

On the wrong side of 30

Eicher Motors' 4Q APAT of Rs 5.4bn (-16% YoY, +2% QoQ), missed our estimates. The 30% EBITDA margin trajectory is behind. In our view, the new margin band is 26-29%. We are lowering estimates for FY20-21 by ~7%. Our revised SOTP is Rs18,900 (21x FY21E, earlier 22x). Re-iterate SELL.

HIGHLIGHTS OF THE QUARTER

- Financial highlights:** Volumes for RE were down -14% YoY at 196K units. However realizations at Rs127,425 was up +5% QoQ as the 650cc twins were rolled out in 4Q. RE revenues were Rs 25bn (-1% YoY). EBITDA margin dipped below 30% to 27.8% (-170bp QoQ) owing to a sharp increase in RM costs (higher +250bp QoQ) to 53.5%. A combination of factors including ramp up of the 650cc twins' production, increase in costs (ABS) as well as weak volume growth led to the GM crack.
- The performance at VECV remained weak due to the changing industry dynamics – axle load norm changes and higher discounting. Thus, reported PAT there fell -21% YoY to Rs 1.4bn.

- Margins are unlikely to sustain in the 30% band in our view:** We believe that margins will moderate to lower levels of ~26-29%. This is because (1) As phase 2 of Vallam commences in 2HFY20, the utilization will fall to ~80%, (2) Competition (Jawa) is offering superior product features including a liquid cooled engine at similar price points as the Classic 350cc, (3) Product related costs (ABS) as well as higher marketing spends will hurt margins, (4) As the 650cc twins ramp up volumes, margins may claw upwards with a lag.
- The management has guided for a production target of 950k units in FY20 (+15% YoY), which is aggressive in our view.** Sluggish macros and rising competition are likely to impact retail discretionary spends.

STANCE

We re-iterate SELL as (1) Royal Enfield's 30%+ margins are behind in our view. We are building in 27.7/27.5% over FY20-21 (vs 30.1% in FY19) for RE business, (2) The demand environment remains weak even as competition (Jawa) has commenced product deliveries, (3) New frontiers – product launches and foreign forays are time consuming, with returns expected with a lag and (4) Earnings growth is falling to single digit over FY19-21E .

Financial Summary: Consolidated

YE March (Rsmn)	4QFY19	4QFY18	YoY (%)	3QFY19	QoQ (%)	FY17	FY18	FY19	FY20E	FY21E
Net Sales	25,001	25,280	(1.1)	23,411	6.8	70,334	89,650	97,971	114,326	125,779
EBITDA	6,847	7,972	(14.1)	6,795	0.8	21,740	28,076	29,031	31,289	34,169
APAT	5,448	6,486	(16.0)	5,330	2.2	17,131	21,797	22,203	24,002	25,164
Diluted EPS (Rs)	199.9	237.9	(16.0)	195.5	2.2	629.6	799.6	814.5	880.5	923.1
APAT Growth (%)						28.0	27.2	1.9	8.1	4.8
P/E (x)						32.3	25.5	25.0	23.1	22.0
RoE (%)						38.1	35.2	28.0	24.4	21.2

Source: Company, HDFC sec Inst Research

INDUSTRY	AUTOS
CMP (as on 10 May 2019)	Rs 20,354
Target Price	Rs 18,900
Nifty	11,279
Sensex	37,463

KEY STOCK DATA

Bloomberg	EIM IN
No. of Shares (mn)	27
MCap (Rsbm) / (\$ mn)	555/7,946
6m avg traded value (Rsmn)	2,624

STOCK PERFORMANCE (%)

52 Week high / low	Rs 31,499/18,780		
	3M	6M	12M
Absolute (%)	(2.4)	(9.5)	(33.6)
Relative (%)	(4.9)	(16.1)	(39.9)

SHAREHOLDING PATTERN (%)

	Dec-18	Mar-19
Promoters	49.3	49.3
FIs & Local MFs	6.2	4.6
FPIs	30.8	32.5
Public & Others	13.7	13.6
Pledged Shares	0.0	0.0

Source : BSE

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Other takeaways

- The response to the 650cc twins has been lukewarm with domestic sales at 2,000 units/month. Management expects to scale up production to 5,000 – with 50% of the units being exported.
- Sales in 4Q have been weak due to lower sales in the CSD department as well as the continued weakness in the Kerala market.
- Financing is now at 50-55% of overall sales.
- Phase II of the Vallam plant will commence in 2HFY20 and the planned capex and investment spends for FY20 is at ~Rs 7bn.

Valuation

- We reiterate our SELL rating on Eicher with a revised TP of Rs 18,900 (earlier Rs 21,000). We reduce the multiple on the RE business to 21x (earlier 22x) to factor in the weaker outlook. We assign 15x to the VECV business.

	Stake held (%)	Valuation methodology	Multiple (x)	Value/sh (Rs)
Royal Enfield	100	P/E on FY21E core EPS	21	17,396
VECV	54.4	P/E on FY21E	15	1,518
TP (Rs)				18,900

Source: HDFC sec Inst Research

Quarterly Financials Snapshot: Standalone

Particulars (in mn)	4QFY18	3QFY19	4QFY19	YoY (%)	QoQ (%)	FY18	FY19	YoY (%)
Volumes (in units)	227,042	194,473	196,162	(13.6)	0.9	820,493	826,098	0.7
Net ASP (Rs/veh)	111,423	120,630	127,425	14.4	5.6	108,098	116,942	8.2
Net sales (incl OOI)	25,298	23,459	24,996	(1.2)	6.6	89,575	97,558	8.9
Material Expenses	12,989	11,972	13,382	3.0	11.8	46,391	50,628	9.1
Employee Expenses	1,436	1,791	1,645	14.5	(8.1)	5,478	6,795	24.0
Other Operating Expenses	2,703	2,778	3,027	12.0	8.9	9,174	11,078	20.8
Total Expenditure	17,128	16,541	18,054	5.4	9.1	61,043	68,501	12.2
EBITDA	8,170	6,918	6,942	(15.0)	0.3	28,532	29,057	1.8
Depreciation	637	765	808	26.9	5.6	2,223	2,989	34.4
EBIT	7,533	6,154	6,134	(18.6)	(0.3)	26,309	26,068	(0.9)
Other Income	848	1,446	1,422	67.6	(1.6)	3,324	5,080	52.8
Interest Cost	7	7	8	11.1	11.1	30	30	(1.6)
EO Items	(3,120)	-	-	-	-	(3,120)	175	
PBT	5,255	7,592	7,549	43.7	(0.6)	26,483	31,293	18.2
Tax	2,653	2,578	2,744	3.4	6.5	9,354	10,785	15.3
RPAT	2,601	5,014	4,804	84.7	(4.2)	17,129	20,508	19.7
APAT	5,721	5,014	4,804	(16.0)	(4.2)	20,249	20,333	0.4
Adj EPS	209.9	183.9	176.2	(16.0)	(4.2)	742.8	745.9	0.4

Source: Company, HDFC sec Inst Research

Margin Analysis: Standalone

As % of sales	4QFY18	3QFY19	4QFY19	YoY (bps)	QoQ (bps)	FY18	FY19	YoY (bps)
Material Expenses	51.3	51.0	53.5	219	250	51.8	51.9	10
Employee Expenses	5.7	7.6	6.6	90	(105)	6.1	7.0	85
Other Operating Expenses	10.7	11.8	12.1	142	27	10.2	11.4	111
Total Expenditure	67.7	70.5	72.2	452	172	68.1	70.2	207
EBITDA	32.3	29.5	27.8	(452)	(172)	31.9	29.8	(207)
APAT	22.6	21.4	19.2	(339)	(215)	22.6	20.8	(176)
Tax as % of PBT	NA	34.0	36.4	NA	240	35.3	34.5	(85)

Source: Company, HDFC sec Inst Research

Raw material expense accounted for 53.5% of the total sales (highest in last 11 quarters)

Higher other income at Rs1.4bn (vs 0.8bnYoY) partially offset the impact of increase in raw material expenses

The EBITDA margin was affected by multiple factors including ramp up in production of the 650cc twins, increase in costs (ABS) as well as weak volumes

VECV margins were lower at 8.5% (-95bps YoY)

Quarterly Financials Snapshot: Consolidated

Rsmn	4QFY18	3QFY19	4QFY19	YoY (%)	QoQ (%)	FY18	FY19	YoY (%)
Net sales (incl OOI)	25,280	23,411	25,001	(1.1)	6.8	89,650	97,971	9.3
EBITDA	7,972	6,795	6,847	(14.1)	0.8	28,076	29,031	3.4
EBITDA margin (%)	31.5	29.0	27.4	-415 bps	-164 bps	31.3	29.6	-169 bps
Depreciation	640	768	811	26.8	5.6	2,233	3,003	34.5
EBIT	7,332	6,027	6,036	(17.7)	0.1	25,843	26,028	0.7
Other Income	850	1,471	1,427	68.0	(3.0)	2,801	4,434	58.3
Interest Cost	14	19	21	58.5	13.8	53	73	37.3
Exceptional gains/(losses)	(1,870)	-	-	-	-	(2,201)	(175)	(92.0)
PBT	6,298	7,479	7,441	18.2	(0.5)	26,390	30,214	14.5
Tax	2,645	2,565	2,748	3.9	7.1	9,359	10,770	15.1
Share of JV profit	963	415	755	-	-	2,566	2,584	0.7
RPAT	4,615	5,330	5,448	18.1	2.2	19,597	22,027	-
APAT	6,486	5,330	5,448	(16.0)	2.2	21,797	22,203	1.9
Adj EPS	237.9	195.5	199.9	(16.0)	2.2	799.6	814.5	1.9

Quarterly Financials Snapshot: VECV

Rsmn	4QFY18	3QFY19	4QFY19	YoY (%)	QoQ (%)	FY18	FY19	YoY (%)
Volumes (in units)	23,101	16,936	21,010	(9.1)	24.1	65,932	72,969	10.7
Net Sales	33,170	28,160	32,090	(3.3)	14.0	100,494	116,292	15.7
EBITDA	3,150	1,920	2,740	(13.0)	42.7	9,055	9,720	7.3
EBITDA margin (%)	9.5	6.8	8.5	-96 bps	172 bps	9.0	8.4	-65 bps
PAT	1,770	760	1,390	(21.5)	82.9	4,716	4,751	0.7

Source: Company, HDFC sec Inst Research

Volume Assumptions

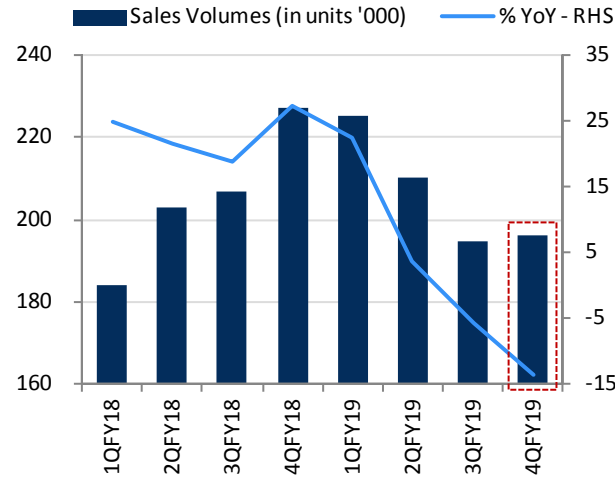
in units	FY16	FY17	FY18	FY19	FY20E	FY21E
RE	601,000	666,490	820,493	826,098	901,023	948,081
% YoY		10.9	23.1	0.7	9.1	5.2
VECV	63,083	58,538	65,932	72,969	80,357	83,626
% YoY		(7.2)	12.6	10.7	10.1	4.1
Total volumes	664,083	725,028	886,425	899,067	981,381	1,031,707
% YoY		9.2	22.3	1.4	9.2	5.1
RE average ASP (Rs)	102,048	104,687	108,098	118,562	126,855	132,638
% YoY		2.6	3.3	9.7	7.0	4.6

Source: Company, HDFC sec Inst Research

In 4QFY19, volumes for RE were down by 14% YoY at 196K units.

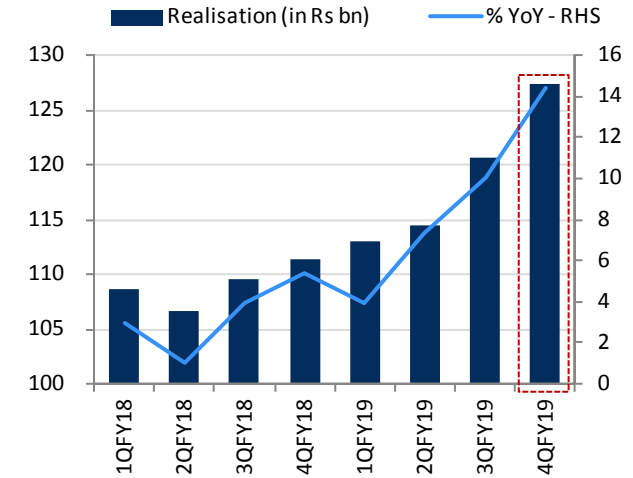
However, realisation growth (+14.5% YoY, +5.5% QoQ) was driven by the roll out of 650cc twins in 4Q

RE volume trend



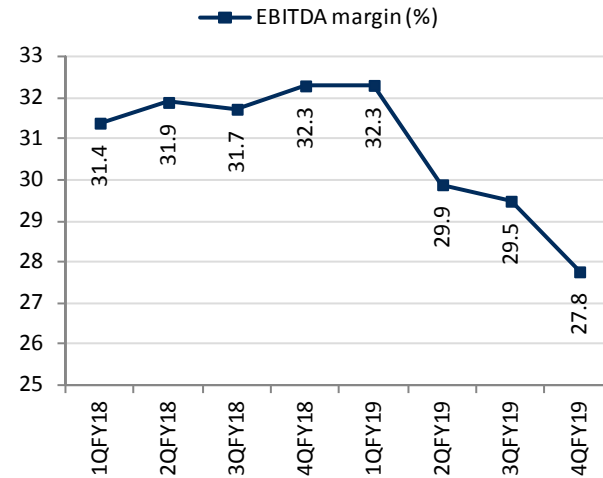
Source: Company, HDFC sec Inst Research

RE average realisation



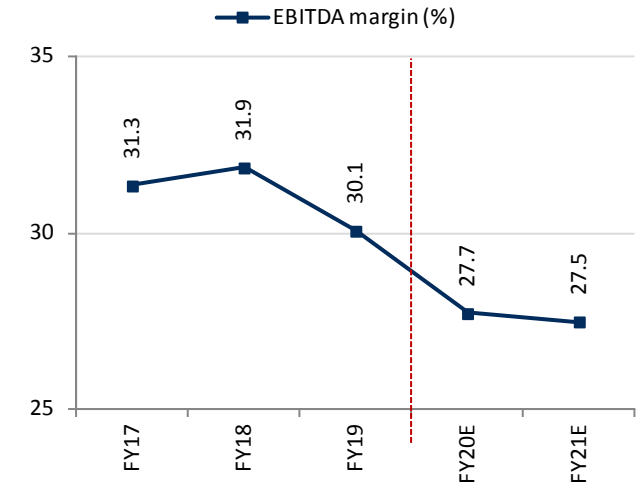
Source: Company, HDFC sec Inst Research

Quarterly EBITDA margin (%): Standalone



Source: Company, HDFC sec Inst Research

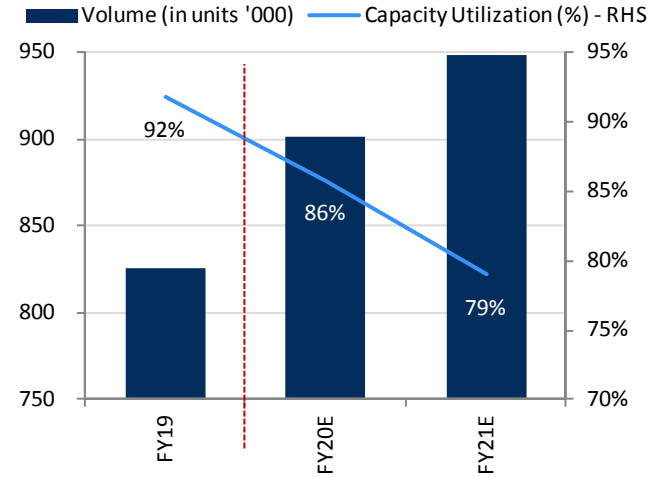
Annual EBITDA margin (%): Standalone



Source: Company, HDFC sec Inst Research

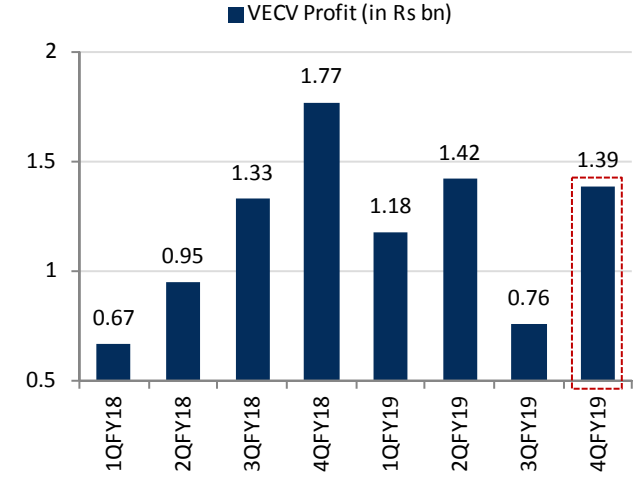
The utilization levels should moderate from the peak levels earlier to ~80% going ahead

RE utilization levels



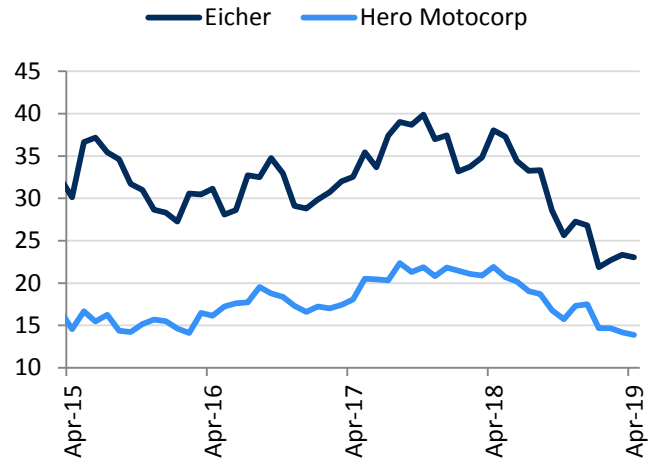
Source: Company, HDFC sec Inst Research

VECV Profit



Source: Company, HDFC sec Inst Research

1 year forward P/E band



Source: Company, HDFC sec Inst Research

The valuation premium of Eicher has been narrowing with the mass market OEM

Peer Set Comparison

	Mcap (Rsbn)	CMP (Rs/sh)	Reco	TP	Adj EPS (Rs/sh)			P/E (x)			EV/EBITDA (x)			RoE (%)		
					FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Maruti Suzuki	2,003	6,632	BUY	7,350	248.4	290.2	334.5	26.7	22.9	19.8	14.9	12.1	10.0	16.9	17.6	17.9
Bajaj Auto	858	2,966	BUY	3,174	149.4	170.5	190.5	15.4	13.0	14.7	14.4	12.1	10.3	21.5	22.1	21.8
Eicher	555	20,354	SELL	18,900	814.5	880.5	923.1	25.0	23.1	22.0	16.4	14.6	12.8	28.0	24.4	21.2
Hero Motocorp	501	2,507	BUY	3,080	169.5	179.9	192.6	14.8	13.9	13.0	8.3	7.7	6.8	26.9	25.2	23.9
Ashok Leyland	251	86	NEU	90	6.7	7.2	6.9	12.7	12.0	12.4	7.2	6.4	6.4	25.7	24.1	20.8

Source: HDFC sec Inst Research

Change in estimates

	NEW		OLD		% chng	
	FY20	FY21	FY20	FY21	FY20	FY21
Net Revenue	114,326	125,779	110,922	123,581	3.1	1.8
EBITDA	31,289	34,169	32,549	36,022	(3.9)	(5.1)
EBITDA margin (%)	27.4	27.2	29.3	29.1	-198 bps	-198 bps
PAT	24,002	25,164	25,174	27,618	(4.7)	(8.9)
EPS	880.5	923.1	923.5	1,013.1	(4.7)	(8.9)

Source: HDFC sec Inst Research

Income Statement (Consolidated)

(Rsmn)	FY17	FY18	FY19	FY20E	FY21E
Net Revenues	70,334	89,650	97,971	114,326	125,779
Growth (%)	13.9	27.5	9.3	16.7	10.0
Material Expenses	37,045	46,435	50,574	61,150	67,277
Employee Expenses	4,263	5,737	7,024	8,515	9,644
Other Operating Expenses	7,287	9,402	11,341	13,371	14,688
Total Expenses	48,594	61,573	68,940	83,037	91,610
EBITDA	21,740	28,076	29,031	31,289	34,169
EBITDA Margin (%)	30.9	31.3	29.6	27.4	27.2
EBITDA Growth (%)	28.7	29.1	3.4	7.8	9.2
Depreciation	1,538	2,233	3,003	3,722	4,607
EBIT	20,201	25,843	26,028	27,568	29,562
Other Income	2,273	2,801	4,434	4,656	4,888
Interest	36	53	73	52	52
Exceptional gains/(losses)	(460)	(2,201)	(175)	-	-
PBT	21,979	26,390	30,214	32,171	34,398
Tax (Incl Deferred)	7,203	9,359	10,770	11,088	11,992
Share of profit from JV	1,895	2,566	2,584	2,919	2,758
RPAT	16,671	19,597	22,027	24,002	25,164
APAT	17,131	21,797	22,203	24,002	25,164
APAT Growth (%)	28.0	27.2	1.9	8.1	4.8
Adjusted EPS (Rs)	629.6	799.6	814.5	880.5	923.1
EPS Growth (%)	27.8	27.0	1.9	8.1	4.8

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

(Rsmn)	FY17	FY18	FY19	FY20E	FY21E
SOURCES OF FUNDS					
Share Capital - Equity	272	273	273	273	273
Reserves	53,179	70,028	88,085	107,869	128,572
Total Shareholders Funds	53,451	70,301	88,357	108,142	128,845
Minority Interest	-	-	-	-	-
Long Term Debt	-	-	-	-	-
Short Term Debt	444	1,508	1,508	1,508	1,508
Total Debt	444	1,508	1,508	1,508	1,508
Net Deferred Taxes	778	1,421	1,435	1,449	1,464
TOTAL SOURCES OF FUNDS	54,673	73,230	91,301	111,099	131,817
APPLICATION OF FUNDS					
Net Block	8,728	15,017	19,554	22,332	23,775
CWIP	3,738	3,332	3,632	3,932	4,232
Total Non-current Assets	12,466	18,349	23,186	26,265	28,007
Cash & Equivalents	50,122	67,928	81,240	99,684	120,071
Inventories	3,359	3,946	4,429	5,168	5,720
Debtors	500	680	913	1,065	1,172
Other Current Assets	3,460	4,319	4,440	4,669	4,941
Total Current Assets	57,441	76,873	91,021	110,586	131,904
Creditors	8,327	11,719	12,347	14,408	15,852
Other Current Liabilities & Provns	6,907	10,274	10,559	11,343	12,242
Total Current Liabilities	15,234	21,992	22,906	25,751	28,094
Net Current Assets	42,207	54,881	68,115	84,835	103,810
TOTAL APPLICATION OF FUNDS	54,673	73,230	91,301	111,099	131,817

Source: Company, HDFC sec Inst Research

Cash Flow (Consolidated)

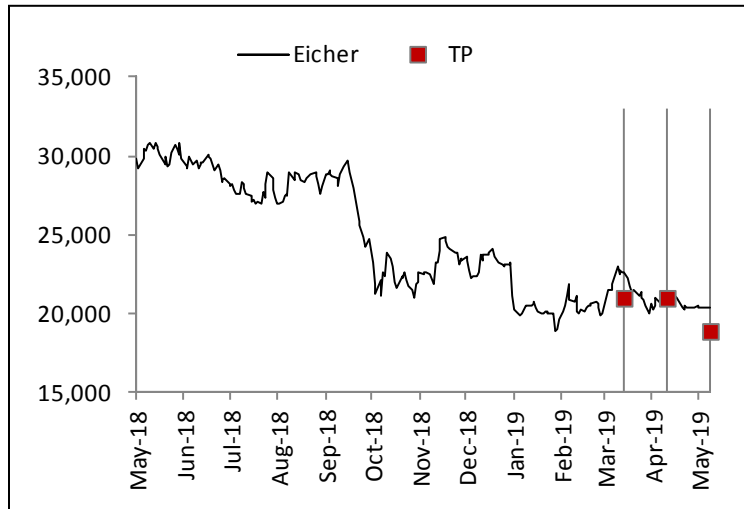
(Rsmn)	FY17	FY18	FY19	FY20E	FY21E
Reported PBT	21,979	26,390	30,214	32,171	34,398
Non-operating & EO Items	460	2,201	175	-	-
Interest Expenses	36	53	73	52	52
Depreciation	1,538	2,233	3,003	3,722	4,607
Working Capital Change	1,815	5,133	77	1,724	1,411
Tax Paid	(7,203)	(9,359)	(10,770)	(11,088)	(11,992)
OPERATING CASH FLOW (a)	18,625	26,651	22,772	26,581	28,477
Capex	(5,117)	(8,117)	(7,840)	(6,800)	(6,350)
<i>Free Cash Flow (FCF)</i>	<i>13,508</i>	<i>18,534</i>	<i>14,932</i>	<i>19,781</i>	<i>22,127</i>
Investments	419	643	14	14	14
Non-operating Income	(460)	(2,201)	(175)	-	-
INVESTING CASH FLOW (b)	(5,158)	(9,674)	(8,001)	(6,786)	(6,336)
Debt Issuance/(Repaid)	218	1,064	-	-	-
Interest Expenses	(36)	(53)	(73)	(52)	(52)
<i>FCFE</i>	<i>13,690</i>	<i>19,545</i>	<i>14,859</i>	<i>19,729</i>	<i>22,075</i>
Share Capital Issuance	1	1	-	-	-
Dividend	3,171	3,493	3,971	4,218	4,461
Others	(1,028)	(3,674)	(5,357)	(5,517)	(6,164)
FINANCING CASH FLOW (c)	2,327	830	(1,460)	(1,351)	(1,755)
NET CASH FLOW (a+b+c)	15,793	17,807	13,311	18,445	20,387
Closing Cash & Equivalents	50,122	67,928	81,240	99,684	120,071

Source: Company, HDFC sec Inst Research

Key Ratios (Consolidated)

	FY17	FY18	FY19	FY20E	FY21E
PROFITABILITY (%)					
GPM	47.3	48.2	48.4	46.5	46.5
EBITDA Margin	30.9	31.3	29.6	27.4	27.2
EBIT Margin	28.7	28.8	26.6	24.1	23.5
APAT Margin	24.4	24.3	22.7	21.0	20.0
RoE	38.1	35.2	28.0	24.4	21.2
RoIC (or Core RoCE)	370.2	338.6	218.1	168.2	166.3
RoCE	29.6	26.1	20.4	17.9	15.9
EFFICIENCY					
Tax Rate (%)	32.8	35.5	35.6	34.5	34.9
Fixed Asset Turnover (x)	8.1	6.0	5.0	5.1	5.3
<i>Inventory (days)</i>	<i>17.4</i>	<i>16.1</i>	<i>16.5</i>	<i>16.5</i>	<i>16.6</i>
<i>Debtors (days)</i>	<i>2.6</i>	<i>2.8</i>	<i>3.4</i>	<i>3.4</i>	<i>3.4</i>
<i>Payables (days)</i>	<i>43.2</i>	<i>47.7</i>	<i>46.0</i>	<i>46.0</i>	<i>46.0</i>
Debt/EBITDA (x)	(2.3)	(2.4)	(2.7)	(3.1)	(3.5)
Net D/E (x)	(0.9)	(0.9)	(0.9)	(0.9)	(0.9)
Interest Coverage (x)	567.5	484.0	355.1	530.1	568.5
PER SHARE DATA (Rs)					
EPS	629.6	799.6	814.5	880.5	923.1
CEPS	669.2	800.8	918.2	1,017.0	1,092.1
Dividend	100.0	110.0	125.0	132.8	140.5
Book Value	1,964	2,579	3,241	3,967	4,727
VALUATION					
P/E (x)	32.3	25.5	25.0	23.1	22.0
P/BV (x)	10.4	7.9	6.3	5.1	4.3
EV/EBITDA (x)	23.2	17.4	16.4	14.6	12.8
EV/Revenues (x)	7.2	5.4	4.8	4.0	3.5
OCF/EV (%)	3.7	5.5	4.8	5.8	6.5
FCF/EV (%)	2.7	3.8	3.1	4.3	5.1
FCFE/Mkt Cap (%)	2.5	3.5	2.7	3.6	4.0
Dividend Yield (%)	0.5	0.5	0.6	0.7	0.7

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY


Date	CMP	Reco	Target
15-Mar-19	22,612	SELL	21,000
12-Apr-19	20,998	SELL	21,000
13-May-19	20,354	SELL	18,900

Rating Definitions

- BUY** : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

INSTITUTIONAL RESEARCH
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