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Eicher Motors

Back on track

Initiating Coverage

3 March, 2011

Reco
Accumulate

CMP	Target Price
Rs1,101	Rs1,505

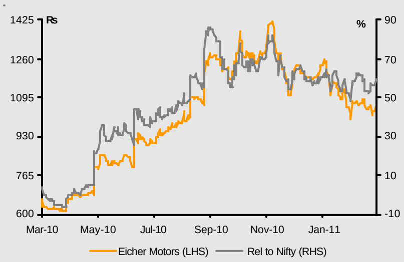
EPS change FY11E/12E (%)	NA
Target price change (%)	NA
Nifty	5,522
Sensex	18,447

Price Performance

(%)	1M	3M	6M	12M
Absolute	5	(4)	(13)	88
Rel. to Nifty	5	1	(14)	68

Source: Bloomberg

Relative price chart



Source: Bloomberg

Stock details

Sector	Automobiles
Bloomberg	EIM@IN
Equity Capital (Rs mn)	270
Face Value (Rs)	10
No of shares o/s (mn)	27
52 Week H/L (Rs)	1,450/595
Market Cap (Rs bn/USD mn)	30/667
Daily Avg Vol (No of shares)	36881
Daily Avg Turnover (US$ mn)	0.9

Shareholding Pattern (%)

	Dec-10	Sep-10	Jun-10
Promoters	55.3	55.6	55.7
FII/NRI	18.2	19.5	19.5
Institutions	12.7	10.8	10.5
Private Corp	2.4	1.1	1.4
Public	11.5	13.0	12.9

Source: Capitaline

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- **Worst is behind; Growth and profitability back on track. CY10 margins of 8.1% sustainable with an upward bias**
- **Expect M&HCV comeback to succeed this time due to strong support from Volvo. Expect 18% CAGR M&HCV growth (twice that of industry) during CY10-12**
- **High ROIC (>100%) despite an asset heavy M&HCV business to ensure cash generation. Healthy growth in 2-wheelers (29% volume CAGR) & outsourcing potential to chusion business model**
- **Expect a 22.7% EPS growth during CY10-12. Initiate coverage with a ACCUMULATE rating and a SOTP price target of Rs 1,505. Key risks are execution delays and higher metal prices**

Worst is behind; Current margins sustainable with an upward bias

Eicher Motors (EML) has embarked on its growth trajectory with a clean slate leaving behind the turbulent FY04-FY08 period when margins plummeted from 11.3% in FY03 to 5.1% in FY08. This was due to business restructuring/non recurring expenses. Strong focus on identified growth drivers and profitability lends confidence to our belief that EML's CY10 margins of 8.1% are sustainable with an upward bias.

Key growth drivers identified

EML has identified three growth drivers - two wheelers (through parent), CVs and outsourcing opportunity for Volvo (through VECV). With assistance from Volvo, EML plans to once again foray into the heavy duty CV space. We expect its M&HCV foray to succeed this time around. We estimate an 18% CAGR in domestic M&HCVs during CY10-CY12 (twice that for industry), driven by higher sales of >12t vehicles (60% CAGR during CY10-CY12 to 10816 units). We expect its two wheeler business also to gain momentum with renewed focus and report a 29% CAGR in volumes to 87,039 units during CY10-CY12. The outsourcing business has strong potential depending upon the success of the engine manufacturing project commencing in end CY12.

Volvo recognizes VECV's importance in its global plans

Volvo recognizes EML as one of its key strategic partners in Asia, with plans to make 'across the spectrum investments' in VE Commerical Vehicles (VECV). It has identified EML (through VECV) for low cost R&D, purchasing and market share gains in M&HCVs It is also focusing on increasing revenues from soft products (engines) and exports.

Valuation and view

We expect EML to report Sales, EBIDTA and net profit CAGR of 19.6%, 20%, and 22.7% during CY10-CY12. We have valued the company on SOTP basis. We like the company for its ability to generate higher ROIC (>100%) despite being in an asset heavy business. We have assigned an 8x EV/EBIDTA multiple for its two wheeler business, given the strong brand equity of its product and cash flow generation. For the CVs, we have assigned a lower EV/EBIDTA multiple of 7x, given the risk of failure/delay in success in the M&HCV space. We have assigned a NPV of Rs 155 to its engine business. We initiate coverage with a ACCUMULATE rating and a TP of Rs 1505 based on CY12 estimates.

Financial Snapshot

Y/E, Mar (Rs mn)	Net Sales	EBIDTA (Core)	EBIDTA (%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E (x)	EV / EBITDA	P/BV (x)
CY09	29,386	1,455	4.9	844	31.3	(746.0)	7.8	35.1	13.2	2.7
CY10	43,971	3,578	8.1	1,899	70.5	124.9	16.5	15.6	9.0	2.4
CY11E	51,143	4,143	8.1	2,467	91.6	30.0	18.6	12.0	7.0	2.1
CY12E	62,901	5,153	8.2	2,858	106.1	15.8	18.7	10.4	5.1	1.8

Company Background

Eicher Motors Ltd (EML) is promoted by the Delhi-based Vikram Lal. Currently, it is managed by the second generation promoter - Mr Siddhartha Lal, who took over charge as group CEO since January 2004. Mr Siddhartha has been associated with the company in different roles since 1999. Today, it is present in commercial vehicles, two wheelers and related component and design services, with commercial vehicles being the key revenue/profit driver. In 2008, Volvo entered into a JV with EML as joint promoter of the commercial vehicles business. Post the entry of Volvo, the commercial vehicle business was transferred into a separate subsidiary (VECV) in which EML holds 54.4% stake and the balance is held by Volvo. Volvo also acquired 8.1% stake in EML.

Key managerial persons

Name of the person	Designation	Company
Mr. S. Sandilya	Chairman	EML
Mr. Siddhartha Lal	MD & CEO	EML
Mr. Vinod Aggarwal	CEO	VECV
Dr Venki Padmanabhan	CEO	Two wheelers

Plant locations

Plant Location	Product	Capacity
Chennai (TN), Thiruvottiyur	Motorcycles (Royal Enfield)	60000
Pithampur (MP)	Commercial Vehicles	48000
Thane, Mumbai	Gears (commercial vehicles)	
Dewas (MP)	Transmission gears and shafts	
Pithampur (MP)	Heavy duty engines	85000

Investment rationale

FY04-08 period- marked by restructuring

FY04-08 period for Eicher Motors (EML) was marked by a series of business restructuring as well as corporate restructuring exercises starting with the merger of its two wheeler and tractor business in FY04 and ending with a JV with Volvo for its commercial vehicle business. The details are indicated in the table below

Year	Particulars
FY04	Tractor/Two wheeler/Gear business de-merged from Eicher Ltd and merged into the company w.e.f. 1st Apr'03
FY04	8.1 mn shares issued to Eicher Ltd representing 28.8% of the diluted equity
FY06	Sold tractor business w.e.f. from 1st Jun'05 to TAFE at a profit of Rs 1,734mn
FY06	Acquired Design Intent Engineering (DIE), USA for USD 2.5mn
FY07	Acquired Hoff and Associates (Hoff), USA for a consideration of $3.5mn
FY08	Hoff merged with DIE and renamed as Eicher Engineering Solutions (EES) w.e.f. 1st Jan'08
CY08	Formed JVC with Volvo for CV business - 54.4% EML share w.e.f. 1st Jul'08
CY08	EES transferred to VECV w.e.f. 1st Jul'08
CY08	Standalone entity has only two wheeler business and investment in VECV
CY08	Volvo acquires 8.1% stake in EML from promoters
CY09	Buyback from minority investors for 1.41mn share(5% of equity & 12% of Free Float) at Rs 691.7 per share

Source: Company, Emkay Research

Volvo – deal structure

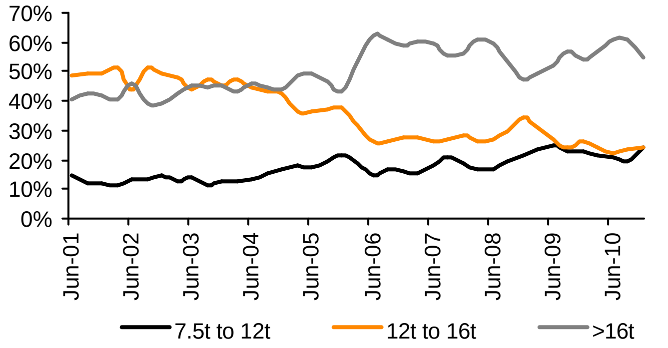
- The commercial vehicle business with related component business has been transferred to a new company called VE Commercial Vehicles (VECV)
- Volvo has acquired 45.6% stake in VECV for a consideration of USD 350m (USD 275m as cash and USD 75m for Volvo's Truck (distribution of vehicles, spares and service) and Bus (only service)
- VECV will have exclusive rights for all the current and future truck products of Volvo
- All future truck projects of Volvo in India will be routed through the JV
- VECV will be jointly managed by Volvo and Eicher with equal representation on Board
- Volvo will acquire 8.1% stake in Eicher Motor at Rs 691.7 per share. As a result, the direct and the indirect holding of Volvo will be 50% in VECV

Source: Company, Emkay Research

FY04-08 - a difficult phase for EML's HCV business

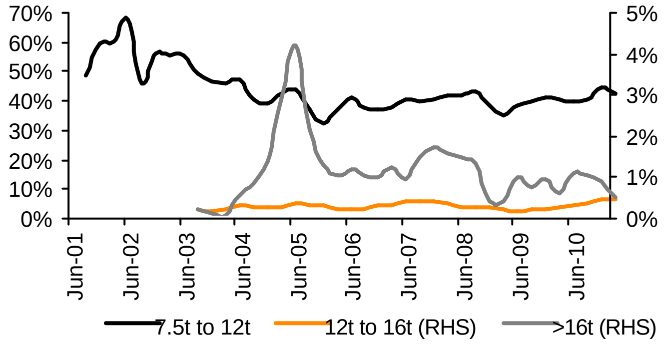
During this period, EML (traditionally strong in the 7.5t to 12t segment) forayed into the high tonnage segment with a series of launches in FY04. However, its HCV foray did not achieve the desired results. After achieving ~2% market share in FY05, its market share continuously declined, resulting in EML becoming a marginal player in the HCV segment. What also affected EML was the rising share of HCVs during the period (FY03-FY08). As can be seen from the graph next page, the share of >16t segment increased from ~39% in June 2001 to ~60% in March 2008.

M&HCV goods - Industry mix



Source: SIAM, Emkay Research

Eicher - Market share in M&HCV goods



Source: SIAM, Emkay Research

EML's inability to establish its presence in the high tonnage segment affected its financial performance. As can be seen from the table below, both return ratios as well as margins nosedived during the period. It should be noted that decline in profitability was not due to change in the business mix - the merger of two wheeler and tractor business in FY04 and subsequent demerger of tractor business in FY06 (refer to next page)

EBITDA Margin (%)	**FY01**	**FY02**	**FY03**	**FY04**	**FY05**	**FY06**	**FY07**	**FY08**	**FY09***	**FY10***	**FY11E***	**FY12E***
Eicher - (Conso From FY06)*	8.5	8.7	11.7	8.2	6.3	3.8	5.6	5.1	0.0	4.9	8.1	8.1
Ashok Leyland	12.6	13.1	12.0	11.5	9.5	10.3	9.8	10.6	7.8	10.5	10.7	10.8
Bajaj Auto	5.9	15.1	18.7	17.1	15.3	17.3	14.7	13.4	13.0	21.4	20.4	19.6
Hero Honda	13.3	15.1	16.7	16.8	15.7	15.6	11.8	13.0	13.9	16.9	12.4	12.1
M&M	8.0	8.4	8.4	11.0	11.8	12.0	12.8	11.1	8.0	15.6	15.3	14.7
Maruti	(1.6)	4.9	6.0	11.8	13.9	14.5	14.5	13.6	7.9	12.5	9.4	9.5
TVS	7.1	7.1	10.1	10.0	9.7	7.7	4.9	3.0	5.0	5.7	6.5	7.0
TML (S)	6.3	9.9	12.5	13.6	12.2	12.2	11.1	9.0	7.3	11.3	10.8	10.2

** for Eicher it is calender year (CY08, CY09, CY10 & CY11E)*

Source: Companies, Emkay Research

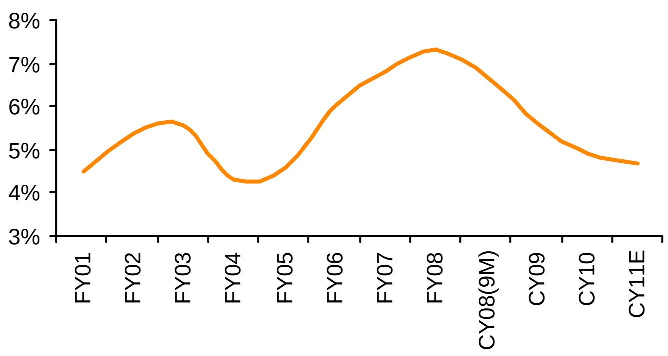
AROIC (%)	**FY01**	**FY02**	**FY03**	**FY04**	**FY05**	**FY06**	**FY07**	**FY08**	**FY09***	**FY10***	**FY11E***	**FY12E***
Eicher - (Conso From FY06)*	30.3	27.1	40.4	24.5	19.0	4.7	18.4	18.9	(7.8)	22.8	106.8	111.8
Ashok Leyland	10.7	11.5	13.4	22.6	25.3	37.2	37.7	37.3	12.6	17.1	23.8	26.4
Bajaj Auto	0.1	17.8	40.0	56.6	86.0	195.7	239.8	124.9	88.5	343.4	1,088.2	805.5
Hero Honda	77.3	228.5	(1,021.9)	(487.8)	(425.2)	(1,042.4)	337.6	339.1	676.5	(262.5)	(127.2)	(287.9)
M&M	5.9	6.8	7.8	24.7	43.4	53.5	68.8	58.6	39.7	106.7	99.5	93.9
Maruti	(13.4)	(1.2)	4.4	25.3	50.4	69.7	80.7	65.3	23.2	60.8	47.9	51.2
TVS	16.6	16.1	43.8	38.1	29.4	21.1	12.1	0.3	6.9	14.8	27.5	35.5
TML (S)	5.2	12.8	17.0	48.2	114.6	59.6	45.2	44.6	24.4	57.1	72.1	69.7

** for Eicher it is calender year (CY08, CY09, CY10 & CY11E)*

Source: Companies, Emkay Research

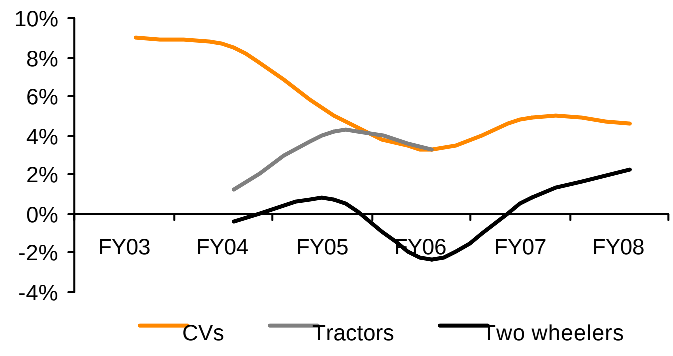
Close analysis of the financials indicate that the pressure on profitability was due to higher warranty, incentive, product development and other S&D expenses during FY04-FY08 period. More importantly, the increase in these costs was largely attributable to its M&HCV business rather than its tractor and two wheeler businesses as reflected by segmental margins (see graph below).

Warranty, incentive, product development expenses as % of sales



Source: Company, Emkay Research

Segmental margins (EBIT)

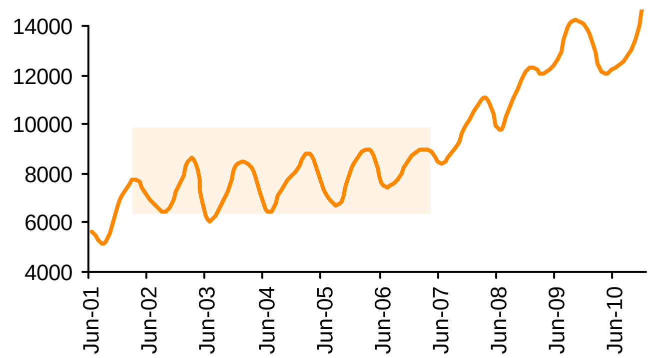


Source: Company, Emkay Research

Two wheeler business was also stagnating

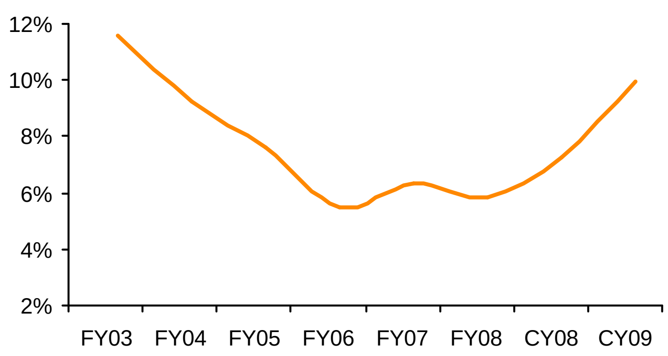
Pressure on the CV business and focus on various restructuring activities resulted in diluted focus on its two wheeler business, which is evident from the lack of volume growth and lower profitability

Two wheelers - quarterly domestic sales



Source: SIAM, Emkay Research

Two wheelers margins



Source: Company, Emkay Research

Worst is behind, Key growth drivers identified

We believe that the worst is over for EML and it is likely to focus on select key growth drivers, ensuring a steady growth rate and improved profitability. Completion of its restructuring process coupled with its learning curve from the past has helped the company chart out a clear growth strategy with strong focus on profitability. EML has identified three key growth drivers to help it attain these goals-

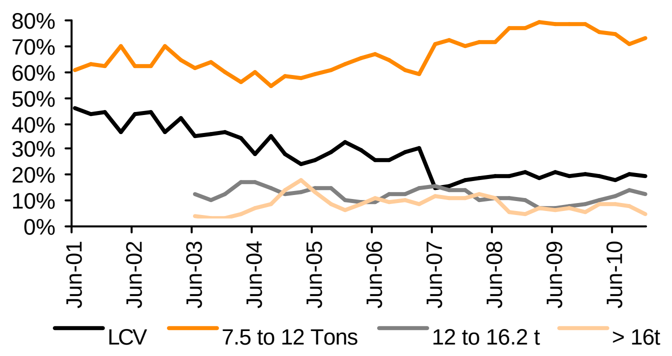
- Commercial Vehicle business (in VECV)
- Two wheeler business (in EML)
- Soft products/outsourcing business (in VECV)

Commercial vehicle business

Transition is underway

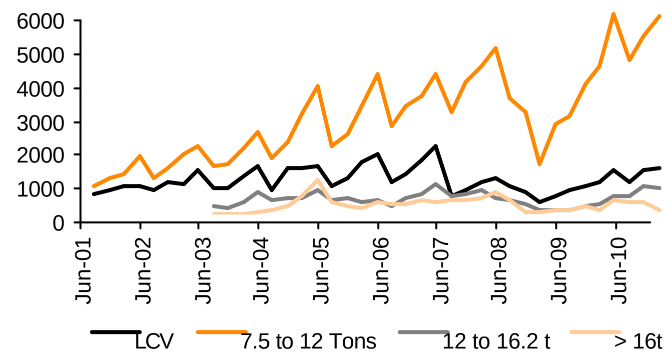
We believe that the first phase of transition from low tonnage vehicles to medium tonnage vehicles is complete. This is evident from the gradual reduction in exposure to the LCV segment. As can be seen from the graphs below, the share of LCV(Goods) has reduced from >40% in 1QFY02 to <20% in 4QCY10. Similarly, the share of ICV (goods) has seen an increase from <60% in 1QFY02 to ~70% in 4QCY10. EML has built a reputation for itself in the ICV (intermediate commercial vehicles) space.

Eicher - Domestic CV (goods) - product mix



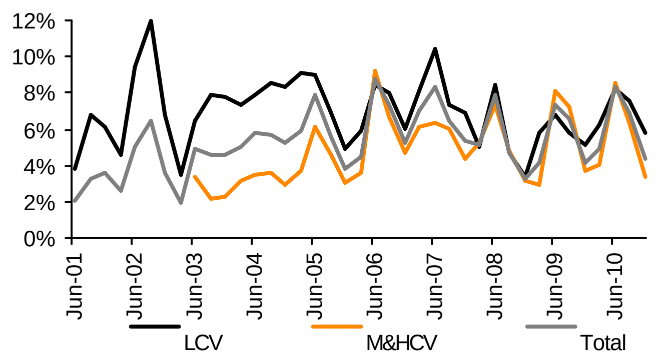
Source: SIAM, Emkay Research

Eicher - Domestic CV (goods) - volumes



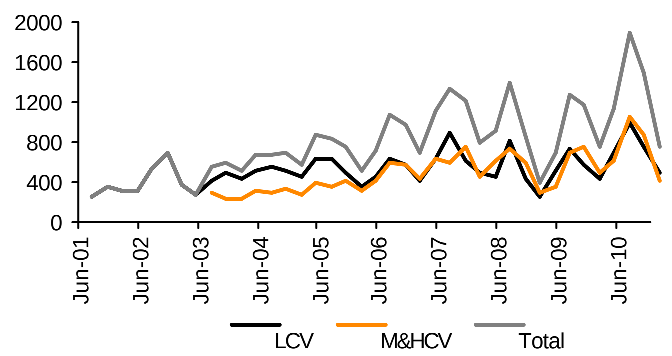
Source: SIAM, Emkay Research

Eicher - Domestic CV (bus) - market share



Source: SIAM, Emkay Research

Eicher - Domestic CV (bus) - volumes



Source: SIAM, Emkay Research

Volvo's entry promises higher chance of success in second phase of transition

The second phase of transition i.e. increasing the share of HCVs in the product portfolio is critical to EML's success. As indicated earlier, EML's first stint in the HCV space did not achieve the desired results. However, it has learnt well from the past. As a result, it has taken several steps to ensure success, the prominent one being, its JV with Volvo. We believe that VECV will achieve success in the HCV segment this time due to the combined strength of Volvo's technological expertise and high quality standards, together with EML's distribution and low cost manufacturing. Given the structure of the JV and the clearly defined roles of each of the players, we believe that the JV has a high probability of achieving success.

The expertise of Volvo will be used in two areas - improving the systems and process and more importantly, technology support. As far as processes are concerned, Volvo has already started leveraging its superior global 3P and IT strengths, enabling EML to sharpen its process across various business segments - like spare parts, customer requirements, customer identification, route identification, etc. We expect its technological support to also gain prominence as and when the new engine plant starts producing engines from end CY12 (refer to next page for more details).

CVs - Product development efforts over the years

Product Devlopment	FY02	FY03	FY04	FY05	FY06	FY07	FY08	CY08	CY09
<7.5t			2						
7.5T - 12.5T			1			1			1
12.5T - 25T									
>25T	2	2	3		2	6			1
Launches									
<7.5t					1	3			
7.5T - 12.5T	2			3					1
12.5T - 25T		1							
>25T			4	1		2			

Source: Company, Emkay Research

Volvo recognizes VECV's importance in its global plans

Volvo recognizes EML as one of its key strategic partners in its plans for Asia. It has identified EML as a low cost R&D base and purchasing location. It also recognizes the opportunity to use its group technology in India through EML in order to gain market share in HCVs (through Eicher as well as the Volvo brand). It also plans to increase revenues from soft products (like engine manufacturing) and export opportunities to Africa, Middle East and South East Asia. Volvo's global plans indicate 'across the spectrum investments' in VECV- engine plant, paint shop, cab plant, and assembly line. Given below are a few snapshots from various investor presentations of Volvo highlighting their outlook and plans for VECV.

Volvo - VECV focus areas

Increase market share in HD trucks

Infuse group technologies in VECV

Expansion of dealer network

Explore export opportunities to Africa, Middle East and South East Asia

Increased focus on soft products

Investments planned in VECV in

- Engine plant
- Paint shop
- Cab plant
- Assembly Lines

Area of focus with respect to HD engine manufacturing in VECV

- Investments in fabrication and assembly
- Secure local sourcing
- Secure Japanese production performance and quality standards

Source: Volvo presentations, Emkay Research

Two wheeler business - in a sweet spot

We believe that EML's two wheeler business is in a sweet spot. Not only is the demand strong, but also the management has renewed its focus on the two wheeler business. Sidhartha Lal (promoter) has relinquished his role as CEO of VECV and assumed the role of CEO of EML. This is largely to focus on the two wheeler business and strengthen the Eicher brand. It was not getting adequate attention due to various restructuring initiatives and focus on HCVs. New model introduction, restyling of products and addressing capacity concerns are likely to result in strong volumes for the company. We do not expect Royal Enfield's business to be affected by competition. The company is increasing capacity at its existing plant to ~70,000 units and also plans to set up a new plant (combined capacity of ~150,000 units). The new plant will enable EML to focus on the export markets, hitherto not catered to due to limited production. We expect a strong traction in export volumes once the new plant commences production.

Soft products/Outsourcing

Post the entry of Volvo, we believe that soft products/outsourcing could be a big business and profitability contributor for EML (through VECV). The announcement of its engine manufacturing plant to cater to Indian as well as export markets is just the beginning. Over the longer term, we do not rule out several similar opportunities in gears/transmission. Some of the key highlights of the engine deal are indicated below:

- VECV will be the global manufacturing hub and industrial base for Euro3,4,5 and 6 medium duty base engine requirements of the Volvo group
- The project involves an investment of Rs 2.9bn
- India will be the hub for manufacturing and assembling engines for Volvo's global requirements
- The new facility will also meet engine requirements of EML
- The plan is to manufacture 85,000 units Of this, VECV will do final assembly of 55,000 engines to meet Volvo's global requirement of Euro III and Euro IV engines as well as VECV's requirement for heavy duty vehicles
- 30,000 base engines will be sent to Volvo Powertrain, France
- Production will commence in 4QCY12 and will be ramped up in CY13

"A global manufacturing hub at VECV's Pithampur plant is an excellent example of how the Volvo group can leverage its global presence to reduce costs for engine manufacturing while making maximum use of its industrial strength. VECV already has a robust supply chain network and with this new development, VECV becomes integrated with the Volvo Group's global supply chain." ***- Peter Karlsten, President, Volvo Powertrain***

In the long run, if the engine outsourcing plans work to perfection, there can be other similar opportunities in transmission/gears for VECV. More importantly, this would provide the much need stability to the inherently cyclical domestic business of CVs.

Profitability - current margins sustainable with an upward bias

Till FY04, Eicher had been in the top quadrant as far as return ratios were concerned despite being involved in an asset heavy business (M&HCVs). From FY04 till FY08, the company went through a tough phase due to its unsucessesful foray into high tonnage M&HCVs and shift in the industry demand to high tonnage M&HCVs. However, with things falling into place, we expect EML's ROIC to improve significantly vis-à-vis FY03 levels. We expect the ROIC of the company to lag only the two leading two wheeler manufacturers. Comparing ROE is erroneous due to significant cash on books, post the Volvo deal.

AROIC (%)	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09*	FY10*	FY11E*	FY12E*
Eicher - (Conso From FY06)*	30.3	27.1	40.4	24.5	19.0	4.7	18.4	18.9	(7.8)	22.8	106.8	111.8
Ashok Leyland	10.7	11.5	13.4	22.6	25.3	37.2	37.7	37.3	12.6	17.1	23.8	26.4
Bajaj Auto	0.1	17.8	40.0	56.6	86.0	195.7	239.8	124.9	88.5	343.4	1,088.2	805.5
Hero Honda	77.3	228.5	(1,021.9)	(487.8)	(425.2)	(1,042.4)	337.6	339.1	676.5	(262.5)	(127.2)	(287.9)
M&M	5.9	6.8	7.8	24.7	43.4	53.5	68.8	58.6	39.7	106.7	99.5	93.9
Maruti	(13.4)	(1.2)	4.4	25.3	50.4	69.7	80.7	65.3	23.2	60.8	47.9	51.2
TVS	16.6	16.1	43.8	38.1	29.4	21.1	12.1	0.3	6.9	14.8	27.5	35.5
TML (S)	5.2	12.8	17.0	48.2	114.6	59.6	45.2	44.6	24.4	57.1	72.1	69.7

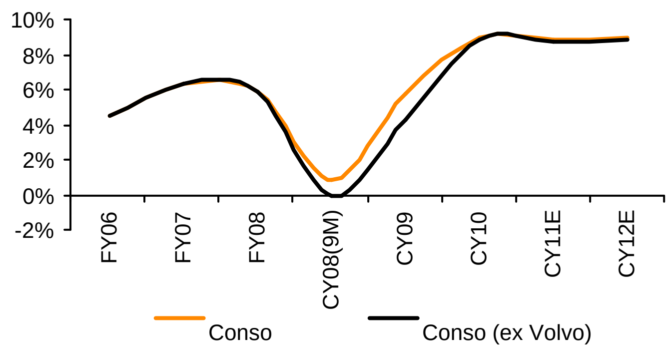
** for Eicher it is calender year (CY08, CY09, CY10 & CY11E)*

Source: Companies, Emkay Research

Core profitability (ex Volvo business) also strong

Our analysis of the margins (ex Volvo Truck distribution business - 5% margins and Volvo spare part business - 15% margins) indicates that core margins are also strong, implying the inherent strength of the business. We attribute this to effective measures taken by the company to control warranty, incentive and product development expenses discussed earlier on Page 5. Volvo's truck and spare part business would account for ~25% of sales and EBIDTA of the consolidated entity in CY11.

EBIDTA Margins



Source: Company, Emkay Research

Rs mn	CY09	CY10	CY11E	CY12E
Sales				
Consolidated	29,386	43,971	51,143	62,901
Volvo	8,092	10,902	12,524	14,403
Volvo % Conso sales	**27.5**	**24.8**	**24.5**	**22.9**
EBIDTA				
Consolidated	1,444	3,569	4,143	5,153
Volvo	708	920	1,076	1,260
Volvo % Conso EBIDTA	**49.0**	**25.8**	**26.0**	**24.5**

Source: Company, Emkay Research

Financials

Volume assumptions

We are factoring in a CAGR growth of 18.1% for M&HCVs during CY10-CY12 period. A large part of this growth is coming from the strong volume assumptions in the high tonnage segment. We expect >12t segment to grow by ~60% CAGR during CY10-CY12 to 10,816 units in CY12. This is below the company's target of 1000 units per month. In the ICV segment (7.5t to 12t) segment, we expect EML to grow in line with the industry (9% CAGR during CY10-CY12).

Volumes	CY08(9M)	CY09	CY10	CY11E	CY12E	CAGR CY10-CY12E
Domestic	**44,927**	**72,533**	**86,022**	**105,674**	**133,605**	**24.6**
MHCV	10,423	16,903	28,221	35,042	44,040	18.1
LCV	2,893	4,696	7,243	8,329	9,444	13.4
Two Wheelers	31,148	50,002	49,444	64,277	83,560	30.0
Volvo	463	932	1,114	1,225	1,348	10.0
Export	**3,476**	**4,618**	**5,347**	**6,013**	**6,832**	**13.0**
MHCV	772	1,622	1,386	1,525	1,744	12.2
LCV	930	1,043	1,331	1,464	1,611	10.0
Two Wheelers	1,418	1,953	2,630	3,025	3,478	15.0
Volvo	356	-	-	-	-	-
Total	**48,403**	**77,151**	**91,369**	**111,687**	**140,437**	**22.1**

Sales

We expect sales to register a strong CAGR of 18.6% during CY10-CY12, driven by all the business segments.

Consolidated	CY08(9M)	CY09	CY10	CY11E	CY12E	CAGR CY10-CY12E
CV	12,371	20,960	33,028	38,152	46,427	18.6
Components	847	1,356	2,122	2,470	3,069	20.3
Spare parts	2,900	4,511	7,238	8,105	9,959	17.3
Two wheelers	2,136	3,682	4,332	5,767	7,681	33.2
Others	115	209	330	382	464	18.6
Total	**18,370**	**30,719**	**47,049**	**54,876**	**67,600**	**19.9**
YoY change (%)	**-**	**25.4**	**53.2**	**16.6**	**23.2**	
Subsidiaries	10,652	26,639	42,205	48,216	58,728	18.0
Standalone	7,718	4,080	4,844	6,660	8,872	35.3

Capex

EML has planned a capex of ~Rs5bn in VECV over the next three years in order to increase its CV capacity from 48,000 units currently to 100,000 units. Similarly, a capex of ~Rs2bn is expected for two wheeler business. Apart from this, the engine business will require a capex of Rs2.9bn (should be completed by CY12).

Key risks

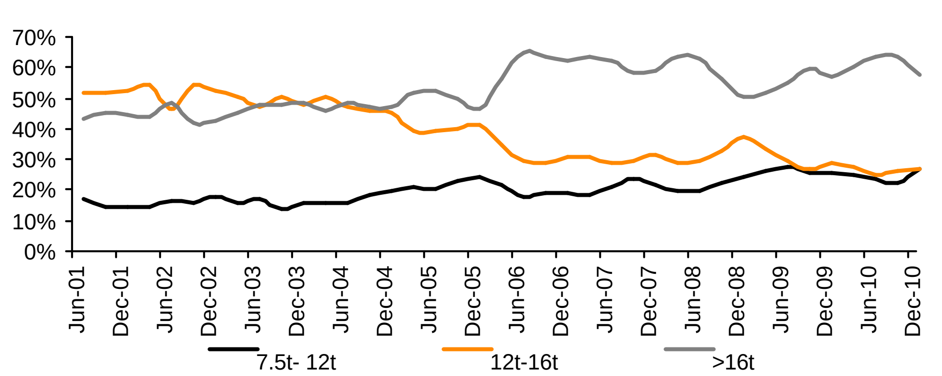
Inability to achieve success in the higher tonnage segment

Our assumption of market share gains in the M&HCV segment is due to strong performance in the higher tonnage segment. In case the company fails to succeed in increasing its market share, there could be pressure on margins (as was witnessed during 2005-08 period) as our current estimates do not factor in higher marketing spend to support volumes.

Sharp change in industry mix

Eicher's strength has been the 7.5t to 12t segment. As can be seen from the graph below, the share of this segment has been increasing in the overall industry mix. We attribute this to the hub and spoke model where the preference has been shifting from 12t to 16t segment to higher tonnage and lower tonnage segment. While we expect the shift to continue, any sudden change in the industry structure in the near term will have significant impact on EML as it is still in the initial phases of establishing itself in the higher tonnage segment.

Domestic M&HCV goods - mix



Source: SIAM, Emkay Research

Metal prices

We have assumed an 8% and 6% increase in metal cost per ton for CY11 and CY12. Our earnings are very sensitive to the changes in the metal prices, especially for VECV. Every 1% change in metal price will impact our EBIDTA margins by 30 bps and EPS by 2.5%

Valuations and View

We expect EML to report Sales, EBIDTA and net profit CAGR of 19.6%, 20%, and 22.7% during CY10-CY12. We like the ability of the company to generate high ROIC (>100%) despite being in an asset heavy business like M&HCV. We are factoring in high tonnage vehicle sales of 10,816 units in CY12 (below the company's target of touching 1,000 units per month). We believe that there is an upside to our volumes as well as margin estimates, if the company is able to achieve success in the high tonnage space. We have valued the company on SOTP basis. We have assigned an 8x EV/EBIDTA multiple for its two wheeler business, given the strong brand equity of its product and cash flow generation. For the CVs, we have assigned a lower EV/EBIDTA multiple of 7x, given the risk of failure/delay in success in the M&HCV space. We have assigned a NPV of Rs 155 to its engine business. We initiate coverage with a ACCUMULATE rating and a TP of Rs 1,505 based on CY12 estimates.

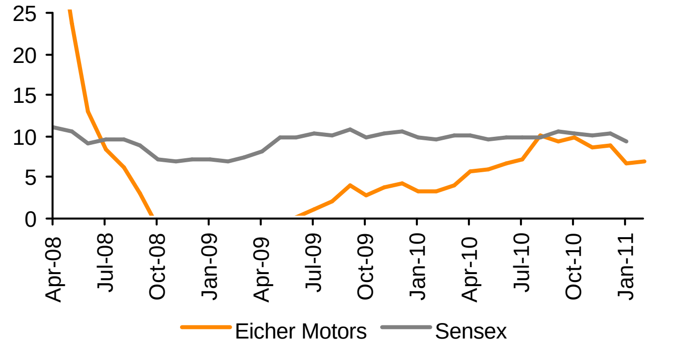
Valuation summary

Rs mn	CY11E	CY12E
Sales		
VECV	45,182	54,961
Standalone	5,961	7,941
Total	**51,143**	**62,901**
EBIDTA		
VECV*	3,324	4,053
Standalone	820	1,100
Total	**4,143**	**5,153**
Target Multiple(EV/EBIDTA)		
VECV	7	7
Standalone	8	8
Target EV (Rs. Mn)		
VECV*	12,657	15,434
Standalone	6,557	8,800
Total	**19,214**	**24,234**
Less. Net Debt (Rs. Mn)*	(10,936)	(12,174)
Target Market Cap (Rs. Mn)	**30,150**	**36,408**
Share Cap. (Nos. mn)	26.9	26.9
Value per share (Rs.)	1,120	1,350
Value of Engine business (Rs. per share)#	155	155
Total value per share(Rs.)	**1,275**	**1,505**

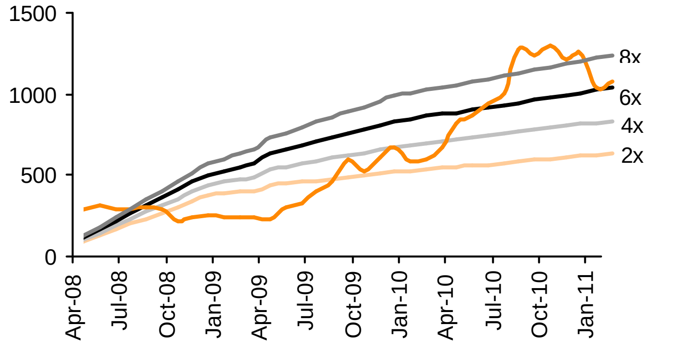
** only EML's share (54.4%) is considered #CY13 - 40,000 engines, ASP - Rs 0.3mn, margins - 10%, COE - 13%*

Source: Companies, Emkay Research

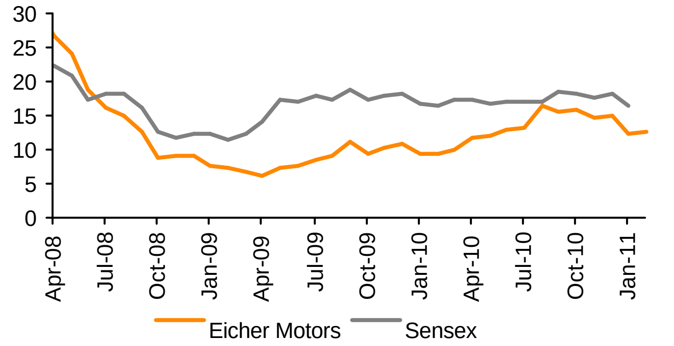
1yr Fwd EV/EBITDA (x)



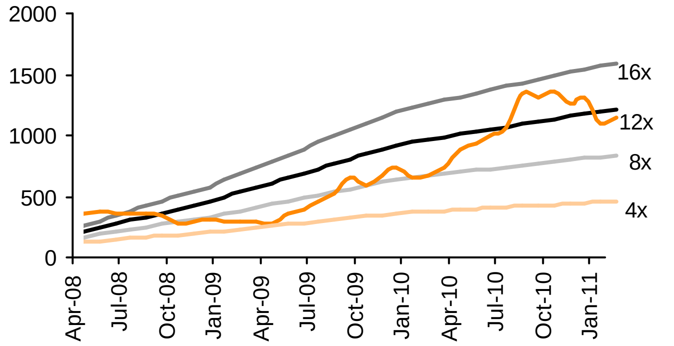
1yr Fwd EV/EBITDA band



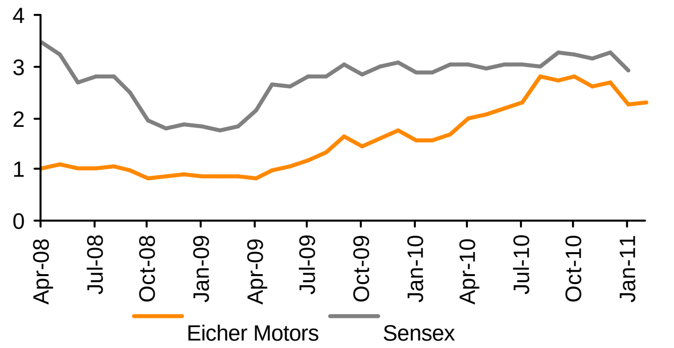
1yr Fwd PE (x)



1yr Fwd PE band

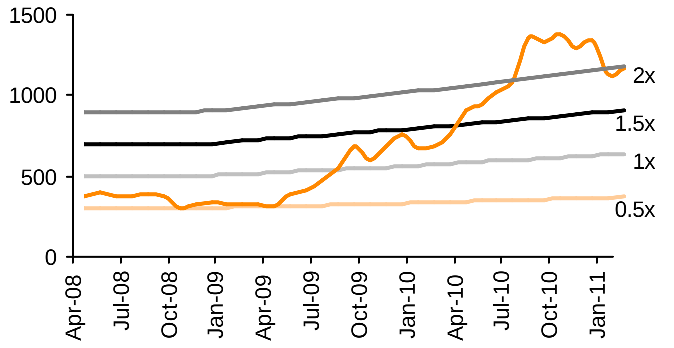


1yr Fwd PB (x)



Source: Company, Emkay Research

1yr Fwd PB band



Source: Company, Emkay Research

Consolidated Financial Tables

Income Statement

Y/E, Mar (Rs. mn)	CY09	CY10	CY11E	CY12E
Net Sales	**29,386**	**43,971**	**51,143**	**62,901**
Growth (%)	*71.1*	*49.6*	*16.3*	*23.0*
Expenditure	**27,932**	**40,392**	**46,999**	**57,748**
Materials Consumed	21,992	33,147	38,927	48,052
Employee Cost	2,152	2,631	2,827	3,494
Other Exp	3,788	4,614	5,245	6,201
EBITDA	**1,455**	**3,578**	**4,143**	**5,153**
Growth (%)	*4,044.2*	*146.0*	*15.8*	*24.4*
EBITDA margin (%)	***4.9***	***8.1***	***8.1***	***8.2***
Depreciation	539	573	685	873
EBIT	**916**	**3,005**	**3,458**	**4,280**
EBIT margin (%)	***3.1***	***6.8***	***6.8***	***6.8***
Other Income	1,054	1,276	1,612	1,656
Interest expenses	87	95	112	112
PBT	**1,884**	**4,186**	**4,958**	**5,824**
Tax	**578**	**1,108**	**1,282**	**1,564**
Effective tax rate (%)	*30.7*	*26.5*	*25.9*	*26.9*
Adjusted PAT	**1,305**	**3,078**	**3,676**	**4,260**
Growth (%)	*(1,657.6)*	*135.8*	*19.4*	*15.9*
Net Margin (%)	***4.4***	***7.0***	***7.2***	***6.8***
(Profit)/loss from JV's/Ass/MI	461	1,179	1,209	1,402
Adjusted PAT after MI	**844**	**1,899**	**2,467**	**2,858**
E/O items	(10)	(9)	-	-
Reported PAT	**834**	**1,889**	**2,467**	**2,858**
Growth (%)	258.7	126.5	30.6	15.8

Balance Sheet

Y/E, Mar (Rs. mn)	CY09	CY10	CY11E	CY12E
Equity share capital	267	269	269	269
Reserves & surplus	10,424	12,018	13,946	16,055
Net worth	**10,690**	**12,287**	**14,215**	**16,324**
Minority Interest	**5,747**	**6,774**	**7,983**	**9,385**
Secured Loans	735	865	735	735
Unsecured Loans	529	91	91	91
Loan Funds	**1,264**	**956**	**826**	**826**
Net deferred tax liability	142	250	142	142
Total Liabilities	**17,842**	**20,267**	**23,166**	**26,677**
Gross Block	7,437	8,113	9,813	12,613
Less: Depreciation	3,802	4,269	4,954	5,828
Net block	**3,635**	**3,844**	**4,859**	**6,785**
Capital work in progress	122	669	1,517	1,017
Investment	**2,941**	**4,586**	**4,586**	**4,586**
Current Assets	**18,121**	**20,500**	**24,987**	**30,104**
Inventories	2,190	3,265	3,895	4,782
Sundry debtors	2,325	2,609	4,102	5,005
Cash & bank balance	11,707	12,457	13,431	15,907
Loans & advances	1,540	1,814	2,929	3,632
Other current assets	360	355	630	779
Current lia & Prov	**6,978**	**9,332**	**12,783**	**15,815**
Current liabilities	6,016	7,942	10,598	13,092
Provisions	962	1,391	2,185	2,723
Net current assets	**11,144**	**11,168**	**12,205**	**14,289**
Misc. exp	-	-	-	-
Total Assets	**17,842**	**20,267**	**23,166**	**26,677**

Cash Flow

Y/E, Mar (Rs. mn)	CY09	CY10	CY11E	CY12E
PBT (Ex-Other income)	**829**	**2,910**	**3,346**	**4,168**
Depreciation	539	573	685	873
Interest Provided	87	95	112	112
Other Non-Cash items	585	-	-	-
Chg in working cap	2,224	726	(62)	391
Tax paid	(578)	(1,108)	(1,282)	(1,564)
Operating Cashflow	**3,685**	**3,196**	**2,799**	**3,980**
Capital expenditure	(259)	(1,222)	(2,548)	(2,300)
Free Cash Flow	**3,426**	**1,974**	**251**	**1,680**
Other income	632	1,266	1,612	1,656
Investments	(2,879)	(1,645)	-	-
Investing Cashflow	**(2,247)**	**(379)**	**1,612**	**1,656**
Equity Capital Raised	(14)	3	-	-
Loans Taken / (Repaid)	(392)	(307)	(130)	-
Interest Paid	(87)	(95)	(112)	(112)
Dividend paid (incl tax)	(219)	(346)	(647)	(749)
Income from investments	-	-	-	-
Others	(929)	-	-	-
Financing Cashflow	**(1,641)**	**(745)**	**(888)**	**(861)**
Net chg in cash	**(462)**	**850**	**974**	**2,475**
Opening cash position	12,318	11,707	12,457	13,431
Closing cash position*	**11,857**	**12,557**	**13,431**	**15,907**

** Represent cash and cash equivalents*

Key ratios

Y/E, Mar	CY09	CY10	CY11E	CY12E
Profitability (%)				
EBITDA Margin	4.9	8.1	8.1	8.2
Net Margin	4.4	7.0	7.2	6.8
ROCE	11.0	22.5	23.3	23.8
ROE	7.8	16.5	18.6	18.7
RoIC	22.8	106.8	111.8	97.3
Per Share Data (Rs)				
EPS	31.3	70.5	91.6	106.1
CEPS	42.8	83.9	108.1	127.2
BVPS	400.5	456.1	527.7	605.9
DPS	7.0	15.7	20.5	23.8
Valuations (x)*				
PER	35.1	15.6	12.0	10.4
P/CEPS	25.7	13.1	10.2	8.7
P/BV	2.7	2.4	2.1	1.8
EV / Sales	1.2	0.7	0.6	0.4
EV / EBITDA	13.2	9.0	7.0	5.1
Dividend Yield (%)	0.6	1.4	1.9	2.2
Gearing Ratio (x)				
Net Debt/ Equity	(1.0)	(0.9)	(0.9)	(0.9)
Net Debt/EBIDTA	(7.2)	(3.2)	(3.0)	(2.9)
Working Cap Cycle (days)	(18.6)	(17.2)	(18.6)	(19.2)

** proporionate share in VECV (54.4%) considered*

Source: Company, Emkay Research

Emkay Rating Distribution

BUY	Expected total return (%) (stock price appreciation and dividend yield) of over 25% within the next 12-18 months.
ACCUMULATE	Expected total return (%) (stock price appreciation and dividend yield) of over 10% within the next 12-18 months.
HOLD	Expected total return (%) (stock price appreciation and dividend yield) of upto 10% within the next 12-18 months.
REDUCE	Expected total return (%) (stock price depreciation) of upto (-)10% within the next 12-18 months.
SELL	The stock is believed to under perform the broad market indices or its related universe within the next 12-18 months.

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