Sharekhan
by BNP PARIBAS

Greaves Cotton

Earnings pressures to sustain

Sector: Automobiles
Result Update

	Change
Reco: **Hold**	↔
CMP: **Rs. 136**	
Price Target: **Rs. 150**	↔

↑ Upgrade ↔ No change ↓ Downgrade

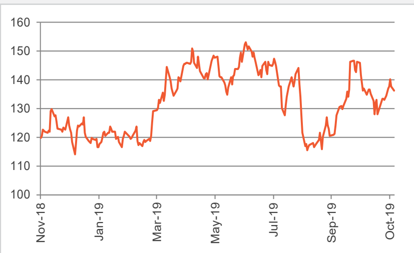
Company details

Market cap:	Rs. 3,330 cr
52-week high/low:	Rs. 157/113
NSE volume: (No of shares)	2.5 lakh
BSE code:	501455
NSE code:	GREAVESCOT
Sharekhan code:	GREAVESCOT
Free float: (No of shares)	11.8 cr

Shareholding (%)

Promoters	51.9
Institutions	16.0
Corporate Bodies	1.2
Foreign	15.5
Public and Others	15.5%

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.3	12.4	-7.5	18.7
Relative to Sensex	-6.9	3.3	-11.4	1.8

Sharekhan Research, Bloomberg

The results of Greaves Cotton Limited's (GCL) Q2FY2020 missed estimates. Topline declined marginally by 1% y-o-y. Subdued performance across engines, agri and aftermarkets segments dragged the revenues down. Operating margins shrunk 270 bps y-o-y to 12.1% (missed estimates) attributable to adverse product mix and high raw material costs. The adjusted PAT at Rs 40 cr declined 19% y-o-y and missed our estimates of Rs 50 cr. Given the headwinds, GCL's topline growth is expected to moderate sharply to flat growth in FY2020. Apart from slowdown in the traditional diesel 3W business (40% of the topline), growth is also expected to remain under stress in aftermarket segment (22% of revenue) and in the agri segment. 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 11% in FY2020. At CMP, the stock is trading at 19x its FY2021 earnings, which is close to its long-term historical average of 17x-18x. We retain our Hold recommendation on the stock with an unchanged PT of Rs. 150.

Key positives

- Volumes in the other engines (industrial engines) though small in size, have growth strongly.

Key negatives

- Revenues are lower by 1% for the quarter on the back of a subdued performance across the segments.
- Operating margins have contracted sharply by 270 bps due to adverse product mix and higher raw material prices. Operating margins at 12.1% missed our estimates of 13.4%.

Our Call

Earnings estimates cut; Retain Hold with an unchanged PT of Rs. 150: GCL's Q2FY2020 results missed estimates due to a subdued performance across segments. Revenue growth is expected to be flat for FY2020 attributable to the apparent challenges across key segments of auto, aftermarket and agri space. Margins are also likely to dip sharply, reflecting a negative operating leverage and elevated costs in the electric 2W business. GCL does not expect the electric 2wheeler business to achieve EBITDA break even in FY2020. We have cut our FY2020/ FY2021 estimates by 2% and 3% to factor in the concerns. At CMP, the stock is trading at 19x its FY2021 earnings, which is close to its long-term historical average of 17x-18x. We retain our Hold rating on the stock with an unchanged PT of Rs. 150.

Key Risks

Prolonged weakness in diesel 3W business and aftermarket segment can impact the financial perfromance. .

Valuation Rs cr

Particulars	FY17	FY18	FY19	FY20E	FY21E
Net sales (Rs cr)	1,634.3	1,792.1	2,015.3	2,015.3	2,156.4
Growth (%)	1.3	9.7	12.5	0.0	7.0
EBITDA (Rs cr)	243.4	255.3	272.2	251.9	268.5
OPM (%)	14.9	14.2	13.5	12.5	12.5
Adjusted PAT (Rs cr)	178.1	154.5	180.5	160.5	168.6
Growth (%)	3.0	-13.3	16.9	-11.1	5.0
FD EPS (Rs)	7.3	6.3	7.5	7.0	7.2
P/E (x)	18.6	21.5	18.2	19.3	18.8
P/B (x)	3.6	3.5	3.4	4.2	4.1
EV/EBITDA (x)	11.9	10.9	10.5	11.5	10.8
RoE (%)	19.3	16.1	18.8	21.9	22.0
RoCE (%)	25.9	25.1	24.2	25.8	26.2

Source: Company; Sharekhan estimates

Weak operating performance; PAT missed estimates: GCL's Q2FY20 results missed estimates. Revenues at Rs 490 cr declined marginally by 1% y-o-y and was in line with our estimates. Subdued performance in the engines, agri and aftermarkets segment dragged the topline down. Operating margins contracted steeply by 270 bps y-o-y to 12.1% and was below the estimated 13.4%. Decline in gross margins and adverse product mix resulted in the margin contraction. EBITDA at Rs 59 cr fell 19% y-o-y and was below our estimates of Rs 67 cr. Other income almost halved on a y-o-y basis. During the quarter GCL reported an exceptional income of Rs 5 cr on pertaining to sales of property. Also the tax rate was low at 19.7% as against 31.5% in Q2FY19 attributable to tax reversals pertaining to Q1FY20. Adjusting for exceptional income, the PAT stood at Rs 40 cr, down 19% and missed our estimates of Rs 50 cr.

GCL's revenues to be flat in FY2020: After nine consecutive quarters of positive growth, GCL's topline has declined in Q2FY2020 on a y-o-y basis. Subdued performance in the key segments (Engines, Agri and Aftermarket) has resulted in a drop in revenues. The wheeler diesel engines (which forms ~ 40% of sales) continues to be under pressure. The agri equipment segment is also under stress due to the expansion of credit cycles. The management expects the situation to improve after a couple of quarters. Further, given the tight liquidity conditions, GCL's aftermarkets business had de-grown and is likely to continue to remain under pressure. Going ahead, the headwinds are likely to sustain over the near term and an immediate revival seems unlikely. We expect GCL's revenue growth to moderate sharply to flat growth in FY2020 as against 12.5% growth in FY2019.

Q2FY20 Conference Call Highlights:

Engines segment volumes fall steeply: GCL's engine segment volumes are lower by 9% to 77,500 units for Q2FY20 aided by a 12% and 79% decline in 3w and 4w engines. Industrial engines (other engines) volumes however grew by 90 % y-o-y.

Agri Segment volumes down sharply: GCL's agri segments volumes dropped 43% y-o-y to 17405 units in Q2FY20. In the agri segment, the pumpset volumes which account for a lion's share of the volumes are down by 45% y-o-y to 15,912 units. The tiller volumes are down by 31% y-o-y to 694 units. The management expects the pain to persist over the near to medium term.

Revenue mix (Standalone): Engines segment constitutes 54% of Q2FY20 standalone revenues. Aftermarkets and others constituted 22% of the revenues each while the E mobility segments share was at 2%.

Ampere Vehicles: GCL's board has given an in-principal approval to increase stake in ampere vehicles to 100% from 81% now. GCL has launched one new product during the quarter and has lined up 2 new products for launch in the near term. Also the management does not expect an EBITDA break even in ampere business in FY2020.

Capex: GCL has outlined a capex of Rs 75 cr for the standalone business and Rs 15-20 cr capex for the Ampere business for FY2020.

Greaves Finance: GCL has tied up to provide financing solution for Ampere two wheelers. It would also provide support to its dealer- distributors.

Results Rs cr

Particulars	Q2FY20	Q2FY19	YoY %	Q1FY20	QoQ %
Revenues	490.0	495.1	-1.0	476.8	2.8
EBITDA	59.1	73.3	-19.3	61.3	-3.5
EBITDA margins (%)	12.1	14.8	(270) bps	12.8	(70) Bps
Depreciation	14.3	12.5	14.4	12.3	16.9
Interest	0.9	1.3	-28.8	0.6	51.6
Other income	6.2	12.7	-50.8	7.4	-15.9
PBT	50.1	72.1	-30.5	55.8	-10.2
Tax	9.9	22.7	-56.6	17.6	-44.0
Adjusted PAT	40.2	49.4	-18.5	38.2	5.4
Reported PAT	45.3	49.4	-8.3	38.2	18.6
Adjusted EPS	1.65	2.02	-18.5	1.56	5.4

Source: Company; Sharekhan Research

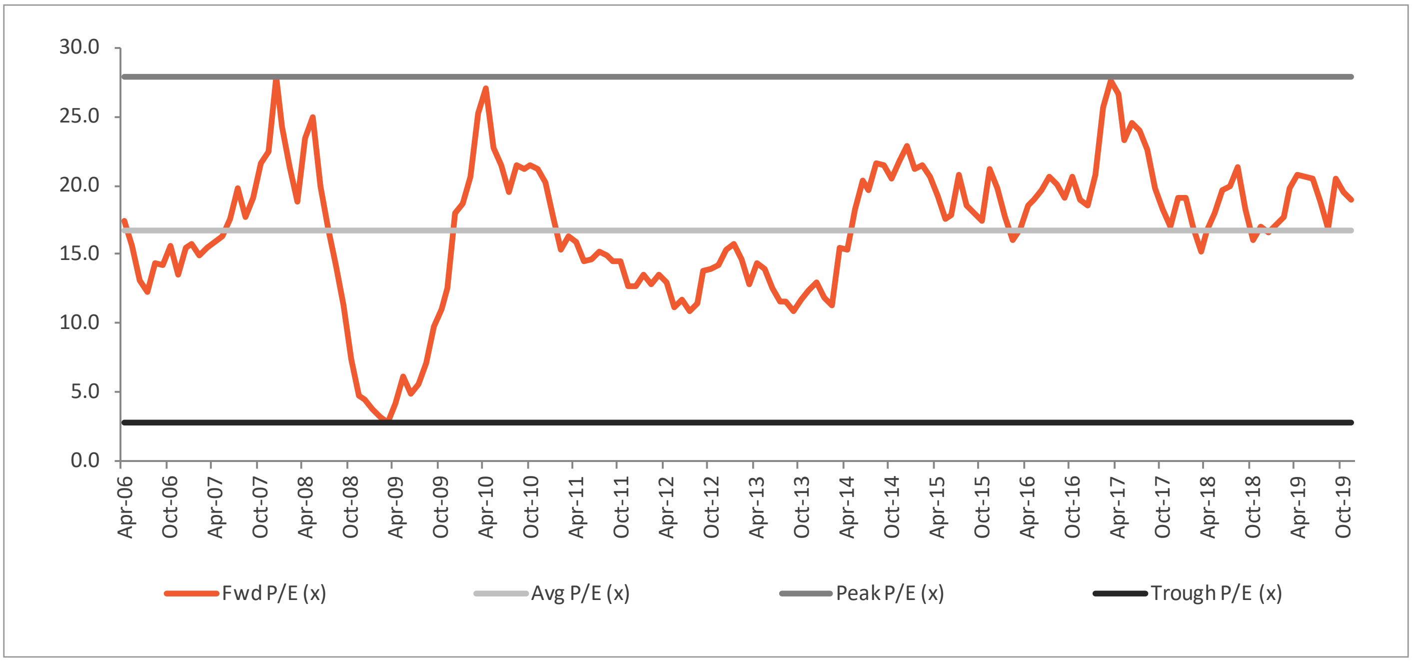
Outlook

Earnings to fall sharply in FY2020: Given the headwinds, GCL's revenues are expected to be under stress over the near to medium term on account of subdued demand environment. The topline is expected to be flat for FY2020. Further, due to operating de-leverage and sustained loss in the electric scooters segments, the operating margins are expected to decline 100 bps to 12.5% for FY2020. Consequently, the earnings are likely to drop in double digit by 11% in FY2020.

Valuation

Earnings estimates cut; Retain Hold with an unchanged PT of Rs. 150: At CMP, the stock is trading at 19x its FY2021 earnings, which is close to its long-term historical average of 17x-18x. We retain our Hold rating on the stock with an unchanged PT of Rs. 150. We have cut our FY2020/FY2021 estimates by 2% and 3% to factor in the concerns. GCL's Q2FY2020 results missed estimates due to subdued performance across segments. Revenue growth is expected to be flat for FY2020 attributable to the apparent challenges across key segments such as auto, aftermarket and agri space. Margins are also likely to dip sharply, reflecting negative operating leverage and elevated costs in the electric 2W business. GCL does not expect the electric 2wheeler business to achieve EBITDA break even in FY2020.

One year forward P/E band



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

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

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	40.4
2	Capital Group Cos Inc/The	8.4
3	KARUN CARPETS PVT LTD	5.8
4	Bharat Starch Products Ltd	5.6
5	SMALLCAP World Fund Inc/Fund Paren	5.5
6	New India Assurance Co Ltd/The	2.7
7	Life Insurance Corp of India	2.4
8	L&T Mutual Fund Tustee Ltd/India	2.4
9	General Insurance Corp of India	2.1
10	VANTAGE EQUITY FUND	1.6

Source: Bloomberg

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;