

Eicher Motors

9 October 2019

Reuters: EICH.NS; Bloomberg: EIM IN

Changing strategy with changing times

We re-initiate coverage on Eicher Motors Ltd (Eicher) with a Buy rating as we believe the worst is behind us since the company is taking promising initiatives to address the declining sales performance. We like the recent steps that Royal Enfield (RE) has taken to tackle the slowdown – (a) Low cost Studio store concept to create touch-points in semi urban and rural regions. It plans to open 450-500 such stores before 2019 Diwali festival. (b) Launch of lower priced variants of Bullet and Classic 350. We believe that these steps will help RE to arrest FY20's decline and should help turn around sales in FY21-22. We expect 3.3% volume CAGR for RE over FY19-22. RE's margin has been under pressure due to negative operating leverage, which we believe will continue for the rest of FY20 and gradually recover with volume growth. We expect 26%/26.5%/27% EBITDA margin for RE in FY20/21/22, respectively. Government's announcement to reduce corporate tax is also a big positive as Eicher was in the full tax bracket (34-35%) and this will be a big relief to its earnings. We expect 12.7% earnings CAGR for RE over FY19-22. We value Eicher on SoTP basis. We value Standalone segment (RE) at 21x Sept 2021 EPS to arrive at Rs20,349 and we add VECV valued at 12x Sept 2021 EPS i.e. Rs778. Our target price of Rs21,127 is 20.8 times Sept 2021 consolidated EPS, which is at a discount to its 10 year average of 29x mainly as we expect volume growth to be below the historical rate.

Customer focused approach to drive growth: RE has adopted Studio stores format to increase distribution in under-penetrated geographies, which are mostly in rural and semi urban regions. This idea is more likely to work as opening a conventional showroom will cost much more and there are not many takers for it. The Studio stores are set up over 500-700 square feet area i.e. 1/4th of the size of a normal showroom and a set-up cost of about 1/10th of the normal store. The initial plan was to open 350 Studio stores in FY20 but it was raised to 450-500 that will be operational by 2019 Diwali festival. The breakeven point is expected to be 7-10 bike sales a month. We believe that it will be able to generate incremental sales of about 10 units per store and service opportunity as well. Also, RE has launched lower priced variants of Bullet and Classic 350, which are Rs9-10k cheaper and come with new colours. This is positive as a lot of customers found the price increase of Rs15-16k post the upgrade to ABS quite steep. We believe that the above steps will help RE to arrest some of the sales volume decline and help recover sooner. We expect 3.3% volume CAGR for RE over FY19-22 as we believe that these will help RE to arrest FY20's decline and should help turn around sales in FY21-22. Demand for 650 Twins remains good in both domestic and international markets.

Margin to remain lower due to negative operating leverage: In 1QFY20, RE's volume declined by 18.5% YoY and the EBITDA margin contracted by 500bps due to negative operating leverage. We believe that volume will remain low and hence margin will not reach 31-32% levels soon. Raw material prices are expected to be benign owing to lower demand. We expect RE's FY20 margin at 26%, which will improve with volume growth in FY21/FY22 to 26.5%/27%.

Valuation: Eicher has enjoyed a premium valuation mainly led by strong growth in RE volume (47% CAGR over FY12-18) and its industry leading margin (30-32% in FY17-19). But both these factors have waned off due to higher base, industry slowdown and hence assigning the historical valuation is unreasonable. We value Eicher on SoTP basis. We value standalone segment (RE) at 21x Sept 2021 EPS to arrive at Rs20,349 and we add VECV valued at 12x Sept 2021 EPS i.e. Rs778. Our target price of Rs21,127 is 20.8x Sept 2021 consolidated EPS, at a discount to its 10 year average of 29x mainly as we expect volume growth to be below the historical rate.

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net Sales	89,649	97,971	94,977	1,14,326	1,33,603
% Growth	27.5	9.3	(3.1)	20.4	16.9
EBITDA	28,076	29,031	24,193	29,696	35,354
EBITDA margin (%)	31.3	29.6	25.5	26.0	26.5
Adj Net profit	21,792	22,203	20,436	25,322	29,992
% Growth	30.7	1.9	(8.0)	23.9	18.4
EPS (Rs)	799.4	814.5	749.7	928.9	1,100.2
EPS growth (%)	30.2	1.9	(8.0)	23.9	18.4
P/E (x)	22.7	22.4	24.3	19.6	16.6
EV/Sales (x)	4.8	4.3	4.3	3.4	2.7
EV/EBITDA (x)	15.3	14.4	16.8	13.0	10.2
P/BV	7.1	5.6	4.7	3.9	3.3
Dividend yield (%)	0.6	0.7	0.7	0.7	0.8
RoCE (%)	39.1	32.5	23.4	24.3	24.4
RoE (%)	31.0	24.9	19.4	20.1	19.8

Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: Automobiles

CMP: Rs18,212

Target Price: Rs21,127

Upside: 16%

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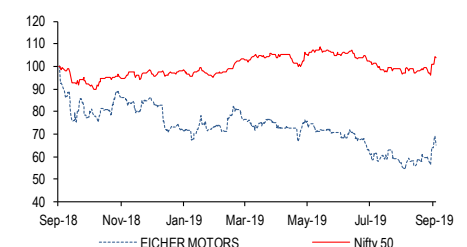
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Key Data

Current Shares O/S (mn)	27.3
Mkt Cap (Rsbn/US\$bn)	497.7/7.0
52 Wk H / L (Rs)	25,350/15,197
Daily Vol. (3M NSE Avg.)	183,031

Share holding (%)	1QFY20	4QFY19	3QFY19
Promoter	49.3	49.3	49.3
Public	50.7	50.7	50.7
Others	-	-	-

One -Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
Eicher Motors	12.5	(12.9)	(13.5)
Nifty Index	3.4	(2.5)	9.3

Source: Bloomberg

Valuation/stock price performance

Eicher has enjoyed a premium valuation mainly led by strong growth in RE volume (47% CAGR over FY12-18) and its industry leading margin (30-32% in FY17-19). Both these factors have waned off due to higher base, industry slowdown and hence assigning the historical valuation is unreasonable. However, we like that the company is taking promising initiatives to address the declining sales performance. We value Eicher on SoTP basis. We value Standalone segment (RE) at 21x Sept 2021 EPS to arrive at Rs20,349 and we add VECV valued at 12x Sept 2021 EPS i.e Rs778. Our target price of Rs21,127 is 20.8x Sept 2021 consolidated EPS, which is at a discount to its 10 year average of 29x mainly as we expect volume growth to be below the historical rate.

Exhibit 1: One-year forward P/E band



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 2: SOTP valuation of Eicher Motors

	Sept'21E
Royal Enfield's EPS (Rs/share)	969
P/E (x)	21
Royal Enfield - standalone	20,349
Eicher Motor's stake in VECV	
EPS @ 54.4% stake (Rs/share)	64.8
P/E (x)	12
VECV share	778
Total	21,127

Source: Nirmal Bang Institutional Equities Research

Exhibit 3: Top five institutional shareholders of Eicher Motors

Name	Holding (%)
Capital Group Companies Inc	3.8
Blackrock	1.8
Vanguard Group	1.8
Republic of Singapore	1.6
Motilal Oswal Asset Management Co Ltd	1.1

Source: Bloomberg

Exhibit 4: Peer valuation

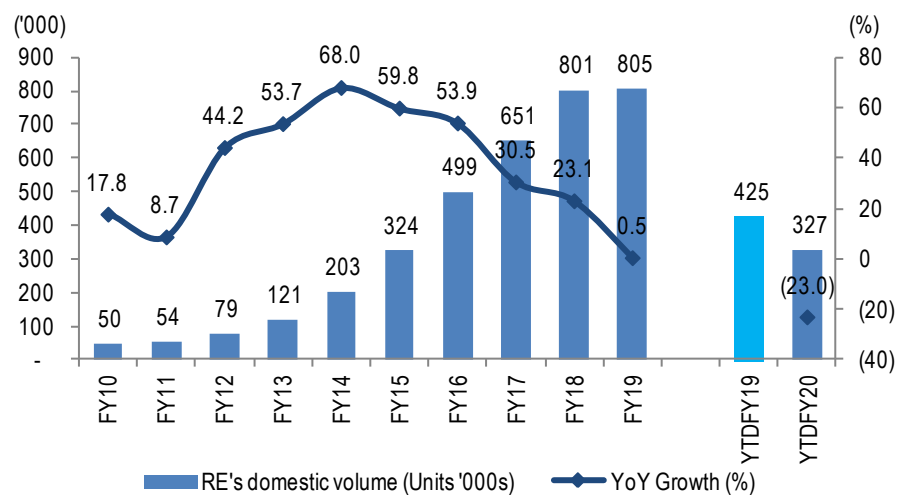
Company	FY19-22 EPS CAGR	ROE (%)			PER (x)			EV/EBITDA (x)		
		FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Eicher Motors	10.5	19.4	20.1	19.8	24.3	19.6	16.6	16.8	13.0	10.2
Hero MotoCorp	2.4	23.1	22.1	21.2	15.5	14.4	13.4	9.9	8.9	7.9
Bajaj Auto	8.6	19.6	19.4	18.5	17.2	15.2	14.2	11.5	9.6	8.4
TVS Motors	9.2	20.1	19.6	18.7	23.7	20.8	18.9	11.0	9.5	8.4

Source: Nirmal Bang Institutional Equities Research

Investment rationale

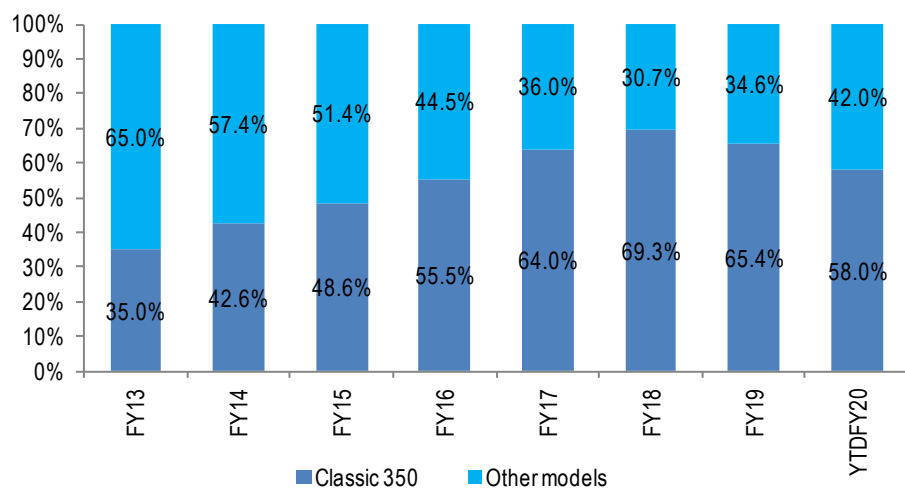
Eicher has had a dream run between FY12 and FY18 on the back of large order backlog for its cult classic motorcycle brand – Royal Enfield, which was aspirational in nature and yet affordable to the Indians. The brand is perceived to be iconic because of its history and legacy. In India, RE was first introduced in 1949 and in 1952 the Indian army started using them as they were rugged and easy to maintain. The first brand introduced in India was ‘Bullet’. But, the real game changer was the Classic 350 with the improved UCE engine launched in 2011. There was a huge demand for this model and it became an instant hit mainly due to its retro looks and modern features for that time. It was a way for customers to own a vintage looking bike that made them stand out in the crowd. Such was the popularity of the model that its black colour was on waiting period for 8-9 months. RE started adding capacity to meet the rising demand and eventually the waiting periods came off. Currently, the waiting periods are only on new models and most dealers now carry stocks in the range of 2-4 weeks for Classic and Bullet models.

Exhibit 5: RE sales volume trend



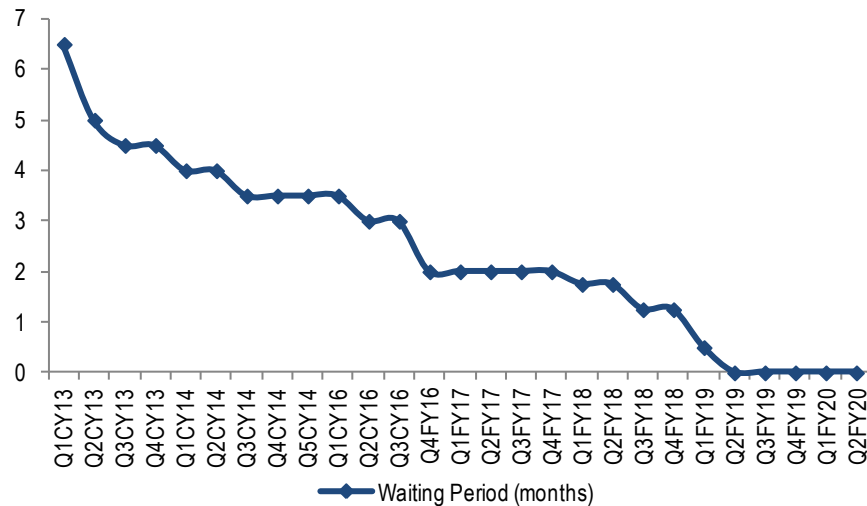
Source: Crisil, Nirmal Bang Institutional Equities Research, YTFY – April to September

Exhibit 6: Share of Classic 350 in total RE sales



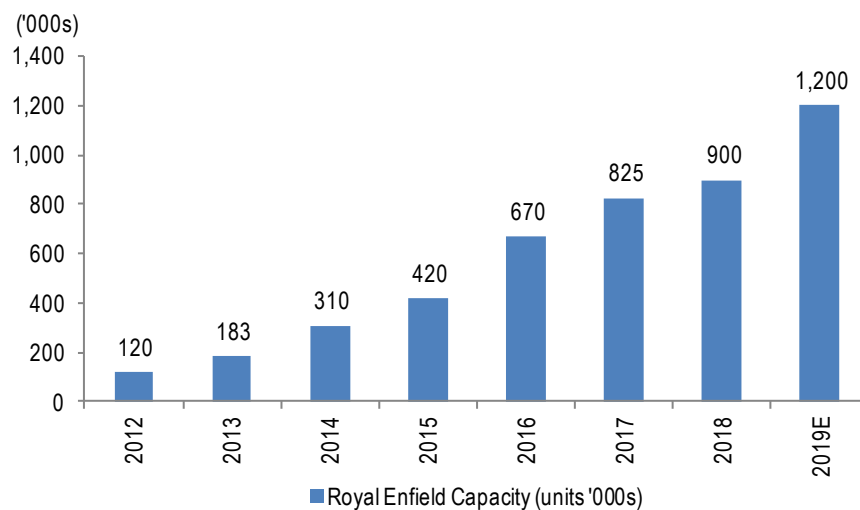
Source: Crisil, Nirmal Bang Institutional Equities Research, YTFY20 – April to August

Exhibit 7: Declining waiting period of Classic 350



Source: Company Conference Call, Nirmal Bang Institutional Equities Research

Exhibit 8: RE's production capacity



Source: Company, Nirmal Bang Institutional Equities Research

Product strategy so far – more variants less new products

RE's major launches in recent years have been the 650 twins and the Himalayan. Other than that it has been launching variants and colors in its existing mainline models i.e. the Classic, Bullet and Thunderbird. Until 2017, it didn't need to make changes in its product offerings as the bikes were selling like hot cakes and there was a large order pipeline. But soon as the capacity was increased there was some moderation in demand. To keep up the excitement, RE has been introducing various colours in the Classic range, like the Redditch series in 2017 with three colours - Red, Green and Blue; RE also launched Stealth Black in Classic 500 and Gunmetal Grey in Classic 350 in 2018. These were the first Classic models with rear disk brakes. Gunmetal Grey witnessed very good interest and soon became more popular than the Classic 350 black. In 2018, RE also launched the Pegasus in Classic 500 and Signals in Classic 350. Signals came in colours which were only available in 500cc models earlier. They come with a unique serial number printed on the fuel tank. RE also launched limited edition bikes.

Exhibit 9: RE product launched in the last few years

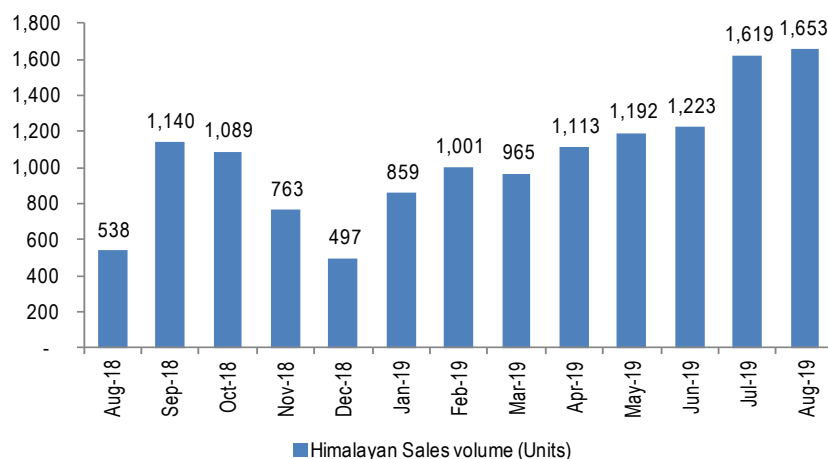
Launch	Date	New Model/New Variant	Comment – like colour, features etc
Himalayan	5QFY16	New Model	Purpose-built for adventure and touring.
Redditch	4QFY17	Variant of Classic 350	Redditch edition inspired by paint scheme of 1950s era, launched in three colours Red, Blue and Green
Stealth Black	2QFY18	Variant of Classic 500	Introduced contemporary Black colour variant of Classic 500cc. First Classic 500 with rear disc brake
Gunmetal Grey	2QFY18	Variant of Classic 350	Introduced contemporary Grey colour variant of Classic 350cc. First Classic 350 with rear disc brake
Thunderbird X	4QFY18	Variant of Thunderbird	Based on regular version of Thunderbird 350 & 500, inspired for young urban explorers and offered in four new colours. First model with alloy wheels
Himalayan Sleet	4QFY18	Variant of Himalayan	Based on same Himalayan model, sleet edition gets an additional Explorer kit along with cosmetic upgrade.
Pegasus	1QFY19	Variant of Classic 500	Limited edition Classic 500 variant designed on a retro-military theme to pay homage to one of Royal Enfield's motorcycles used in World War II was launched in two colours.
Signals	2QFY19	Variant of Classic 350	Special edition was launched ABS and host of cosmetic changes, to celebrate RE's association with the Indian Armed Forces.
Interceptor 650	3QFY19	New Model	Available in three variants - Standard, Classic, and Custom and comes with dual-channel ABS as standard. New twin cylinder 650cc engine
Continental GT 650	3QFY19	New Model	Available in three variants - Standard, Classic, and Custom and comes with dual-channel ABS as standard. New twin cylinder 650cc engine
Bullet Trails	4QFY19	Variants of Bullet 350/500	Scrambler like versions of the Bullet 350 and the Bullet 500 are made to take on bad roads and no roads.
Bullet ES/KS	2QFY20	Variants of Bullet 350	Affordable version of Bullet 350cc with blacked out mechanicals and single-channel ABS launched in three colour schemes.
Classic 350 S	2QFY20	Variant of Classic 350	Affordable version of Classic 350cc with blacked out engine and single-channel ABS launched in two colour schemes.

Source: Company, Nirmal Bang Institutional Equities Research

Himalayan

Launched in March 2016, the Himalayan was the first off-roader from RE, deriving its name from the company's famous annual event of Himalayan Odyssey. This was mainly targeting customers who were looking for a tourer with off road capabilities. Since it was very functional and lacked the peculiar exhaust note 'thump' associated with RE bikes, it was not a mass product and the response was very limited. It faced teething issues initially and hence sales started dropping. During the transition of BS3 to BS4, the company took time before launching the improved BS4 version after addressing all the issues. Since then the model is selling as per company's expectations.

Exhibit 10: Himalayan monthly sales trend

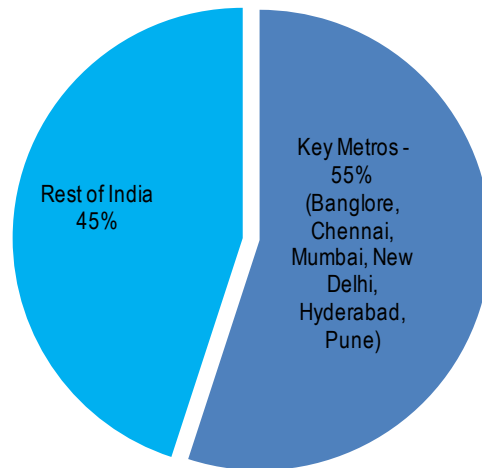


Source: Crisil, Nirmal Bang Institutional Equities Research

650 Twins

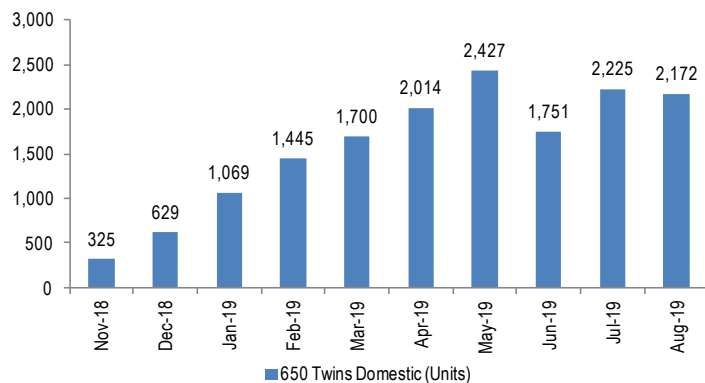
RE first showcased its first twin cylinder 650cc models – The Interceptor and Continental GT in 2017. It immediately received a lot interest and created a buzz on the internet and social media. It was eventually launched in 2018 with prices starting from Rs249k (ex-showroom) and got pretty good reviews worldwide, especially given its price point. As usual, like every new launch, these bikes are having waiting in most regions in the range of 1-2 months. Recently, their prices were increased in the range of Rs6000-7000. The current production capacity is about 5000 units a month. RE has sold more than 15,000 units in the domestic market and another 12,000 in exports. Around 55% of the sales come from the top 5 metros.

Exhibit 11: Geography mix of Twins sales



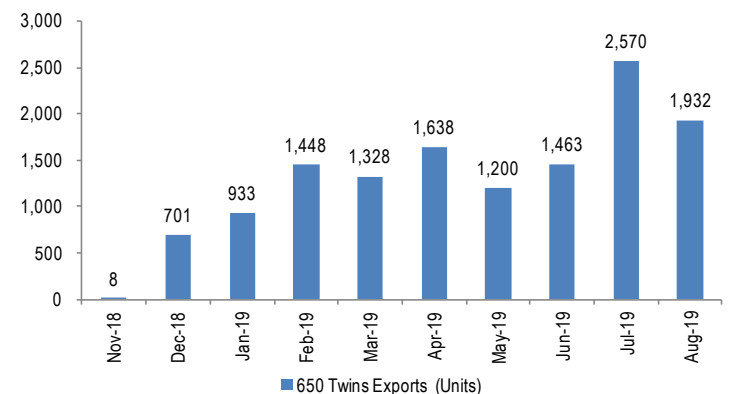
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Twins sales trend in the domestic market



Source: Crisil, Nirmal Bang Institutional Equities Research

Exhibit 13: Twins sales trend in the export market



Source: Crisil, Nirmal Bang Institutional Equities Research

Consumer focused initiatives – accessibility and product offerings

Cheaper variants

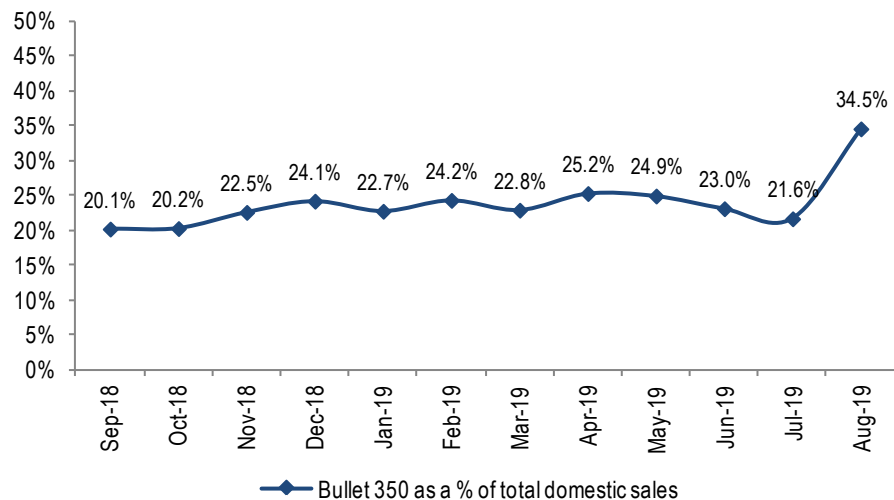
RE launched strip down versions of Bullet called Bullet X with more colour options and priced it Rs9,000-10,000 lower than the standard bullet price. It did this mainly to introduce more colours and used the opportunity to pass the cost benefit and thus launch was at a lower price. We believe that this will work well for RE as post the ABS price increase the gap between Bullet and Classic had increased as Classic comes with dual channel ABS and has become much more expensive. Consequently, customers found more value in Bullet and its sales proportion started to increase.

Exhibit 14: Bullet 350 vs. Bullet 350X

	Bullet 350	Bullet 350X
Mechanicals' Paint Scheme	Chrome-plated	Blacked out.
Fuel tank theme	Handmade pinstripes on the fuel tank and 3D badge on side quarter panels	RE sticker
Wheels	Chrome-plated wheels	Black-rim spoked wheels
Suspension	Gas-charged units at the rear	Conventional twin rear shock absorbers
Price (in '000s) (ex-showroom, Delhi)	122	112

Source: Nirmal Bang Institutional Equities Research

Exhibit 15: Bullet 350's contribution in total sales



Source: Crisil, Nirmal Bang Institutional Equities Research

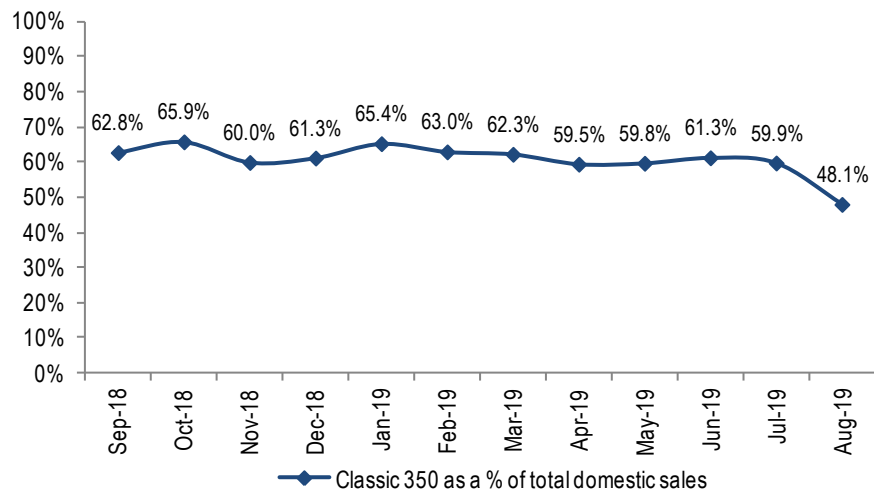
RE also launched Classic 350S with single channel ABS in Kerala and Tamil Nadu markets priced Rs9,000-10,000 lower than the regular model with dual channel ABS to give more options to customers as they got a feedback that Classic models have become very expensive post the ABS cost increase. Classic 350 sales proportion has been declining in the last few months.

Exhibit 16: Classic 350 vs. Classic 350 S

	Classic 350	Classic 350 S
ABS	Dual-channel ABS and a twin-disc configuration	Single-channel ABS with drum brake at the rear
Mechanicals' Paint Scheme	Shiny bits	Blacked out
Logo	Black and gold logo	RE sticker
Price (in '000s) (ex-showroom, Kerala)	155	145

Source: Nirmal Bang Institutional Equities Research

Exhibit 17: Classic 350's contribution in recent months



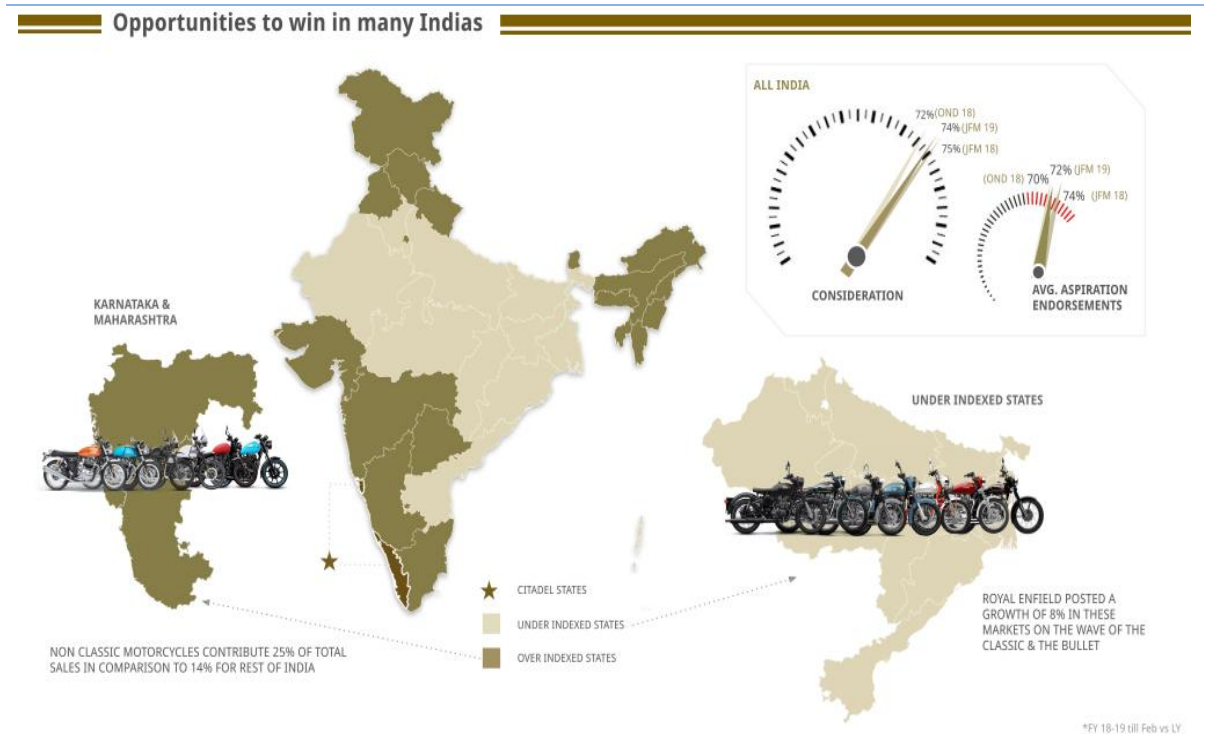
Source: Crisil, Nirmal Bang Institutional Equities Research

Change in regional strategy

Over the last few years, RE's biggest markets – Maharashtra and Karnataka have been underperforming the other regions and was a cause for concern for the company. To compensate, RE started focusing on regions with high potential but where RE's penetration is low like UP, Bihar and MP by increasing penetration and branding activity. This move paid off as the contribution from these states increased but the market share didn't improve much due to the size of the market and lower GDP per capita.

RE classifies India into three segments as per market share – Citadel states, Over indexed states and under indexed states. Kerala and Goa are Citadel states as RE's market share is more than 30% in these regions. Northern, north eastern and states in west India, as indicated in the chart below, are over indexed markets with 7-12% markets share. In these states non Classic sales' contribution is 25% vs 14% in India. These are the states where they want to sell more of non Classic models. Rest of the regions are under indexed and poor in terms of GDP per capita and hence creates an opportunity for more Bullet and Classic model sales, especially after launching the lower priced variants.

Exhibit 18: States classified in terms of penetration



Source: Company, Nirmal Bang Institutional Equities Research

RE has been underperforming the domestic 2W market in the last 15 months mainly due to industry slowdown, Kerala floods and continued sales decline in Maharashtra and Karnataka. To overcome this, it has come up with a region specific strategy in which the states are divided into four quadrants on the basis of market share of 150cc and above segment (PST) with a cut-off of 23.5% and RE's market share in this segment with a cut-off of 26%. There is a quadrant specific objective that the company will work towards with specific marketing budget for each. Please see the chart below for details.

Exhibit 19: Classifying states for focused approach



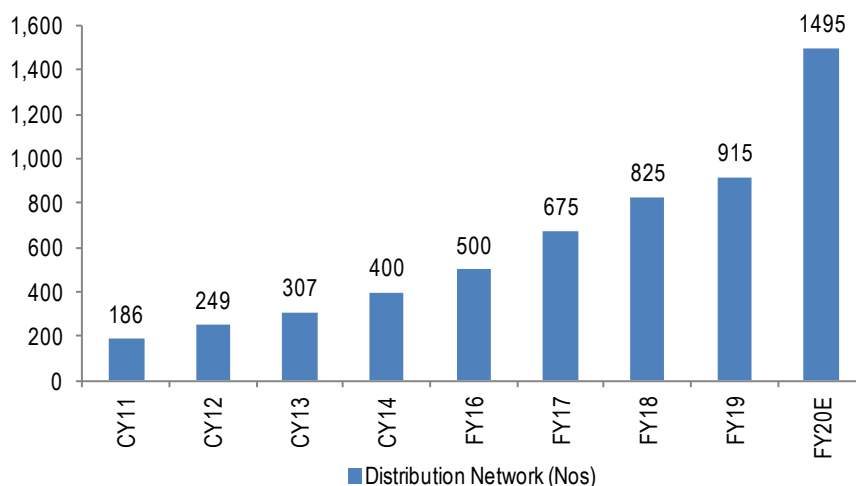
Source: Company, Nirmal Bang Institutional Equities Research

Distribution network

Network expansion so far

RE had 915 stores when it started FY20. It has planned to increase them to 1000 stores this year and most of them will be in the opportunity market. Other than that there is plan to add 450-500 Studio stores this year mainly before the 2019 Diwali festival.

Exhibit 20: RE's distribution network has always been increasing



Source: Company, Nirmal Bang Institutional Equities Research

Studio stores

Eicher opened 250 Studio stores across India in Aug'19, targeting customers from tier-2, tier-3 and below regions. As compared to normal dealership store with size of 2,500-3,500 sq.ft., these compact-format Studio stores are spread over a 500-700 sq.ft. area and house a few display models, alongside service and spares as well as some accessories and apparels. The Studio stores concept is aimed at lowering the investment and break-even point for dealers while expanding the accessibility of the RE brand.

Exhibit 21: Layout of Studio stores



350 NEW STUDIO STORES PLANNED IN 2019

THE TARGET IS TO INCREASE ROYAL ENFIELD'S RETAIL FOOTPRINT TO 1100 TOWNS WITH 1350 STORES

Source: Company, Nirmal Bang Institutional Equities Research

Royal Enfield Studio checks

We interacted with more than a dozen dealers of Studio stores, including two personal visits in West Uttar Pradesh region. We believe that most of the Studio stores are opened in the opportunity markets of UP, Bihar, MP, Rajasthan, Gujarat etc and hence we have conducted our checks in these regions. Following is the feedback we received.

Conditions for setting up studios

Firstly, only existing dealers are allowed to open Studio stores as sales and inventories are booked on the main dealership code. Secondly, as a practice, these Studios should be at least 15kms away from any store or studio to avoid major cannibalization. Thirdly, these Studios should be within 1km proximity of a Maruti store/workshop or any other two wheeler dealership. Lastly, the rent should be within Rs10,000-15,000 range and each Studio should have at least four employees. Most dealers we spoke to have fulfilled these conditions.

Cost of setup and dealer support

Most of the Studios were built on a 500-700 square feet area and incurred a set up cost of Rs400k-600k. This was after getting a company support in the form of furniture, light & fittings, display boards etc worth Rs150,000-200,000. 100% of this support was offered to dealers who opened the stores on 9th August. Dealers opening in September got 50% support while 25% support was provided to dealers opening in October. All the studios in our checks were inaugurated on 9th August. Dealers were very happy with this cost sharing and most of them expect a recovery in under one year's time.

Operating cost, sales and breakeven

Major costs for these Studios are rent, salaries and utility bills. Rents for the Studios we checked were in the Rs10k-15k per month range as most were located in semi urban and rural areas. Since most dealers had employed 4-6 people, the salary cost was in the range of Rs35-50k. Most stores had two guys in the workshop and three guys in the showroom. Other than these, the major cost was electricity bill which should be under Rs5k a month. With a total operating cost in the range of Rs45-70k, a breakeven can be achieved with a sale of 7-10 units a month.

On an average, from our channel checks, the dealers expect to sell 15-20 bikes a month and more than 50% of these would be incremental sales coming due to the Studio. Rest of it would cannibalise sales of nearby stores. However, the major delta is expected in the form of servicing revenues. Most of the existing customers in the vicinity of the Studios never used to get the bike serviced from the dealerships as they were quite far. Now, these customers can come to the Studios for basic servicing. Many of the dealers we spoke to were already servicing 1-2 bikes a day and they expect this number to grow going forward as the awareness spreads.

Customer response and dealer feedback

Most of the Studios received an overwhelming response in the form of enquiries and walk-ins. Sales have been decent so far and could have been better if not for Shradh (mourning period in Hindus during which most north Indian customers don't buy vehicles). However, most dealerships have been getting bookings for the Diwali and Dhanteras deliveries, which should cover up the sales. Dealers are carrying out promotional activities to spread awareness and to push sales and services. Most stores are already getting existing customers' bikes for servicing. In most dealerships, 2-3 models (mostly 350cc models) of Royal Enfield are on display. Other models are showcased via tablet/brochure.

Most of the dealers are very optimistic about the Studio initiative. They believe that it couldn't have come at a better time – in slowdown and just before festivals. Also, most of them were appreciating the Bullet X model launch which is cheaper than the regular Bullet. They believe that the combination of Studio stores and Bullet X will increase sales in the untapped rural/semi-urban markets. Bullet X is expected to sell well in the wedding season.

Exhibit 22: Dealer feedback

	Region (state)	Nearest store distance (kms)	Operating cost pm (Rs)	Rent Pm (Rs)	Employees	Sales so far	Bookings	Service so far	Sustainable monthly run-rate	
									Sales	Service
1	Rajasthan	26	25-30K	12K	4	8	4	47	10-12	25-30
2	Uttar Pradesh 1	35	45K	1.5K*	5	32	8	48	10-12	25-30
3	Uttar Pradesh 2	40	55-60K	30K	6	3	9	26	15-20	30-35
4	Uttar Pradesh 3	35	30-35K	12K	4	5	1	5	10-15	15-20
5	Uttar Pradesh 4	15	45-55K	10K	6	9	18	50	20-25	40-50
6	Uttar Pradesh 5	15	45-55K	10K	5	7	30	45	20-25	50-60
7	Gujarat 1	50	55-60K	12K	5	11	2	32	25-30	45-50
8	Gujarat 2	45	50-60K	15K	4	8	8	45	15-20	45-50
9	Bihar 1	40	40-45K	11K	5	15	0	30	15-20	25-30
10	Bihar 2	70	30-35K	12K	4	4	0	yet to start	10-12	15-20
11	Bihar 3	75	35-40K	14K	4	3	2	yet to start	10-12	15-20
12	Bihar 4	45	60-65K	16K	5	10	0	30	15-20	25-30
13	Bihar 5	35	70-80K	10K	4	7	15	30	15-20	25-30
14	Madhya Pradesh 1	52	35-40K	15K	5	13	5	25	10-15	30-35
15	Madhya Pradesh 2	50	30-35K	20K	6	30	10	150+	18-20	50-60

Source: Nirmal Bang Institutional Equities Research

* Upfront payment of Rs2.5mn towards 25 years lease.

Our view

We believe that using the Studio to widen the reach across traditionally untapped markets will surely be positive for RE over the long term. We see good response in the form of enquiries and walk-ins in these Studios already and dealers have retailed a decent number of bikes already. This strategy will be useful to tackle the current slowdown by opening new markets and becoming reachable ahead of the festivals along with the launch of cheaper variants of Bullet and Classic 350 that have good potential in these markets. We believe that these stores can sell incremental 8-10 bikes per month and should help RE to arrest some decline in FY20. We also believe that with recovery in the industry and with the full effect of these Studios, RE should post growth in sales in FY21-22.

Exhibit 23: Studio store front view and entry



Exhibit 24: Workshop with two bays

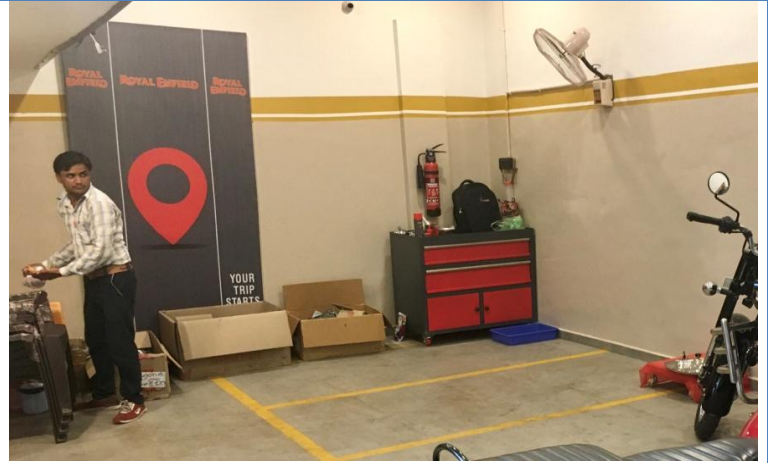


Exhibit 25: Accessories shelf at Studio store



Exhibit 26: History Wall



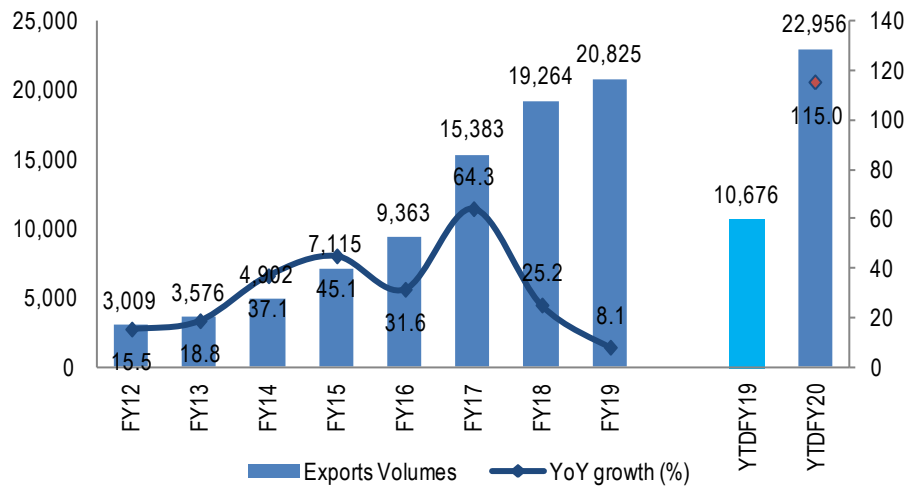
Exhibit 27: Showroom inside view



Exports

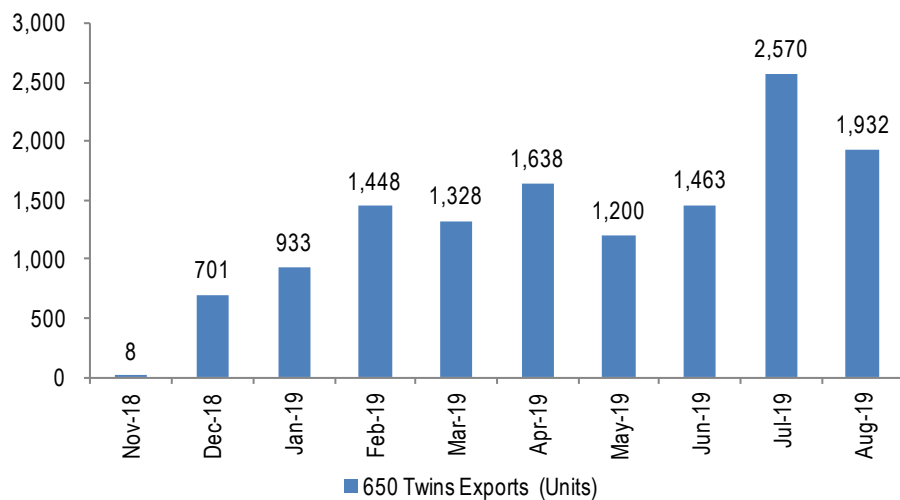
RE first started exporting in 1998 and by 2015 it was exporting to 40 countries through independent distributors but sales figures were not that exciting. After that it started putting more efforts into export sales. Firstly, Mr.Siddharth Lal started operating from the UK office to oversee exports more closely. Secondly, it set up Royal Enfield North America (RENA) as its first wholly-owned direct distribution subsidiary in 2016. Subsequently, the company created similar subsidiaries in Brazil and Thailand in 2017 and 2018, respectively. But it always lacked the right product to compete in these markets and that purpose was served with the launch of 650cc twins. Currently, the company derives half of the Twins volume from the international market.

Exhibit 28: Export sales volume trend



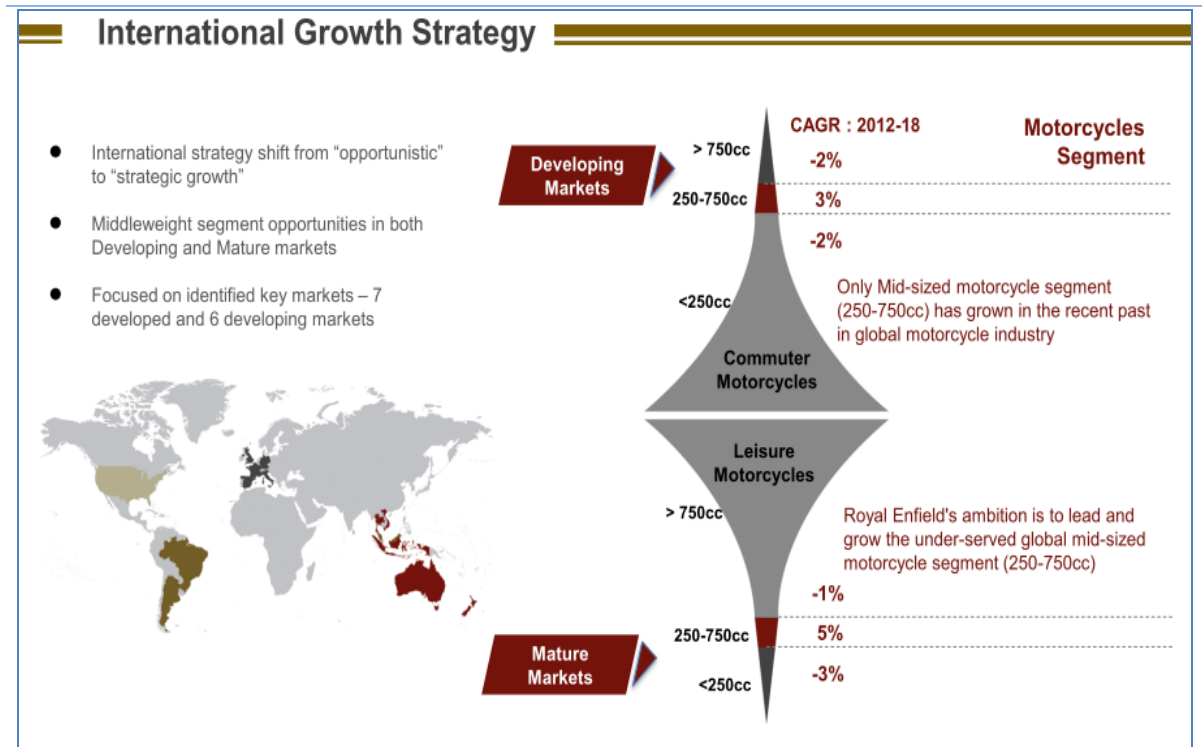
Source: Crisil, Nirmal Bang Institutional Equities Research, YTFY – April to September

Exhibit 29: Twins have gained traction in international markets



Source: Crisil, Nirmal Bang Institutional Equities Research

Exhibit 30: International market strategy



Source: Company, Nirmal Bang Institutional Equities Research

We highlight below some of the key markets that RE is focusing on:

Exhibit 31: International market opportunity size and RE's strategy

Market	Opportunity - 250-750cc market size	Development so far - like Presence	Strategy	Other Comments
North America	9mn registered motorcycles	Started Royal Enfield North America, wholly owned subsidiary, with focus on brand building and building dealer network mainly through MBOs	Leverage new launches, focus on PR with its launches and build brand awareness	250-750cc segment is growing. Royal Enfield aims to be in "Top 7" by market share in 3-5 years
Brazil	111,303 units in 2018	Sales grew by 56% YoY to 522 motorcycles.	Brand development, Network/dealer expansion & New product launches	A strong motorcycling culture including commuting & leisure exists in Brazil and has the largest mid-size market globally (Excl India).
Colombia	21,977 units in 2018	Network - 8 exclusive stores and 11 MBOs for sales. 32 service points across Colombia.	-	Middleweight segment is growing steadily and On/Off road motorcycles are popular.
Argentina	46,277 in 2018	2 stores in Argentina	-	Middleweight segment is growing steadily and On/Off road motorcycles are popular.

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 32: International markets - Distribution network

International Network	FY17	FY18	FY19
Exclusive stores	25	36	48
Multi Brand Outlets	568	568	600
Touchpoints	593	604	648

Source: Company, Nirmal Bang Institutional Equities Research

Management change

RE appointed Mr Vinod Dasari as a new CEO in April'19. Having worked with Ashok Leyland, Cummins India, Timken Co and General Electric among many others, Mr Dasari brings decades of experience to RE and Eicher. Mr Dasari's primary responsibilities are to steer RE operations with focus on new product launches, network expansion and adoption of more customer-focused approach among other things. Mr Dasari replaces Mr Siddhartha Lal who will continue to support the CEO and the company on product and brand related areas. Mr Lal has moved to London in 2016 and is focusing on establishing RE as a global brand

Challenges going forward in the domestic market

Along with slowdown in the economy, RE sales have been impacted by the following factors

ABS cost increase has made RE bikes little less accessible

To comply with the new safety norms starting 1st April, 2019, RE needed to add ABS to its models. It decided to go for a dual channel ABS for which all the models had to be fitted with rear disc brakes and then the ABS system. The total cost increase due to this change was quite steep at Rs15k-16k. Our channel checks reveal that this has been one of the major deterrents of demand in the recent months.

Exhibit 33: Classic 350 has witnessed c.17% price increase in last one year

Date	On road price Rs '000 (Mumbai)	Comments
Aug-18	158.9	-
Sep-18	164.9	Change in Insurance premium
Sep-18	173.9	Introduced rear disc brakes
Feb-19	179.7	Introduced ABS
Feb-19	181.2	Price hike of Rs1,500 taken (~1%)
Sep-19	185.4	Various price hikes
Increase	26.5	~17% increase in price in last 1 year

Source: Nirmal Bang Institutional Equities Research

BSVI cost increase

Eicher is currently working towards transitioning all the RE platforms to BS6 and is expected to roll out BS6 compliant motorcycles from Jan'20 onwards in a phased manner. The company's BS6 transition plan is on track, as these products are getting tested and validated at its new facility in Chennai. BS6 compliant RE products are expected to come up with electronic fuel injection (EFI) and some modification to engine to meet regulatory requirements. Though the company refrained from giving any indicative price increase, prices are expected to increase by Rs12,000-15,000 for BS6 compliant RE motorcycles.

Jawa

Mahindra and Mahindra Ltd revived the Jawa brand and launched two models - Jawa and Jawa 42 in November 2018. The starting price was Rs155k for Jawa 42 and Jawa was priced at Rs164k, ex-showroom Delhi. These bike engines are BS6 ready and they had single channel ABS. They are pitted against RE's best selling Classic 350, which is priced similarly. Online booking of the bikes started in Nov'18 itself and got fully booked till Sept'19 due to which the bookings were stopped in Dec'18. The deliveries started in March'19 and the company has opened 105 dealerships till then.

M&M expects to launch third product under the Jawa brand called Perak before BS6 regulation kicks in. Booking trends remain healthy and the company is working to supply to existing customers. It is already working on increasing production capacities for Jawa. M&M believes it is building a cult brand with Jawa and hence will continue to keep data disclosure low on Jawa for now. However, M&M indicated that planned production capacity could be 5K per month. The next brand of motorcycles to be launched could be BSA. Our channel checks suggest that production would be at 2,500-3,000 per month levels and it is facing some vendor issues. Production is expected to double once M&M sorts out these issues. Footfalls have decreased lately due to slowdown but conversion rate is good and the company is maintaining booking levels every month. M&M thinks that the bookings will increase once waiting period comes down. Dealers are prepared to wait for 1.5-2 years to achieve breakeven which it believes would be at about 200/month sales levels. Indicated waiting period is 7-8 months now.

We believe that Jawa has created enough buzz to attract some RE customers who are looking for something different. Jawa is also perceived as an iconic brand and has the potential to get a cult following. The brand can gain RE share in the geographies where there is a Jawa dealership. In one of the tier-2 city, RE sales have declined by 30% in the last few months which is as much as Jawa sales in the region.

Exhibit 34: Jawa 42 vs. Classic 350

	Jawa 42 STD	Royal Enfield Classic 350
Mileage (Overall)	40 kmpl	40.8 kmpl
Engine Type	Single Cylinder, 4 Stroke, Liquid Cooled, DOHC	Single cylinder, 4 stroke, twinspark, air-cooled
Displacement	293 cc	346 cc
Max Power	27 BHP	19.8 BHP
Max Torque	28 NM	28 NM
Front Brake	Disc	Disc
Rear Brake	Drum	Disc
Fuel Capacity	14 L	13.5 L
Fuel Supply	Fuel Injection	Carburetor
Starting	Self Start Only	Kick and Self Start
Transmission	Manual	Manual
Gear Box	6 Speed	5 Speed
Compression Ratio	11:01	8.5:1
ABS	Dual Channel	Dual Channel
Odometer	Digital	Analogue
Chassis	Double Cradle	Single Downtube, Using Engine As Stressed Member
Front Suspension	Telescopic Hydraulic Fork	Telescopic forks
Rear Suspension	Gas Canister - Twin shock hydraulic	Twin gas charged shock absorbers
Kerb Weight	170 kg	192 Kg
Price ('000s)(Ex-showroom Delhi)	164	153

Source: Company, Jawa Motorcycles, Nirmal Bang Institutional Equities Research

Other competition

Competitive intensity expected to increase going forward. Maintaining high growth will be challenging.

RE has enjoyed a phenomenal run over the last few years on the back of its cult appeal. Muscular and pliant, RE appealed its' customers with its Vintage feel. It introduced the concept of Leisure Motorcycling in India and was the sole beneficiary of trend shift towards premium and leisure motorcycling whereas, most of the competing players focused on premium sports segment.

Classic and Bullet in 350cc segment has had a non parallel run as they faced little competition in this segment and at their price point. However, 500cc variants did not succeed as there was no product differentiation and they resembled the 350cc models (except that they were higher cc models with significantly lower mileage and higher operating costs, priced at premium). 650cc twins are also yet to establish themselves.

Until last year, RE enjoyed limited competition as most of the domestic and foreign players were focused on sports bikes and not in the segment RE was present in. Most of the competing models were also priced at significant premium to RE's models (except for Jawa, which is a direct competitor to RE, launched last year).

Exhibit 35: Royal Enfield faces little competition in its price segment, right now

Brand	Model	Engine capacity (cc)	Ex-showroom price (Rs'000s)Mumbai
Royal Enfield	Royal Enfield Bullet 350	346	121.8
	Royal Enfield Classic 350	346	153.9
	Royal Enfield Thunderbird 350	346	156.7
	Royal Enfield Himalayan	411	181.0
	Royal Enfield Bullet 500	499	188.8
	Royal Enfield Classic 500	499	202.0
	Royal Enfield Thunderbird 500	499	207.3
	Royal Enfield Interceptor 650	648	256.4
	Royal Enfield Continental GT 650	648	271.7
Jawa	Jawa Forty Two	293	184.0
	Jawa Standard	293	194.2
Bajaj	Bajaj Avenger Street 220	220	102.7
	Bajaj Avenger Cruise 220	220	102.7
	Bajaj Dominar 400	373	180.0
KTM	KTM 250 Duke	248	196.7
	KTM RC 390	373	243.5
	KTM 390 Duke	373	247.8
Harley Davidson	Harley-Davidson Street 750	749	684.0
	Harley-Davidson Street Rod	749	809.0
Triumph	Triumph Street Triple 765	765	1,030.5
	Triumph Street Twin	900	863.1
	Triumph Bonneville T100	900	994.6

Source: Industry, Nirmal Bang Institutional Equities Research

However, competitive intensity is expected to increase in the 250-500cc segment with the Jawa receiving overwhelming response and increased focus of players like KTM, Triumph and Harley Davidson in the 250-500cc segment. In Nov'18, M&M revived the iconic and aspirational brand Jawa. Banking on its heritage and legacy looks, aggressive pricing and over 100 dealership and service centers to start with, Jawa received strong response with 6-8 months of production booked (i.e. till Sept'19) within 40 days of launch. Our channel checks suggest that delivery of Jawa, which had been facing delays, is now improving as it continues to ramp up production and solve supply side issues. Waiting period is still 6-8 months which suggests strong customer response. Triumph has tied-up with Bajaj Auto for introducing affordable products in the 250-500cc segment, with its first model expected to be rolled out in late 2020. Last year, Harley Davidson in its strategy, 'More roads to Harley-Davidson' revealed its plan to develop affordable, small displacement 250-500cc motorcycles in India. According to various media reports, Harley-Davidson is in advance talks with Hero MotoCorp for an alliance to produce affordable motorcycles in the 250-500cc segment.

We believe that these new players will provide huge up-trading opportunity in the existing RE customer base. Premiumization trend of shift from entry and mid cc segment to leisure and premium segment remains intact but customers will now have options of Jawa (at price point similar to RE) and other foreign brands at some premium price points (unlike only RE being an option). So, we believe that maintaining high growth incrementally will be challenging over longer term.

Exhibit 36: Expected upcoming launches in the premium segment

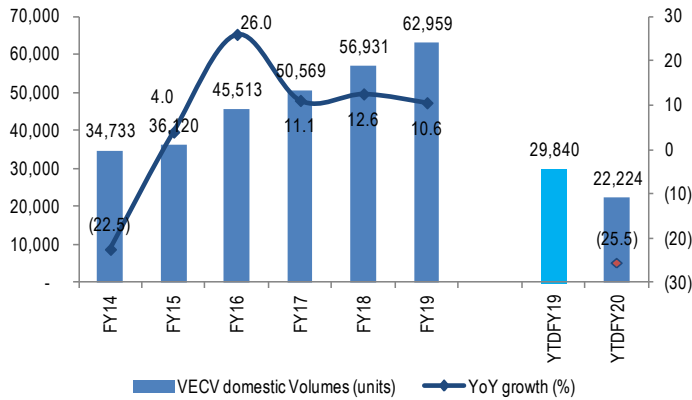
Brand	Launch Date (tentative)	Model	Engine capacity	Expected price (Rs '000s)
Royal Enfield	January 2020	RE Meteor	648cc	230
	February 2020	2020 Royal Enfield Classic 350	346cc	170
	February 2020	2020 Royal Enfield Thunderbird 350	346cc	185
	February 2020	2020 Royal Enfield Thunderbird 350X	349cc	185
Jawa	October 2019	Jawa Perak	334cc	189
Bajaj Auto	March 2020	Bajaj Avenger 400	373cc	150
KTM	October 2019	KTM 390 Adventure	373cc	300
	February 2020	KTM 390 Duke	373cc	250
Yezdi	February 2020	Yezdi 300	293cc	105
Harley-Davidson	February 2021	Harley-Davidson 350	338cc	250
Yamaha	December 2019	Yamaha MT 03	321cc	300
Hero	March 2020	Hero XF3R	300cc	185
Honda	December 2019	Honda CB500X	471cc	500
Suzuki	February 2020	Suzuki Intruder 250	250cc	180
Kawasaki	October 2019	Kawasaki Z400	399cc	400
Hyosung	October 2019	Hyosung Aquila GV300	275cc	300
	March 2020	Hyosung GT300R	275cc	250
CFMoto	February 2020	CFMoto 300SR	294cc	300
	February 2020	CFMoto 400NK	400cc	350
Benelli	September 2019	Benelli 302 S	300cc	330
	October 2019	Benelli 502 c	500cc	500
	March 2020	Benelli 402 S	399cc	380
	May 2020	Benelli Imperiale 400	373cc	180
Norton	September 2020	Norton 500	500cc	250
Husqvarna	November 2019	Husqvarna Svartpilen	373cc	300
	November 2019	Husqvarna Vitpilen	373cc	250

Source: Industry, Nirmal Bang Institutional Equities Research

VECV

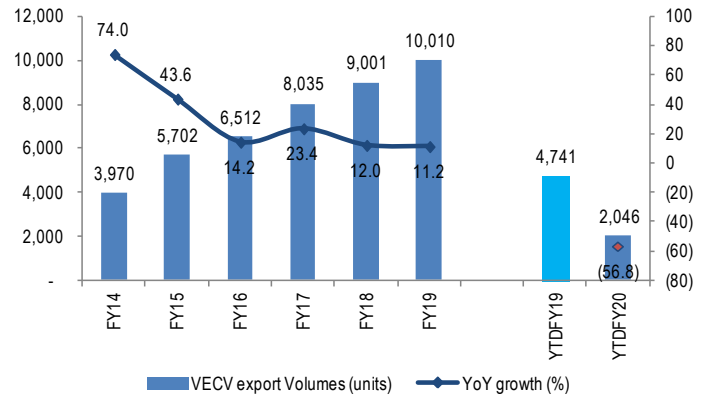
Volvo Eicher Commercial Vehicles (VECV) is a 50:50 JV between the Eicher group and Volvo and was formed in 2008. Over the years, VECV has made its mark in the ICV (7.5 to 12 ton) segment where it has been gaining share, which stood at 29.4% in FY19. VECV has performed well in the Bus segment and reached 17% share in FY18 before losing some share in FY19.

Exhibit 37: Domestic volume trend



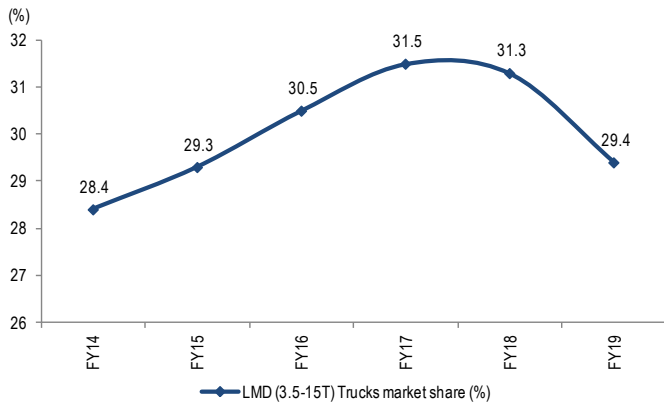
Source: Crisil, Nirmal Bang Institutional Equities Research, YTFDY – April to September

Exhibit 38: Exports volume trend



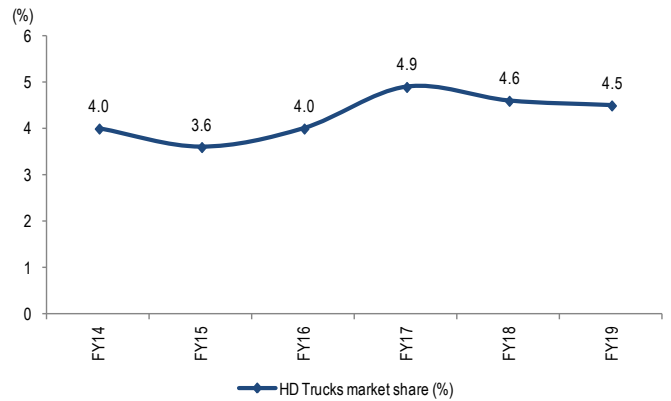
Source: Crisil, Nirmal Bang Institutional Equities Research, YTFDY – April to September

Exhibit 39: LMD market share trend



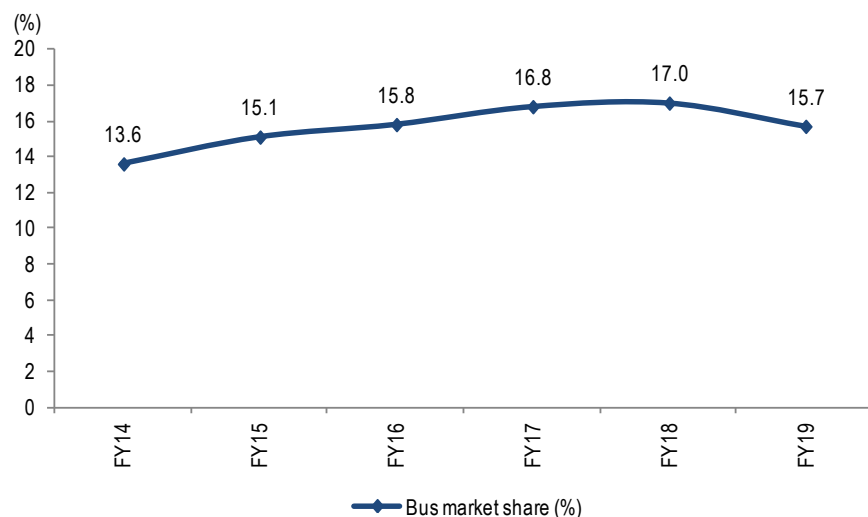
Source: Crisil, Nirmal Bang Institutional Equities Research

Exhibit 40: HD market share trend



Source: Crisil, Nirmal Bang Institutional Equities Research

Exhibit 41: Bus market share trend

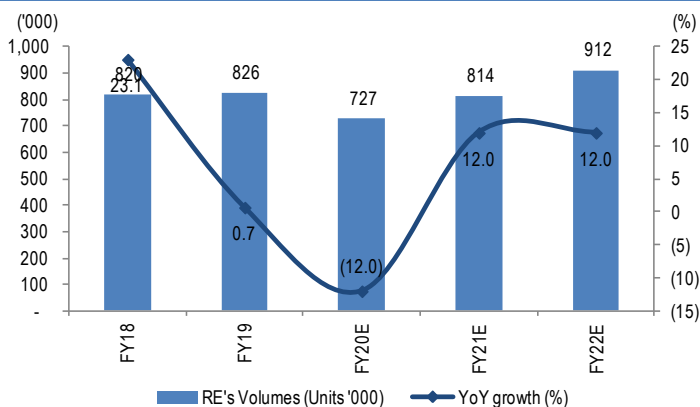


Source: Crisil, Nirmal Bang Institutional Equities Research

Financials

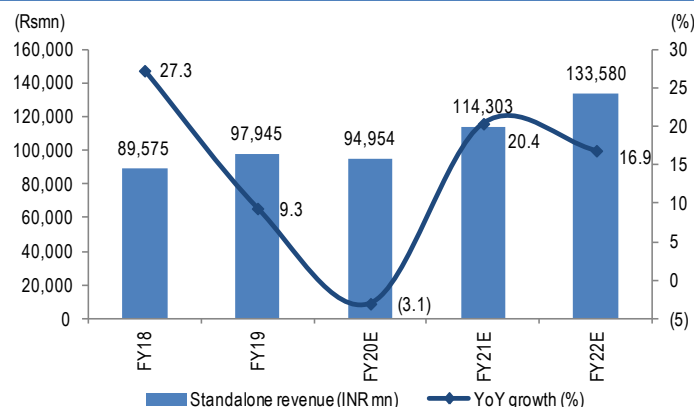
RE volume has declined by 19.6% YoY for the first six months of FY20 due to the slowdown in the domestic industry. We expect the Studio stores and lower priced variants of Bullet and Classic 350 to arrest this declining going forward, and hence we have estimated 12%YoY volume decline for the full year. We expect 3.3% CAGR decline in volume over FY19-22. We expect realizations to increase in FY20 due to full effect of ABS price increase and in FY21 due to BS6 cost increase. Hence we expect a 10.9% CAGR for revenue in the period FY19-22. Margin will remain under pressure due to negative operating leverage. Our PAT estimate is 12.7% CAGR for the same period. For VECV, we expect volume/PAT CAGR of -8/-8.7% for FY19-22, driven by down cycle in the CV industry.

Exhibit 42: RE volume estimates



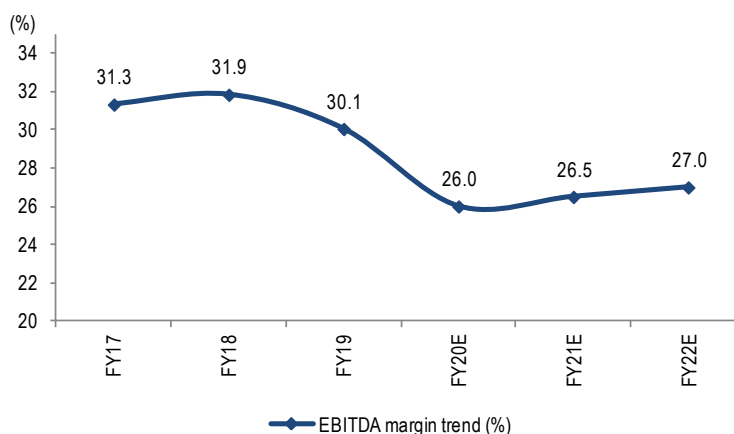
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 43: Standalone revenue estimates



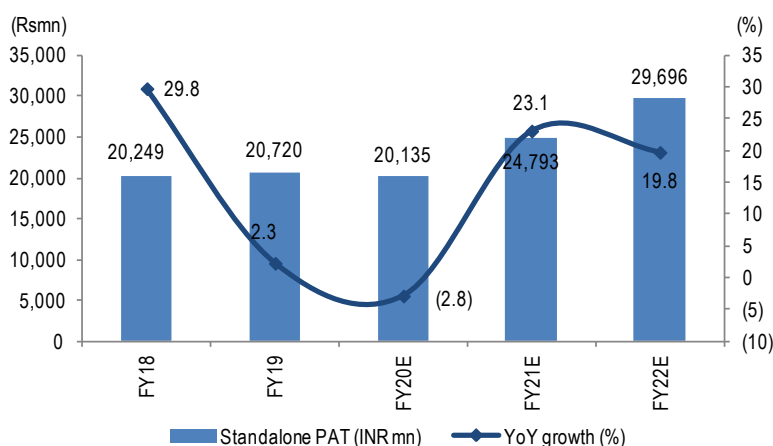
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 44: Standalone EBITDA margin estimates



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 45: Standalone PAT estimates



Source: Company, Nirmal Bang Institutional Equities Research

Risks to our rating

Underwhelming response to Studio stores – Studio store are expected to get some sales that would have anyways happened and some incremental sales due to penetration. A lower than expected response will be negative for Eicher.

Tepid demand for lower priced variants – We expect the new variants to perform well in the under indexed markets and lower than expected traction of these variants would be a risk to our volume estimates.

2W market revival – If the industry revival takes longer than we expect then there is a risk to our volume growth estimates.

Financials (Consolidated)

Exhibit 46: Income Statement

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net Sales	89,649	97,971	94,977	114,326	133,603
% Growth	27.5	9.3	-3.1	20.4	16.9
Raw material	46,435	50,574	50,896	60,924	70,931
Staff costs	5,737	7,024	8,071	9,487	10,686
Other expenses	9,402	11,341	11,818	14,219	16,632
Total expenses	61,573	68,940	70,784	84,630	98,250
EBITDA	28,076	29,031	24,193	29,696	35,354
% Growth	29.1	3.4	(16.7)	22.7	19.1
EBITDA margin (%)	31.3	29.6	25.5	26.0	26.5
Other income	2,801	4,434	5,099	6,119	7,343
Interest costs	53	73	84	97	111
Depreciation	2,233	3,003	3,587	4,125	4,744
Profit before tax (before exceptional items)	28,591	30,389	25,620	31,593	37,841
Exceptional items	2,201	175	0	0	0
Share of profit/(loss) of Joint ventures	2,561	2,584	1,477	1,944	1,990
Tax	9,359	10,770	6,661	8,214	9,839
Adj PAT	21,792	22,203	20,436	25,322	29,992
% Growth	30.7	1.9	-8.0	23.9	18.4
Adj PAT margin (%)	24.3	22.7	21.5	22.1	22.4
EPS (Rs)	799.4	814.5	749.7	928.9	1,100.2
% Growth	30.2	1.9	-8.0	23.9	18.4
DPS (Rs)	110.0	125.0	135.0	135.0	150.0
Payout (incl. div. tax) (%)	16.6	18.5	21.7	17.5	16.4

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 48: Balance Sheet

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Share capital	273	273	273	273	273
Reserves	70,028	88,914	104,912	125,796	150,856
Net worth	70,301	89,187	105,184	126,069	151,129
Total debt	1,508	1,868	1,868	1,868	1,868
Net deferred tax liability	1,421	2,739	2,739	2,739	2,739
Capital employed	73,230	93,794	109,791	130,675	155,736
Gross block	21,443	27,673	34,673	40,673	45,673
Depreciation	6,426	8,927	12,514	16,640	21,384
Net block	15,017	18,746	22,159	24,033	24,289
Capital work-in-progress	3,332	4,497	4,497	4,497	4,497
Investments	55,808	49,225	59,225	69,225	79,225
Inventories	3,946	6,334	6,706	8,081	9,452
Debtors	680	903	875	1,055	1,234
Cash	12,120	29,653	31,668	41,735	57,593
Loans & advances	7	13	38	63	88
Other current assets	4,311	4,497	4,997	5,497	5,997
Total current assets	21,064	41,400	44,285	56,431	74,363
Creditors	11,719	12,341	11,956	14,408	16,850
Other current liabilities & provisions	10,274	7,734	8,419	9,104	9,789
Total current liabilities	21,992	20,075	20,375	23,512	26,639
Net current assets	-928	21,325	23,910	32,919	47,724
Application of funds	73,230	93,794	109,791	130,675	155,736

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 47: Cash Flow Statement

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
OP/(loss) before tax	25,843	26,028	20,606	25,571	30,610
Depreciation & amortization	2,233	3,003	3,587	4,125	4,744
Other income	2,801	4,434	5,099	6,119	7,343
(Inc.)/dec. in working capital	5,133	(4,720)	(569)	1,057	1,054
Direct taxes paid	(8,716)	(9,452)	(6,661)	(8,214)	(9,839)
Other/extra-ordinary Items	1,233	3,378	1,476	1,944	1,990
Cash flow from operations (after E/O)	28,527	22,670	23,538	30,602	35,901
Capital expenditure (-)	(8,117)	(7,897)	(7,000)	(6,000)	(5,000)
Net cash after capex	20,411	14,773	16,538	24,602	30,901
Other investing activities	(5,937)	6,583	(10,000)	(10,000)	(10,000)
Dividends paid (-)	(3,616)	(4,109)	(4,438)	(4,438)	(4,931)
Inc./(dec.) in total borrowings	1,011	286	(84)	(97)	(111)
Others	1	-	-	-	-
Cash from financial activities	(2,604)	(3,824)	(4,522)	(4,535)	(5,043)
Opening cash balance	251	12,120	29,653	31,668	41,735
Closing cash balance	12,120	29,653	31,668	41,735	57,593
Change in cash balance	11,869	17,533	2,015	10,067	15,858

Source: Company, Nirmal Bang Institutional Equities Research

*Excluding other bank balances

Exhibit 49: Key Ratios

Y/E March	FY18	FY19	FY20E	FY21E	FY22E
Per share (Rs)					
EPS	799.4	814.5	749.7	928.9	1,100.2
EPS Growth (%)	30.2	1.9	(8.0)	23.9	18.4
Cash EPS	706.7	823.4	827.1	1,008.9	1,201.2
Book value per share	2,578.9	3,271.7	3,858.6	4,624.7	5,544.0
DPS	110.0	125.0	135.0	135.0	150.0
Payout (incl. div. tax) %	16.6	18.5	21.7	17.5	16.4
Valuation (x)					
P/E	22.7	22.4	24.3	19.6	16.6
Cash P/E	25.8	22.1	22.0	18.1	15.2
EV/EBITDA	15.3	14.4	16.8	13.0	10.2
EV/Sales	4.8	4.3	4.3	3.4	2.7
P/BV	7.1	5.6	4.7	3.9	3.3
Dividend yield (%)	0.6	0.7	0.7	0.7	0.8
Return ratios (%)					
RoCE	39.1	32.5	23.4	24.3	24.4
RoE	31.0	24.9	19.4	20.1	19.8
Profitability ratios (%)					
EBITDA margin	31.3	29.6	25.5	26.0	26.5
PAT margin	24.3	22.7	21.5	22.1	22.4
Turnover ratios					
Debtors (days)	3	3	3	3	3
Inventory (days)	16	24	26	26	26
Creditors (days)	48	46	46	46	46
Asset turnover (x)	1.2	1.0	0.9	0.9	0.9
Leverage Ratio					
Debt/equity (x)	0.0	0.0	0.0	0.0	0.0

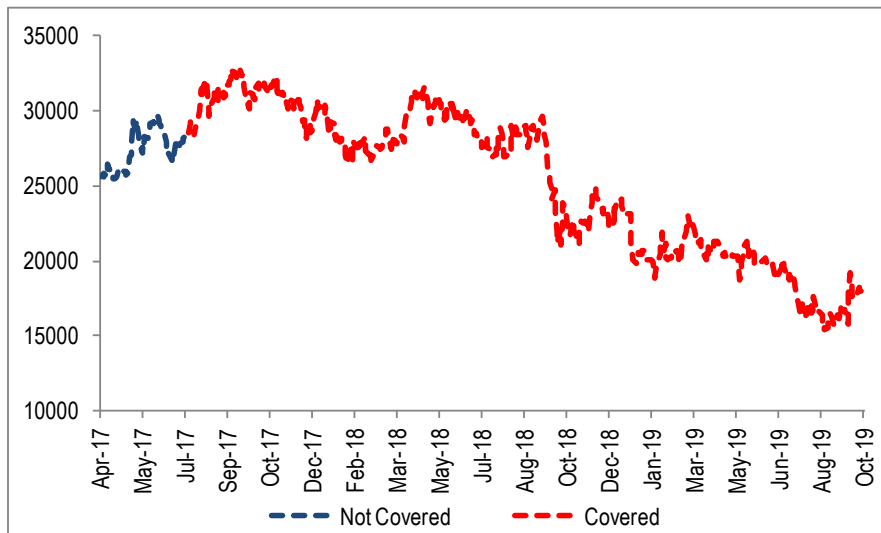
Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
18 July 2017	Buy	28,059	32,566
10 August 2017	Accumulate	31,440	33,462
15 November 2017	Buy	30,090	35,375
8 February 2018	Buy	28,010	36,271
10 May 2018	Buy	30,316	36,529
10 August 2018	Buy	27,439	36,529
13 November 2018	Buy	21,934	29,402
1 August 2019*	Under Review	16,240	N.A
9 October 2019	Buy	18,212	21,127

* Coverage shifted to Anish Rankawat wef 1 August 2019

Rating track graph



DISCLOSURES

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BUY > 15%

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