PROFITMART advisory

RESEARCH REPORT

3rd Jan 2018

GREAVES COTTON LTD

BSE : GREAVESCOT **Sector: Diesel / Petrol Engines, Gensets and Pumpsets** **BSE: 501455**

Position: Close

CMP : Rs. 138
Target Price: Rs 200 (In next 12 to 18 mths)

BUSINESS BACKGROUND

Established in 1859, Greaves Cotton Ltd is one of India's leading and well-diversified engineering companies. It manufactures a wide range of industrial products to meet the requirement of core sectors in India and abroad. GCL's core competencies are in manufacturing of Diesel / Petrol Engines, Gensets and Pumpsets primarily used in the automotive and farm segments.GCL is one of the leading manufacturers of diesel engines for 3Ws with a a market share of 25-30% in 3W passenger vehicles as Bajaj Auto manufactures engines in-house. It has a 90% market share of the 3W goods segment (< 1 ton category) as the market leader is Piaggio which is the single largest client. GCL operates through 11 manufacturing units located all over India with overseas offices in UAE, Tanzania and China.

INVESTMENT HIGHLIGHTS

Steady Financials for GCL as on H1 FY18 –

GCL has reported a steady set of H1FY18 numbers with net sales at Rs 907 crs , from Rs 933 crs, a EBIDTA of Rs 95.06 crs from Rs 91.71 crs in H1 last year and a PAT of Rs 90.70 crs from Rs 90.22 crs. on a equity base of Rs 48.84 crs.

For FY17 GCL posted a Topline of close to Rs 1819.09 crs, a EBIDTA of Rs 245.51 crs with EBIDTA margins of 13.49% and a PBT of Rs 252.19 crs followed by a PAT of Rs 181.29 crs. GCL declared a dividend of 275% last year.

Accelerated focus on Agriculture/Farm Equipment business will augur well for GCL's growth prospects –

GCL is amongst the top 3 players in the farm equipment business. A cheerful monsoon after 2 years of consecutive drought augur well for this business prospects. In the pumps segment it enjoys more than 40% market share while in power tiller it commands 16-17% market share.

Geographical expansion in gensets business to facilitate growth –

GCL sees its efforts of geographical expansion (with concerted marketing and service backup) and new products paying results. GCL has already completed Phase I of geographical expansion as of now. In FY17 the business recorded highest ever volume growth of 60% to 3200 units compared to 2000 units in FY16. On a PAN India basis GCL has a 3-5% market share in this business whereas particular states like Maharashtra and Gujarat the share is in double digits currently

KEY DATA

FACE VALUE Rs	2.00
DIVD YIELD %	3.90
52 WK HI/LOW	178/112
NSE CODE	GREAVESCOT
BSE CODE	501455
MARKET CAP	RS 3405 CRS

SHAREHOLDING PATTERN

PROMOTERS	-	51%
BANKS, MFs & DIIs	-	16%
FIIs	-	27%
PUBLIC	-	6%

KEY FUNDAMENTALS

YE	FY18	FY19	FY20
Rev Gr%	7	19	14
EBIDTA Gr%	22	22	16
PAT Gr%	16	27	9
EPS Gr%	16	27	9
EPS (Rs)	8.60	10.90	12.00
ROE %	21	25	24
ROCE %	24	25	25
P/E(x)		13	12

Auto Engine business to stage a gradual pick up –

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Auto Engine business constitutes 55-60% of the overall revenues and we expect the same share to continue over FY17-FY19E. In FY17, the 3 wheelers segment did not perform well on the back of weak economic pickup, demonetisation and transition phase from BS III to BS IV emission standards. This has impacted the volumes in the 3rd and 4th quarter. 3 wheelers segment was the biggest hit where volumes degrew by 16.3% and 19.4% in 3rd and 4th quarter respectively. 4 wheelers, however, survived the shock in 4th quarter posting 6.7% volume growth offsetting the 3rd quarter impact of demonetization. We believe GDP growth of 7.2-7.5% in FY19 should lead growth in MH&CV segment.

Agriculture/Farm equipment business augur's well for GCL's growth prospects –

GCL is amongst the top 3 players in the farm equipment business wherein it offers wide range of products such as portable engines, pump set, power tiller etc. . In the pumps segment it enjoys more than 40% market share while in power tiller it commands 16-17% market share. GCL is also focused in this segment with suitable R&D and farm mechanizing operations. A good monsoon after 2 years of consecutive drought augur's well for this business prospects..

In FY17, GCL sold 3800 units compared to 3500 units in FY16, thereby, registering a growth of 8.6% YoY. With normal rainfall and company's focused approach in the farm segment, we factor in 10-15% volume growth over FY18-FY19E.

Increasing expansion in gensets business to facilitate GCL's growth –

GCL sees its efforts of geographical expansion (with concerted marketing and service backup) and new products paying results. GCL has already completed Phase I of geographical expansion as of now. In FY17, the company sold around 3200 units compared to 2000 units in FY16, thereby, registering a growth of 60% YoY. In the gensets business, the company has 3% market share PAN India basis except in Gujarat and Maharashtra where the company is experiencing double digit market share.

We believe that gensets business will be the key growth driver in the future ahead and this business will record 50% volume growth YoY on the back of improving fundamentals in the gensets business, geographical expansion and grabbing a lion's share in states like Gujarat and Maharashtra

Auto share domination – but expect growth to be steady for coming quarters –

GCL is amongst the largest manufacturer of single cylinder (diesel and gasoline engines) and dual cylinder engines, which find application in running 3 wheelers vehicles and 4 wheelers. GCL's 3 wheelers segment is able to grab a chunk of 55-60% revenue share in the business alone and we expect the same share to continue over FY17-FY19E.

In the 3 wheeler's business, GCL has one major client i.e Piaggio (single largest client of company) which sells the highest 3 wheelers goods carrier in the domestic market.

In FY17, the company's 3 wheelers business did not fare well on the back of weak economic pickup, demonetisation and transition phase from BS III to BS IV emission standards. We continue to keep faith in this business on the back of improving fundamentals at the economic level and a decent growth the business will provide a strong growth prospects for GCL going ahead.

Expanding the product line will further strengthen the business model for GCL –

GCL is working on new products and is in talk with their OEM's customers. GCL recently launched 1.5 litre, 3 cylinder, 105 bhp diesel engines developed for passenger cars and for light CV applications. While the design is ready, GCL plans to build capacity as and when demand comes from customer. At present, GCL is ready with a 265cc engine for Quadricycle to cater the needs of OEM's who intends to introduce the product in the market

The government's major push on building public transport infrastructure for various cities and towns in the form of metros or mono-rails or buses augurs well for 3W growth as they form the main medium for last mile connectivity from the station/stop to the place of residence.

After Market business – Steady and attractive business opportunity going forward -

GCL has a massive network of over 3000 service outlets along with 1200 dealers across India. This service network is comparable only to Maruti Suzuki which has a similar number of service outlets, pointing to the magnitude of GCL's service network.

GCL management believes that the addressable after market opportunity is about Rs 1500 crs. Depending on component to component the market share of unorganized player will be around 35-45% in after-market sales.

GCL is astutely leveraging the same by offering spares of varied brands to 3W and SCV in the form of electrical, transmission, body parts lubricants etc. GCL plans to offer the spares at a healthy discount to original OEM products and at a reasonable premium to local players selling non-genuine products.

GCL has already started selling products (spares) under its brand for key established players in the market. After-market segment forms around 20% of the revenue at present. This business yields healthy margins of 30%+ and if scaled up appropriately, this business could prove to be immensely profit accretive in the long run

With the rollout of GST from July 2017, it is expected that organized players would be benefited as it would narrow down the price difference with the unorganized players and would reduce its competitive advantage.

The implementation of GST would lead unorganized players to increase the prices of the products in order to claim the input credit, which helps the organized players like Greaves Cotton to grab market share from unorganized manufacturers,thus would result in higher revenues for GCL.

GCL remains confident that it would be able to gain 8-10% market share in the multi brands business over the next two years.As per GCL management, the multi brand spares business is not capital intensive and woiuld hence enable GCL to sustain its high return ratios.

Agriculture business to pave the way for strong growth for GCL –

GCL procures tillers from a major Chinese manufacturer and sells it under their brand name. GCL is now keen on bolstering its presence in the agriculture segment and has introduced a new range of mini power tillers and paddy weeders which will be manufactured in-house. GCL plans to use engines used in its automobiles to power tillers which will lead to increase in margins

Power Tiller business presents a substantial market opportunity in India. The current market size stands at around Rs 7-8 bn with tiller penetration still low at just around 3%. Power tillers form the largest market for farm equipment after tractors and threshers. We expect the power tiller market to be on a strong footing primarily on account of the following reasons:

1.Reduction in average size of operational holdings –

The average size of operational holdings has decreased from 2.28 hectares in FY71 to 1.16 hectares in FY11 and is on a downtrend as the share of urbanization increases in India. Power tillers are better suited for smaller land holdings since they cost almost 10-20% of the price of a tractor and it can be maneuvered around the field manually.

2. Dearth of Agricultural Labour –

The proportion of workers in the agriculture sector to the total workforce has reduced from 59.1% in 1991 to 54.6% in 2011. This is forecasted to reduce to 41% and 26% by 2020 & 2050 respectively as the pace of urbanization gathers steam and then finally matures. This will propel the increase in the usage of power tillers as farm mechanization becomes more and more integral to agriculture.

3. Increase in farm power availability to spur tiller growth –

A direct and a strong correlation exists between farm power availability and farm yield, a fact which has been empirically testified by various research studies. It also increases the efficacy of farm labour and reduces monotonous tasks and strenuous workloads. It is estimated that farm mechanization reduces time of various farm activities by 15-20%

New Leap Engine capable of being transited to BS VI norms-could be a potential game changer –

GCL has been at the forefront of developing engines compliant with the latest emission norms and has already started supplying its BS-IV engines from Q4FY17 to several OEMs with a price increase of 8-10% over BS-III engines. This engine can be used for exports as well

GCL has developed a new leap engine catering to the 300k, 1.5-3.5 tonnage diesel CV market. This has been developed in collaboration with a German knowledge partner and has taken more than 3 years to develop. Germany is held in high regard for its excellence in diesel engines and GCL has developed an engine capable of being transited to BS VI norms which will be applicable in India from 2020. Compliance to BS VI is expected to be stringent in India which augurs well for GCL

GCL is also associating with international players for commercial development of LEAP engines which could take about 24-36 months post agreement with customers.Leap engine is capable of fully transitioning to the stringent BSVI emission norms and Greaves Cotton is confident of delivering technological fit between BS IV standards and BSVI standards for both 3W and4W engines.

This would prove as a big positive for OEM transition to the BS VI norms is very challenging.OEMs will take atleast 2 years to develop new engines which would be capable of fully transitioning to the BS VI requirement. Hence,OEMs would choose Greaves cotton as partner if it wants to hit the market earlier than its competitors.

Further,indigenization of tiller engines along with launch of multiple variants in different nodes could witness traction in the farm equipments pace.In order to reduce the dependency on diesel engines,company is putting efforts to develop CNG and other fuelty pe engines.

GCL is also expanding its existing distribution network for all product segments in phased manner,thus strengthening its reach. GCL has also set up a“Greaves Auto Care”,which is a one stop shop for all 3W and LCV services,thus underpinning its aftermarket services.

With the liquidity situation improving posted monetization,the demand for automotive engines from OEMs is expected to improve,which would augur well for GCL.

GCL enjoys a strong balance sheet and both Topline and Bottomline growth is likely to remain strong going ahead –

GCL has maintained a strong balance sheet over the years.It is a virtually zero debt company with healthy operating cashflows. Operating cashflows between FY12-FY17 has grown at a CAGR of 19%, while FCF has shown a growth of 133% CAGR during the same period.GCL has also reported average RoE of 18-20% during the past 5 years, thus showing strong commitment on delivering shareholders return. Further,company has maintained healthy dividend payout ratio of around 44% in the last 5 years. Hence we expect GCL has the capability to sustain the robust financials performance given its strong business performance and entry in to lucrative new business segments.

We expect that going ahead overall bottomline growth in the next 3 years starting FY17 onwards should easily increase at a CAGR of 18-20% and going ahead also we believe that net cash flows generated will remain healthy going ahead.

Business Outlook & Stock Valuation –

On a rough cut basis, in FY18, Revenue is expected to touch Rs 1950 crs.

On the bottomline level we expect the company to record a PAT of Rs 210 crs in FY18E. Thus on a conservative basis, GCL should record a EPS of Rs 8.61 for FY18E. For FY19E and FY20E our expectation is that earnings traction for GCL will continue to remain strong wherein we expect a EPS of Rs 10.80 and Rs 12 respectively.

GCL is the second largest manufacturer of 3W engines,next only to Bajaj Auto. Greaves core competencies are in manufacturing engines, power tillers,auxiliary power and farm equipment which are expected to witness traction in demand going ahead due to new product launches and wider distribution network.

GCL's emphasizes on launching of new products which will accelerate its future growth pace. Further, in order to reduce the dependency on diesel engines, company is putting efforts to develop CNG and other fuel engines. GCL is also expanding its existing distribution network for all product segments in phased manner,thus strengthening its reach.In a bid to strengthen its after-market services,it has set up"Greaves Auto Care",which is a one stop shop for all 3W and LCV services.

GCL has also stepped up to foray into multi-brand spares business targeted at the 3W and 4W vehicles. The multi brand spares market in India is estimated at Rs1,500 crs with35-40% is unorganized and it is expected that unorganized marketshare likely to shrink on wake of GST rollout. The GST rollout will reduce the competency advantages of unorganized players as they have to increase the prices of the products in order to claim the input credit. Company's strong business model aids It to sustain healthy balance sheet with strong FCF growth over the past years. We are optimistic on GCL's longterm growth story given new launch of products,steady increase in demand from auto OEMs post demonetization,foraying in to new business segments, strong RoE and a healthy dividend payout ratio.

We expect that going ahead overall bottomline growth in the next 3 years starting FY17 onwards should easily increase at a CAGR of 18-20% with the ROE and ROCE is also expected to improve to 24% and 25% and 24% and 25% by FY19 and FY20.

Hence we believe that the GCL stock should be purchased at the current price for a price target of around Rs 200 for the next 12 to 18 months

FINANCIALS

For the Year Ended March RsCrs	FY17A	FY18E	FY19E	FY20E
Net Sales	1819.09	1950.6	2320.1	2650.2
EBIDTA	245.41	300.2	365.20	424.03
EBIDTA %	13.49	15.39	15.74	16.00
Interest	0.81	0.20	0.25	0.25
Depreciation	46.66	51.00	57,00	64.00
Non Operational Other Income	50.19	45.00	45.00	45.00
Profit Before Tax	252.13	294.00	352.95	404.78
Profit After Tax	181.29	210.30	267.00	290.4
Diluted EPS (Rs)	7.42	8.61	10.93	11.89
Equity Capital	48.84	48.84	48.84	48.84
Reserves	872.13	947.43	1079.43	1233.83
Borrowings	0.00	0.00	0.00	0.00
GrossBlock	258.42	358.42	458.42	533.42
Investments	411.00	411.00	411.00	411.00

Source Company our Estimates

KEY CONCERNS.

Any slowdown in Indian economy could hurt auto sales which in turn can adversely impact GCL's revenue growth going ahead.

Volatility in raw material prices could have negative bearing on its margins.

Inability of the company to ramp up the new business segment could bring down its future revenue growth