

# Eicher Motors

13 November 2018

Reuters: EICH.NS; Bloomberg: EIM IN

## Weak Performance Because Of Lower Margins

Eicher Motors' (EML's) 2QFY19 earnings were below our expectations, with PAT at Rs4.8bn coming in 12% below our estimate. Net sales at Rs24.0bn posted a low double-digit growth rate of 11% YoY on 4% YoY growth in volume. EBITDA margin for the quarter at 30.6% fell 127bps YoY and was ~90bps below our estimate because of higher other expenditure. Absolute EBITDA at Rs7.4bn grew 7% YoY and was 4% below our estimate. PAT at Rs4.8bn fell 1% YoY and was 12% below our estimate. The company, in the conference call, indicated that lower margins were because of higher other expenditure in the wake of new launch expenses of twin 650cc motorcycles and the same is expected to continue in the current quarter because of India launch of the same models. On the demand side, the company's management indicated that the festive demand was good this year, but following the strike at its plant the production was impacted. Overall production impact because of the strike was close to 25,000 units and the strike is still not resolved, resulting in an impact of 800 vehicles/day. Same-store sales growth was negative for the quarter because of weak demand in some few states. In Kerala, the management indicated that demand has normalised. Despatches to dealers of new 650cc twin motorcycles have started for test rides, while for the global market the same will start soon. The company believes the full impact of despatches of 650cc twin motorcycles will be in 4QFY19. The management indicated that EML has appointed 28 new dealers in India and set up another store in Thailand. Total dealers of the company's vehicles in India now stand at 860. Following the strike impact on its plant and lower production, we have cut our volume estimates for FY19/FY20 by 3% each. We have cut our earnings estimates by 6% each for FY19/FY20 to factor in lower margins. EML stock, after a sharp correction in the past quarter, currently trades at 21x FY21E EPS. We have retained our Buy rating on the stock with a target price of Rs29,402 (28x September 2020E EPS + Rs1,792 valuation for VE Commercial Vehicles business).

**Strong growth in realisation:** Royal Enfield's 2QFY19 numbers indicate strong YoY growth in realisation. The company reported a strong 7% YoY growth in realisation because of improved mix of recent new launches. The product mix improvement does not factor in the new launch of 650cc bikes, which we believe will further drive realisation in the coming quarters. Net sales of the company during the quarter grew 11% YoY on 4% YoY growth in volume. Realisation for the quarter at Rs113,808 grew 7% YoY and 1.3% QoQ, indicating the improving mix of recent new launches and higher spare part sales. In the conference call, the company's management indicated that it is facing shortage in SKU supplies for premium variants which will be resolved in two to three months.

**VECV business growth continues:** VE Commercial Vehicles (VECV) witnessed volume improvement of 26% YoY at 18,696 units during the quarter driven by sales of improved value trucks. The company has finalised the design and will start production at its new plant in Bhopal which will have a total capacity of 40,000 vehicles per annum. The new capacity is expected to come on stream after 24 months. The total investment in the plant is Rs4,000mn.

**Outlook and valuation:** We expect EML to report a 12% CAGR in Royal Enfield motorcycle volume over FY18-FY20E. We have retained Buy rating on EML and revised our target price to Rs29,402 (28x September 20E EPS+Rs1,737 valuation for VECV business) from Rs36,529 earlier.

## BUY

**Sector:** Automobiles

**CMP:** Rs21,934

**Target Price:** Rs29,457

**Upside:** 34%

**Gaurant Dadwal**

Research Analyst

gaurant.dadwal@nirmalbang.com

+91-22-6273 8145

**Vivek Sarin**

Research Associate

vivek.sarin@nirmalbang.com

+91-22-6723 8176

### Key Data

|                          |               |
|--------------------------|---------------|
| Current Shares O/S (mn)  | 27.3          |
| Mkt Cap (Rsbn/US\$bn)    | 598.1/8.2     |
| 52 Wk H / L (Rs)         | 32,237/20,001 |
| Daily Vol. (3M NSE Avg.) | 96,745        |

### Price Performance (%)

|               | 1 M   | 6 M    | 1 Yr   |
|---------------|-------|--------|--------|
| Eicher Motors | (8.2) | (29.0) | (28.2) |
| Nifty Index   | 0.1   | (3.0)  | 1.6    |

Source: Bloomberg

| Y/E March (Rmn)    | 2QFY18 | 1QFY19 | 2QFY19 | YoY (%)  | QoQ (%)  |
|--------------------|--------|--------|--------|----------|----------|
| Net revenues       | 21,636 | 25,449 | 24,041 | 11.1     | (5.5)    |
| Raw material costs | 11,270 | 13,097 | 12,176 | 8.0      | (7.0)    |
| Staff costs        | 1,302  | 1,653  | 1,706  | 31.0     | 3.2      |
| Other expenses     | 2,164  | 2,477  | 2,797  | 29.3     | 12.9     |
| Total expenditure  | 14,736 | 17,227 | 16,679 | 13.2     | (3.2)    |
| EBITDA             | 6,901  | 8,222  | 7,361  | 6.7      | (10.5)   |
| EBITDAM (%)        | 31.9   | 32.3   | 30.6   | (127)bps | (169)bps |
| Depreciation       | 490    | 698    | 718    | 46.7     | 2.9      |
| Interest costs     | 7      | 7      | 8      | 4.2      | 4.2      |
| Other income       | 699    | 1,260  | 953    | 36.3     | (24.4)   |
| PBT                | 7,103  | 8,776  | 7,588  | 6.8      | (13.5)   |
| Tax                | 2,239  | 2,864  | 2,599  | 16.1     | (9.2)    |
| Net profit (adj.)  | 4,864  | 5,912  | 4,989  | 2.6      | (15.6)   |
| NPM (%)            | 22.5   | 23.2   | 20.8   | (173)bps | (248)bps |
| EPS (Rs)           | 179.5  | 218.2  | 184.1  | 2.6      | (15.6)   |

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 1: Key financials

| Y/E March (Rsmn)  | FY17   | FY18   | FY19E    | FY20E    | FY21E    |
|-------------------|--------|--------|----------|----------|----------|
| Net sales         | 70,380 | 89,575 | 1,04,474 | 1,20,026 | 1,34,529 |
| EBITDA            | 22,058 | 28,532 | 33,004   | 37,128   | 41,614   |
| Net profit        | 15,600 | 20,249 | 23,041   | 25,577   | 28,290   |
| EPS (Rs)          | 573.3  | 742.8  | 845.2    | 938.3    | 1,037.8  |
| EPS growth (%)    | 18.9   | 29.6   | 13.8     | 11.0     | 10.6     |
| EBITDA margin (%) | 31.3   | 31.9   | 31.6     | 30.9     | 30.9     |
| P/E (x)           | 38.3   | 29.5   | 26.0     | 23.4     | 21.1     |
| P/BV (x)          | 15.2   | 11.1   | 8.9      | 6.9      | 5.5      |
| EV/EBITDA (x)     | 27.0   | 20.5   | 17.7     | 15.8     | 0.0      |
| RoE (%)           | 39.8   | 37.7   | 34.2     | 33.1     | 28.9     |
| RoCE (%)          | 38.5   | 36.2   | 33.1     | 32.2     | 28.3     |

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 2: SOTP valuation

| (Rs)                                | September 2020E |
|-------------------------------------|-----------------|
| Royal Enfield's EPS (Rs/share)      | 988             |
| P/E (x)                             | 28              |
| <b>Royal Enfield- standalone</b>    | <b>27,665</b>   |
| <b>Eicher Motors' stake in VECV</b> |                 |
| EPS @ 54.4% stake (Rs/share)        | 115.8           |
| P/E (x)                             | 15              |
| <b>VECV's share</b>                 | <b>1,737</b>    |
| <b>Total</b>                        | <b>29,402</b>   |

Source: Nirmal Bang Institutional Equities Research

## Exhibit 3: Change in our estimates

| (Rsmn)            | New estimates |           |           | Old estimates |           |       | Change (%) |       |
|-------------------|---------------|-----------|-----------|---------------|-----------|-------|------------|-------|
|                   | FY19E         | FY20E     | FY21E     | FY19E         | FY20E     | FY21E | FY19E      | FY20E |
| Volume            | 9,23,548      | 10,36,508 | 11,31,679 | 9,55,390      | 10,71,534 | -     | (3.3)      | (3.3) |
| Net sales         | 1,04,474      | 1,20,026  | 1,34,529  | 1,07,749      | 1,23,701  | -     | (3.0)      | (3.0) |
| EBITDA            | 33,004        | 37,128    | 41,614    | 35,029        | 39,295    | -     | (5.8)      | (5.5) |
| EBITDA margin (%) | 31.6          | 30.9      | 30.9      | 32.5          | 31.8      | -     | (92)       | (83)  |
| PAT               | 23,041        | 25,577    | 28,290    | 24,422        | 27,054    | -     | (5.7)      | (5.5) |
| EPS (Rs)          | 845           | 938       | 1,038     | 896           | 992       | -     | (5.7)      | (5.5) |

Source: Nirmal Bang Institutional Equities Research

## Exhibit 4: Deviation of our estimates from actual performance in 2QFY19

| (Rsmn)     | Actual performance | Our estimate | Deviation |
|------------|--------------------|--------------|-----------|
|            | 2QFY19             | 2QFY19       | %         |
| Net sales  | 24,041             | 24,323       | (1.2)     |
| EBITDA     | 7,361              | 7,662        | (3.9)     |
| Net profit | 4,989              | 5,496        | (9.2)     |

Source: Nirmal Bang Institutional Equities Research

**Key takeaways from post-result conference call**

- The company witnessed good festive demand, despite the strike at its Oragadam plant. The strike at this plant, which started from 24 September 2018, continues and has caused production loss of 25,000 vehicles in September and October. Its current daily production stands at ~2,300 vehicles.
- While raw material expenses are on the rise, EML has been able to deflect the pressure by cost management measures. Gross margin during the quarter improved because of an improved product mix. There was increase in expenditure during the quarter following the launch of twin motorcycle models in 2QFY19. Its Interceptor model in the US has been priced at US\$5,800/vehicle onwards, while the GT model has been priced at US\$6,000/vehicle. These have also been launched in the UK, priced at GBP 5,500 and Europe (GBP 6,200).
- The company launched its Classic Signal model in August 2018 and with that it has started the transition to the anti-lock braking system. All RE models have shifted to rear disc brake, barring the Bullet which retains rear drum brake.
- The management expects commercial production at Phase II of Vallam Vadagal plant by 2HFY20. Its medium duty engine sales grew 11% in 2QFY19 and stood at 11,362 units.
- EML has an aggregate order book of two to three weeks.
- Close to 45% of its sales are through financing and the same topped 50% in October 2018. The same stood at ~33% in the year-ago period.
- As regards its spare part business, the company wants to focus on better market penetration, better part availability and strong focus on after-market segment and customer retention. EML is also witnessing rising sales of merchandise, accessories etc. The contribution of non-motorcycle revenues to total revenues stood at less than 10%.
- The company added 28 dealers in 2QFY19, taking the total dealer count to 858. It added one additional store in Thailand, taking the total stores in Thailand to three and 38 exclusive stores outside India.
- VE Commercial Vehicles (VECV) witnessed volume improvement of 26% YoY at 18,696 units during the quarter driven by sales of improved value trucks. The company has finalised the design and will start production at its new plant in Bhopal which will have a total capacity of 40,000 vehicles per annum. The new capacity is expected to come on stream after 24 months. The total investment in the plant is Rs4,000mn.
- Demand from Kerala market has largely normalised. Same-store sales growth (barring states like Kerala) witnessed single-digit decline during the quarter.

**Exhibit 5: One-year forward P/E**



Source: Nirmal Bang Institutional Equities Research

## Financials

### Exhibit 6: Income statement

| Y/E March (Rsmn)         | FY17          | FY18          | FY19E           | FY20E           | FY21E           |
|--------------------------|---------------|---------------|-----------------|-----------------|-----------------|
| <b>Net sales</b>         | <b>70,380</b> | <b>89,575</b> | <b>1,04,474</b> | <b>1,20,026</b> | <b>1,34,529</b> |
| % growth                 | 13.8          | 27.3          | 16.6            | 14.9            | 12.1            |
| Raw material expenses    | 37,066        | 46,391        | 53,523          | 61,571          | 68,905          |
| Staff costs              | 4,090         | 5,479         | 6,465           | 7,567           | 8,702           |
| Other expenses           | 7,166         | 9,174         | 11,482          | 13,759          | 15,307          |
| Total expenditure        | 48,322        | 61,043        | 71,470          | 82,898          | 92,915          |
| <b>EBITDA</b>            | <b>22,058</b> | <b>28,532</b> | <b>33,004</b>   | <b>37,128</b>   | <b>41,614</b>   |
| % growth                 | 29.1          | 29.3          | 15.7            | 12.5            | 12.1            |
| <b>EBITDA margin (%)</b> | <b>31.3</b>   | <b>31.9</b>   | <b>31.6</b>     | <b>30.9</b>     | <b>30.9</b>     |
| Other income             | 2,273         | 3,324         | 3,657           | 4,055           | 4,497           |
| Interest costs           | 28            | 30            | 36              | 44              | 44              |
| Gross profit             | 33,314        | 43,184        | 50,951          | 58,455          | 65,624          |
| % growth                 | 21.5          | 29.6          | 18.0            | 14.7            | 12.3            |
| Depreciation             | 1,533         | 2,223         | 2,841           | 3,637           | 4,587           |
| Profit before tax        | 22,770        | 29,603        | 33,784          | 37,503          | 41,481          |
| % growth                 | 22.9          | 30.0          | 14.1            | 11.0            | 10.6            |
| Tax                      | 7,170         | 9,354         | 10,743          | 11,926          | 13,191          |
| Effective tax rate (%)   | 31.5          | 31.6          | 31.8            | 31.8            | 31.8            |
| <b>Net profit</b>        | <b>15,600</b> | <b>20,249</b> | <b>23,041</b>   | <b>25,577</b>   | <b>28,290</b>   |
| % growth                 | 19.2          | 29.8          | 13.8            | 11.0            | 10.6            |
| <b>EPS (Rs)</b>          | <b>573.3</b>  | <b>742.8</b>  | <b>845.2</b>    | <b>938.3</b>    | <b>1,037.8</b>  |
| % growth                 | 18.9          | 29.6          | 13.8            | 11.0            | 10.6            |
| DPS (Rs)                 | 100.0         | 110.0         | 169.0           | 197.0           | 228.3           |
| Payout (%)               | 17.4          | 14.8          | 20.0            | 21.0            | 22.0            |

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 8: Balance sheet

| Y/E March (Rsmn)                     | FY17          | FY18          | FY19E         | FY20E         | FY21E           |
|--------------------------------------|---------------|---------------|---------------|---------------|-----------------|
| <b>Equity</b>                        | <b>272</b>    | <b>273</b>    | <b>273</b>    | <b>273</b>    | <b>273</b>      |
| Reserves                             | 38,954        | 53,450        | 67,078        | 86,478        | 1,07,610        |
| Net worth                            | 39,226        | 53,722        | 67,350        | 86,750        | 1,07,883        |
| Net deferred tax liabilities         | 792           | 1,430         | 1,430         | 1,430         | 1,430           |
| LT liabilities/provisions            | 565           | 848           | 848           | 848           | 848             |
| Total loans                          | 674           | 860           | 860           | 860           | 860             |
| <b>Liabilities</b>                   | <b>41,257</b> | <b>56,860</b> | <b>70,488</b> | <b>89,888</b> | <b>1,11,021</b> |
| Gross block                          | 12,818        | 21,285        | 29,285        | 38,285        | 48,285          |
| Depreciation                         | 4,159         | 6,351         | 9,191         | 12,828        | 17,415          |
| Net block                            | 8,658         | 14,934        | 20,094        | 25,457        | 30,869          |
| Capital work-in-progress             | 3,738         | 3,332         | 3,332         | 3,332         | 3,332           |
| Long-term investments                | 26,623        | 32,365        | 37,365        | 49,365        | 61,365          |
| Other long-term assets               | 2,780         | 2,072         | 2,072         | 2,072         | 2,072           |
| Inventories                          | 3,225         | 3,792         | 4,094         | 4,704         | 5,272           |
| Debtors                              | 489           | 780           | 499           | 655           | 734             |
| Current investments                  | 8,836         | 6,334         | 6,944         | 10,294        | 15,444          |
| Cash                                 | 206           | 12,088        | 12,137        | 12,223        | 12,322          |
| Other current assets                 | 848           | 2,250         | 4,185         | 4,688         | 5,024           |
| Total current assets                 | 13,604        | 25,244        | 27,860        | 32,564        | 38,796          |
| Trade payables                       | 7,645         | 11,705        | 11,229        | 12,911        | 14,472          |
| Other current liabilities/provisions | 6,500         | 9,382         | 9,004         | 9,989         | 10,942          |
| Total current liabilities            | 14,145        | 21,087        | 20,233        | 22,901        | 25,413          |
| Net current assets                   | (542)         | 4,158         | 7,626         | 9,663         | 13,383          |
| <b>Total assets</b>                  | <b>41,257</b> | <b>56,860</b> | <b>70,488</b> | <b>89,888</b> | <b>1,11,021</b> |

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 7: Cash flow

| Y/E March (Rsmn)                | FY17          | FY18          | FY19E         | FY20E         | FY21E         |
|---------------------------------|---------------|---------------|---------------|---------------|---------------|
| <b>EBIT</b>                     | <b>22,798</b> | <b>26,513</b> | <b>33,820</b> | <b>37,547</b> | <b>41,525</b> |
| (Inc.)/dec. in working capital  | 1,852         | 4,303         | (2,810)       | 1,399         | 1,529         |
| Cash flow from operations       | 24,650        | 30,816        | 31,010        | 38,946        | 43,054        |
| Other (income)/expense, net     | (2,058)       | 186           | (3,657)       | (4,055)       | (4,497)       |
| Depreciation                    | 1,533         | 2,223         | 2,841         | 3,637         | 4,587         |
| Tax paid                        | (6,516)       | (8,071)       | (10,743)      | (11,926)      | (13,191)      |
| <b>Net cash from operations</b> | <b>17,609</b> | <b>25,154</b> | <b>19,451</b> | <b>26,602</b> | <b>29,953</b> |
| Capital expenditure             | (5,448)       | (7,435)       | (8,000)       | (9,000)       | (10,000)      |
| Net cash after capex            | 12,161        | 17,719        | 11,451        | 17,602        | 19,953        |
| Other investment activity       | (12,076)      | (14,150)      | (6,066)       | (11,295)      | (12,653)      |
| Cash from financial activity    | (187)         | (2,804)       | (5,336)       | (6,221)       | (7,201)       |
| Opening cash balance            | 229           | 128           | 893           | 942           | 1,028         |
| Closing cash balance*           | 128           | 893           | 942           | 1,028         | 1,127         |
| Change in cash balance          | (101)         | 765           | 49            | 86            | 99            |

Source: Company, Nirmal Bang Institutional Equities Research

\*Excluding other bank balances

### Exhibit 9: Key ratios

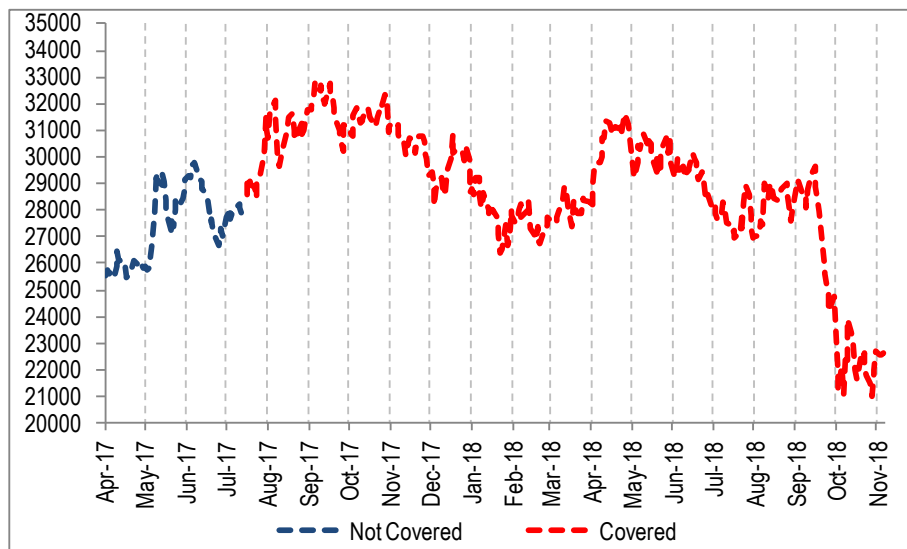
| Y/E March                                     | FY17 | FY18 | FY19E | FY20E | FY21E |
|---|------|------|-------|-------|-------|
| <b>Profitability &amp; return ratios</b>      |      |      |       |       |       |
| EBITDA margin (%)                             | 31.3 | 31.9 | 31.6  | 30.9  | 30.9  |
| EBIT margin (%)                               | 32.4 | 33.1 | 32.4  | 31.3  | 30.9  |
| Net profit margin (%)                         | 22.2 | 22.6 | 22.1  | 21.3  | 21.0  |
| RoE (%)                                       | 39.8 | 37.7 | 34.2  | 33.2  | 29.1  |
| RoCE (%)                                      | 38.5 | 36.2 | 33.1  | 32.3  | 28.4  |
| <b>Working capital &amp; liquidity ratios</b> |      |      |       |       |       |
| Receivables (days)                            | 2    | 2    | 2     | 2     | 2     |
| Inventory (days)                              | 16   | 14   | 14    | 14    | 14    |
| Payables (days)                               | 56   | 58   | 57    | 57    | 57    |
| Cash conversion cycle (WC days)               | (37) | (42) | (40)  | (40)  | (40)  |
| Current ratio (x)                             | 0.9  | 1.2  | 1.3   | 1.4   | 1.5   |
| Quick ratio (x)                               | 0.7  | 1.0  | 1.1   | 1.2   | 1.3   |
| <b>Valuation ratios</b>                       |      |      |       |       |       |
| EV/Sales (x)                                  | 8.5  | 6.5  | 5.6   | 4.9   | 0.0   |
| EV/EBITDA (x)                                 | 27.0 | 20.5 | 17.7  | 15.8  | 0.0   |
| P/E (x)                                       | 38.3 | 29.5 | 26.0  | 23.4  | 21.1  |
| P/BV (x)                                      | 15.2 | 11.1 | 8.9   | 6.9   | 5.5   |

Source: Company, Nirmal Bang Institutional Equities Research

## Rating track

| Date             | Rating     | Market price (Rs) | Target price (Rs) |
|------------------|------------|-------------------|-------------------|
| 18 July 2017     | Buy        | 28,059            | 32,566            |
| 10 August 2017   | Accumulate | 31,440            | 33,462            |
| 15 November 2017 | Buy        | 30,090            | 35,375            |
| 8 February 2018  | Buy        | 28,010            | 36,271            |
| 10 May 2018      | Buy        | 30,316            | 36,529            |
| 10 August 2018   | Buy        | 27,439            | 36,529            |

## Rating track graph



## DISCLOSURES

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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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| Team Details:  |                  |                               |   |
|----------------|------------------|-------------------------------|---|
| Name           |                  | Email Id                      | Direct Line                             |
| Rahul Arora    | CEO              | rahul.arora@nirmalbang.com    | -                                       |
| Girish Pai     | Head of Research | girish.pai@nirmalbang.com     | +91 22 6273 8017 / 18                   |
| Dealing        |                  |                               |   |
| Ravi Jagtiani  | Dealing Desk     | ravi.jagtiani@nirmalbang.com  | +91 22 6273 8230, +91 22 6636 8833      |
| Pradeep Kasat  | Dealing Desk     | pradeep.kasat@nirmalbang.com  | +91 22 6273 8100/8101, +91 22 6636 8831 |
| Michael Pillai | Dealing Desk     | michael.pillai@nirmalbang.com | +91 22 6273 8102/8103, +91 22 6636 8830 |

## Nirmal Bang Equities Pvt. Ltd.

### Correspondence Address

B-2, 301/302, Marathon Innova,  
 Nr. Peninsula Corporate Park,  
 Lower Parel (W), Mumbai-400013.

Board No. : 91 22 6273 8000/1; Fax. : 022 6273 8010