

# AUTO SECTOR REPORT

Geared to be the Leader !

October 27, 2016

# ACGL

RECOMMENDATION:

Buy @ 680, Target 1300



**DYNAMIC LEVELS™**

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## Indian Auto-Component Industry- Geared to be the Leader!

• Economic Overview .....	3
• About The Sector.....	4
• Positives for the Sector.....	5
• Transformation .....	6
• Automotive Mission Plan 2016–26.....	6
• Road Ahead.....	7
• Automobile Corporation Of Goa Ltd.(Acgl)- An Untold Story Of Success.....	7
◆ Why ACGL ?.....	10
◆ History.....	8
◆ Products Offered.....	8
◆ Bus Body Building Division.....	9
◆ Sheet Metal Division.....	10
◆ Financial Highlights.....	10
◆ Investment Opinion.....	11
◆ Buy Recommendation.....	11



## **Economic Overview**

India, a rapidly developing economy, finds an important place in the global forum with its seventh position in terms of nominal gross domestic product (GDP). It was classified as the fastest growing major economy in the world in the fourth quarter of 2014, replacing the People's Republic of China. It holds an important position as a newly industrialized country, a major G-20 player and third largest nation in terms of Purchasing Power Parity (PPP). As on December 2015, India's GDP stood at 2074 USD billion which constitutes 3.34% of the world economy. The annual growth rate in GDP stood at 7.1% as on June 2016. According to Fitch Ratings Agency, India's GDP is expected to grow by 7.7% in FY 2016-17 and gradually accelerate to 8% by FY 2018-19, primary drivers being higher disposable income, gradual restructuring of important segments, and improvement in economic activity.

The consumer prices depict a 5.05% increase in August 2016, which is lower than the July inflation figures of 6.07%. This slowdown has been more than the market expectations and is also the lowest in five months. The major reason attributed to this is small increases in the prices of food and beverages which have seen a 5.83% YoY rise (in comparison to 7.96% in July). The current consumer inflation target is 4%, with a band of plus or minus 2 percentage points. Inflation forms a very important parameter for an economy's study because it directly impacts the purchasing power and growth of the economy. Money supply is an important determinant of inflation rates and Quantitative Easing by the Central Bank helps in moderating the inflation targets.

In accordance with the market expectations, the repo rate remained unchanged at 6.5% as per the meeting held on 9<sup>th</sup> August. This is the lowest in five years indicating the accommodative monetary stance focussing on adequate provision of liquidity in the country. Interest rate in India averaged 6.71% in the 2000-2016 period, touching an all time high of 14.5% in August 2000 and a low of 4.25% in April 2009. Also, the Cash Reserve Ratio (CRR) was fixed at 4% to provide for liquidity.

From an investment perspective, India forms a very attractive destination because of its remarkable growth and developments. The FII holdings in India stand at USD 279 billion. Since its independence, there has been a turnaround in the agricultural sector as India has transformed from a situation of chronic dependence on grain imports to a global powerhouse which is now a net exporter of food. Life expectancy rates have seen a two-fold increase, literacy rates have quadrupled, and the health scenario has also seen a drastic improvement. Indian companies have been entering into much private equity (PE) deals.



According to the Ministry of MSME's annual report for FY 2012–13, the total number of registered micro, small and medium enterprises (MSME) in India saw a 19% growth in FY 2011–12.

## **About The Sector**

Following the growth of the China's manufacturing sector, India has opened up significant prospects as a manufacturing destination. When it comes to skill intensive industries, India has a clear advantage over other Asian countries. The evolving demographics of developing and developed countries have had a favorable impact on India. Studies have revealed that the rapidly aging population of the developed countries has resulted in a shift in manufacturing activities to the cost effective developing countries. As per analyst expectations, India is supposed to have the highest percentage of young working age population by 2050. In this light, the automotive sector of India, also termed as the 'sunrise sector', is playing a pioneering role in the development of Indian industries and has been contributing more than 5% to the Indian GDP since 2005-06.

As a whole, the automotive industry in India is amongst the largest in the world with a recorded annual production of 23.37 million vehicles in the financial year 2014-15 which accounted for 7.1% of India's GDP. It is responsible for the employment of 19 million people who are directly or indirectly associated with this sector. In FY 2014-15, automobile exports rose by 15%.

Considering the Automobile Components sector in particular, India has experienced a healthy rising trend over the past years, primarily due to positive consumer sentiments, a bustling end-user market, and the presence of adequate liquidity in the financial system. The auto-components industry can be broadly classified into the organised sector and the unorganised sector. The organised sector comprises of Original Equipment Manufacturers(OEMs) and constitutes high-value precision instruments whereas the unorganised sector caters to low-valued products mostly belonging to the aftermarket category. In the financial year 2015-16, the Indian Auto Component Industry reported a turnover of USD 39 billion accounting for 2.3% of India's GDP and directly employed 1.5 million people. The sector witnessed a compounded annual growth rate (CAGR) of 14% in the 2006-16 period. Also, exports of merely the automobile components saw a spurt from USD 3.2 billion in 2006 to USD 10.81 billion in 2016. In the last financial year, auto components constituted 4% of India's overall exports. This has been driven by strong domestic growth as well as enhanced globalisation of many Indian suppliers.



<i>Crs</i>	<i>Figures in INR' 00</i>					
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
<b>Turnover</b>	1,883	2,046	2,160	2,117	2,348	2,556
<b>Growth rate (%)</b>	35.9	8.7	5.6	-2.0%	11.1%	8.8%
<b>Export</b>	303	427	526	614	685	709
<b>Growth rate (%)</b>	60.3%	40.9%	23.2%	16.7%	11.4%	3.5%
<b>Import</b>	497	667	744	771	829	906
<b>Growth rate (%)</b>	38.1%	34.2%	11.5%	3.6%	7.5%	9.3%
<b>Investment</b>	91-102	72-92	69-95	32-44	20-28	27-40

### Positives For The Sector

- India is emerging as a global hub for sourcing of auto parts. Geographically, it is **strategically positioned** to take advantage of key automotive markets in the ASEAN, Europe, Korea and Japan.
- Being amongst the fastest growing economies in the world, India is bestowed with a rich pool of skilled and semi-skilled labour. These account for the majority of the working age population which makes India a **cost competitive manufacturing destination**.
- Excise duties for motor vehicles sector has reduced which serves as a catalyst for **enhanced demand** in the auto component industry. The aftermarket sector has reported a growth in CAGR at 12% annually.
- This sector allows for **100% FDI** (Foreign Direct Investment), subject to all applicable laws and regulations.
- The growth of the auto components sector has been supported through various **government incentives** for industrial projects. A number of special auto parks, automotive training institutes, auto-design centres and virtual SEZs have been established.
- **Investments in R&D** in terms of innovative operations and new laboratories have increased to encourage simulation, analysis and engineering animations. Under section 35(2AA) of the Income Tax Act, a weighted deduction of 200% is allowed



for payments made to national laboratories, universities, or specific people if the money is used for scientific research within the approved program.

- Department of Heavy Industries & Public Enterprises has provided a **fund of USD 200 million to modernise** the auto-component industry by provision of interest subsidies on loans and investments in new plants and equipment.

## **Transformation**

Previously, Indian commercial auto-makers like [Tata Motors](#) and [Mahindra & Mahindra](#) followed the western market strategy of vertical integration. However, with the advent of Japanese companies like Suzuki which entered the Indian markets as a Joint Venture(JV) partner with the PSE [Maruti](#) in the mid 80s, it took over a majority share of the passenger car segment. After the JV began operations in India, they outsourced most of their component requirements to suppliers. They brought their critical technology intensive parts from Japan, while developing local facilities for standard parts. In order to survive, a large number of global assemblers entered the Indian markets. The need for new and innovative products greatly increased to compete in the widely diversified low-cost market. These global players took advantage of the existing supply chain system to source technology intensive parts from outside and labour intensive parts locally. Over time, Indian suppliers who excelled in quality, cost optimisation, delivery reliability, etc. became single source suppliers to global OEMs. The entry of a large number of auto-makers weakened the economies of scale and led to low sale volumes despite multiple product launches, and in this scenario, the auto components sector established its importance by meeting the global OEM needs and hence, providing for break-even.

## **Automotive Mission Plan 2016–26**

The AMP 2026 is a vision of the Government of India which provides of guidance of where the various segments of the automotive industry is expected to be in the next 10 years. Key highlights of the plan are-

- The Indian Automotive Industry is to witness a 3.5-4x growth from the current value of USD 74 billion to USD 260-300 billion.
- Auto-component sector to witness a fivefold growth from the current USD 39 billion to a target of USD 171-194 billion and exports to grow from USD 10 billion to USD 70-74 billion.
- Contribution to India's GDP to be over 12%.
- India targeted to be among the world's top three automotive industries.
- Generation of additional employment for 65 million people.



## **Road Ahead**

With rapid globalisation, the world is lining up newer prospects for the transportation industry, primarily while it takes a turn towards electric, electronic and hybrid cars, which are supposedly more efficient, safe and reliable transportation modes. Over the coming years, this will make way towards newer opportunities for auto-part manufacturers, who are required to adapt to the change through systematic research and development.

As per ICRA Limited, the Indian Auto Component industry is expected to register an increase in growth by 8-10% in FY 2017-18, owing to the higher localisation by OEMs, increased auto-components per vehicle, and enhanced exports from India. According to the Automotive Component Manufacturers Association of India (ACMA), the auto-components industry is to record a turnover of USD 100 billion by 2020 with strong exports ranging between USD 80-100 billion by 2026.

## **Automobile Corporation Of Goa Ltd.(Acgl)- An Untold Story Of Success**

### **Why ACGL ?**

The following facts point out why the company forms an attractive investment-

- Right from its origination ACGL with its vehemence on lineament, safety, productivity and dependability has managed to attain and sustain customer satisfaction.
- In an environment of evolution, innovation has kicked in and the bus industry has been witnessing significant changes on the grounds of technology, passenger comfort, safety, etc. With rapid industrialization and economic growth in a country like India, having a population of over 1.25 billion, demand for bus facilities in various spheres has grown remarkably. In this light, ACGL has achieved certain milestones in its bus segment in the financial year of 2015-16. The Company has manufactured 4960 buses in the year, which is the highest annual production till date. Also, it has reached total sales of 50000 buses since its inception. Also, sheet metals have shown an 11% improvement in the same period.
- ACGL has managed to produce world class products with the help of the skilled



and incessantly trained manpower of engineers and the other staff including technicians. The introduction of new products has received a positive response. The 4T School Bus was well adopted in the domestic market while the Elanza Bus received good response in the Middle East. Also, Tata Motors has made the decision to partner with ACGL for the execution of an order of Tata Starbus Diesel Series Hybrid Electric Bus which is very crucial assignment and will boost the prestige of the Company.

- In the pursuance of business excellence, the Company has also ensured safety of its employees, and also maintained a healthy environment in all its operations. Its corporate social responsibility (CSR) has extended its initiatives to spheres of education, women empowerment, support to the disabled and public health.
- The Company has planned payout ratio of 70% in the FY 2015-16 as the recommended aggregate dividend sums upto 150%, which highlights the healthy corporate governance on the part of the Management to achieve the goal of maximisation of shareholders' wealth.

## **History**

The inaugural engineering unit was setup in Goa. It was highly supported by the Tata Motors Ltd, which is one of the largest automobile fabricator in India along with EDC Ltd (formerly known as the Economic Development Corporation of Goa, Daman and Diu Ltd).

Since 1982, ACGL was one the most prominent supplier of Tata Motors' Pune factory. The company has managed to provide the customers 'just in time' supplies thereby ensuring customer satisfaction.

In 1987 the organization embarked a proficient collaboration with Fuji Heavy Industries Ltd, Japan. Fuji Heavy industries which are the producers of the Subaru car for several models of chassis mounted bus bodies and set up a fully vanned Bus Body Building Division. The Company also had an agreement with the FHI to build the Monocoque busses.

## **Products Offered**

The Company operates with two divisions, namely the Bus Body Building Division and the Sheet Metal Division. Both of these cater to the rising and highly specialized requirements of the modern world with the wide range of products that they produce. An overview of the products under the divisions, various models and specific features under each category are as follows-



• **Bus Body Building Division :**

<b>PRODUCT</b>	<b>MODELS</b>	<b>FEATURES</b>
1. Staff Transport Application Buses	Comfort EX Standard, Pleazur Semi-Luxury, Classic LCV, Classic ICV, Comfort, Comfort EX Executive AC Coach	Full driver partition, Foldable seat in cabin, Elegant dashboard, Highback seats
2. Luxury Application Buses	Classic MCV, Classic MCV Luxury, Classic ICV Luxury, Comfort EX Intercity and Pleazur Trips	Luxurious highback and reclining seats, Pleasant interiors, Mobile charging points, Roof mounted LCD, Refrigerator boxes
3. City Application Buses	JNNURM FESLF, CNF Bus with BRTS, LE DIESEL CITY, Mass Rapid Transit Bus, S.T.U Buses	BRTS doors, Aluminium floors, Provision for wheelchair, Plastic Molded Seats
4. Defence Application Buses	Police Van, Dog Squad, Army Bus, Light Armoured Bullet Proof Troop Carrier, Police Van-LCV	Lathi stand, Lathi and umbrella stand, Rifle rack, Bench seats and rear exit
5. Airport Application Buses	Ultra Low Floor CNG	Sofa seats, Provision for wheelchair, Spacious saloon area
6. School Application Buses	MCV School Bus COMFORT, LCV School Bus CLASSIC, MCV School Bus 6HD	Low height handstraps, Underseat storage for bags, Signages and stickers
7. Sleeper Bus	Sleeper Coach	Lower double berth, LED internal lighting and speakers, Shoe rack and under berth luggage space
8. Special Application Vehicles	Tipper Body, Mobile Dental Clinic, Ambulance, Tourism Bus, Mobile Library, Mobile Blood Bank	Dental facilities, Spacious seating, Aluminium flooring



- **Sheet Metal Division**

Various products under this division are gear cover, floor middle front, floor middle side, floor middle rear, emergency door, driver door, etc.

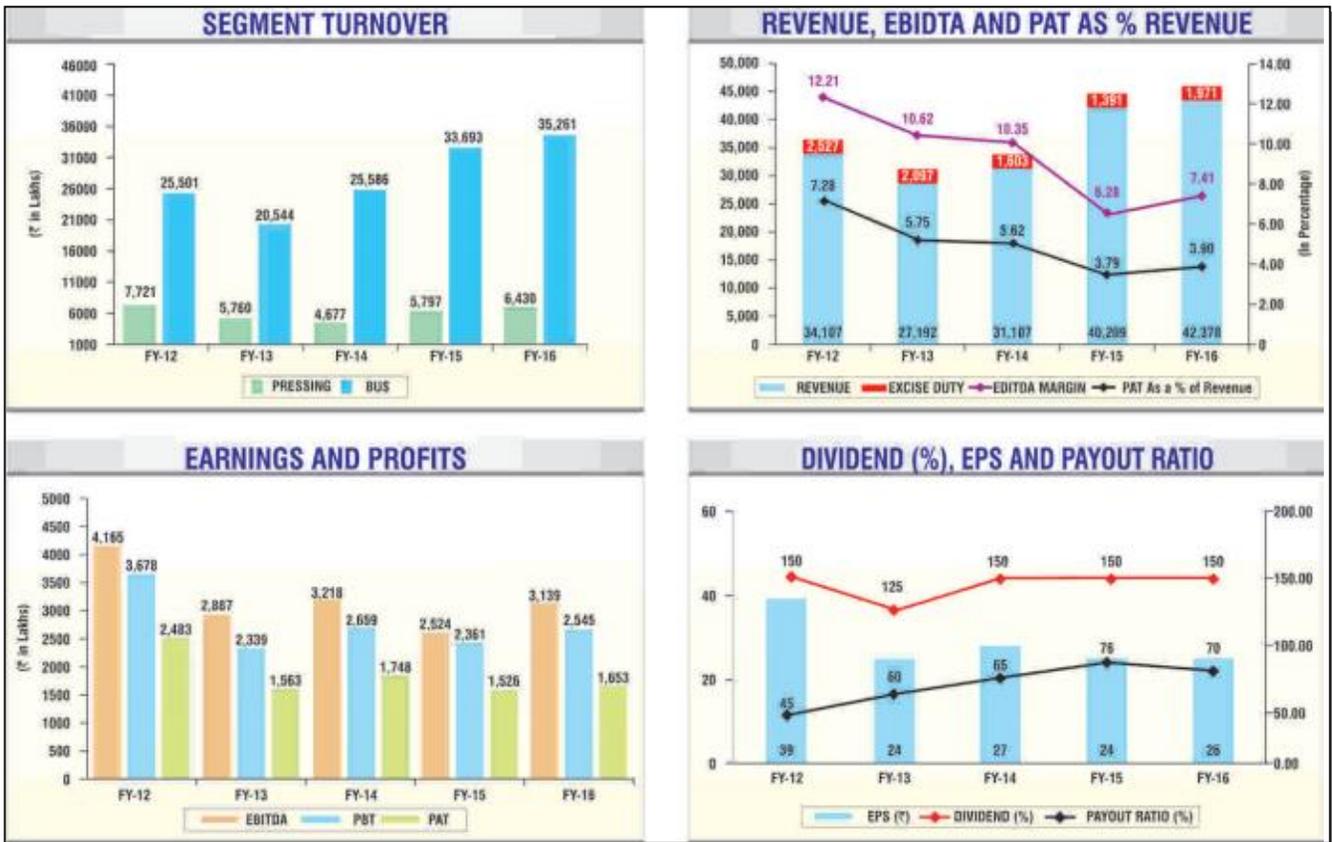
### **Financial Highlights-**

- The total income of the company for the June quarter of FY 2016-17 was recorded at Rs.126.63 million, which depicts a jump of 24.33% in comparison at the June quarter of 2015-16. Also, income figures show an impressive growth of 13.75% on a QoQ basis.
- The PAT figure as of the June quarter of FY 2016-17 was reported at Rs.6.33 million compared to Rs.3.52 million in the same quarter of the previous financial year. This shows a remarkable growth of 79.83%. On a quarter-on-quarter basis, the company has registered almost a 50% rise in net profit figures.
- The EPS has increased to 9.78 in the June quarter of FY 2016-17 from 5.47 in the corresponding quarter of the previous year and 6.59 in the March quarter of 2016.
- The operating profit margin of the company has reported a 31.63% YoY growth and 23.83% QoQ growth.

An overview of the annual figures of ACGL depicting the growth trends is as follows-

<b>Parameter</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Revenue	5.55%	30.37%	15.04 %
Expenditure	4.12%	35.13%	14.75 %
Net Profit	8.32%	- 12.70%	11.84 %

This shows that the revenue of the Company has been trending upwards but it has not been able to decrease its expenditure, which has increased in line with revenue. Hence, for increased profitability, ACGL's focus should be on cost optimisation and decreased expenses.



## Investment Opinion

Given the current macro-economic and sector indications, ACGL shows strong prospects for the future. Its operational performance growth has maintained its momentum and no stone has been left unturned in its endeavor to make a place in the competitive world. The Company depicts strong fundamentals, adequately followed and adopted quality and safety norms, ensured employee satisfaction and is thus perceived as a confident investment.

## Buy Recommendation

While the industry price-to-earnings (P/E) ratio stands at 24.36, ACGL is available at an impressive P/E of 19.31. Given its growth trends, it forms a good buy between Rs.680 with a long term target of Rs.1300.



## **Disclaimer**

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