Sharekhan
by BNP PARIBAS

Greaves Cotton

Earnings to drop in FY20

Sector: Automobiles
Result Update

	Change
Reco: **Hold**	↔
CMP: **Rs. 117**	
Price Target: **Rs. 125**	↓

↑ Upgrade ↔ No change ↓ Downgrade

Company details

Market cap:	Rs. 2,852 cr
52-week high/low:	Rs. 165 / 111
NSE volume: (No of shares)	2.9 lakh
BSE code:	501455
NSE code:	GREAVESCOT
Sharekhan code:	GREAVESCOT
Free float: (No of shares)	11.8 cr

Shareholding (%)

Promoters	51.9%
Institutions	15.7%
Corporate Bodies	1.7%
Foreign	15.9%
Public and Others	14.9%

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-20.3	-21.2	-0.4	-20.3
Relative to Sensex	-14.4	-18.3	-0.5	-19.3

Sharekhan Research, Bloomberg

Greaves Cotton Limited's (GCL) Q1FY2020 results missed estimates as topline growth moderated sharply to 4% and margins contracted by 50 BPS y-o-y due to operating deleverage. Net profit fell by 4%. Apart from slowdown in the traditional diesel 3W business (40% of the topline), growth is also expected to slow in the aftermarket segment (22% of revenue) due to liquidity concerns and in the agri segment due to rural stress. While emerging business of CNG engines and electric 2W are growing rapidly, given their small size, it would not meaningfully offset the slowdown in diesel engine and aftermarket segment. We expect GCL's topline growth to moderate sharply to 3% in FY2020 (from 12% growth in FY2019). Margin contraction on account of negative operating leverage and increased losses in the electric 2W segment would lead to 100 BPS margin contraction in FY2020. We expect net profit to drop by 17% in FY2020. At the CMP, the stock is trading at 17.9x and 17.3x its FY2020 and FY2021 earnings, respectively, which is close to its long-term historical average of 17x-18x. We retain our Hold recommendation on the stock with a revised PT of Rs. 125.

Key positives

- Electric 2W business and CNG engine business though small in size are witnessing strong growth.

Key negatives

- Management indicated that the aftermarket (due to liquidity squeeze) and the agri segments (due to farm stress) are witnessing sharp slowdown in demand.
- Negative operating leverage due to demand slowdown led to 50 BPS y-o-y contraction in OPM. OPM at 12.8% missed our estimate of 13.4%.

Our Call

Earnings to decline in FY2020; Retain Hold: GCL's traditional 3W diesel engine business (40% of revenue) continues to face demand headwinds, as volumes continue to decline. Moreover, growth has slowed in the aftermarket and the agri segments. We expect overall growth to decelerate sharply to 3% in FY2020. Negative operating leverage due to volume slowdown coupled with increased losses of the electric 2W business would lead to 100 BPS OPM contraction in FY2020. We have lowered our FY2020 and FY2021 estimates by 13% each. We retain our Hold rating on the stock with a revised PT of Rs. 125.

Key Risks

Any fiscal incentives by the government would lift sentiments of the automotive space and could lead to revival of 3W engine volumes. Moreover, faster-than-anticipated ramp-up in the electric scooter segment remains key risk to our Hold rating.

Valuation Rs cr

Particulars	FY17	FY18	FY19	FY20E	FY21E
Net sales (Rs. cr)	1,634.3	1,792.1	2,015.3	2,075.8	2,231.5
Growth (%)	1.3	9.7	12.5	3.0	7.5
EBITDA (Rs. cr)	243.4	255.3	272.2	259.5	279.8
OPM (%)	14.9	14.2	13.5	12.5	12.5
Adjusted PAT (Rs cr)	178.1	154.5	180.5	148.8	157.5
Growth (%)	3.0	-13.3	16.9	-17.6	5.9
FD EPS (Rs.)	7.3	6.3	7.5	6.5	6.8
P/E (x)	16.0	18.5	15.6	17.9	17.3
P/B (x)	3.1	3.0	2.9	3.7	3.7
EV/EBITDA (x)	10.0	9.1	8.8	9.6	8.9
RoE (%)	19.3	16.1	18.8	20.7	21.2
RoCE (%)	25.9	25.1	24.2	26.5	27.7

Source: Company, Sharekhan estimates

Results miss estimates: GCL's Q1FY2020 results missed estimates. Revenue growth moderated sharply to 4% at Rs. 477 crore and was lower than estimated Rs. 504 crore. Weakness in OEM demand, slowing aftermarket growth and dip in the agri segment resulted in substantial moderation in topline. OPM for the quarter at 12.8% contracted by 50 BPS y-o-y and stood below our estimates of 13.4%. Negative operating leverage due to slowing topline and adverse mix led to fall in margins. EBITDA at Rs. 61.3 crore was almost flat y-o-y and below the estimated Rs. 68 crore. Other income for the quarter declined by 28% y-o-y to Rs. 7.4 crore. This resulted in adjusted PAT declining by 4% y-o-y to Rs. 38 crore and missed our estimate of Rs. 44 crore.

Topline growth to moderate sharply in FY2020: After six quarters of consistent double-digit growth, GCL's topline growth slowed down substantially to 4% in Q1FY2020. All segments – 3W engines, agri and aftermarket reported weak performance. Headwinds in the form of slow economic growth and weak demand environment are expected to sustain over the near to medium term and would continue to impact 3W diesel engine volumes (40% of revenue). The agri segment's volumes have also been under stress, declining by 24% y-o-y in Q1FY2020. Given delayed monsoon and lower Kharif sowing, sentiment in rural areas have deteriorated and the agri segment is expected to remain under pressure. The aftermarket business (22% of revenue) has also slowed down with ongoing liquidity crunch in markets and is expected to remain under stress in the medium term. We expect GCL's revenue growth to moderate sharply to 3% in FY2020 as against 12% growth in FY2020.

Margins to contract in FY2020: Steep moderation in the topline would lead to negative operating leverage and would exert margin pressures. Further, losses of the electric 2W segment are likely to expand in FY2020 as the company looks to add new vendors (due to increased localisation requirement under FAME-2 scheme) and new vendors would not be cost effective in the initial years of operations. We expect GCL's margins to contract by 100 BPS in FY2020.

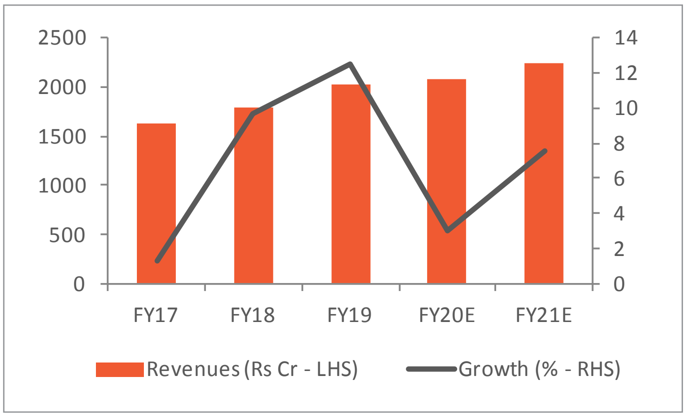
Results Rs cr

Particulars	Q1FY20	Q1FY19	YoY%	Q4FY19	QoQ%
Revenues	476.8	458.2	4.1	528.1	-9.7
EBITDA	61.3	60.9	0.5	70.0	-12.5
EBITDA margins (%)	12.8	13.3	(50) bps	13.3	(50) bps
Depreciation	12.3	12.5	-2.2	11.7	4.9
Interest	0.6	0.5	26.5	0.5	19.2
Other income	7.4	10.3	-28.2	8.6	-13.3
PBT	55.8	58.2	-4.2	66.3	-15.9
Tax	17.6	18.4	-4.1	16.1	9.7
Adjusted PAT	38.2	39.8	-4.2	50.3	-24.1
Reported PAT	38.2	39.8	-4.2	37.4	2.1
Adjusted EPS	1.56	1.63	-4.2	2.06	-24.1

Source: Company; Sharekhan Research

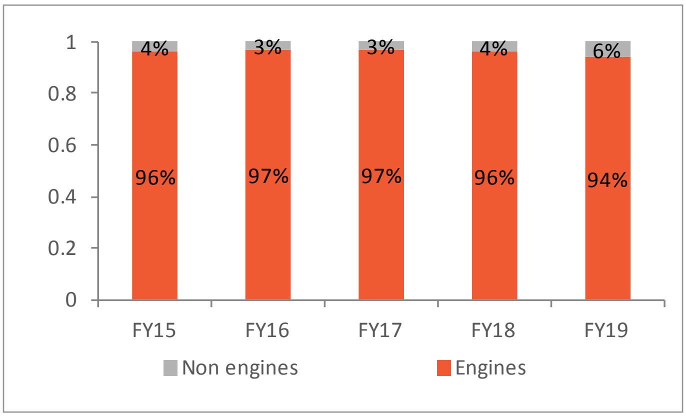
Financials in charts

Revenue growth expected to moderate substantially in FY20



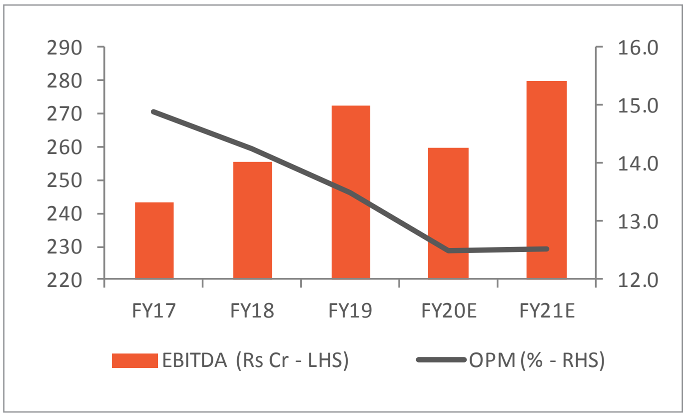
Source: Company, Sharekhan Research

Share of revenues from Engines business dips in FY19



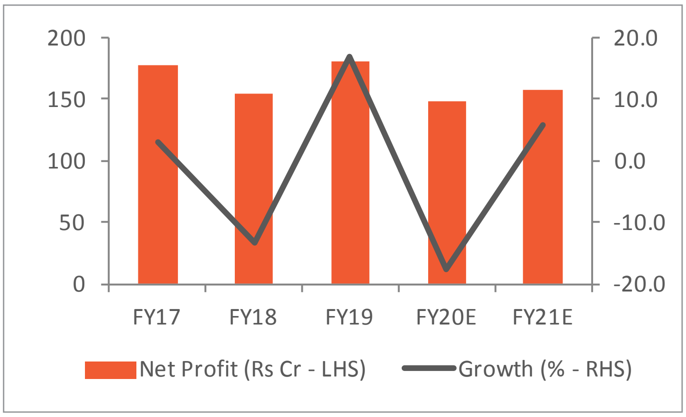
Source: Company, Sharekhan Research

OPM's to continue declining in FY20



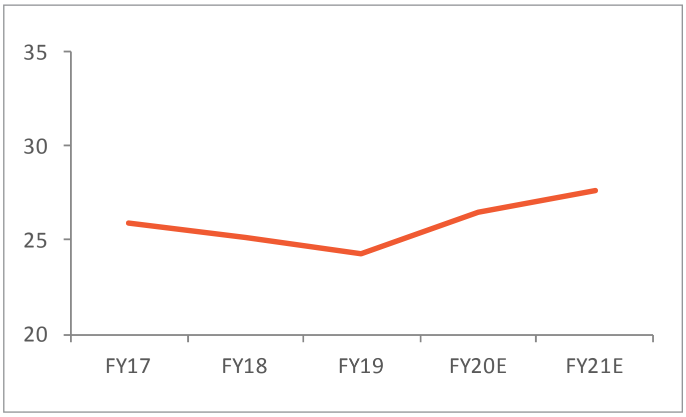
Source: Company, Sharekhan Research

PAT to fall drastically in FY20



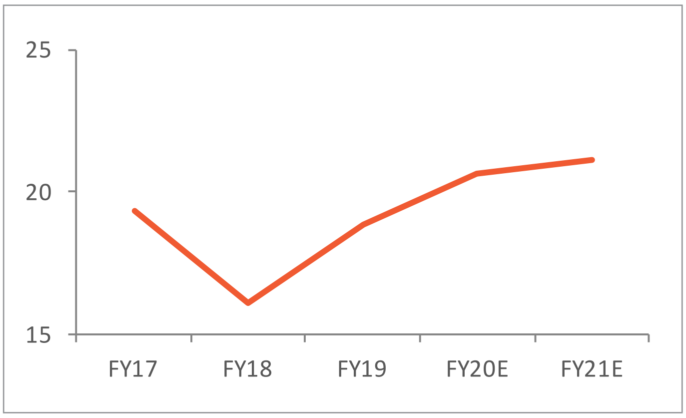
Source: Company, Sharekhan Research

ROCE trend



Source: Company, Sharekhan Research

ROE trend



Source: Company, Sharekhan Research

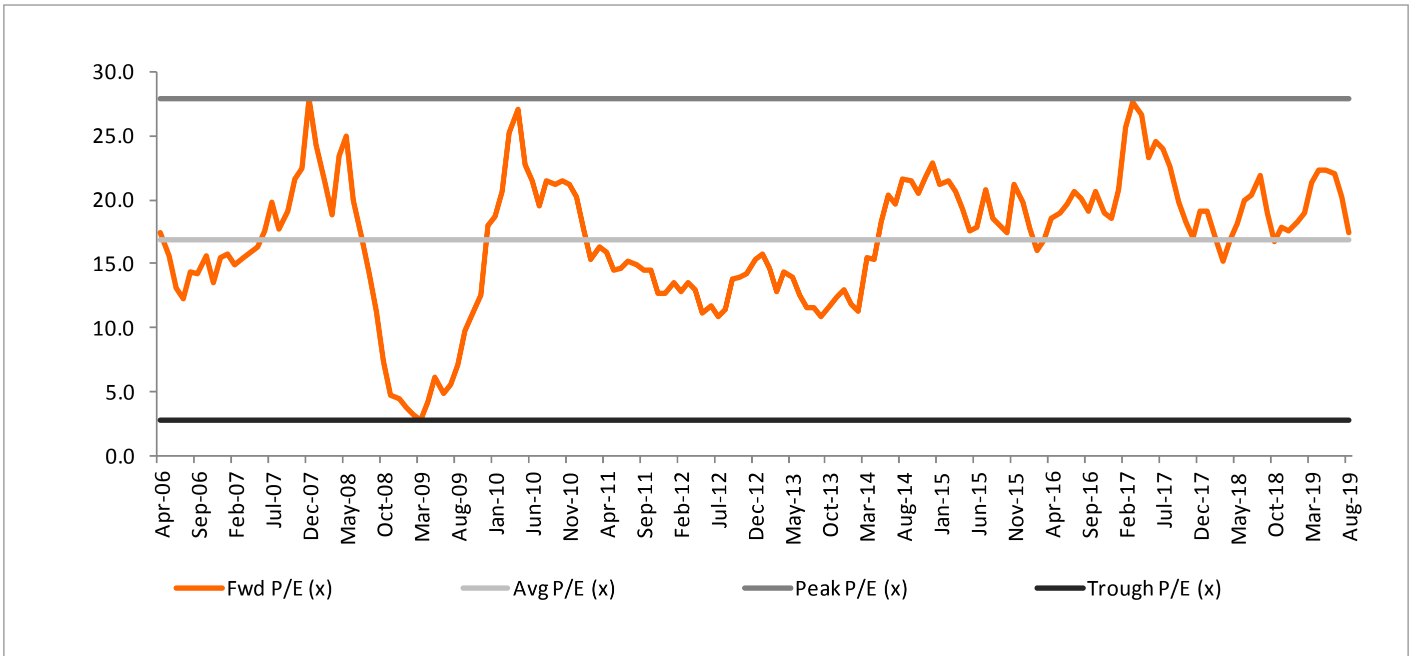
Outlook

Earnings to fall sharply in FY2020: GCL's revenue growth is likely to moderate substantially to 3% in FY2020 because of sustained weak demand environment and liquidity crunch. Negative operating leverage and increased losses in the electric scooter business would exert margin pressures with OPM likely to contract by 100 BPS to 12.5%. Consequently, GCL's earnings are likely to fall sharply by 17% in FY2020.

Valuation

Valuations: Earnings estimates cut; Retain Hold with a revised PT of Rs. 125: GCL's Q1FY2020 results missed estimates. Revenue growth is expected to moderate substantially in FY2020, given apparent challenges across key segments of the auto, aftermarket and agri space. Margins are also likely to dip sharply, reflecting negative operating leverage and elevated costs in the electric 2W business. We have cut our FY2020/FY2021 estimates by 13% each to factor in the concerns. The stock price has also corrected by around ~25% in a little over the past two months, reflecting concerns. We retain our Hold rating on the stock with a revised PT of Rs. 125.

One Year Forward PE



Source: Sharekhan Research

About company

GCL is one of the leading suppliers of power-train and related solutions to auto OEMs. The company has a lion's share in the 3W diesel segment. GCL's products can be classified into three categories – engines, aftermarkets and others. The others segment includes power gensets, agri-equipment and trading business.

Investment theme

GCL is the market leader in 3W diesel engine business having a share of about 70% with all major OEMs engaged for a long-term supply agreement. The company is scaling up the multi-brand aftermarket business through its strong distribution reach. In addition, GCL has recently forayed into the fast-growing electric 2W space and plans to scale up its business substantially. However, any meaningful benefits from initiatives are unlikely to flow through in the near to medium term. Core 3W engines business is expected to remain under pressure for the next two years, given the gradual shift towards gasoline and CNG engines. Moreover, recent slowdown in the aftermarket and agri segments is likely to impact earnings.

Key Risks

- With the advent of BS6 emission norms, the share of diesel engines is slated to reduce, given the high cost. This would impact GCL's revenue substantially.
- Adverse product mix and cost headwinds could impact margins.
- Slower-than-expected ramp-up in the aftermarket segment.

Additional Data

Key management personnel

Karan Thapar	Chairman
Nagesh Basavanhalli	Managing Director & CEO
Neetu Kashiramka	Chief Financial Officer
Atindra Basu	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	DBH International Pvt Ltd	40.44
2	Capital Group Cos Inc/The	8.37
3	KARUN CARPETS PVT LTD	5.82
4	Bharat Starch Products Ltd	5.64
5	SMALLCAP World Fund Inc/Fund Paren	5.49
6	New India Assurance Co Ltd/The	2.84
7	Life Insurance Corp of India	2.43
8	General Insurance Corp of India	2.38
9	L&T Mutual Fund Tustee Ltd/India	2.36
10	VANTAGE EQUITY FUND	1.6

Source: Bloomberg

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