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Minda Industries Ltd

Section I – Industry Dynamics & Competitive Landscape

Domestic auto components segment is approx. 2,50,000 Cr market per year with approx. 90,000 Cr of exports

While the number of players in the industry is a big number, the number of players making > 2000 Cr sales per annum is less than 30. Number of players > 4000 Cr sales per annum is less than 15

Most Auto Comp players work in the 8-12% EBITDA range with minimal control over pricing except for those who get a large % of revenue from the replacement market (total domestic size of 62,000 Cr). The average player makes a PAT in the range of 4-6%

Addressable market size for the average auto component is in the range of 5000 – 8000 Cr and the industry structure an oligopoly. Very few players have capabilities cutting across components, possible reasons being limited ability to invest into new technologies. Pure in-house R&D driven product development is very rare, most technology transfer has been through collaboration with global players who aren't keen to run operations in India by themselves and hence look for a local partner.

At an annual sales of 2000 Cr, PAT for the average auto comp player is in the range of 80-120 Cr. There is a heavy reliance on sales to OEM segment (> 90%) which makes most auto component players display sales growth equal to the industry growth rate over a secular period. Industry growth rate is expected to be in the range of 10-12% from here.

Hence, the average auto comp story gets a multiple between 10 - 25 depending on how good the market conditions are. This translates into a market cap of 1000 – 3000 Cr during most market conditions.

For an auto comp story to trade at market cap in excess of 4000 Cr the company needs to demonstrate ability to

- deliver market leading growth rate over a secular period
- expand addressable market size either through product category expansion or through geographical expansion
- reduce over reliance on a single OEM and Segment (2W, 4W) and hence contain cyclicality

Every auto comp story that trades above a market cap of 4000 Cr except for Tyre and Battery Makers (where the addressable market size and the replacement proportion are way higher) meets the above criteria.

Examples being Motherson Sumi, Bosch, Endurance technologies, Bharat Forge, Varroc Engineering, Minda Industries.

*Please refer the file "**Data Sheet – Auto Ancillary**" for an overview of the financials, valuation and 5-year growth rate of auto component players that track market cap > 500 Cr at this point of time.*

Section II – Company & Management background

Minda Group has been in existence from 1958, now exists in two separate groups – Uno Minda group controlled by Nirmal K Minda and Spark Minda Group controlled by Ashok Minda. The rest of this note pertains to the Uno Minda group whose flagship company is Minda Industries (MIL).

Group Turnover – 7000 Cr (as of March 31, 2018)

MIL Consolidated Turnover – 4470 Cr (as of March 31, 2018)

Current Product Portfolio & Timeline

- Automotive Switches – Before 2000
- Automotive Horns – 2001, Clarton Horns acquired in 2015
- Automotive Lighting – Before 2000 (Rinder acquired in 2017)
- Die Casting – 2010-14
- Blow Molding – 2001-08
- Alloy Wheels, Air Bags, Steering Wheels – 2015-16
- CNG/LPG Kits – 2001-08
- Automotive Batteries – 2001-08
- Infotainment System & Speakers – 2017-18
- HVAC Panels, Sensors – 2017-18
- Telematics, Driving Assistance & Other advanced electronics – 2017-18

Most of the new products have been introduced through the JV mode with global technology leaders in respective areas like Tokai Rika, Emer, Kyoraku, Toyoda Gosei, Denso Ten, Kosei, TTE, Onkyo, Sensata & Katolec. The earlier areas were mostly through organic diversification backed up by technical agreements and in-house R&D.

Since 2012 MIL has been consolidating associate companies and JV's by buying additional stake from partners. KPMG has been helping them in this restructuring exercise – roadmap has been drawn up till FY2019 which has largely been on track. While investment in new areas has been continuing through the JV route (which is an industry standard in the Auto space), management has been communicating that over a period as the business in each of these JV's scales up and stabilizes, consolidation activity within MIL will continue to align incentive structure of promoters, management and minority investors.

Group has presence across the 2W, 3W, 4W and CV segments. Share from OEM is 80%, Exports is 15% and Aftermarket is 5%. Over time, as the revenue from the new investments has been growing, MIL's reliance on the legacy businesses of Switches, Horns & Lighting has been coming down though each of these areas has been growing at a healthy rate.

Management

Nirmal Minda and Anand Minda from the Promoter family are involved in operations. Rest of the management is professional management with the dependence on promoters to run the day to day operations reducing over time.

Section III –Business Highlights & Historical Financials

Product lines	Global presence	Domestic presence	Approx market share	2018 Revenue in Cr (MIL)
Switching systems	Yes	Leader	65%	1580
Acoustic systems	2nd largest	Leader	47%	717
Lighting systems	Yes	3rd Largest	25-30%	1164
Alloy wheels	NIL	Leader	30-35%	436
Sensors, Actuators and controllers	NIL	New venture	Not significant	
Fuel caps / Fuel systems	NIL	small player	Not significant	
Blow moulding system	NIL	small player	Not significant	139
Aluminium castings	NIL	small player	Not significant	274
Airbags	NIL	Leader	35%	
Batteries	NIL	small player	Not significant	
Air filtration system and canisters	NIL	small player	Not significant	
Hoses	NIL	small player	Not significant	
RPAS & DAPS	NIL	New venture	NA	
PCB and Box build assemblies	NIL	New venture	NA	

	2010	2011	2012	2013	2014	2015	2016	2017	2018
2 Wheeler	76%	75%	70%	70%	68%	62%	64%	61%	56%
4 Wheeler	24%	25%	30%	30%	32%	38%	36%	39%	44%

OEM	77%	84%	83%	82%	82%	83%	82%	87%	89%
Replacement	23%	16%	17%	18%	18%	17%	18%	13%	11%

2W Switches – Bajaj Auto maximum share (46% in 2015 to 35% in 2018)

4W Switches – MSIL maximum share (45% in 2017 and 55% in 2018)

Lighting across 2W and 4W – 65% outside India, within India MSIL at 29% and M&M at 10%

Blow Moulding – MSIL 23%, Toyota 27%

Die Casting – 59% HMSI, 16% WABCO India, 25% TVS

Alloy Wheel – 90% MSIL

- Steady portfolio expansion through the years, reliance on legacy business (Switches, Horns & Lighting) coming down. 95% contribution in 2012 to 75% in 2018
- New Businesses tracking EBITDA > 15% while legacy business is around 10.5%
- Future portfolio expansion also expected to be margin accretive (> legacy EBITDA)
- Over reliance on single OEM coming down, replacement segment growing at 14-15%

Consolidated Numbers	2012	2013	2014	2015	2016	2017	2018
Balance Sheet							
Net Worth	298	321	326	387	581	1165	1603
Gross Block	488	605	1073	1151	1429	1995	2319
Debt	160	160	170	209	353	447	543
Net Current Assets	137	66	101	117	134	161	462
Profit & Loss							
Income from Ops	**1179**	**1340**	**1706**	**2226**	**2527**	**3385**	**4470**
Gross Margin (%)	31.07%	29.82%	31.36%	33.63%	36.31%	37.49%	38.19%
Employee Cost (%)	11.39%	10.74%	13.18%	12.93%	12.91%	13.33%	13.13%
Other Expenses (%)	13.25%	12.11%	13.62%	13.77%	13.98%	13.13%	13.12%
EBITDA (%)	7.82%	7.79%	5.55%	7.96%	9.96%	11.44%	12.69%
EBIT (%)	4.41%	4.34%	2.09%	4.21%	6.30%	7.42%	9.00%
PAT (%)	2.06%	2.15%	0.27%	2.93%	4.39%	4.87%	6.88%
PAT	24	29	5	65	111	165	308
Comprehensive Income	28	28	5	68	123	185	331
Cash Flows							
OCF	82	95	42	135	146	335	362
Fixed Assets Investment	**105**	**137**	**122**	**74**	**211**	**254**	**517**
JV/Subsidiary acquisition					58	35	138
FCF	**-23**	**-41**	**-80**	**61**	**-64**	**80**	**-154**
Key Ratios							
D/E	0.54	0.5	0.52	0.54	0.61	0.38	0.34
ROCE (%)	11.82%	12.77%	6.43%	16.50%	18.16%	19.89%	18.76%
ROE (%)	8.15%	8.96%	1.39%	16.90%	19.07%	14.17%	19.20%
Gross Asset Turns	2.42	2.22	1.59	1.93	1.77	1.70	1.93
Working Capital Days	43	18	22	19	19	17	38

- Sales growth at 28% since 2010, PAT growth at 38.5%
- Improvement in profitability led by increase in Gross Margins that is now translating into higher EBITDA – as newer businesses gain scale employee expenses and overheads are spread over higher sales
- Heavy investments into Fixed Assets that has not yet translated into commensurate Sales (Gross Asset Turns has been under 2 while 2.5X is doable)
- Debt levels not scaling up with heavy fixed asset investments since Working Capital cycle is being managed well. MIL has done QIP for 300 Cr in March 2017
- Once the heavy Capex for 2019 and 2010 is done, MIL may turn free cash flow positive

Possibilities

MIL appears to be a business that can continue industry leading growth rate (> 15%) over the next 4-5 years due to category expansion through the JV model followed by consolidation into the MIL entity. Strong linkages with OEM's are likely to result in incrementally lower sales effort to derive greater sales, resulting in higher kit value per vehicle. As the recent investments start translating into higher sales, return ratios are very likely to look healthier eventually resulting in D/E coming down, in turn leading to higher PAT

Proven Category Expansion capability + Growth in existing products → Industry leading Sales Growth → Higher EBITDA Margins → Better Cash Flows → Ability to reinvest to derive more growth without stressing balance sheet

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Section IV – Assumptions & Risks

Key assumptions and Hypothesis

1. Overall Auto OEM sales will track the 8-12% range over the next 8-10 years on a CAGR basis though one may have the occasional down year

2. MIL will continue to add new categories and products through the JV/Technology collaboration route. This is very critical to the long-term success, a good chunk of the hypothesis hinges on this aspect continuing well

3. No disruptive regulations will be brought in a big bang manner (though the product portfolio suggests that disruptive action is unlikely to affect MIL too much)

4. Newer categories will continue to be EBITDA accretive, while we are not banking on EBITDA being significantly higher from current levels the assumption is that it will not be lower than 12% barring the occasional blip

5. Alloy Wheel penetration crosses 60% by 2027, LED lighting penetration crosses 80% by 2027. Likely market size of airbags by 2027 is 6000 Cr, Alloy Wheels at 10,000 Cr (MIL will have 30% market share in both categories by 2027)

Risks

1. If the Auto industry were to go into a sudden downturn, sweating existing investments may take higher than anticipated which will dilute the hypothesis to a good extent

2. As Kit value per vehicle goes up for MIL, OEM's may start negotiating with MIL as an entity as opposed to procurement based on individual categories

3. MSIL and Bajaj Auto underperforming in their respective markets may impact growth rate of MIL since reliance on these two OEM's is higher

4. As MIL enters categories that call for higher reliability and safety requirements (alloy wheels, driving assistance), their liability towards the OEM might go up considerably

5. Scaling up of newer categories may take longer than expected which may depress margins in the meanwhile

6. There is a possibility that as volumes of newer products like alloy wheels and airbags go up, OEM's may demand lower pricing thus taking EBITDA lower

7. Since corporate restructuring and corporate activity is very high, risk of creative accounting increases significantly.

8. As the proportion of international business goes up over time, the business will start hinging on more external variables that can follow different cycles

9. As reliance on professional management increases, there is a possibility that the execution capabilities slow down and hence the sales growth falls below 15% over the medium term

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Section V – Financial Projections & Valuation

The following is a realistic scenario in my opinion

- Growth rate of 14% over the period, legacy business and Harita Seating growing at 9-10%
- Overall EBITDA in the 12-13% range
- Incremental working capital at 12% of sales – effectively at 40 days
- New Business areas like advanced electronics, controllers, driving assistance to contribute 1000 Cr sales by 2027. EBITDA in these new areas will get to the target of 14% over 4-5 years
- Business segment of Alloy Wheels, Airbags, Die Casting and Blow Moulding is likely to grow at 20% till 2027

	2020	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**
Balance Sheet								
Gross Block	3260	3910	4630	5490	6400	7460	7820	8630
Debt	1100	1191	1068	976	787	259	-	-
Net Current Assets	737	941	1250	1265	1439	1610	1790	1990
Net Worth	2600	2980	3960	3990	4640	5340	6220	7140
Profit & Loss								
Legacy Business	3900	4200	4570	4982	5490	5920	6550	7050
Other Business	2537	3170	3870	4642	5385	6130	6890	7700
Harita Biz	325	1070	1190	1330	1490	1650	1820	1980
New Biz	50	100	150	250	350	450	550	650
Total Income	**6759**	**8535**	**9780**	**11200**	**12650**	**14164**	**15700**	**17368**
EBITDA	839	1054	1222	1420	1615	1820	2018	22240
Depreciation	228	274	324	384	448	522	547	604
Finance Cost	99	107	96	89	71	54	-	-
PBT	**522**	**673**	**802**	**943**	**1096**	**1240**	**1471**	**1636**
Taxes	146	188	225	264	307	347	412	458
PAT	**376**	**484**	**578**	**680**	**790**	**892**	**1060**	**1180**
Investments								
Capex Outlay	300	400	450	500	550	350	350	400
JV Outlay	100	100	100	200	200	200	200	250
Inc WC	190	213	149	171	174	181	184	200
Equity Issuance	400							
Cash Flows								
Operating Cash	568	623	822	956	1115	1270	1422	1580
FCF	168	123	272	256	364	373	872	932
Dividend Outgo	75	95	116	136	158	178	212	236
Validation								
Gross Asset Turns	2.07	2.18	2.11	2.04	1.98	1.99	2.01	2.01
EBITDA %	12.4%	12.35%	12.5%	12.6%	12.8%	12.8%	12.9%	12.9%
ROCE %	22.4%	24.2%	25.5%	25.3%	25.6%	27.5%	29.6%	31.2%

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Cost of Equity at 15.10%

WACC at 12.8%

At these assumptions present value of discounted cash flows (EV) works out to 10100 Cr. Adjusting for Debt on books, value of owner's equity works out to the 9000 Cr range before dilution for Harita Seating acquisition.

Current Market Cap = 8550 Cr

Dilution due to Harita Acquisition assuming everyone opts for share swap = 4.5%

Current market cap adjusted for dilution = 8200 Cr

Sensitivity Analysis

This is for post diluted market cap as calculated above

	Growth over the period (2020-2027)				
Exit Multiple	**12%**	**14%**	**16%**	**18%**	**20%**
14	4,199	5,076	6,998	8,505	10,151
16	5,114	6,567	8,074	9,258	11,627
18	5,706	7,428	8,935	10,389	12,919
20	6,352	8,128	9,850	12,703	14,211
22	6,890	8,892	10,766	13,780	15,502

On a TTM basis sales growth has already been 30%, sales growth of 20%+ looks likely in the immediate future while over the period it may trend lower towards the 15-16% mark

FY19 PAT is likely to be in the range of 360 Cr, TTM PAT already reflects 350 Cr

Barring bad market conditions, exit multiple of 18 looks reasonable to assume

Historical Valuation Range

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Market Cap	**315**	**263**	**332**	**311**	**335**	**995**	**1,675**	**3,584**	**8,439**
Enterprise Value	572	570	424	442	562	1,174	1,971	3,654	8,822
Mcap to Sales	0.51	0.28	0.28	0.23	0.20	0.45	0.66	1.06	1.89
Price to Book	2.26	1.32	1.11	0.97	1.03	2.57	2.88	3.08	5.27
Price to Earnings (TTM)	13.14	7.37	13.68	10.82	73.94	15.23	15.11	21.72	27.42
Enterprise Value to EBITDA	7.81	5.73	4.60	4.23	5.94	6.62	7.83	9.43	15.55

Stock Performance

	YTD	1-Month	3-Month	1-Year	3-Year	5-Year	10-Year
Minda Industries	-0.51	12.14	-0.39	-17.19	79.48	93.86	49.27
S&P BSE Mid Cap	-6.06	-0.95	-3.57	-11.90	13.70	17.39	18.03
S&P BSE Auto	-9.16	-0.31	-9.45	-23.75	4.64	8.47	21.55

Company's return has been calculated on basis of BSE's price. As on Mar 01, 2019

Source: Valueresearch.com