



Eicher Motors – It’s Firing on Both Engines

16th May 2017
CMP: Rs 28,890
Sector - Automotive

Large Cap with Mkt Cap Rs 78,575 crores

Advice: Investors can BUY now with a 2 year perspective.



- **Overview:** Eicher Motors is an auto firm making commercial vehicles and two wheelers. The iconic Royal Enfield bikes business has been growing rapidly and they are selling as fast as they can be produced. The CVs business includes great technology from partners Volvo and Polaris of USA. Revenues, EBITDA and Net profits have grown at 28%, 53% and 45% CAGR over the last 7 years from 2009 through 2016.
- **Why Buy Now:** 1) The recent FY17 results confirmed another record year of all round growth and profitability 2) Capacity expansion plans for two wheelers funded by internal accruals could power a robust volume growth in 2 years 3) The so far underperforming CV business is now seeing improved traction and recovery.
- The main risks are international markets growth in bikes, and a continued recovery in CVs.
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Here is a note on Eicher Motors Limited (EM)

Description and Profile

- Eicher Motors is an auto firm based in Gurgaon, NCR that makes two wheelers and CVs.
- It’s FY17 revenues were Rs. 7,033 cr. and profits 1,668 cr. Due to the new IND AS rules, the sales of JV companies are not reported in the consolidated financial statements, however net profits/losses from the same are reported. The total sales including VECV business stood at Rs. 15,582 cr. See Fig 1
- They manufacture and sell two wheelers and commercial vehicles (CVs). EM owns Royal Enfield, a premium motorcycle brand. Fig 1.

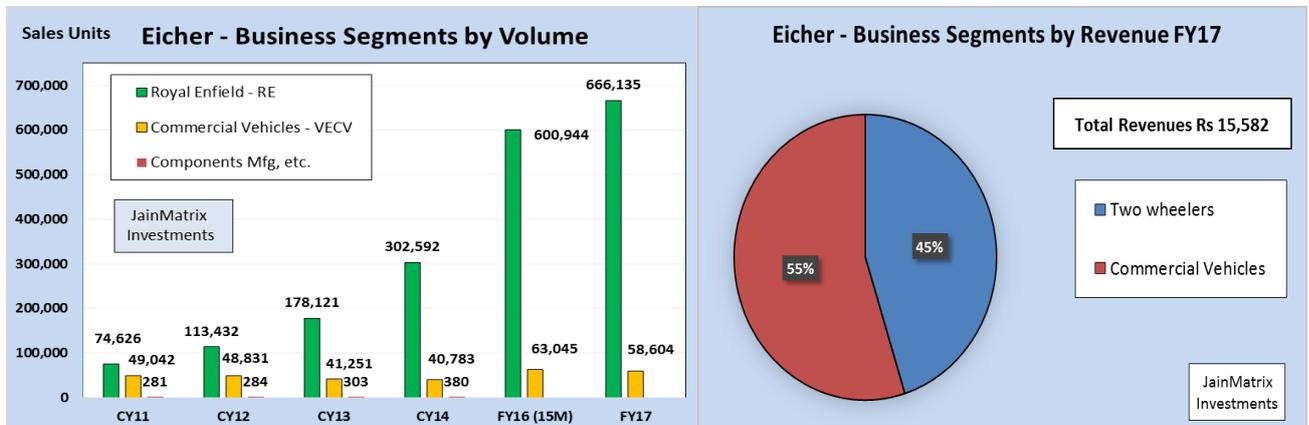


Fig 1 – Business Segments by Volume and by Revenue

- EM is the flagship of Eicher Group, and includes a 50:50 JV with Volvo Group (VE Commercial Vehicles Ltd.), and a 50:50 JV with US-based Polaris Industries (Eicher Polaris Pvt Ltd.).
- EM has a market share of 96% in the 250-750 CC two wheeler segment in India, 23.1% in the 150+ CC two wheeler segment and 13.6% in the commercial vehicles space. Overall EM has a 4.4% market share in the 2W industry in terms of volumes.
- Royal Enfield has 5 brands: Thunderbird, Classic, Bullet, Himalayan and Continental GT, with many models. See Fig 2. They are: Thunderbird has 350 & 500 cc; Continental GT 535 cc; Classic (350 & 500 cc), Classic Chrome; Bullet (350 & 500 cc); Bullet Electra 350 cc and Royal Enfield Himalayan in 410 cc.
- Leaders are S Sandilya (Chairman), Siddhartha Lal (MD/CEO), Lalit Malik (CFO) and B Govindarajan (COO).
- Shareholding in % is: Promoters 50.58, QFI's 32.45, DII 4.03, Individuals 9.19 & others 3.75.



Fig 2 – Products profile of Royal Enfield and VE Commercial Vehicles



Business Notes, Strategies and Events

- EM is highly profitable among auto companies with no debt and a consistently growing top line.
- RE volumes grew 31% YoY and 21% QoQ in Q4FY17. VECV volumes grew 12.7% YoY and 12% QoQ.
- EM reported strong performance in Q4 FY17. Its revenues from the bike and VECV business grew 23.2% and 23.1% YoY. The PAT grew 31.0% and 1964.8% for the businesses resp. during the same period. The VECV business PAT growth is however on a small base of Rs. 6 cr.
- EM JV with Polaris launched Multix in June 2015, a personal utility vehicle. Eicher Polaris had invested Rs 350 cr. towards product development and setting up a mfg. facility at Jaipur. The plant has an annual capacity of 60,000 units which can in future be scaled up to 1,20,000 units. Currently Eicher Polaris is present in 85 points of sales locations.
- EM will expand its dealer network with 150 new RE dealers in 2 years taking it to 825 by FY19.
- Management has guided its RE production at 825,000 units (FY18) and 900,000 units (FY19).
- EM will be investing Rs 800 cr. in bike business and Rs 450 cr. in CVs for FY18. The third bike plant is expected to start production in Aug 2017 at Vallam Vadagal, Chennai.

- The Supreme Court banned sale of BS-III vehicles in India from April 1, 2017 which affected the industry. Apart from the ban, the industry was hit by demonetization and rising fuel costs. In spite of these challenges, EM reported robust performance from the CV business. The management maintained that they have a very low inventory of BS III vehicles (1,700-1,800) and they would be able to export almost 50% of it and convert the remaining vehicles to BS IV compliant vehicles.
- EM launched a range of heavy duty trucks with BS IV technology in April 2017. The company launched Eicher Pro 5000 series to strengthen its presence in the heavy duty segment.
- With a view to deliver exciting and path breaking mid-sized motorcycles, RE acquired Harris Performance, a motorcycle engineering and design firm based in UK in May 2015.
- According to a news report, RE had reportedly been approached by the Volkswagen group, which owns Ducati, for a possible acquisition of the Italian motorcycle brand. In 2016, Ducati posted sales of 593 mn. Euros (over Rs 4,000 cr.), selling over 55,000 bikes worldwide. Ducati's annual earnings for VW are estimated to be around 100 mn. Euros (Rs. 700 cr.), and the Italian brand's current market valuation is estimated to be 1.5 bn. Euros (over Rs 10,000 cr.). However this may be speculation.
- EM guided that their tech center in Leicester in UK was ready for their teams to move in. The full array of the entire testing, validation equipment will only be done around Q3 of this year.
- The Classic 350 is a higher selling model currently has a waiting period of 2 months (Q4 FY17).
- EM's management plans to enter the mini truck segment to compete with Tata Ace. So far EM has focused on medium and heavy vehicles. Currently Tata Ace, Mahindra Maxximo and Jeeto, as well as the Piaggio Ape are competing in this market. However nothing has fructified yet.
- The Board re-appointed Mr. Siddhartha Lal as MD for 5 years from May 2016.
- The Board approved an interim dividend of Rs 100/share, at the rate of 1000%, for the FY16-17.
- However the iconic Volvo buses are not part of EM, and are made by Volvo India directly.
- **Personal Visit:** A visit to RE showroom gave us a great first hand feel for the brand. The store was on a prominent road, so visibility and location were excellent. The ambience within was good. The sales reps were able to explain the products and help customers on their queries. A price sheet with models and on road prices with breakup was shared. The products on display had a solid feel and good style. They were premium segment products. Overall the experience was positive.

Indian Automobiles Industry Review

- The Indian auto industry accounts for 7.1% of the country's GDP. It is large globally, and in FY15, around 31% of small cars sold globally were manufactured in India.
- Two Wheelers (2W) are used in India primarily for daily work commutes and local transportation. A small fraction of 2W owners possess 4W vehicles. In the Indian auto, the 2W have 79% share by volume, followed by 4W with 15% and CVs 6%. Two wheelers dominate owing to a large middle class and young population. See market shares of 2W and 4W in Fig 3.
- The 2W sector recorded an impressive volume CAGR of 10% in the last 10 years, and it had been performing better than the rest of the auto industry, in the last 5 years.
- The Indian auto sector has the potential to generate up to US\$ 300 bn. in annual revenue by 2026, create 6.5 cr. additional jobs and contribute over 12% to India's GDP, as per the Automotive Mission Plan 2016-26 prepared jointly by the SIAM and government.
- GoI aims to make auto sector the main driver of 'Make in India' initiative, as it expects passenger vehicles market to triple to 94 lakh units by 2026, as highlighted in the AMP 2016-26.

- The Govt. plans to promote eco-friendly cars in the country i.e. CNG based vehicle, hybrid vehicle, and electric vehicle and also made mandatory of 5% ethanol blending in petrol.
- The govt. has formulated a Scheme for Faster Adoption and Mfg. of Electric and Hybrid Vehicles in India, under the National Electric Mobility Mission 2020 to encourage the progressive induction of reliable, affordable and efficient electric and hybrid vehicles in the country.

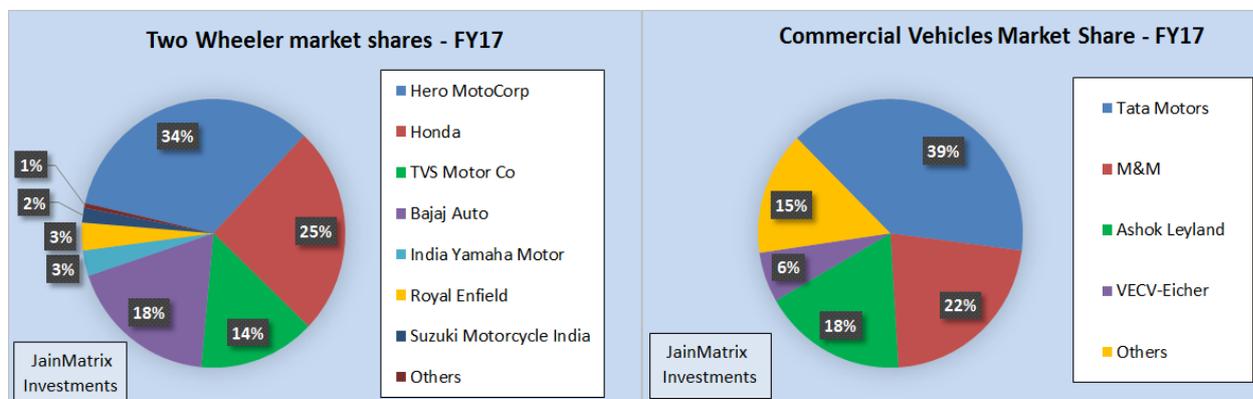


Fig 3 - Market shares of Two wheelers and Commercial Vehicles

Stock Evaluation, Performance and Returns

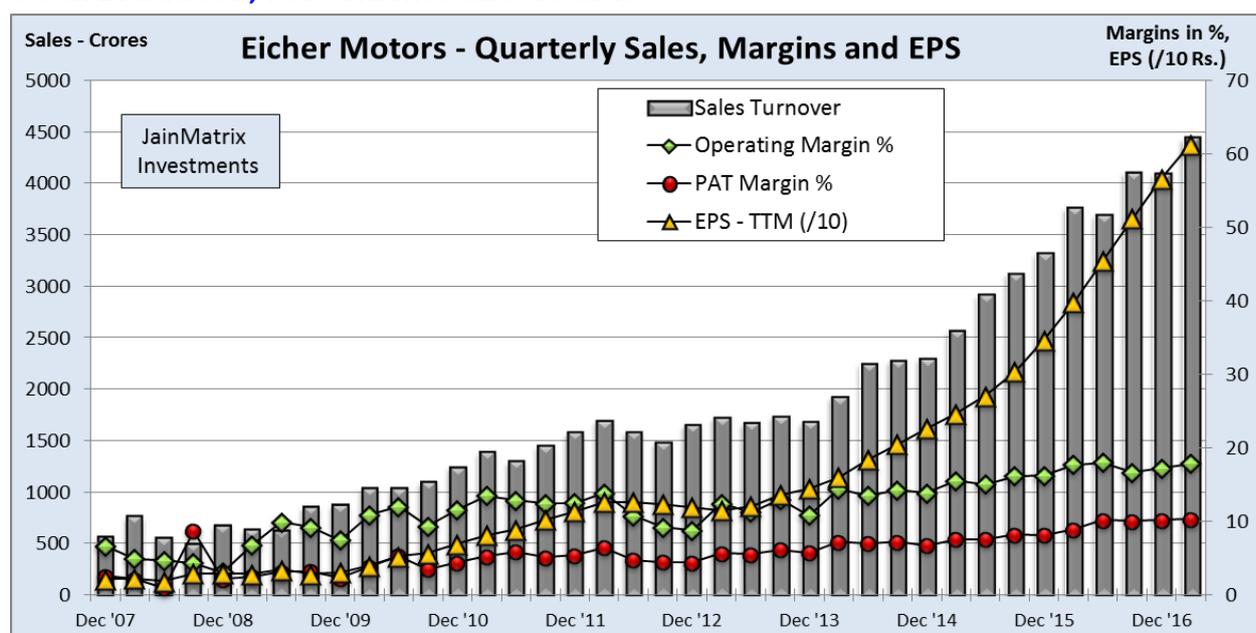


Fig 4 - Quarterly Sales, Margins and EPS

- **Note:** The company has adopted Indian Accounting Standards (IND AS) from 1st April 2016. The principle of consolidation of accounts between holding and subsidiary/ JV has thus been impacted. Hence the following change has taken place in the accounting reporting of consolidated statements of Eicher Motors Limited:
 - ✓ The topline (sales) of VECV would not be added to revenues of consolidated statements of EML as treatment of JV is different under IND AS, but the net profits/losses would be reflected in the consolidated statements.
- In Fig 4, we have considered sales of both EM and its JV with VECV for a clear understanding of real quarterly performance and growth.
- The quarterly financials of EM in Fig 4 reveal a steady increase in revenues, margins and volumes.
- Revenues, EBITDA and profits have grown at 28%, 53% and 45% CAGR over 7 years.

- There have been no bonus, rights or splits, so the equity base is unchanged at 2.72 cr. shares of FV Rs 10. Thus the share price is high. See price history detailed in Fig 5.
- In last 5 years, the share price has appreciated 70.4% CAGR thus generating excellent returns. In the last 2 years, the share price has appreciated 24.4% CAGR.
- We can see that the share price is currently at an all-time high of Rs 29,983 in May 2017.



Fig 5 - Price History

- EM has been investing heavily in its operations, so it had a negative FCFE in 4 out of 7 years, see Fig 6. However the last 3 years have been FCFE positive for the company inspite of investments and negligible borrowings.
- Dividends have been rising over 40% CAGR in last 7 years which is a big positive.

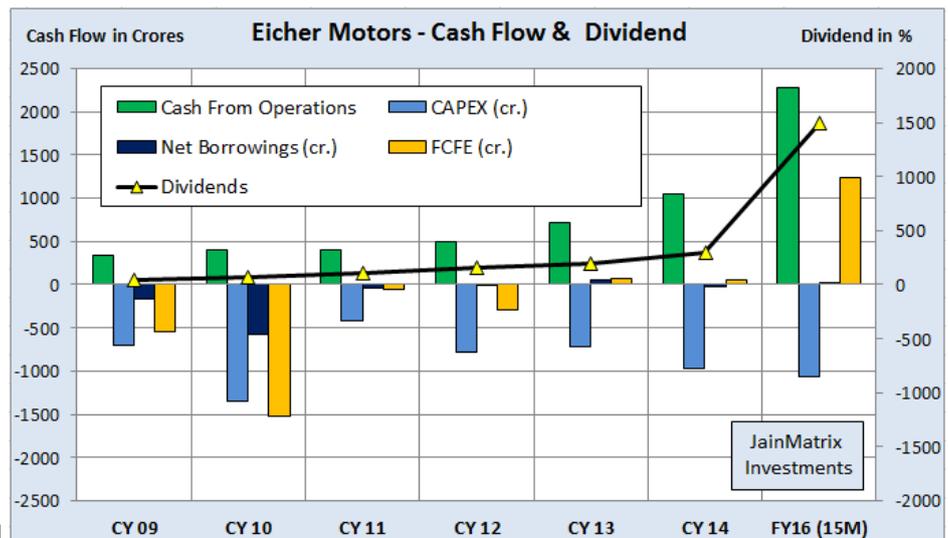


Fig 6 - Cash Flow & Dividend

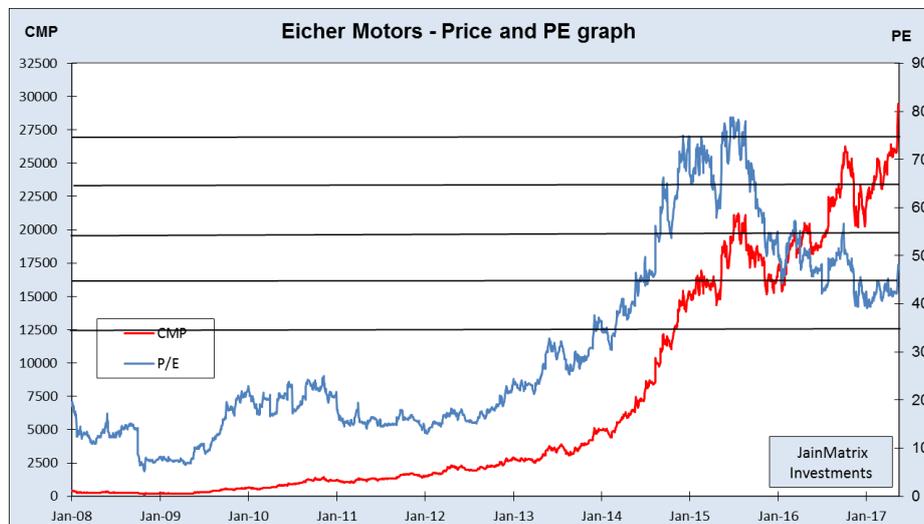
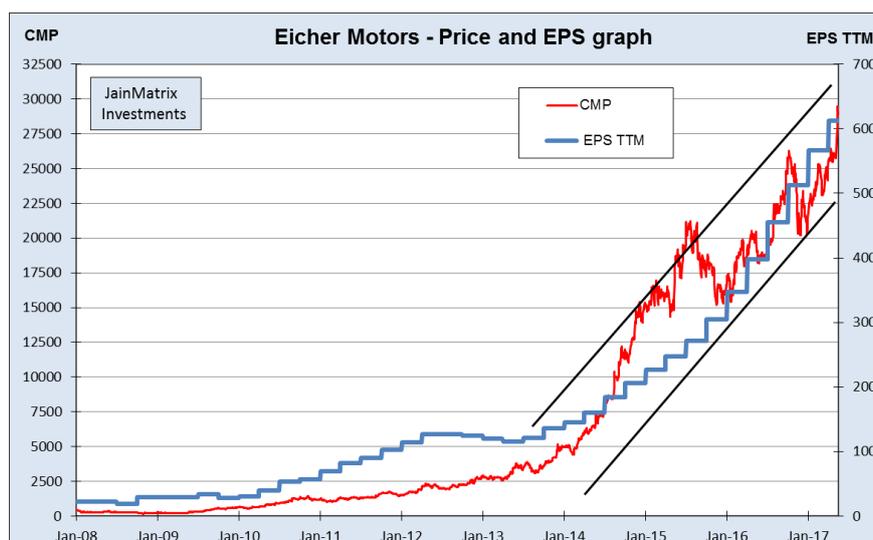


Fig 7 – Eicher Price and PE chart/ Fig 8 – Eicher Price and EPS chart (below)



- The Price and PE chart, Fig 7, reveals that the PE ratio had a historical average of 55 times over the last 2.5 years (and see this as a base for the foreseeable future).
- The PE of EM falls in the range of 40-80 times, giving us 4 quadrants for investments. Today it is at trading at 47.2 times which places it in the undervalued quadrant.
- The channel in Fig 8 tracks the recent path of the EPS numbers.
- The debt to equity ratio is only 0.02 times which is negligible. This is a very good indicator.
- In the Price and EPS chart, Fig 8 we can see a sharp surge in EPS in the last 3 years. The CAGR of EPS is 45.5% over 7 years (2009-16). The share price has gained more or less in line with this.

Benchmarking and Financial Projections

- In this benchmarking exercise, we compare EM with players in 2 wheeler and CV segments. Fig 9.

Particulars	Eicher Motors	Force Motors	Bajaj Auto	Hero MotoCorp	TVS Motors
Sales (Rs. in Cr.)	15,689	3,060	22,688	28,614	11,516
EBITDA (Rs.in Cr.)	2,559	346	5,603	4,771	796
Net Profit (Rs. in Cr.)	1,242	179	3,549	2,967	372
Market Cap	73,224	5,777	82,846	67,774	23,660
PE (x)	46.71	29.07	19.66	19.40	42.38
Price to Book Value (x)	21.14	3.90	6.35	8.53	9.48
3 Yr CAGR Sales (%)	34.91	15.75	4.22	6.36	15.31
3 Yr CAGR Profit (%)	60.09	132.31	4.63	16.67	43.97
Asset Turnover Ratio (x)	3.65	2.13	1.84	3.79	4.41
Inventory Turnover Ratio(x)	16.57	7.42	31.28	38.03	12.38
Debt to Equity Ratio (x)	0.02	0.00	0.01	0.02	0.82
Interest Coverage(x)	233.13	58.78	11032.90	364.31	8.59
Return on Capital Employed (%)	52.97	17.73	43.00	57.50	23.18
Return on Equity (%)	38.85	12.83	29.51	42.09	27.08

Fig 9 - Industry Benchmarking

- It appears that EM is overvalued with highest P/E and P/B. However this may be justified by the high growth numbers, almost zero debt and high returns ratios.
- Other than valuations, EM has good financial ratios on other parameters, while not being the best.
- EM has 2 divisions RE and VECV. We can sense that RE has excellent financial performance on these parameters, while VECV is performing fair, but has high upside potential.
- We can also see two high performers in this list, Force Motors and Hero MotoCorp.

Strengths

- EM has created strong brands of royal Enfield and Volvo with an excellent brand recall and demand.
- The capacity addition has been fast over the last few years. However inspite of this EM is unable to fulfil the demand growth in bikes space, with waiting lists for several models.
- EM has steadily improved its products and distribution over the last few years which is reflected in its multi-year performance.
- EM has negligible debt on its book. Hence its growth is funded through internal accruals. In spite of heavy CAPEX YoY, EM has been FCFE positive in the last few years without any substantial borrowing. This is excellent.
- EM has an experienced management team. The entire top management has professional degrees from prestigious institutes worldwide.

Risks

- A high share price, of over Rs 29,000 is seen as a hurdle for investors. In reality the equity capital of this firm has seen remarkable stability and few dilutions. Investors willing to buy even a few shares have seen high percentage returns for ownership. However small investors have avoided the stock.
- Competition in 2W market in India is intensifying from Bajaj Auto, Hero Motors and MNCs. They are strongly entrenched in lower end 2Ws, and are attempting to enter the high end market. Players like Ducati, Honda and Harley Davidson are global high-end bike firms with presence in India.
- EM is attempting to export 2Ws to many new markets around the world. They need to adapt rapidly to those countries and launch successfully in each. There are many currency, regulatory and consumer risks in this initiative. However the potential is tremendous.
- With close to 100% capacity utilization at 2W plants, the firm will hurt with any mfg. disruption.
- Chennai is the mfg. base for all 2Ws, with 2 current plants and the planned third plant too. There is a geographic risk with one location, illustrated during the Dec 2015 Chennai floods, that disrupted normal life. We see no solution except insurance and a supply buffer.
- Green risks: Pollution and use of fossil fuels is an inherent risk. EM can only reduce this by working on improving fuel efficiencies, as well as on electric models (our suggestion).
- On the VECV business side too, competition is intense.
- The CVs sector is highly dependent on the economic and business cycle. As of now the cycle is reviving so VECV appears to be growing, but we have to see if this bears out over the next few years.
- Volatility in prices of Raw Materials and petrol may lead to disruption in supplies and demand.

Opinion, Outlook and Recommendation

- The auto sector in India has many unique advantages – good local demand and production, export momentum, presence of many global names, design skills, component suppliers and ecosystems and availability of skilled staff. It's developing into a small car and 2W hub with a global scale.
- In this environment EM with its 50+ years in the auto industry brings together a visionary management, good brands and branding, excellent technology partners and conservative financials.
- In 2W, EM is capturing the mass premium market, a very high potential segment. In CVs, there is an economic cycle uptrend, and VECV is starting to see a growth revival, particularly high end trucks.
- EM is following good growth strategies, by entering foreign markets, solid Indian operations, low debt and capital expenditure funded by internal accruals. By all indications, EM is on a sustainable

multiyear - volumes, revenues and profit expansion. With both business segments doing well, Eicher Motors is firing on Both Engines.

- Valuations look expensive in terms of P/E and P/B ratios but when measured against expected financials, they are attractive. Our experience is that well known quality firms (like EM) tend to stay expensive for many years.
- **Investors can buy now with a 2 year perspective.**

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