Stock Update

Muted earnings outlook

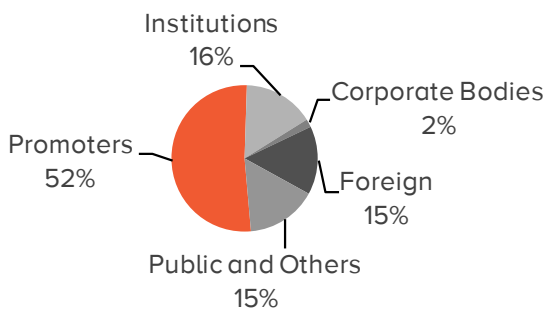
Greaves Cotton

Reco: Hold | CMP: Rs148

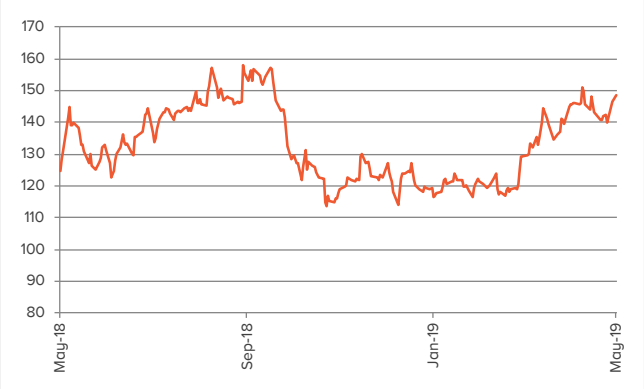
Company details

Price target:	Rs155
Market cap:	Rs3,624 cr
52-week high/low:	Rs165/111
NSE volume: (No of shares)	3.4 lakh
BSE code:	501455
NSE code:	GREAVESCOT
Sharekhan code:	GREAVESCOT
Free float: (No of shares)	11.8 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6.0	24.3	31.3	23.4
Relative to Sensex	5.0	15.3	15.5	9.8

Key points

- **Q4FY2019 earnings below estimates:** Greaves Cotton Limited (GCL) reported lower than expected earnings for Q4FY2019. Revenues grew 9% y-o-y to Rs 528 cr. The traditional 3W engines business reported a healthy volume growth of 8% y-o-y, while the new business of multi brand spares (aftermarkets) remained under pressure for the quarter due to liquidity crunch. Healthy growth in agri pumpset business further aided the revenue growth. Revenues were broadly in line with estimates. However, operating margins dropped 110 bps y-o-y to 13.3% driven by higher raw material cost pressures. (RM/Sales rose 150 bps yoy). Margins were lower than our estimates of 14.4%. EBIDTA at Rs 70 cr was flat on a y-o-y basis. Lower depreciation and tax expenses largely offset the weak operating performance. Adj Net Profit grew 16% y-o-y to Rs 50.3 cr but was lower than our estimates of Rs 55 cr. During the quarter, GCL reported exceptional expenses of Rs 12.9 cr relating to provision for fixed deposits. Reported Net Profit dropped 34% y-o-y to Rs 37.4 cr.

- **Traditional 3W diesel business to remain under pressure; electric scooter and agri business to remain under stress in near term:** GCL derives around 40% of its revenues from the 3W diesel engine segment. The diesel engine segment demand has been under pressure in the recent past given the Government thrust to promote environment friendly fuel to curb pollution levels. Various OEM's have launched CNG powered vehicles even in the goods segment which is leading to market share loss for the diesel powered vehicles. The Government has also lifted the need for permits for alternate fuel (CNG and petrol) in the 3W passenger category in which GCL supplies to only one OEM customer compared to 4-5 customers currently, which would lead to the underperformance of the GCL. As diesel forms around 95% of the 3w engines business, GCL is likely to be impacted substantially by the changing trends. Further the BS6 emission norms would come into effect from 1st April 2020, would result in a 10-12% increase in the vehicle costs which would adversely impact the volumes in the 3w segment. We expect GCL's 3w segment volumes to remain flat in the FY2020. Further with Government making stringent norms for electric scooters under the revised FAME 2 scheme and weak sentiment in rural areas we expect these segments to remain under stress in the near term.

- **Margin pressures to sustain; improving electric scooter business to partially offset cost increases due to BS6:** GCL's margins dropped 70bps in FY2019. We expect margin pressures to sustain and expect OPM to fall 40 bps in FY2021. Cost increases due to transmission from BS4 to BS6 norms would entail steep price increases of about 10-12%. GCL would be unable to entirely pass on the cost increases to customers particularly in the environment of muted volumes. We expect the improved financial performance of the electric scooter business (on account of increased volumes and cost control measures) to partially offset the margin pressure on account of BS6 norms.

- **Outlook – GCL's earnings growth to decelerate sharply; expect flat earnings CAGR over FY2019-FY2021:** GCL's 3W business is expected to remain under pressure over the next two years triggered by a shift towards gasoline/ CNG engines. Further, margin is expected to remain under pressures due to the adverse mix and challenges in passing BS6 related costs. Morever, other income is expected to drop given the cash balance which will be utilized for the buyback announced by the company. We expect flat earnings over the next two years.

- **Valuations: Cut estimates on lower other income and margin pressures; retain Hold; Buyback to support stock price:** GCL's Q4FY2019 results were below estimates. We have lowered other income (on account of reduction in cash balance due to buy back) and also lowered our margin assumptions as GCL will be unable to entirely pass BS6 cost increases. Factoring in the above concerns, we have revised our estimates downwards by 6% and 7% for FY20/21 respectively. At CMP, the stock is trading at 19.8x and 19.1x FY2020 and FY2021 earnings respectively. Given the muted earnings growth, we retain our Hold rating on the stock with an unchanged PT of Rs 155. The Buyback offer would enhance GCL's return ratios from 18.5% currently to 22% in FY2020. We expect the buyback programme to support company's stock price in the near term.

Results Rs cr

Particulars	Q4FY19	Q4FY18	YoY%	Q3FY19	QoQ%
Revenues	528.1	486.2	8.6	506.5	4.3
EBITDA	70.0	69.9	0.2	70.6	-0.8
EBITDA margins (%)	13.3	14.4	(110 bps)	13.9	(60 bps)
Depreciation	11.7	13.1	-11.0	12.1	-3.1
Interest	0.5	0.6	-13.3	1.0	-48.0
Other income	8.6	15.0	-43.0	10.1	-14.9
PBT	66.3	71.1	-6.7	67.5	-1.8
Tax	16.1	27.8	-42.2	19.8	-19.0
Adjusted PAT	50.3	43.3	16.0	47.7	5.3
Reported PAT	37.4	56.7	-34.0	42.7	-12.5
Adjusted EPS	2.06	1.77	16.0	1.95	5.3

Valuations Rs cr

Particulars	FY17	FY18	FY19E*	FY20E*	FY21E*
Net sales (Rs cr)	1,634.3	1,792.1	2,015.3	2,216.9	2,438.5
Growth (%)	1.3	9.7	12.5	10.0	10.0
EBITDA (Rs cr)	243.4	255.3	272.2	299.3	319.4
OPM (%)	14.9	14.2	13.5	13.5	13.1
Adjusted PAT (Rs cr)	178.1	154.5	180.5	172.1	180.4
Growth (%)	3.0	-13.3	16.9	-4.6	4.8
FD EPS (Rs)	7.3	6.3	7.5	7.5	7.8
P/E (x)	20.3	23.4	19.8	19.8	19.1
P/B (x)	3.9	3.8	3.7	4.4	4.3
EV/EBITDA (x)	13.1	12.1	11.6	10.6	9.9
RoE (%)	19.3	16.1	18.5	22.4	22.4
RoCE (%)	25.9	25.1	25.9	32.4	32.6

*Includes electric scooter subsidiary results

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