Initiating coverage: Greaves Cotton

KEYNOTE

Date: 8th May 2019

Rating matrix	
Reco	Buy
CMP	141
Target	200
Upside	42%

Market Data	
Sector	Cap. Goods
M.Cap (in cr)	3609
Div yield	3.7%
EBITDA	13.7%
PEG	7.9
Debt / Equity	0.0
Shares OS	24.24
Avg Vol (in lacs)	485
52 week H/L	165 / 111

Share holding pattern	
Prom. holding	52%
Institutional	30%
Others	18%

Valuation	
Stock PE	20
P/B	3.7
ROCE	25.9%
ROE	17.7%

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Foray into 3W CNG engines & electric 2W & 3W

From being a pure play 3 wheeler diesel engine manufacturer, Greaves Cotton has been able to successfully increase their revenue contribution in the aftermarket, gensets & agri equipments segment. In 2013, the revenue contribution from the engines segment stood at 88%. To diversify its revenue stream, the firm has successfully brought down its revenue contribution from the engines sector to different divisions such as gensets, pumpsets, tillers etc. Currently the revenue contribution of engines stands at 49%. Moreover, in FY19, the "after market" portion has increased and currently stands at 24%. They were able to achieve this, by implementing a rigorous strategy of getting closer to consumers and focusing on B2C businesses.

To diversify its product range, the firm has recently purchased a 67 percent stake in Ampere for Rs 77 crore, making a foray into the electric vehicle space in August last year. They plan to sell Ampere electric vehicles through the Greaves retail stores. Then firm now controls over 300+ stores, which have transformed Greaves into a B2C player in last mile mobility. Through diversification of the product range, we expect earnings to grow at CAGR of 22.6% over FY19-21e. Initiate with BUY rating.

Leadership Position in Niche Segment: GCL remains one of the leading companies in India's three-wheeler (3W) engine market. According to the company, it has a market share of around 75% in the 3W diesel engine segment. Moreover, it supplies engines to around 30 original equipment manufacturers in India, such as Piaggio Vehicle Limited, Tata Motors Limited, Mahindra & Mahindra Limited (latest addition), Scooters India Limited and Atul Auto Limited. Greaves is servicing all three-wheeler manufacturers except for Bajaj.

Tailwinds for gensets: As per the CSO (Central Statistics Office) estimates, the capacity utilization levels have gone up substantially and are likely to improve further going forward. Current utilization levels are expected to be ~76% with several private players having committed towards a capex. If the private sector capex cycle posts stronger-than expected recovery, then that would be a positive for the genset industry.

BS-VI to drive growth: Pre buying from OEMs for BS-VI compliant engines will drive growth for its main business of diesel engines. But this will substantially increase the cost for Greaves cotton (~10-12%) which may not pass it to the consumers immediately. Moreover, the volumes growth for 3 wheelers has been muted and hence taking a price increase will not be easy. We expect 3 wheelers to show decent growth in FY20 which will ease the pricing scenario and hence help greaves maintain its margins in this segment.

Key financials	FY18	FY19	FY20e	FY21e
Revenue	1839.7	2015.3	2387.4	2730.0
Profits	202.2	162.6	198.3	244.6
% revenue growth		9.5%	18.5%	14.4%
EPS	8.3	6.7	8.1	10.0
ROE	21%	17%	18%	20%
PE	17.0	21.1	17.3	14.1

Source: Company, Keynote

BS-VI to bring down margins

While there is an industry wide need for sustainable and greener fuel, CNG engines have proven to be better & cheaper alternatives which will deliver topline growth. Diesel engines should continue to grow in FY20 due to BS-VI pre-buying; however this is expected to be unsustainable. In addition to this, the sale of BS-VI diesel engines will bring down company margins. On the other hand, with implementation of BS-VI, emission of NOx will be limited to 160 mg/km, whereas the previous limit was 345 mg/km. This will make diesel engines a very tough sell and additional modifications will be required to lower the emissions.

Additional reduction catalyst & need for secondary air injector are expected to increase the cost of manufacturing BS-VI engines. However, passing on all the cost to the consumers is not possible for the OEMs and hence Greaves will have to take a hit on their margins.

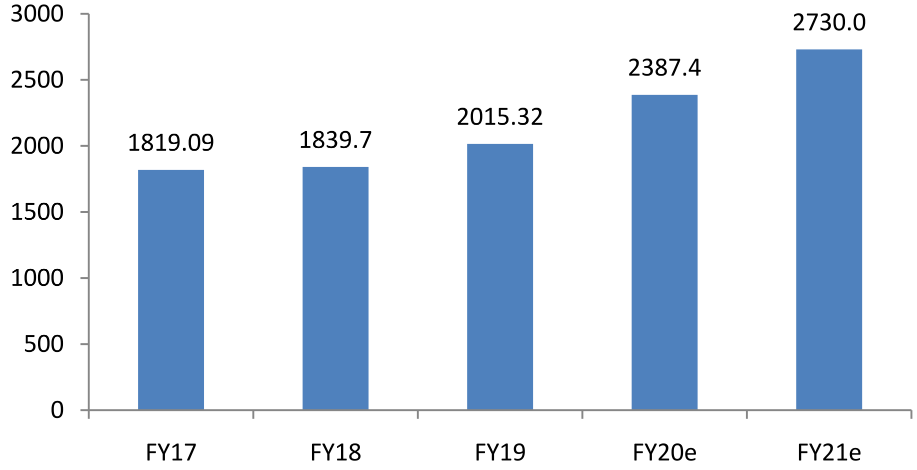
CNG engine growth to make up for de-growth in diesel engines

While BS-VI pre buying will support the sale of diesel engines in FY20, FY21 should see results due CREST CNG engines. Greaves is working of transformational clean technology for CNG engines which promises a 25%+ fuel efficiency gains. There have been lab tests to prove the higher efficiency. Company is also in talks with various OEMs to prove this on Indian road conditions. Once this goes through, there CNG engines should reduce the overall adverse impact on engine sales.

Capex driven growth

Greaves cotton is expected to spend 200 crores in FY19 & FY20, with capex in FY20 expected to be 85 crores. A capex of 200 crores has been done by greaves cotton in the last 5 years put together. This is a considerable amount in comparison to their past 5 years. If they are able to maintain the current asset turnover and ROCE, the company will see a very exciting growth rate.

Revenue in Cr.

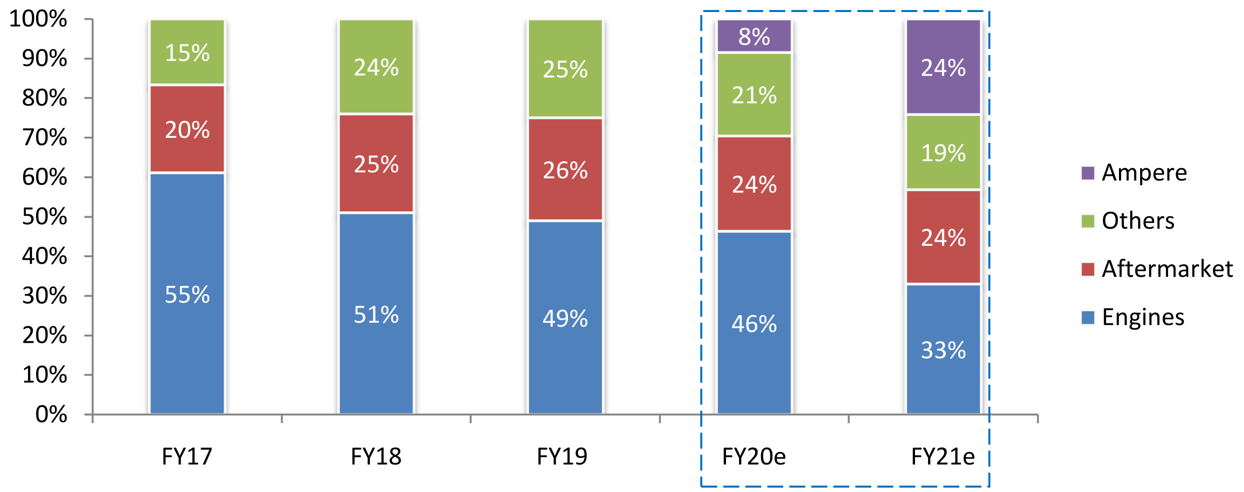


Source: Company, Keynote

Electric 2 wheeler witnessing traction

Ampere, set up in 2008, posted revenue of Rs 16 crore during the April-July period of 2018-19. That indicates it's growing at a fast pace; its revenue for the full 2017-18 was Rs 18.5 crore. For the full year, Ampere has posted revenue of 53 crores. Ampere has ~15% market share in electric 2 wheelers at the end of FY19. The company has strategically integrated the Greaves retail as a one stop shop for aftermarket spare products, servicing and sale of Ampere vehicles. They had started Greaves retail with 50 stores and have a footprint of over 300 stores today. Also they have 120 exclusive Ampere stores. Going forward they can better synergize and strategize to improve the sales of electric vehicles. We expect electric vehicles to be an important business unit and contribute significant revenue over the next 2 years.

Revenue contribution



Source: Company, Keynote

Increased average realization from Ampere

Currently, a dominant portion of Ampere sales comes from the slow 2 wheeler space. These vehicles have maximum speed of 25-35 kms and run on lead acid batteries. The lead-acid battery type is heavier, has a lesser range of 45-50 km and takes longer time (8 to 10 hours) to charge. In comparison, the more expensive lithium-ion batteries take about 5-6 hours for a full charge and run for 60-65 km. According to our estimates, the current realization for greaves should be ~35000 per vehicle. As they enter the higher speed lithium ion charged, 2 wheeler space, their average realization is expected to increase 20% to ~Rs. 42,000.

Strong aftermarket performance

Company has expanded its after dealers network from 3000 to 5300. Although Q4FY19 has been a muted quarter due to inventory lying with the dealers, it has managed to post a 12% growth in FY19. As the company has now crossed over 300 retail stores, aftermarket is expected to grow and support margins. Multi-brand spares business has also posted good growth in the last year and will aid to the aftermarket performance.

Agri business can surprise going ahead

Agri business which comprises of Power Tillers & pumpsets is heavily dependent on rains. We have not built in growth in the pumpsets business but with good monsoons, this business segment too could see some growth and aid to the overall performance of the company. Power Tillers have also not grown much and that has been the same for other players in the industry, there could be numerous tailwinds for the agri sector as a whole with the new government coming in, we have not factored any revenue increase for the same.

Valuation & view

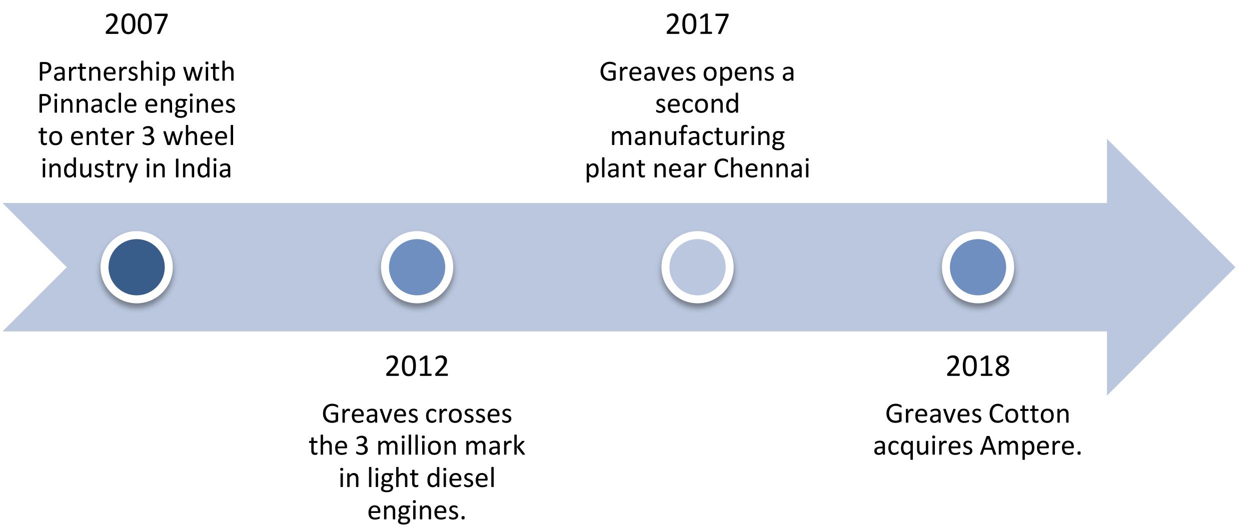
From being a pure play diesel engine manufacturer, Greaves will have to diversify and become a market leader in sustainable fuel vehicles. Although this transition will not be easy, it does open newer opportunities for Greaves cotton. With a comfortable leverage position, management expertise and sustainable margin visibility, we expect Greaves to trade at 20x FY20 earnings. Greaves has in the past 10 years had an average PE of 18x and max PE of 41x.

Latest corporate action

The company has approved a proposal to buy back up to 137,142,869 equity Shares of the Company being 5.6% of the total paid-up equity share capital, at a tender price of Rs. 175 per Equity Share for an aggregate amount not exceeding Rs. 240 Crores. The promoters will not participate in the buyback.

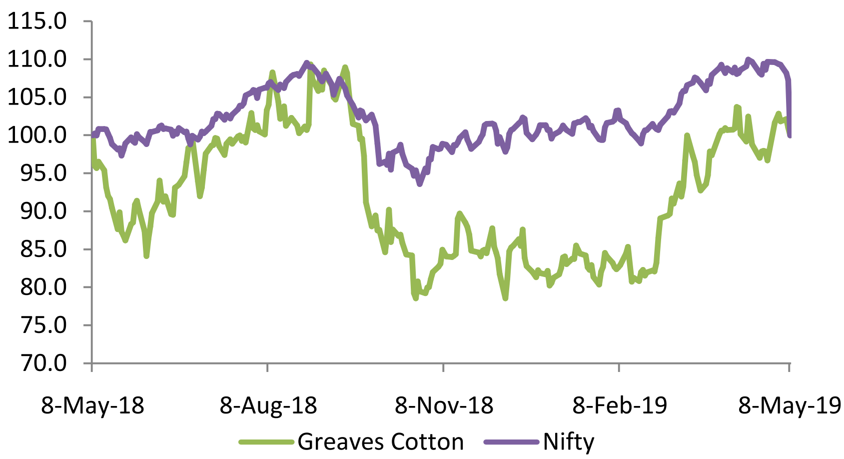
About the company

Greaves Cotton Ltd. is an engineering company that manufactures engines and heavy equipment. The company was founded in 1859 by James Greaves and George Cotton. It was incorporated in 1922 as a private limited company. Greaves Cotton was purchased by Lala Karam Chand Thapar of the Thapar Group in 1947. It has been a publically listed company since 1950. The company produces diesel, petrol, kerosene, gasoline engines, diesel pump sets, gensets, farm equipment, and construction equipment. With the acquisition of Ampere it has become a fuel agnostic engine manufacturer and service provider.



Source: Company, Keynote

Price performance vs Nifty



KEYNOTE

Management Team

Name	Position	Background
Mr. Karan Thapar	Chairman	Well-rounded individual with interests in diversified areas. Qualified as a CA and expertise in both private and public companies.
Mr. Nagesh Basavanhalli	Managing Director & CEO	Highly educated, with a Ms in mechanical engineering from University of Texas. Mr. Nagesh then went on to complete his MBA from University of Chicago Booth School of Business. He is well trained in establishing new brands and businesses, with strategic partnerships with other businesses globally.
Ms. Neetu Kashiramka	CFO	Currently appointed as the CFO, beginning 5th February 2018. She has over 20 years of experience in the field of finance and holds a bachelors degree in commerce from University of Mumbai, with an additional qualification as a CA. She previously worked as an assistant general manager of finance at Jyothy Laboratories Ltd.
Mr. Amit K. Vyas	Company Secretary	Mr. Amit fulfills several roles at several firms previously. He is the company secretary at Greeves Cotton, but previously served as the compliance officer and company secretary of Gillette India. He was committed to the similar role at P&G Hygiene and Health Care before Gillette. He is a graduated law student from Delhi University.
Mr. Vikram Tandon	Independent Director	Qualified as an IIT-ian, Delhi with an honors in B. Tech. He is specializes in corporate development and strategy.

Profit & Loss account (INR Cr.)				
Year ended March 31	**FY18**	**FY19**	**FY20e**	**FY21e**
Revenue from operations	**1839.7**	**2015.3**	**2387.4**	**2730.0**
Total Expenses	1584.4	1743.1	2077.0	2347.8
Operating Profit	**255.3**	**272.2**	**310.4**	**382.2**
Other Income	45.6	41.8	41.1	41.1
Interest expense	0.8	4.0	5.0	6.0
Depreciation	52.4	52.2	54.8	57.5
Profit Before tax	247.7	257.8	291.7	359.8
Tax expense	93.0	77.3	93.3	115.1
Profit after tax	**154.7**	**180.5**	**198.3**	**244.6**

Growth	**FY18**	**FY19**	**FY20e**	**FY21e**
Sales	9.70%	9.5%	18.5%	14.4%
EBITDA	9.10%	6.6%	14.0%	23.2%
PAT	12.20%	16.7%	9.9%	23.4%

Efficiency ratios	**FY18**	**FY19**	**FY20e**	**FY21e**
Asset turnover	5.3	5.1	5.3	5.6
Receivable days	51	62	61	60
Inventory days	34	38	37	37
Payable days	65	66	64	64
Cash conversion cycle	21	34	34	33

Leverage ratios	**FY18**	**FY19**	**FY20e**	**FY21e**
Debt / Equity	0	0.0	0.0	0.0
Current Ratio	2.0	1.8	2.3	1.9
Interest coverage ratio	306.8	64.8	59.3	61.0

Valuation ratios	**FY18**	**FY19**	**FY20e**	**FY21e**
PE	17.0	21.1	17.3	14.1
PEG	1.4	1.3	1.8	0.6
P/B	3.6	3.5	3.2	2.8
Dividend yield	3.9%	3.5%	2.3%	2.8%
EV/EBITDA	13.3	12.5	11.0	8.7
EV/EBIT	13.7	13.0	11.5	9.1

Balance Sheet (INRCr.)				
Year ended March 31	**FY18**	**FY19**	**FY20e**	**FY21e**
Net fixed assets	296.4	410.7	402.9	445.4
Investments	298.4	238.1	238.1	238.1
Other noncurrent assets	43.8	50.7	25.9	100.0
Total Noncurrent assets	638.6	699.5	666.9	783.5
Inventory	109.4	133.8	174.2	199.3
Debtors	252.7	342.3	399.0	448.8
Cash & Bank balance & CI	33.5	44.9	60.9	144.0
Loans & advances & others	312.1	235.3	235.3	235.3
Current assets, Loans & adv.	**698.6**	**747.2**	**860.4**	**1018.3**
Total assets	**1349.2**	**1455.7**	**1527.3**	**1801.8**
Share Capital	48.8	48.8	48.8	48.8
Reserves & Surplus	916.1	934.0	1040.5	1173.3
Net worth	**965.0**	**982.8**	**1089.3**	**1222.2**
Debt	0.0	11.1	21.1	31.1
Deferred tax liabilities	25.3	27.8	27.8	27.8
Liabilities	304.7	365.8	310.9	442.5
Provisions	23.7	21.0	21.0	21.0
Total liabilities	**353.7**	**425.7**	**380.7**	**522.4**

Performance ratios	**FY18**	**FY19**	**FY20e**	**FY21e**
ROE	16.0%	18.4%	18.2%	20.0%
ROCE	25.0%	25.4%	25.9%	28.6%
ROA	18.4%	18.0%	19.4%	20.3%

Cash Flow statement (INR Cr.)				
Year ended March 31	**FY18**	**FY19**	**FY20e**	**FY21e**
PBT	247.7	257.8	291.7	359.8
Depreciation	52.4	52.2	54.8	57.5
Interest expense	1.5	4.0	5.0	6.0
(Inc)/Dec in Working capital	104.1	-99.6	-97.2	-74.8
Tax paid	-91.9	-77.3	-93.3	-115.1
Less: Int / Div income received	-81.6	0.0	0.0	0.0
Other operating cash flow	47.5	-17.9	0.0	0.0
CF from operating activities	**279.6**	**119.3**	**160.9**	**233.4**
Capital expenditure	-1.6	-46.6	-53.3	-42.5
Inc/(Dec) in investments	-95.6	60.3	0.0	0.0
Add: Int/Div received	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0
CF from investing activities	**-97.2**	**13.6**	**-53.3**	**-42.5**
Inc/(Dec) in debt	0.0	11.1	10.0	10.0
Dividend paid	-161.7	-143.7	-93.8	-113.8
Others	-0.8	9.7	-3.0	-4.0
CF from financing activities	**-162.5**	**-122.9**	**-86.8**	**-107.8**
Net Cash flow	**19.9**	**10.0**	**20.8**	**83.1**
Opening balance	10.2	30.2	40.1	60.9
Closing balance	**30.2**	**40.1**	**60.9**	**144.0**

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