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FIRST LIGHT

27 December 2021

RESEARCH

Automobiles

Smoother road ahead but drive carefully

SUMMARY

Automobiles

- Growing middle / upper class to drive 4Ws demand. SUVs in particular to grow strongly but competition is higher versus hatchback segment
- CV growth driven by ageing fleet and demand recovery. Tractor growth driven by low mechanisation and falling farm labour
- Retain BUY on ESC as Kubota stake rise and upgrade MM to BUY on strong launch pipeline. Upgrade AL to HOLD and retain MSIL at HOLD

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Daily macro indicators

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.49	4bps	(13bps)	57bps
India 10Y yield (%)	6.46	0bps	11bps	57bps
USD/INR	75.25	0.4	(1.1)	(2.3)
Brent Crude (US$/bbl)	76.85	2.1	(3.6)	49.8
Dow	35,951	0.6	0.9	19.0
Shanghai	3,643	0.6	1.7	8.3
Sensex	57,315	0.7	(2.0)	22.0
India FII (US$ mn)	**22-Dec**	**MTD**	**CYTD**	**FYTD**
FII-D	41.9	(854.9)	(771.5)	1,255.7
FII-E	(61.3)	(1,707.9)	3,794.6	(3,531.7)

Source: Bloomberg

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AUTOMOBILES

24 December 2021

Smoother road ahead but drive carefully

- **Growing middle / upper class to drive 4Ws demand. SUVs in particular to grow strongly but competition is higher versus hatchback segment**
- **CV growth driven by ageing fleet and demand recovery. Tractor growth driven by low mechanisation and falling farm labour**
- **Retain BUY on ESC as Kubota stake rise and upgrade MM to BUY on strong launch pipeline. Upgrade AL to HOLD and retain MSIL at HOLD**

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Recommendation snapshot

Ticker	Price	Target	Rating
AL IN	126	121	HOLD
ESC IN	1,856	2,201	BUY
MM IN	827	1,011	BUY
MSIL IN	7,387	7,771	HOLD

Price & Target in Rupees | Price as of 23 Dec 2021

PVs growth outlook intact but rising SUV share will increase competition: In 2018-30 households in Middle class (5.5 to 27.5 l/y) will grow by 2.8x to 168m and in upper class (+27.5/l) will grow by 3.6x to 29m, driving PV demand. But rising share of SUV's, c50% now, will increase competition as SUV model portfolio of global majors is much larger versus hatchbacks which dominated the market in the past.

CV will grow due to freight, ageing fleet and despite some traffic shift to rail: CV market will continue to grow strongly due to 1) macro recovery 2) replacement demand as fleet is the oldest in a decade and due to scrappage policy. But there are risks like traffic shifting to rail after East / West Dedicated Freight Corridor (DFC) are completed in FY23E and better utilization of trucks (from 65% to developed market average of 80%) with rising share of organised logistics. But change will be gradual.

Tractor demand should grow steadily: Demand for tractors should continue due to low mechanisation rates and continued drop in availability of farm labour and demand from non – agricultural sectors like infrastructure.

Rate MM & ESC BUY; MSIL & MSIL HOLD: We upgrade MM to BUY from SELL driven by strong SUV/ UV launch pipeline (XUV700, Scorpio), steady tractor sales, reasonable valuation and group's focus on capital efficiency. Our new TP of Rs.1,011 (630 earlier) is based on market cap of listed subsidiaries and 13.6x FY23 PE of auto business in line with historical median. We retain ESC at BUY as expected majority control by global major Kubota will help tractor business. As deal milestones are reached, stock price should rise. Our new TP of 2,201 (1,350 earlier) implies a FY23 PE of 25x – 48% above median – justified by positive developments.

We retain MSIL at HOLD but cut TP to Rs7,771 (8,000 earlier). MSIL should recover in next few quarters as chip supply normalizes and SUV launches help get back lost share but lack of an EV pipeline until FY25e will cap investor interest given premium valuation of EV players. We upgrade AL to a HOLD from SELL as we expect a sharp recovery in sales volumes in FY23-24 due to growth in the CV industry. Our new TP of Rs121 (80 earlier) implies PE of 34x.

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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