healthy volume growth of ~20% YoY, largely driven by 2Ws and PVs, even as demand for CVs and tractors remained weak. While exports improved in 4QFY24, overall outlook across major geographies is still uncertain. Moreover, gross margins were supported by higher volume growth, a better product mix, and foreign exchange benefits, resulting in an EBITDA margin expansion of 140bp/100bp YoY for OEMs/auto ancillaries. However, commodity prices appear to have bottomed out, and incremental margin improvement, if at all, will largely be driven by the improved mix and operating leverage benefits from hereon. The most prominent FY26E EPS downgrades in OEMs were for EIM (-7%) and TTMT (-5%), as we believe margins have largely peaked out in 4QFY24 for these companies. In terms of rating downgrades, we have downgraded BHFC to Neutral (from BUY) and EIM to Sell (from Neutral) largely due to the sharp run-up in the stocks.
- **FY25 starts on a positive note:** The current fiscal has commenced on a positive note, with all segments displaying steady YoY growth. In the initial two months, wholesale volumes for 2Ws, PVs, CVs, and tractors registered a YoY increase of 20%, 3%, 13%, and 3.5%, respectively. Notably, this growth occurred despite subdued demand sentiments due to factors such as heat waves (affecting footfalls), unseasonal rains (adversely impacting certain segments), and pre-election season (adversely impacting the fleet utilization levels). Additionally, the recovery in export volumes contributed to the overall volume growth, especially for 2Ws. The major export players in India, e.g., BJAUT and TVSL posted a volume growth of ~10% and ~20% YoY, respectively, during Apr-May'24. The CV growth of 13% YoY over Apr-May'24 was ahead of our and consensus estimates so far. We had highlighted our positive stance on CVs in our recent thematic report ([click here to refer our note](#)) released in Apr'24, where we had argued that the inherent underlying demand drivers for CVs remained intact and the slowdown in 2HFY24 was largely due to the near-term concerns related to elections and a high base of last year.
- **Government stability would mean long-term policy continuity:** A stable government at the Centre would mean long-term policy continuity. We also expect the government to continue with its focus on infra push, as it has been delivering for the last decade. This has been one of the key reasons why we continue to remain positive on the CV sector. Further, the relatively lower-than-expected election mandate may also see some policy action to lift up the rural sector. If this were the case, it is likely to be positive for PVs, 2Ws, and tractors. We are summarizing our current segmental view as follows:
 - After reporting consecutive double-digit growth over the last two years, the domestic 2W ICE industry is still 17% below its previous peak of 21.1m units achieved in FY19. Given the relatively low base and a good momentum observed in the 125cc+ segment, we anticipate the 2W ICE industry to achieve ~9% volume CAGR over FY24-26.

- The PV industry has witnessed a strong 16% volume CAGR over the last three years. Hence, we expect the PV industry to take a breather in FY25. We anticipate it to report ~5% YoY growth in FY25, driven primarily by a high single-digit growth in UVs.
- We believe the long-term demand drivers for the CV industry will remain in place. Besides, one has to note that, unlike in previous cycles, a few factors would be favorable for the industry, such as: 1) the average fleet age, which is at a record high of more than nine years; and 2) fleet operators' profitability, which has remained sound as fleet utilization levels have been healthy, allowing them to pass on the rising cost pressures. Further, the fleet sentiment index is also positive. Hence, beyond the near-term weakness, we expect the CV industry to revive from 2HFY25. However, given a relatively weak 1HFY25, we expect the industry to report a mid-single-digit growth in FY25.

Valuation and View

- The Auto sector clocked a healthy earnings growth of 96% YoY in FY24 backed by steady volume growth, improved mix, pricing discipline, and benign input costs. This is also reflected in the outperformance of the Auto index (by 45%) relative to Nifty over the last 12 months. Apart from this, there have been sector-specific events that have driven the sub-sector outperformance relative to Nifty.
- It is also now an established fact that the majority of easy gains in the Auto OEM stocks are now behind us, as we have witnessed significant volume growth across segments over the last two years, and input costs also appear to have bottomed out. Hence, one will have to make selective micro strategies to outperform from hereon. Against this backdrop, **Maruti Suzuki is our top pick in Auto OEMs** as: 1) we expect it to continue outperforming the PV segment aided by new launches; 2) its improved mix will help margins sustain at elevated levels; and 3) it could be the key beneficiary if the government decides to reduce GST on hybrid vehicles. **We also like Ashok Leyland** as: 1) we anticipate a revival in CV demand by 2HFY25 after the near-term weakness; and 2) its valuations are attractive compared to peers. We are also positive on Mahindra & Mahindra given: 1) the continued strong demand momentum in UVs; and 2) a likely revival in the tractor segment in FY25, after the corrected base in FY24.
- Further, given the strong long-term growth opportunities for the domestic auto ancillary industry, we continue to remain positive on the sector. Within the auto ancillary sector, **our top picks** include: **1) Craftsman Automation** (well-positioned to benefit from global supply chain de-risking, strong growth opportunities from lightweighting, and multiple growth drivers in the storage solutions business); **2) Samvardhana Motherson** (a key beneficiary of global trends towards premiumization and EV transition, as well as the recent acquisitions); and **3) Happy Forgings** (enjoying a sustainable competitive advantage in forgings, with robust new orders helping to offset the near-term weaknesses in core segments).

Comparative valuations

Auto OEM's	Rating	CMP (INR)	P/E (x)		EV/EBITDA (x)		PB (x)		FY25 Yield (%)		EPS CAGR (%) FY24-26E
			FY25E	FY26E	FY25E	FY26E	FY25E	FY26E	Div	FCF	
Bajaj Auto	Neutral	9,917	30.4	26.5	24.1	20.6	9.9	8.6	2.0	2.4	16.5
Hero MotoCorp	Buy	5,756	24.2	20.6	16.6	14.1	5.7	5.1	2.3	3.2	16.9
TVS Motor	Neutral	2,469	44.7	37.9	27.6	23.7	11.8	9.3	0.3	1.4	21.9
Eicher Motors	Sell	4,926	30.2	27.1	27.9	24.8	6.4	5.6	1.1	4.2	11.6
Maruti Suzuki	Buy	12,560	25.4	22.5	16.3	13.9	4.1	3.6	1.2	1.9	14.7
M&M	Buy	2,961	27.0	23.1	20.9	17.4	2.8	2.4	0.8	3.1	19.8
Tata Motors	Neutral	986	16.9	14.6	5.9	4.9	3.5	2.8	0.4	5.5	7.2
Ashok Leyland	Buy	239	20.5	18.1	13.1	11.4	6.7	5.7	2.5	3.9	20.4
Escorts	Neutral	4,301	42.3	35.6	30.8	29.0	5.2	4.6	0.4	2.9	12.8
Auto Ancillaries											
Bharat Forge	Neutral	1,696	43.8	34.7	24.9	21.1	9.4	7.8	0.7	0.0	54.1
Exide Industries	Neutral	565	34.5	29.9	20.6	18.3	3.4	3.1	0.6	1.7	23.4
Amara Raja	Neutral	1,372	24.5	22.7	13.6	12.5	3.3	2.9	0.7	4.4	10.5
BOSCH	Neutral	33,273	40.5	35.0	35.0	30.0	7.4	6.6	1.2	1.5	23.8
Endurance Tech	Buy	2,722	41.4	33.6	23.5	19.9	6.7	5.7	0.4	1.5	30.9
SAMIL	Buy	180	28.2	23.1	11.5	9.9	4.2	3.7	1.1	1.3	45.2
CIE Automotive	Buy	582	23.8	19.7	14.2	11.9	3.3	2.9	0.8	2.2	18.5
CEAT	Buy	2,504	15.6	12.8	7.4	6.5	2.2	1.9	1.2	4.6	7.4
Balkrishna Ind	Neutral	3,350	36.8	29.3	23.3	19.1	6.5	5.6	1.0	2.2	22.3
MRF	Sell	1,25,823	27.4	24.6	12.4	11.2	2.9	2.6	0.4	2.3	1.2
Apollo Tyres	Buy	485	16.1	14.0	6.9	6.0	1.6	1.4	1.3	16.0	9.2
Sona BLW	Neutral	641	54.9	45.9	31.2	26.1	11.5	9.8	0.6	1.0	25.0
Tube Investments	Buy	4,370	70.2	56.7	29.5	23.9	13.8	11.4	0.2	1.4	49.6
MSUMI	Buy	79	42.1	35.0	24.0	20.1	16.2	13.1	1.6	1.6	25.0
CRAFTSMAN	Buy	4,776	27.4	20.7	9.9	8.2	4.4	3.6	0.4	4.0	26.5
Happy Forgings	Buy	1,200	34.6	26.7	22.7	18.3	6.0	5.1	0.5	1.3	32.0

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