

15th November 2006**ACCUMULATE**

Price

Rs322**Sensex - 13,426****Price Performance**

(%)	1M	3M	6M	12M
Absolute	(10)	(5)	(28)	41
Rel. to Sensex	(14)	(22)	(38)	(17)

Source: Capitaline

Stock Details

Sector	Engines
Reuters	GRVC.BO
Bloomberg	GRV@IN
Equity Capital (Rs mn)	488
Face Value (Rs)	Rs 10
52 Week H/L (Rs)	465/196
Market Cap (Rs)	16.2 bn
Daily Avg Volume (No of shares)	39,174
Daily Avg Turnover (US\$)	273,797

Shareholding Pattern (%)

(30th Sept 06)

Promoters	50.0
FII/NRI	3.4
Institutions	32.6
Private Corp.	2.2
Public	11.7

Source: Capitaline

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Greaves Cotton Ltd.Company
Update**Piaggio to set its own engines plant****Greaves Cotton in a fix– Piaggio to set up diesel engines unit**

We currently have Accumulate rating (Reco price Rs322, Target Rs406). The current announcement of Piaggio setting up diesel engines plant of 200,000 units and likely fall out on the long-term prospects of Greaves Cotton (GCL), makes us believe that the stock would see limited upside in the intermediate period and would trade at discount to its peers (~11-12x FY08E i.e. target of Rs340-350) as compared to Cummins-18x FY08E, KOEL – 15x FY08E. The discount is justified on back of uncertainties in the future course of action of both the companies that will have its dark shadow on the stock price. This is what had exactly happened when Nokia decided to go on its own, bringing HCL Info price (down 30% from the peak at Rs180 and still struggling at Rs150 for the past 3 quarters). But we also believe that the downside is limited after the 18% drop in price to Rs322 on Tuesday (14th November 2006).

We would review to reduce our target price post getting clear picture on the events, as the target of Rs406 (14x FY08E) is difficult given the negative event, though the earnings would not impact for next 3-4 years.

News –

Piaggio to spend 65mn euros to set up manufacturing facility of 200,000 diesel engine units in India by 2010.

The press release from Piaggio- 14th Nov 2006: Diesel engine production plant in India

The Board of Directors also approved an industrial project in India for the construction of a new diesel engine production facility by the Indian subsidiary PVPL. The facility will have an annual production capacity of up to 200,000 engines and will begin operations between the end of 2009 and the start of 2010. According to preliminary estimates, the total investment, to be paid over the next four years, will be around € 60-65 million.

This is the strategy adopted by the new management team at Piaggio after the CEO Mr Rocco Sabelli resigned on 25th Oct (unknown reasons).

Impact:

This would be body blow for Greaves Cotton future growth prospects, which were in a way linked to Piaggio's outsourcing of engines from the company. Though the impact would be seen post 2010, the overall growth in the profitability would slowdown and might see flattish growth, if its other business (infrastructure equipment – 15% of revenues) fail to replace the Piaggio's loss.

The management of Greaves is closing watching the situation and would react after full clarification of Piaggio's strategy.

Analysis:

1. Piaggio form close to 28-30% of Greaves overall revenues of Rs9bn for FY06 and similar in profits of Rs780mn for FY06. The ratio would remain more or less similar for next 3 years.
2. Currently Piaggio has sales of 1.3-1.4 lac units and 85-90% is supplied by Greaves; ie 1.1-1.2 lac units. This is expected to grow by 22-23% CAGR for next 3 years. Thus Piaggio's requirement would be 2.5-2.6 lac units by 2010. Since, it is building up capacity of 2lac, it will need to still outsource 50000-60000 units. If the growth is above 30% for next 3 years, its third party buying will be at the current levels of 1-1.2lac units. Thus we are looking at zero to 35% degrowth in Greaves revenues from Piaggio from the current level in 2011.
3. The quadricycles will be launched in next 2-3 months and it was new business opportunity for Greaves over the 3W growth rate. We feel that the quadricycles volumes could be 40000-45000 units by 2010 for Piaggio, which needs to be addressed. This will be, we believe jointly catered to by Greaves and captive plant of Piaggio..

Not all is lost???

Greaves is underway in expanding its engines capacity by spending Rs1.1bn. This has to be reconsidered and the key point to watch out would be, how Piaggio will source engines for its growth of 22-23% over next three years, till the time its own facility is on track, if Greaves cancels its expansion.

Piaggio would be at loss in the intermediate period, which would have large impact on its long-term plans for India. This would result in potential positive in the intermediate period for Greaves, as it will have higher bargaining power.

The long term possibility from the scenario building in the intermediate period could be that both the companies join hands to respond to the large growth in next 4-5 years in both 3W and particularly quadricycles.

Greaves has 4 years to build alternate strong revenue model

- a. Enhanced supply to other buyers like M&M (like Piaggio it might also get into captive manufacturing as it already has expertise), Atul Auto and Scooters India
- b. Increase share of infrastructure equipment business from the existing 15% by adding new range of products and build new product portfolio, this would help to limit the impact of Piaggio's loss.
- c. Enter into new business segment altogether, which can stabilize in next 3 years and start contributing to the profits of the company.

We expect the company generate over Rs4bn in positive cash flows from operations in next 4 years and assuming it spends minimal on capacity expansion, it has enough cash to enter new businesses or return it to the shareholders.

Overall, we feel that the news is definitely negative for Greaves long term growth prospects, but the company still has 3 years of stable growth and time to decide on the future plan of action as it can not sit idle on large cash flows that will be generated in next 3-4 years. We believe that the stock will under go derating in the intermediate period, till full clarification and confidence is achieved in the strategy of Greaves. Though the estimates for FY07E EPS of Rs21.5 and Rs29 for FY08E (CAGR of 36% FY06-08) remain unaffected (assuming capex is done as planned earlier), the stock will remain now in a range bound after the correction seen today (down 18% to Rs322).

We feel that at Rs322, the stock can see some more decline, may be 8-10% to reach around Rs280-290. The stock would be down Rs100 from the top and is factoring most of the negatives. At that price it would be 10x FY08E EPS of Rs29, which we feel is good price to enter.

Following table shows the likely scenario post 2010- if no new business line is set to replace Piaggio.

	Overall EPS	growth (%)	Piaggio's share (assumed @30%)	growth (%)	EPS excl Piaggio	growth (%)	P/E (x)	P/E (x)
FY07	21.5	36%	6.4		15.0		15.0	21.4
FY08	29.1	36%	8.7	36%	20.4	36%	11.1	15.8
FY09 #	37.8	30%	11.3	30%	26.5	30%	8.5	12.2
FY10 #	47.7	26%	14.3	26%	33.4	26%	6.8	9.7
FY11 #	42.7	-10%	0		42.7	28%	7.5	7.5

Growth assumed for FY09-10-11.

Profit & Loss					Balance Sheet				
Rs mn	FY05	FY06	FY07E	FY08E	Rs mn	FY05	FY06	FY07E	FY08E
Net Sales	6,523	9,396	11,843	15,077	Equity Capital	456	488	488	488
<i>Growth (%)</i>		44.1	26.0	27.3	Adv for warrants	24	-	-	-
Raw Material	4,365	6,592	8,290	10,554	Reserves	996	1,673	2,219	2,972
<i>% to sales</i>	66.9	70.2	70.0	70.0	Networth	1,476	2,161	2,708	3,460
Staff cost	519	522	579	694	Total Debt	787	550	550	550
<i>% to sales</i>	8.0	5.6	4.9	4.6	Deferred Tax Liabilities	(393)	(43)	239	726
S/G Admin	293	421	533	633	Total Capital Employed	1,870	2,668	3,496	4,737
<i>% to sales</i>	4.5	4.5	4.5	4.2	Gross Block	1,847	2,209	3,573	4,323
Other expenses	406	536	722	890	Less Depreciation	948	1,063	1,238	1,453
<i>% to sales</i>	6.2	5.7	6.1	5.9	Net Fixed Assets	899	1,146	2,335	2,870
EBITDA	940	1,325	1,719	2,306	CWIP	151	164	150	50
<i>% of Sales</i>	14.4	14.1	14.5	15.3	Investments	390	894	494	494
Depreciation & Amort.	114	132	175	215	Inventory	665	880	1,248	1,680
EBIT	827	1,193	1,544	2,091	Debtors	625	920	1,460	1,983
<i>% of Sales</i>	12.7	12.7	13.0	13.9	Cash and Bank	662	335	315	737
Other Income	82	80	90	100	Loans & Advances	542	576	947	1,206
Interest	115	79	70	70	Total Curr. Assets	2,494	2,710	3,971	5,605
EO Items	223	127	-	-	Current Liabilities	1,689	1,949	2,953	3,614
PBT	1,016	1,321	1,564	2,121	Provisions	375	298	501	668
Tax	392	458	516	700	Total Curr. Liabi. & Prov.	2,064	2,246	3,454	4,283
<i>ETR %</i>	38.6	34.7	33.0	33.0	Net Current Assets	430	464	517	1,323
PAT	624	863	1,048	1,421	Total Assets	1,870	2,668	3,496	4,737
Adjusted PAT	484	768	1,048	1,421					
<i>Growth (%)</i>		58.5%	36.5%	35.6%					

Source : Company Data, Emkay Research

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Cash Flow					Ratios				
Rs mn	FY05	FY06	FY07E	FY08E	Rs mn	FY05	FY06	FY07E	FY08E
PBT	1,016	1,321	1,564	2,121	EBITDA %	14.4	14.1	14.5	15.3
Depreciation	114	132	175	215	EBIT%	12.7	12.7	13.0	13.9
Other Income	(25)	19	2	(100)	NPM%	7.4	8.2	8.8	9.4
Interest (paid)	115	79	70	70	ROCE (avg) %	36.5	44.0	47.4	52.1
EO items	(128)	-	-	-	Adj. ROE %	37.2	42.2	43.0	46.1
Others	(93)	(144)	-	-	Adj. EPS	10.6	15.7	21.5	29.1
Change in working capital	80	(283)	(277)	(551)	Reported EPS	13.6	17.4	21.5	29.1
Tax Paid	(81)	(134)	(235)	(212)	Cash EPS	16.1	20.1	25.0	33.5
CFO	998	991	1300	1543	Book Value	31.2	44.2	55.4	70.9
Capex	(68)	(397)	(1,350)	(650)	DPS	7.0	7.0	9.0	12.0
(Inc)/Decr in Inv	0	(414)	400	-	Payout %	70.1	48.1	47.1	48.3
Other Income	40	-	90	100	Debtors days	43	40	45	48
CFI	(28)	(812)	(860)	(550)	Creditors days	95	76	91	88
Equity Issue	100	219	-	-	Total Debt: Equity (avg)	0.8	0.4	0.2	0.2
Net Borrowings	(489)	(239)	-	-	Asset Turnover (adj)	2.8	3.8	4.0	4.1
Dividend Paid	(202)	(480)	(390)	(501)	PE (x)	23.7	18.5	15.0	11.1
Interest Paid	(160)	(98)	(70)	(70)	Cash PE (x)	20.0	16.0	12.9	9.6
CFF	(751)	(597)	(460)	(571)	P/BV (x)	10.3	7.3	5.8	4.5
Incr/(decr) in cash	219	(418)	(20)	422	EV/Sales (x)	2.3	1.7	1.3	1.0
Cash beginning	443	662	244	224	EV/EBITDA (x)	14.5	11.3	8.8	6.5
Cash ending	662	244	224	645	Dividend Yield %	2.2	2.2	2.8	3.7

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