Initiating Coverage

Atul Auto

30 December 2015

Reuters: ATUL.BO; Bloomberg: ATA IN

Rising Star In Oligopolistic Market

Atul Auto (AAL) is one of the youngest and fastest-growing players in the three-wheeler industry in India with its production facility located in Rajkot, Gujarat. The company almost doubled its domestic market share from 3.8% to 7.5% over FY11-FY15. AAL is the third largest player in domestic cargo three-wheeler segment with a market share of 18% and the fourth-largest in domestic passenger three-wheeler segment with a market share of 5% in FY15. AAL has now entered the petrol passenger three-wheeler segment with the launch of Atul Gemini. The launch opens new opportunities for the company in overseas market (93% of addressable market) and domestic market (34% of addressable market). We expect the volume to post a CAGR of 14% over FY16E-FY18E backed by petrol vehicle launch and rising penetration in domestic and export markets. Following the increase in volume and a richer product mix driven by 5x likely rise in export volume, we expect margins to expand 390bps over FY15-FY18E, driving 23% earnings CAGR. With a new gasoline-based product launch, rising market share and improvement in margins along with a strong debt-free balance sheet, AAL is a compelling growth story in an oligopolistic market. We have assigned Buy rating to AAL with a target price of Rs671, valuing the stock at 20x FY18E EPS of Rs33.5.

Petrol/CNG three-wheeler passenger variants to improve domestic market share: Petrol engine vehicles account for around 34% of vehicles in domestic market (mainly Tier-I cities). Lack of petrol variant prevented AAL from addressing this huge market. To increase its footprint in Tier-I cities, AAL started (since November 2015) manufacturing 0.35tn petrol variant for sale in select domestic markets. Once manufacturing of petrol three-wheelers is fully operational, the company will be able to cater to the requirements of the entire domestic market. Equipped with adequate capacity and a new petrol variant, we expect AAL to post domestic volume CAGR of 10% over FY16-FY18E.

Opening up of export market opportunities: Apart from China, India is the only major manufacturer of three-wheelers in the world. Exports posted a robust growth of 19% over FY10-FY15. Contribution of exports to total volume steadily increased from 26% in FY07 to 43% in FY15. Exports of three-wheelers comprise predominantly (~93%) vehicles having petrol engines. With the launch of a petrol variant and the distribution network in place, we believe AAL is perfectly placed to drive its export volume. On account of a low base, we expect AAL's export volume to grow 5x over FY15-FY18E.

Strong volume growth with margin expansion to drive earnings CAGR of 23% over FY16-FY18E: AAL has increased its volume by a robust CAGR of 28% over FY10-FY15. We expect a volume CAGR of 14% over FY16E-FY18E. With improvement in volume, higher contribution from export markets (higher realisation), gross margin is expected to expand 290bps from 24.5% in FY15 to 27.3% in FY18E, which coupled with better operating efficiencies will drive a 390bps EBITDA margin expansion over FY15–FY18E to 15.6%. This is expected to drive 23% earnings CAGR over FY16E-FY18E.

Valuation: AAL is expected to clock revenue/EBITDA/PAT CAGR of 16%/23%/23%, respectively, with volume growth of 14% over FY16E-FY18E. AAL stock currently trades at P/E of 20x FY17E and 16x FY18E, respectively. We have valued the stock at 20x FY18E earnings (10% premium to its two-year historical P/E average) and assigned Buy rating to it with a target price of Rs671, up 24% from the current market price of Rs541.

Y/E March (Rsmn)	FY14	FY15	FY16E	FY17E	FY18E
Revenue	4,301	4,928	5,408	6,144	7,222
YoY (%)	*18.3*	*14.2*	*10.0*	*13.6*	*17.5*
EBITDA	453	578	748	902	1,128
EBITDA Margin (%)	*10.5*	*11.7*	*13.8*	*14.7*	*15.6*
Adj. PAT	297	405	486	588	734
YoY (%)	*14.6*	*36.2*	*20.2*	*20.8*	*25.0*
Adj. EPS (Rs)	13.6	18.5	22.2	26.8	33.5
RoE (%)	*35.2*	*37.6*	*36.0*	*35.6*	*36.3*
RoCE (%)	*30.0*	*32.4*	*34.4*	*34.1*	*35.7*
P/E (x)	39.9	29.3	24.4	20.2	16.1
P/BV (x)	12.6	9.8	8.4	8.0	6.6

Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: Automobile

CMP: Rs541

Target Price: Rs671

Upside: 24%

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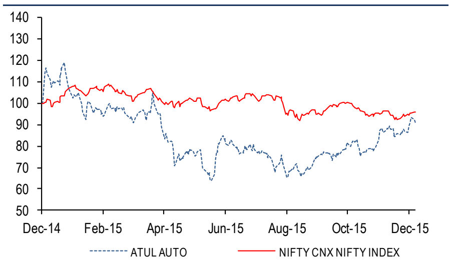
Key Data

Current Shares O/S (mn)	21.9
Mkt Cap (Rsbn/US$mn)	11.9/178.9
52 Wk H / L (Rs)	722/330
Daily Vol. (3M NSE Avg.)	75,359

Share holding (%)	4QFY15	1QFY16	2QFY16
Promoter	52.7	52.7	52.7
FII	6.1	6.9	6.4
DII	8.5	9.5	9.9
Others	32.7	30.9	31.0

One -Year Indexed Stock Performance



Price Performance (%)

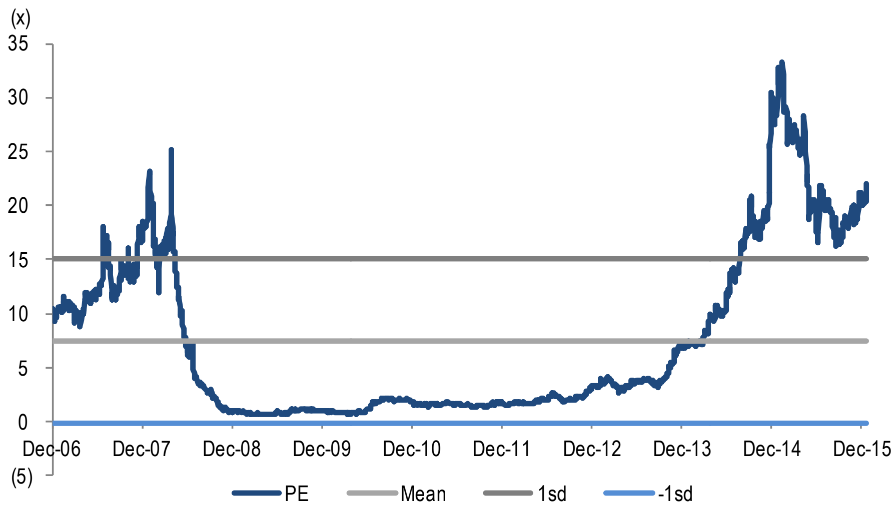
	1 M	6 M	1 Yr
Atul Auto	5.5	13.1	(8.9)
Nifty Index	(0.2)	(4.7)	(3.8)

Source: Bloomberg

Investment Rationale

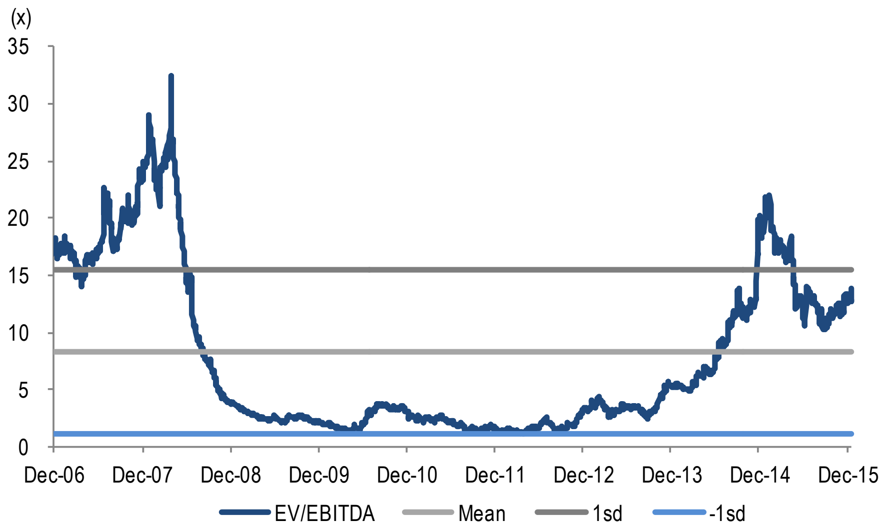
We have assigned Buy rating to AAL with a 12-month price target of Rs671. Our target price is driven by the following key factors: 1) Launch of Atul Gemini 0.35tn gasoline/alternative fuel-based model which will allow AAL to cater to the requirements of Tier-1 cities and urban areas in India, 2) Likely strong growth in export markets, which grew 19% (industry level) over FY10-FY15, 3)Rising AAL's presence across India by establishing its brand and strengthening the dealer network at a CAGR of 17% over FY11-FY15, and 4) 14% volume CAGR likely to drive better economies of scale and improve operating margin by 390bps from 11.7% in FY15 to 15.6% in FY18E. AAL is expected to clock revenue/EBITDA/PAT CAGR of 16%/23%/23%, respectively, with volume growth of 14% over FY16E-FY18E. AAL stock currently trades at P/E 20x FY17E and 16x FY18E, respectively. We have valued AAL based on 20x FY18E earnings (10% premium to its two-year historical P/E average) and assigned Buy rating to it with a target price of Rs671, up 24% from the current market price of Rs.541.

Exhibit 1: P/E chart



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 2: EV/EBITDA chart



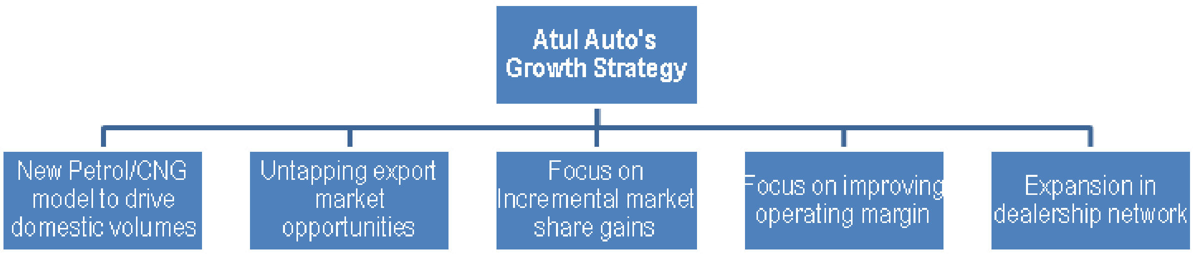
Source: Bloomberg, Nirmal Bang Institutional Equities Research

Investment rationale

Led by new product launch and opening up of export market opportunities, volume likely to post 14% CAGR over FY16E-FY18E

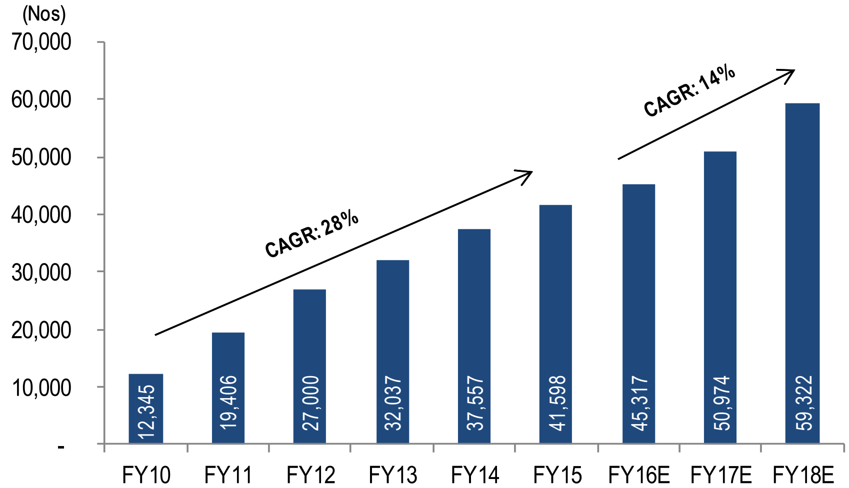
AAL has adopted a five-pronged strategy which includes: a) Launch of petrol/CNG variants coupled with improvement in domestic economic environment to help drive domestic volume CAGR of 10% over FY16E-FY18E, b) Currently the export market, largely dominated by petrol engine vehicles (~93%), will become addressable and lead to an export volume growth of 5x over FY15-FY18E, c) Incremental market share gains in domestic cargo and passenger segments d) Better economies of scale because of higher volume to push EBITDA margin to 15.6% by FY18E, and e) Deepening market penetration with its presence in 18 Indian states and six countries will make AAL a truly pan-India player and one of the key players in export markets going forward.

Exhibit 3: Atul Auto's growth strategy



Source: Nirmal Bang Institutional Equities Research

Exhibit 4: Sales volume



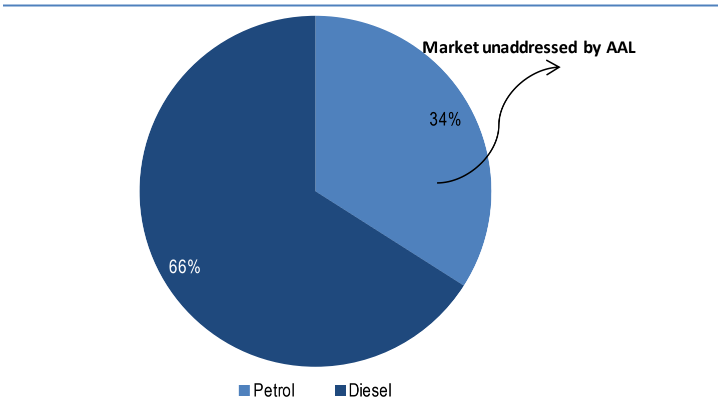
Source: Company, Nirmal Bang Institutional Equities Research

Foray into petrol/CNG three-wheelers likely to drive a 10% domestic volume CAGR over FY16E-FY18E

When AAL began its operations way back in 1990s, its strategy was to target only a certain segment of the three-wheeler market so as to avoid direct competition with giants such as Bajaj Auto and Piaggio. Hence, it chose the 0.5tn diesel segment and decided to cater only to the requirement of Tier II and Tier III cities in India, and this strategy did turn out to be successful. Despite having limited resources to begin with and a tough competitive domestic market, AAL's management smartly navigated business in domestic market and helped drive a volume CAGR of 27% over FY10- FY15 (industry as a whole grew 4% during the same period). AAL more than doubled its market share in domestic market from ~4% in FY11 to ~8% by the end of FY15. AAL transformed itself from a regional player with a strong foothold in Gujarat and Rajasthan (which accounted for ~70% of sales a few years ago) to a pan-India player. AAL steadily expanded its presence from 10 states in FY09 to 18 states in FY15. The company extended its primary dealer network from 105 in FY11 to 200 in FY15. As of FY15-end, the company sold its vehicles through 320 showrooms (200 primary dealers and 120 secondary dealers). AAL has also been able to make inroads in emerging towns of India such as Kota, Bikaner, Alwar and Nanded. In the past five years, the company established strong brand loyalty and a good distribution network in Tier II and Tier III cities.

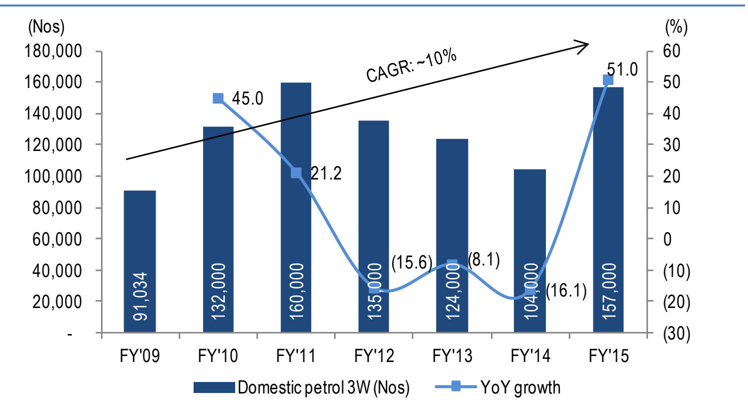
As of FY15-end, 34% of total domestic market constituted petrol/alternate fuel-based vehicles while the rest was accounted for by diesel engine-based vehicles. As AAL didn't have there-wheelers with petrol engines (as of 1HFY16-end), it was left with only 66% of domestic three-wheeler market to cater to. To expand its footprint across urban geographies in domestic market, AAL has come up with 0.35tn petrol variant of its three-wheeler Gemini.

Exhibit 5: Domestic three- wheeler Industry by engine type



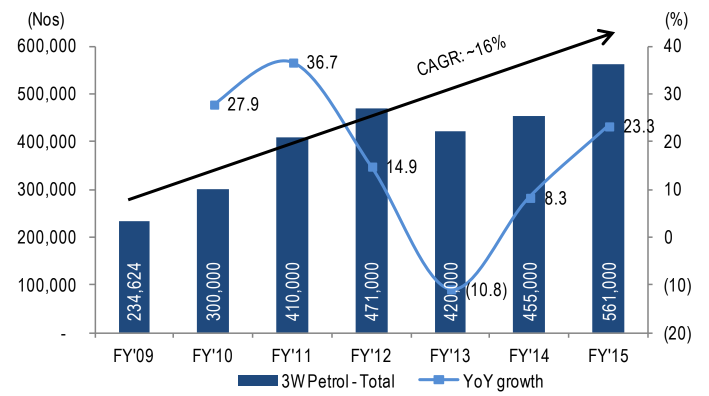
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Three-wheeler petrol vehicles-domestic market growth



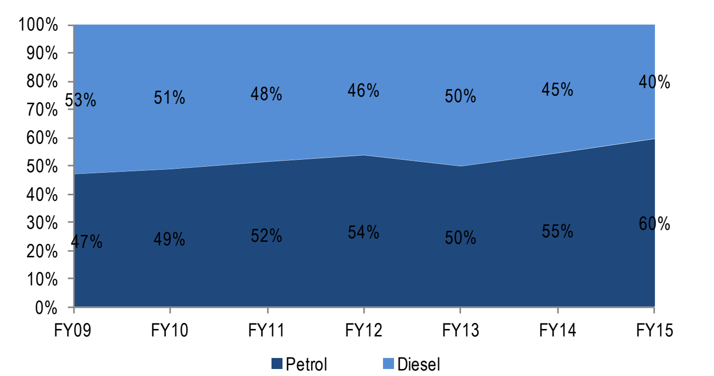
Source: TVS Motor Annual Reports, Nirmal Bang Institutional Equities Research

Exhibit 7: Three-Wheeler Petrol Industry [Domestic + Exports]



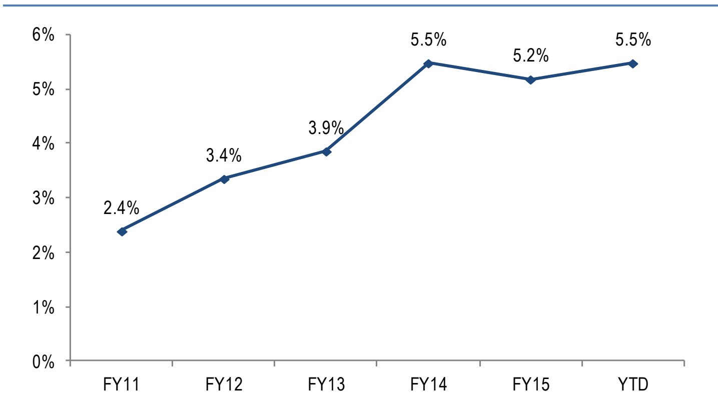
Source: TVS Motor Annual Reports, Nirmal Bang Institutional Equities Research

Exhibit 8: Three-Wheeler Industry – Petrol/Diesel mix



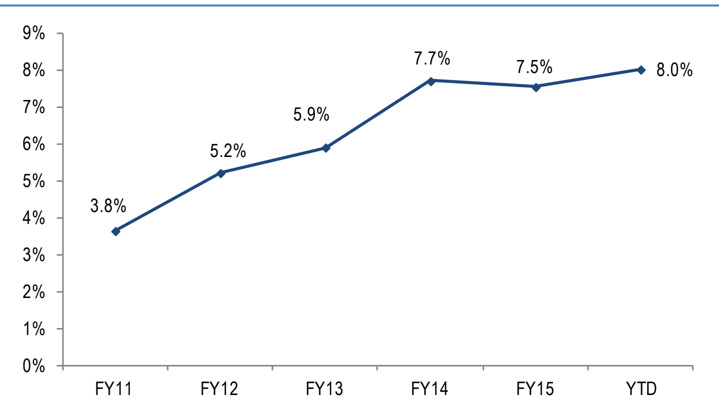
Source: TVS Motor Annual Reports, Nirmal Bang Institutional Equities Research

Exhibit 9: Domestic 3W passenger vehicle market share



Source: Society of Indian Automobile Manufacturers or SIAM, Nirmal Bang Institutional Equities Research

Exhibit 10: Market share – Domestic 3W [passenger + cargo]



Source: SIAM, Nirmal Bang Institutional Equities Research

Most passenger three-wheelers (diesel or petrol engine-fitted) need respective state government permits before they can be sold in local market. Issuance of fresh permits involves a lot of political decision-making and therefore petrol three-wheeler volume can show uneven spikes YoY. FY12 and FY14, which didn't see much action in terms of issuance of new permits, led to decline in petrol three-wheeler volume while FY15, which witnessed fresh permits from Maharashtra and Delhi governments, led to a huge 51% spike in volume YoY.

Despite challenges in getting fresh permits from state governments, domestic petrol/alternate fuel-based (3+1) three-wheelers posted a robust CAGR of ~10% over FY09-FY15. Total three-wheeler industry (domestic + exports) posted a CAGR of 16% over the same period.

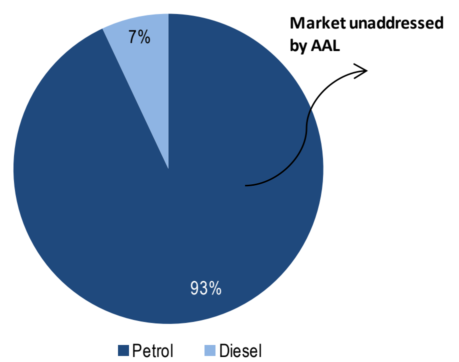
We believe that given AAL's strong past of coming out with excellent products, its new version of petrol three-wheeler should be able to make its mark in domestic petrol vehicle segment and provide incremental revenue to the company.

AAL has got approval from a few state governments and is awaiting approval from others. AAL will start rolling out its new variant in different phases. It has started selling petrol three-wheelers in Gujarat since last month (November 2015). With new states under its belt and an established dealer network, we believe that volume and margins will not show lumpiness in domestic market and stabilise as and when its petrol three-wheeler volumes increase.

Access to huge untapped export market opportunity, exports likely to grow 5xover FY15- FY18E

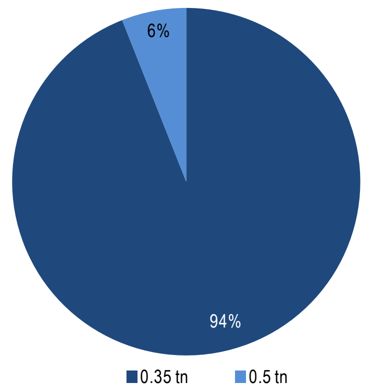
AAL, which has been mainly in 0.50tn diesel vehicle segment, didn't have a suitable product for exports. Export markets, which prefer predominantly (~94%) 0.35tn petrol vehicles, was untapped by AAL. As a result, the contribution of exports to total sales volume of AAL was a mere 4% by the end of first eight months of FY16. However, the company has started manufacturing 0.35tn petrol variant, which will allow it to cater to export markets.

Exhibit 11: Export market share in terms of engine type



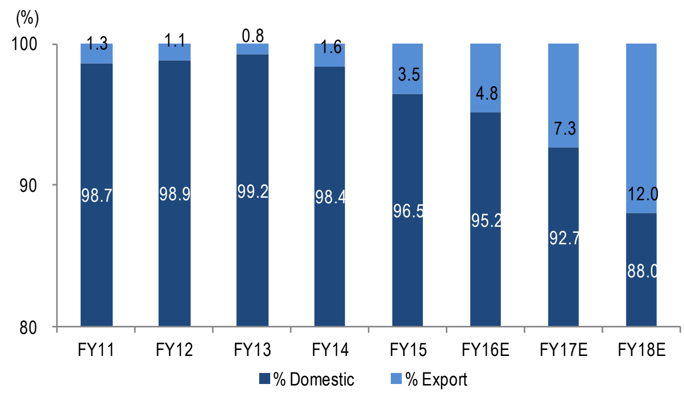
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Export market share in terms of tonnage



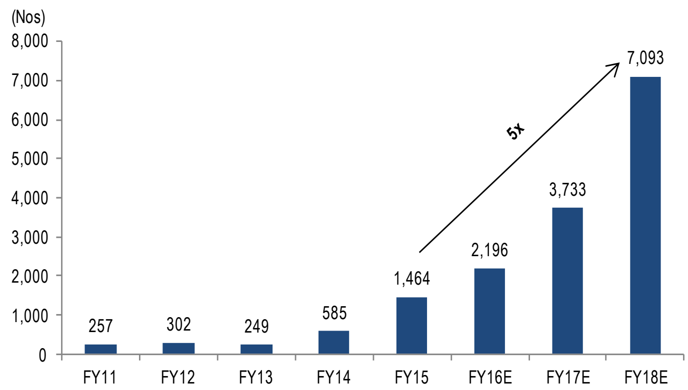
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Improvement in domestic/export market mix for Atul Auto



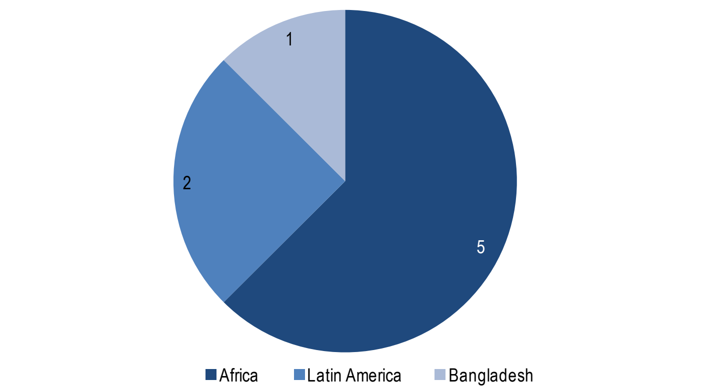
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Export volume – Atul Auto



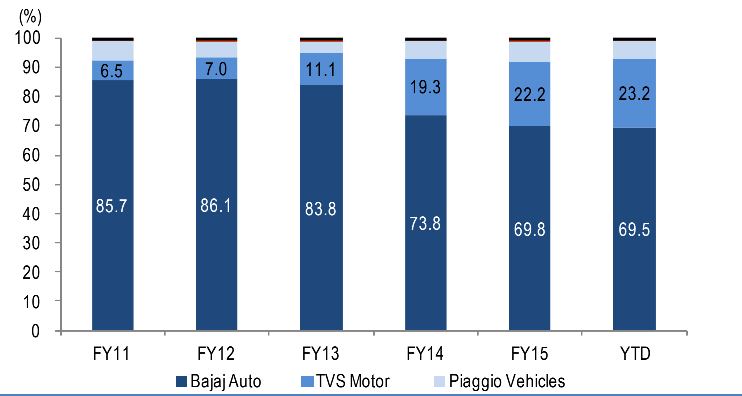
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: International Distributors



Source: Company, Nirmal Bang Institutional Equities Research

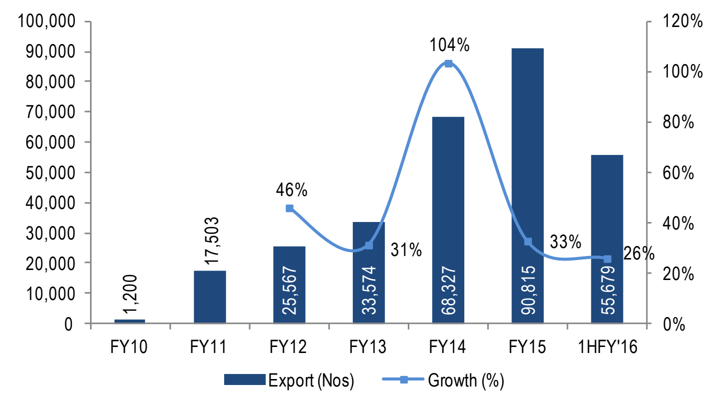
Exhibit 16: Industry export volume – Bajaj Auto & TVS Motor dominate three-wheeler exports



Source: SIAM, Nirmal Bang Institutional Equities Research

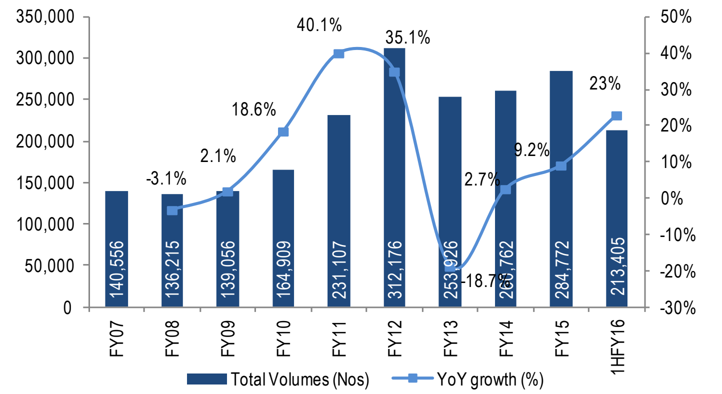
Given its history of coming out with strong products over the past two decades, we believe that petrol variant of AAL will get a good response in export markets. Exports of Indian three-wheelers have been growing consistently over the past decade. The contribution of export volume as a percentage of total volume increased steadily from 26.3% in FY07 to 43% in FY15. Indian petrol/alternate fuel three-wheelers have done exceptionally well in export markets over FY10 – FY15 with a strong CAGR of ~19%. Bajaj Auto, which has been the undisputed leader in three-wheeler exports, witnessed its position weakened slightly by TVS Motor Company. TVS Motor Company launched TVS King model in FY09, its first three-wheeler product in petrol and LPG variants, in select five states in India. TVS Motor Company began exporting its products to select countries like Burundi, Sri Lanka, Ethiopia and Egypt in FY10 and became highly successful there. AAL posted a volume CAGR of 138% over FY10-FY15 and a growth of 26% in 1HFY16. As of 1HFY16-end, Bajaj Auto and TVS Motor Company together accounted for ~92% of export market share. Currently, AAL has eight distributors in international markets with five in Africa, two in Latin America and one in Bangladesh.

Exhibit 17: Three-wheeler export volume of TVS Motor



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 18: Three-wheeler export volume of Bajaj Auto



Source: Company, Nirmal Bang Institutional Equities Research

AAL doubles its domestic market share over FY11-FY16E (YTD)

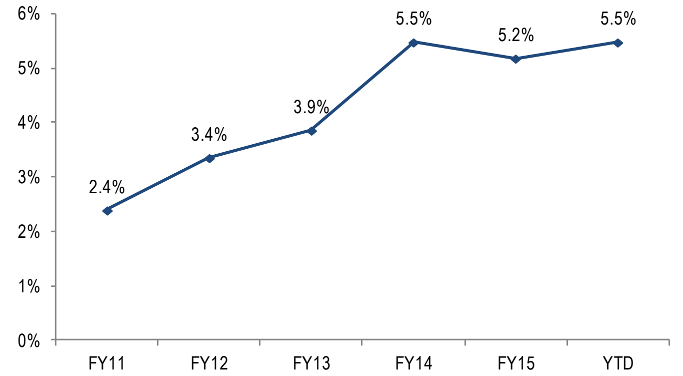
AAL has come a long way from being a manufacturer of Chhakaras in 1975 to one of the leading players in the three-wheeler segment in India. The company captured market share from its peers (Piaggio, Bajaj Auto, etc.) and increased its total domestic market share from ~4% in FY11 to 8% at the end of first eight months of FY16. The company's share in passenger vehicle segment stood at 5.5% and was as high as 20.1% in cargo three-wheeler segment at the end of first eight months of FY16.

AAL managed to gain market share continuously through product innovation and increased product lines, expansion in dealer network, financing deals with the help of banks, offering a higher warranty period (24-month) compared to rivals, faster service turnaround, better fuel efficiency and higher overload capacity by building strong chassis for its vehicles.

Industry Domestic sales volume of three-wheelers (passenger and goods carriers) grew at a modest CAGR of 4% from ~0.44mn units in FY10 to ~0.54mn units in FY15. Export sales volume (passenger & goods carriers), on the other hand, posted a robust CAGR of 19%. The volume increased from ~0.17mn units in FY10 to ~0.40mn units in FY15.

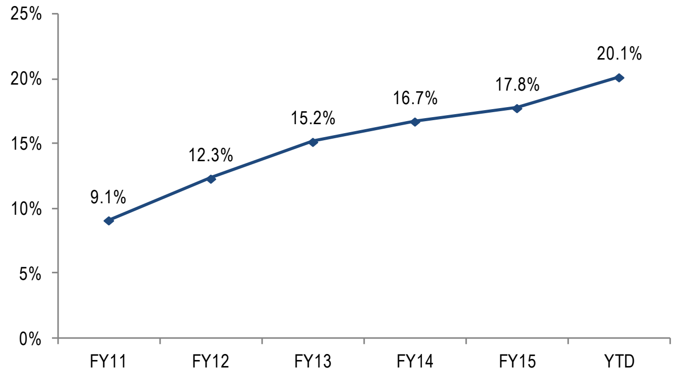
Despite a challenging growth environment in India, AAL's domestic sales volume posted a strong CAGR of 27% from ~12,000 units in FY10 to ~40,000 units in FY15. In the past 44 months, domestic industry had 20 negative growth periods while AAL barely had one. Improvement in volume, better as well as an enhanced product mix, and benign operational costs are expected to improve AAL's gross margin by 290bps from 24.5% in FY15 to 27.3% in FY18E.

Exhibit 19: Market share - Domestic passenger vehicle



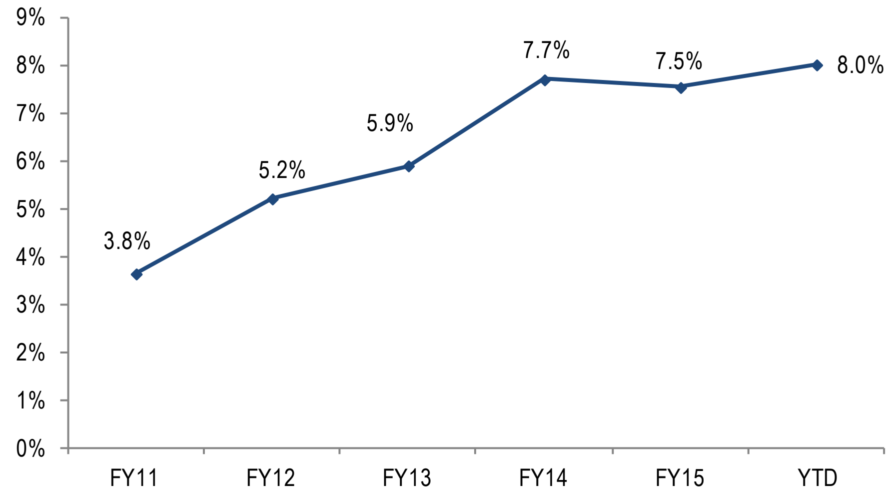
Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 20: Market share - Domestic cargo vehicle



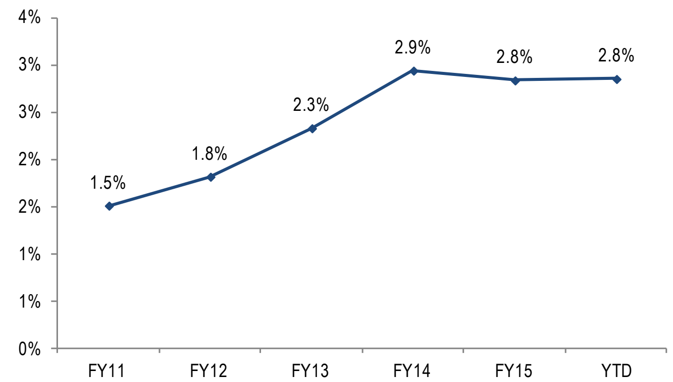
Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 21: Market share - Domestic [passenger + cargo]



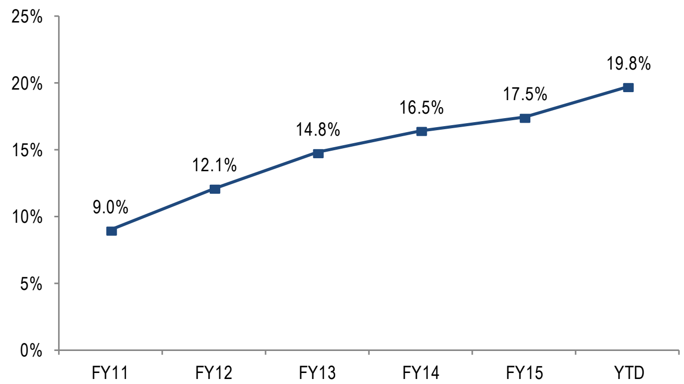
Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 22: Market share - Passenger three-wheelers (domestic + exports)



Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 23: Market share - Cargo three-wheelers (domestic + exports)



Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 24: Market share – Three Wheeler Domestic (passenger + cargo)

Market share - Domestic (%)	FY11	FY12	FY13	FY14	FY15	YTD
Piaggio Vehicles	39%	36%	34%	35%	32%	31%
M&M	12%	13%	12%	13%	11%	11%
Atul Auto	**4%**	**5%**	**6%**	**8%**	**8%**	**8%**
Bajaj Auto	39%	40%	42%	39%	44%	46%
Scooters India	4%	3%	3%	3%	3%	3%
Force Motors	3%	3%	3%	3%	2%	2%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 25: Market share – Domestic cargo vehicles

Market share - Dom. cargo (%)	FY11	FY12	FY13	FY14	FY15	YTD
Piaggio Vehicles	63%	55%	53%	52%	53%	54%
M&M	16%	17%	21%	23%	23%	21%
Atul Auto	**9%**	**12%**	**15%**	**17%**	**18%**	**20%**
Bajaj Auto	4%	7%	3%	0%	0%	0%
Scooters India	7%	9%	9%	8%	6%	5%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

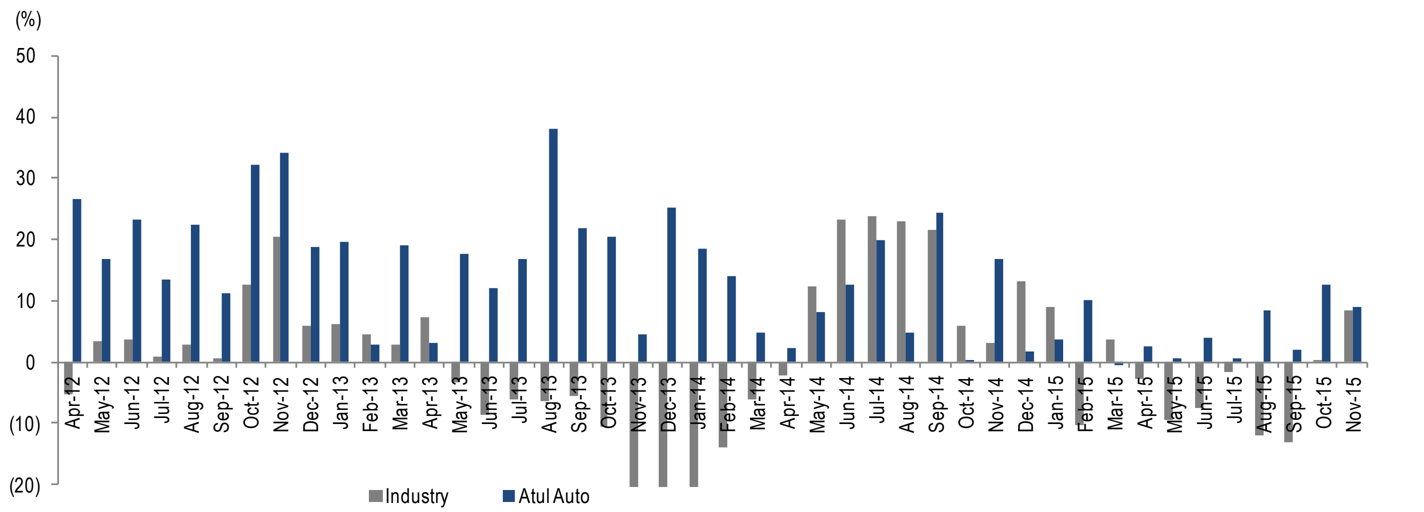
Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 26: Market share – Domestic passenger vehicles

Market share - Dom. passenger (%)	FY11	FY12	FY13	FY14	FY15	YTD
Bajaj Auto	47%	48%	51%	49%	54%	55%
Piaggio Vehicles	33%	31%	30%	30%	27%	26%
M&M	11%	12%	10%	11%	8%	9%
Atul Auto	2%	3%	4%	5%	5%	5%
TVS Motor	5%	3%	4%	3%	4%	4%
Scooters India	2%	2%	2%	2%	1%	1%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 27: AAL consistently outperforms domestic industry's growth – Monthly growth (%)

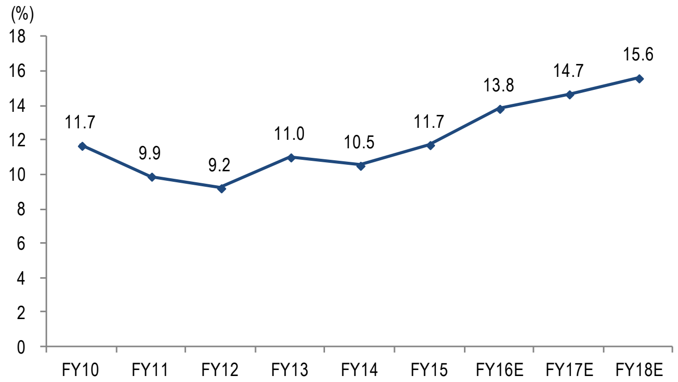


Source: SIAM, Nirmal Bang Institutional Equities Research

EBITDA margin likely to expand 390bps to 15.6% over FY15-FY18E

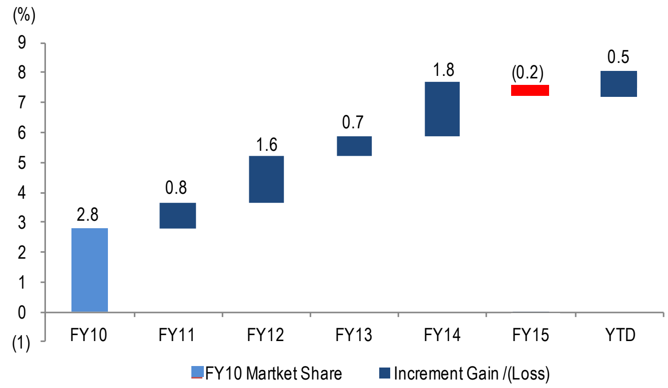
AAL has been consistent in volume growth and improvement in operating margin following better economies of scale and improved operating efficiency. EBITDA margin has been improving consistently from 9.6% in FY11 to 11.7% in FY15. We believe that with further increase in volume, AAL should be able to increase its operating margin by 390bps to 15.6% over FY15-FY18E.

Exhibit 28: Expect steady increase in EBITDA margin



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 29: Incremental gain in domestic market share



Source: SIAM, Nirmal Bang Institutional Equities Research

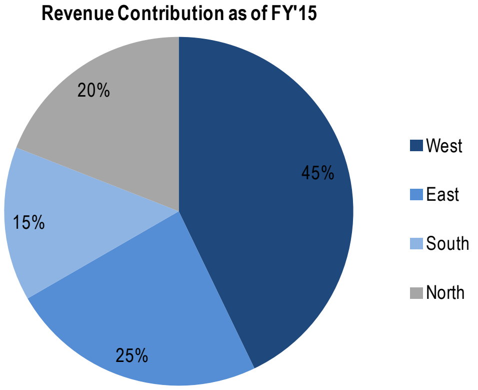
Expansion in dealer network to drive volume over FY16-FY18E

AAL's core strength lies in its deep market penetration. Gujarat market, which the company has deeply penetrated, remained an undisputed market leader for the past decade-and-a-half with revenues from the state contributing as much as 32%-33% to total revenues in FY15. Apart from Gujarat, Jharkhand, Rajasthan, Bihar, Orissa and Maharashtra remain key states for AAL, with each contributing anywhere between 5% to 8% total revenues. AAL is witnessing good growth visibility in eastern states and has been growing at a healthy rate. The company, which started its operations in Gujarat in 1970s, has penetrated the market deeply there with ~21 dealers. Orissa and Bihar, other high revenue generators for AAL, have 12-15 dealers each.AAL has very low market penetration in South India and has got ~50 dealers in the region. Thus there is a huge scope for AAL to penetrate into hinterlands in South India, which is one of the biggest domestic markets for three-wheelers. The company is also improving its focus on emerging towns and has established a network in towns such as Kota, Alwar, Bikaner and Nanded. Beginning last year, the company forayed into key markets such as Mumbai, Delhi and Bengalaru.

AAL increased its dealer network by a healthy CAGR of 17% over FY11-FY15. By the end of FY15, the company had a dealer network consisting of 320 dealer touch-points, including 200 primary dealers and 120 sub-dealers. The management is determined to increase dealer touch-points by at least 20-25 YoY.

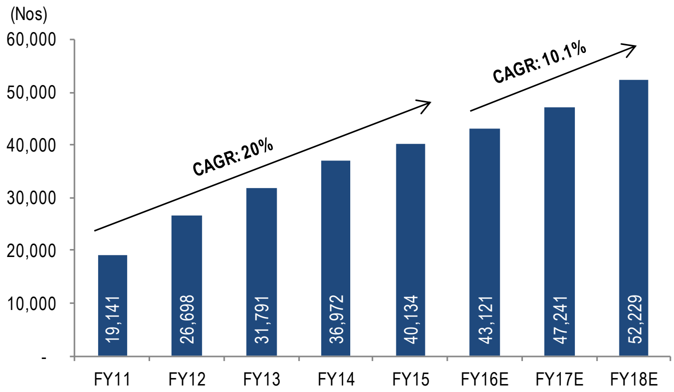
Good dealer network is one of the key reasons why AAL has been able to capture market share from the likes of Piaggio. Firstly, dealers who want to be part of AAL's dealer network are mandated to have a decent showroom coupled with good servicing capability and infrastructure. Monthly sales targets are set mutually between the dealers and AAL. The company asks the dealer to quit if the mandates from it are not respected. Normal churn ratio of dealers is ~10% a year. Secondly, dealer size is much smaller when compared to the dealer size of its competitors. Thirdly, AAL has three training centres – Ranchi, Vishakhapatnam and Rajkot - which provide training to dealers and dealers' mechanics. Post sales maintenance is key determinant in making a three-wheeler vehicle purchase. Given the amount and quality of product and product maintenance training provided to dealers, we believe that with further dealer network penetration, AAL will be able to capture more market share from existing players. Finally, AAL has tied up with Bank of India (BoI) and IDBI Bank to enable channel financing for its dealers. This is a unique proposition which provides dealers with a stop-gap arrangement and handles their working capital needs. In case of BoI and IDBI Bank, the sanction limit is Rs1.0bn and Rs0.5bn, respectively. With the current scale and size of AAL's network, it can make further inroads and increase market penetration by optimising new dealerships.

Exhibit 30: Region-wise revenue contribution



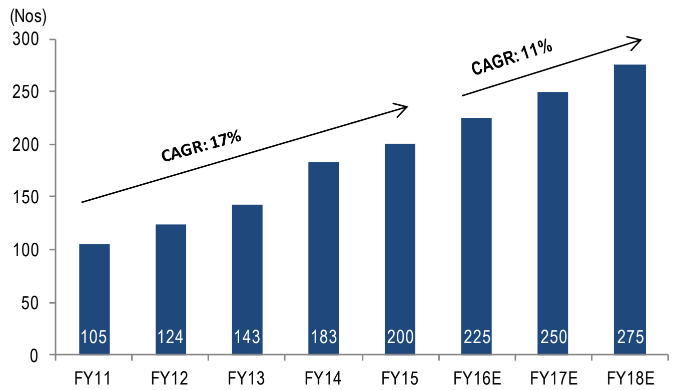
Source: Company

Exhibit 31: Domestic sales volume



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 32: Primary dealers



Source: Company, Nirmal Bang Institutional Equities Research

Better understanding of its customers and higher customer-level engagement allowed AAL to expand its operations from Gujarat to 10 other states by the end of FY09, and to as many as 18 states and 200 cities by the end of FY15. Reaching out to customers in person in the hinterlands of India is very crucial in understanding customer satisfaction levels. Prominent way of generating incremental sales in rural regions is through word-of-mouth referrals by existing customers. Gaining the trust of rural consumers can reinforce marketing message. AAL has dedicated rural executives at dealers who travel deeper into small towns and cities to build relationships. Through this initiative, AAL has been able to increase customer satisfaction and engagement level. AAL also launched a new initiative called 'Atul Sahay' under which it provided certified training to 500 key technicians across India for service touch-points. These technicians are provided with AAL's spare parts. Equipped with spare parts and the required training, Atul Sahay will act as a first port of call for customers. This is extremely helpful for customers located in rural pockets of India who have to travel all the way to the cities for maintenance work. Apart from the above factors, what helps to distinguish AAL from its competitors in terms of good service is the warranty period. AAL provides a warranty period of 24 months compared to 12 months and 8 months provided by Bajaj Auto and Piaggio, respectively.

We believe that with increased dealer penetration across India, AAL will improve its customer reach and increase brand awareness as well as brand loyalty. With increased reach and brand loyalty, we expect AAL to benefit from incremental volume.

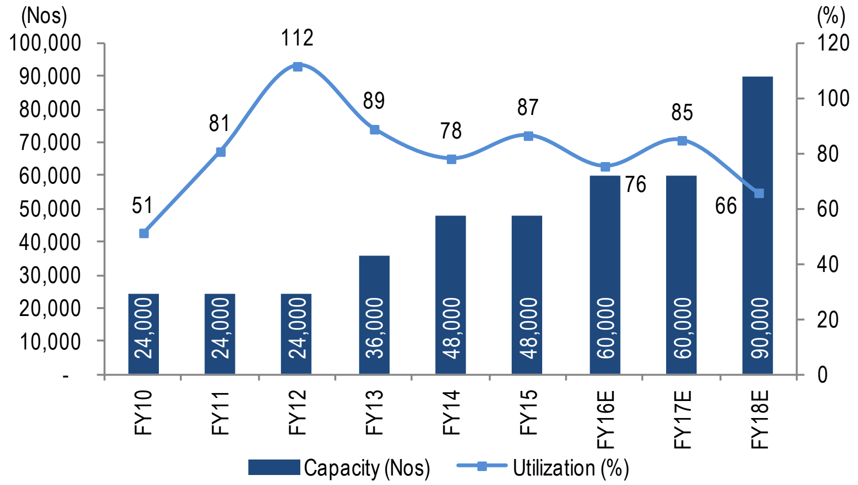
Doubling capacity via greenfield expansion

Last year, AAL installed a paint shop, which was a major bottleneck at its existing manufacturing unit in Shapar, Rajkot. By removing the bottleneck at its Rajkot plant, AAL was able to expand its existing capacity from 48,000 units per annum to 60,000 units per annum from June 2015. The company has procured land in Ahmedabad for its future expansion. Capex required for the plant will be managed through internal accruals. The management expects remaining capex for its Ahmedabad plant to be Rs1.2bn, which will be incurred during the remaining part of FY16E, FY17E and FY18E. Capex for FY16E/FY17E/FY18E is expected to be Rs.220mn/Rs.500mn/Rs.500mn, respectively. As of now, Rs.0.4bn has been spent on the plant. The company intends to start building the plant from January 2016.

In terms of operations, the plant will be similar to the one in Rajkot, except for the fact that flow at the new plant will be better than the flow at its existing plant. The Rajkot plant is expected to be operational by 1HFY18.Capacity expansion is expected to be in incremental phases - first 30,000 units to be added by 1HFY18 and the next 30,000 units by the end of FY19, subject to the demand situation at that time.

AAL has consistently increased its capacity from 24,000 units per annum in FY10 to 60,000 units per annum at the end of 1QFY16. With the launch of petrol/CNG variants and rising demand from export markets, we believe there is huge scope for the company to ramp up its export business. With improved scale, we believe AAL will have better bargaining power with its vendors. The company procures its diesel engines, which constitute ~30% of total raw material costs, from Greaves Cotton. Given the relatively smaller scale of AAL, it has to pay 5% more on Greaves Cotton engines than what Piaggio pays to Greaves Cotton. We expect this pricing premium to decline as AAL scales up its business.

Exhibit 33: Capacity and capacity utilisation levels



Source: Company, Nirmal Bang Institutional Equities Research

Competitor Analysis

Atul Auto versus Bajaj Auto

Bajaj Auto operates in multiple segments (motorcycles, three-wheelers and cars) while AAL, a much smaller player, operates only in three-wheeler segment. Bajaj Auto stopped selling goods carriers since FY14 and currently operates only in passenger vehicle segment as against AAL, which operates in both segments. Bajaj Auto has been industry pioneer and a leading three-wheeler exporter in the past four decades. Bajaj Auto's capacity in three-wheelers is over 600,000 units per annum at Waluj plant in Aurangabad as against AAL's 60,000 units per annum. Given its capability to do in-house development of three-wheeler engines and also the ability to achieve high economies of scale due to large scale of operations, Bajaj Auto enjoys much higher EBITDA margin (~30.0%) than AAL (11.7% in FY15). The company enjoys a near monopoly in auto-rickshaws in urban and permit markets (~1,50,000 units). Well established brands and a deeply entrenched distribution network allowed Bajaj Auto to maintain a market share of 55% in domestic passenger segment as of FY16 (YTD).

Comparing AAL with Bajaj Auto: Given AAL's relatively smaller scale and being a younger player, AAL enjoys a growth rate higher than the industry average and Bajaj Auto. Bajaj Auto's three-wheeler passenger vehicle volume grew 4.7% while AAL's volume grew 22.6% over FY11-FY15. Bajaj Auto sold ~518,000 units (domestic ~2,34,000, export ~2,84,000 units) while AAL sold a total of ~41,600 units including 23,700 units of passenger vehicles in FY15.

Atul Auto versus Piaggio

Piaggio & C. Spa is an Italian automobile company which operates in India through Piaggio Vehicles Pvt. Ltd. Piaggio Vehicles, a much larger outfit than AAL and market leader in three-wheeler cargo vehicle segment, is the second-biggest entity in passenger vehicle segment in domestic market. Piaggio, unlike AAL, is not a pure player in three-wheeler segment. It sells two-wheeler, three-wheeler (passenger and cargo vehicles) and four-wheeler cargo. It is one of the strongest players in LCV segment, producing popular brands such as Maxx, Maxximo and Gio.

Piaggio sells three-wheeler cargo vehicles under brand names – Ape XTRA & Ape XTRA LD, while three-wheeler passenger vehicles are sold under brand names – Ape City 200 (petrol/CNG/LPG), Ape City Compact Diesel and Ape XTRA DLX (diesel/CNG/LPG). The company focuses on 0.50tn and 0.75tn three-wheeler cargo vehicle segments. Piaggio has a widespread dealer network with around 290 dealers and 425 authorised after-sales centres.

Piaggio as of FY16 (YTD) enjoys a market share of 26% in domestic passenger segment and 54% in domestic cargo segment, although it has been losing market share over the past five years, mainly because of the loss of share in diesel goods carrier segment. In FY15, it sold ~1,43,000 units in passenger segment and ~55,300 units in goods carrier segment.

AAL versus other domestic players

Given that AAL mostly operates in domestic market with exports contributing a meager 3.5% to its total volume, comparing its peers in domestic market will be a fair comparison. Other major domestic players operating in the three-wheeler segment are Mahindra & Mahindra (M&M), TVS Motor Company and Scooters India. As a whole, other domestic players have lost sizable market share in domestic passenger segment from 18% in FY11 to 13% in FY15. AAL has been one of the beneficiaries of this by more than doubling its market share from 2.4% in FY11 to 5.2% in FY15. In domestic goods carrier segment, contribution by other players has more or less stayed stagnant at 29% as of FY15-end. Stagnant market share of these players and a declining market share of Piaggio in this segment allowed AAL to gain market share from 9% in FY11 to 18% in FY15. TVS Motor Company has been one of the better performers among the pack of other domestic players. It gained major traction in three-wheeler passenger segment, thanks mainly to exports, where it has increased market share from 5.7% in FY11 to 12.9% in FY15. Exports account for 84% of TVS Motor Company's volume, while the rest comes from domestic market.

Exhibit 34: Quarterly performance

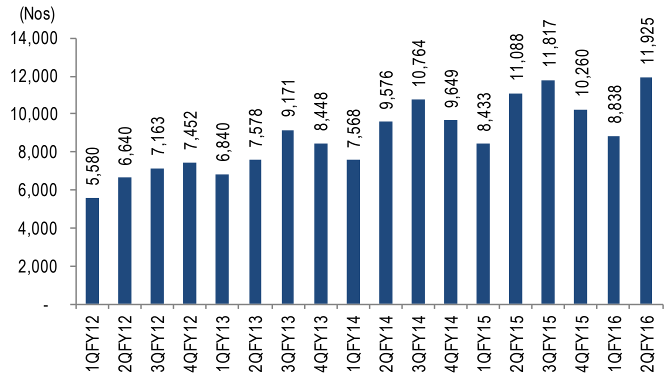
Y/E March (Rsmn)	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15	4QFY15	1QFY16	2QFY16
Total sales	1,231	1,126	997	1,313	1,393	1,225	1,068	1,429
Raw material costs	946	868	759	995	1,050	919	784	1,044
Employee costs	70	69	80	82	81	81	93	94
Other expenses	66	72	63	78	86	76	72	71
Total expenditure	1,081	1,008	902	1,155	1,217	1,076	949	1,209
EBITDA	149	118	96	158	177	149	119	219
EBITDA margin (%)	*12.1*	*10.5*	*9.6*	*12.0*	*12.7*	*12.2*	*11.1*	*15.3*
Depreciation	14	13	15	14	13	14	13	13
Interest costs	1	0	1	2	1	2	1	6
PBT	144	112	135	151	170	137	108	204
Tax	48	28	38	41	57	51	37	69
Net profit	97	84	97	110	113	86	71	135
NPM (%)	*7.9*	*7.5*	*9.7*	*8.4*	*8.1*	*7.0*	*6.7*	*9.4*
EPS (Rs)	4.4	3.8	4.4	4.9	5.0	3.9	3.2	6.1

Source: Company, Nirmal Bang Institutional Equities Research

Metrics	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15	4QFY15	1QFY16	2QFY16
Vehicles sold (Nos.)	10,764	9,649	8,433	11,088	11,817	10,260	8,838	11,925
Average realisation (Rs)	114,316	116,675	118,273	118,371	117,906	119,376	120,797	119,807
RM costs as % of sales	*76.8*	*77.1*	*76.1*	*75.8*	*75.3*	*75.0*	*73.4*	*73.1*
EC as % of sales	*5.7*	*6.1*	*8.0*	*6.3*	*5.9*	*6.6*	*8.8*	*6.6*
OE as % of sales	*5.3*	*6.4*	*6.4*	*6.0*	*6.2*	*6.2*	*6.8*	*5.0*
Gross margin (%)	*23.2*	*22.9*	*23.9*	*24.2*	*24.7*	*25.0*	*26.6*	*26.9*
EBITDA margin (%)	*12.1*	*10.5*	*9.6*	*12.0*	*12.7*	*12.2*	*11.1*	*15.3*
PAT Margin (%)	*7.9*	*7.5*	*9.7*	*8.4*	*8.1*	*7.0*	*6.7*	*9.4*

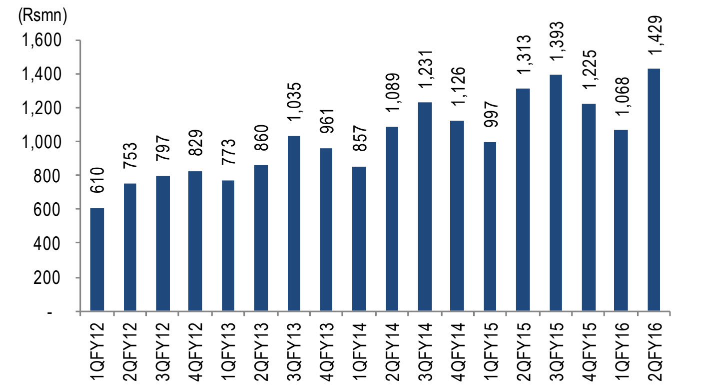
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 35: Quarterly sales volume



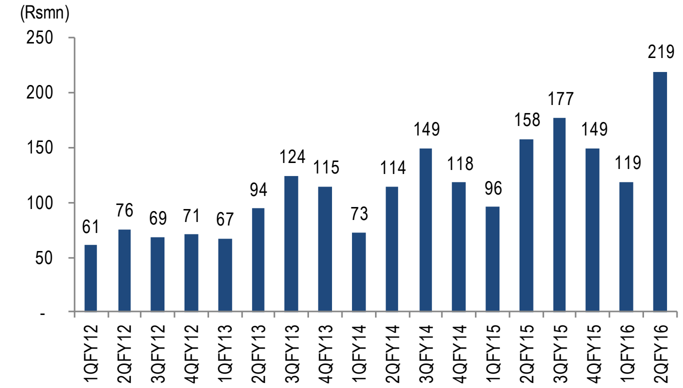
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 36: Quarterly net sales



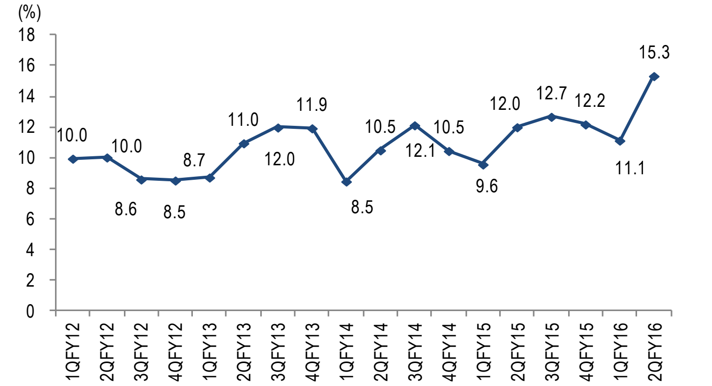
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 37: Quarterly EBITDA – strong double-digit growth in 2QFY16 backed by strong volume growth YoY and QoQ



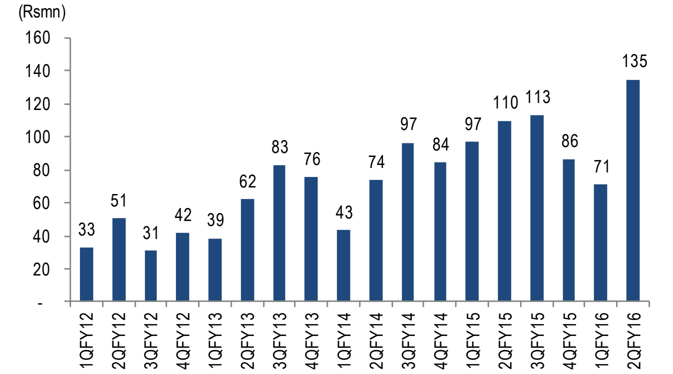
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 38: Quarterly EBITDA margin (%) – Life-time high margin in 2QFY16



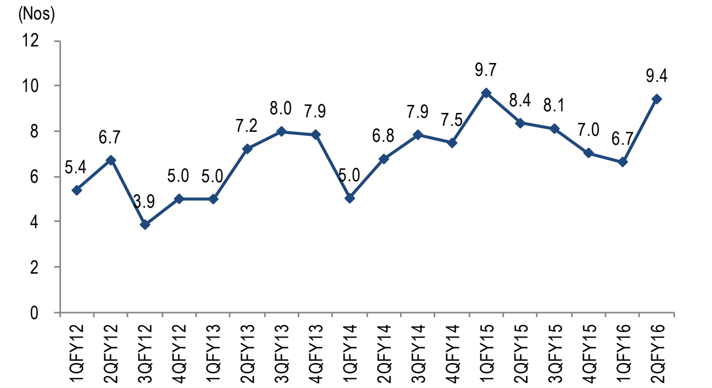
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 39: Quarterly PAT



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 40: Quarterly PAT margin (%)

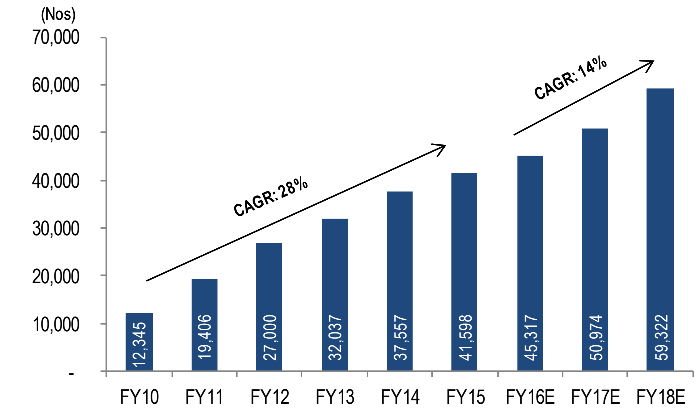


Source: Company, Nirmal Bang Institutional Equities Research

Strong earnings growth of 23% likely over FY16E-FY18E

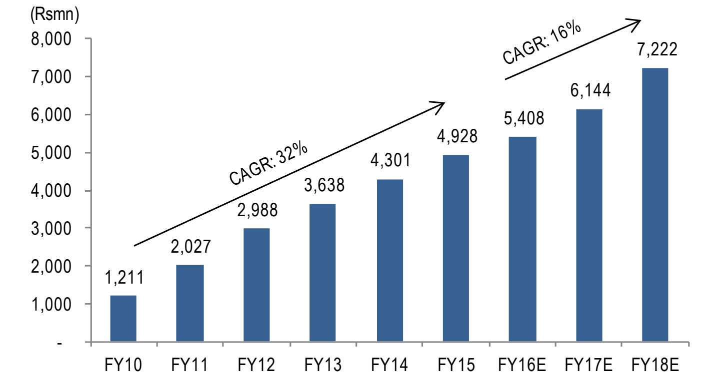
AAL increased its volume by a robust CAGR of 28% over FY10-FY15. We expect total volume growth to be 14% over FY16E-FY18E. With improvement in volume, higher contribution from export markets (higher realisation) and benign operational costs, we expect gross margin to expand 290bps from 24.5% in FY15 to 27.3% in FY18E. Also, improving operational efficiency and accruing benefits of operating leverage will drive EBITDA margin up 390bps from 11.7% in FY15 to 15.6% in FY18E. This is expected to drive earnings CAGR of 23% over FY16E-FY18E.

Exhibit 41: Yearly total sales volume – Expect a 14% CAGR over FY16E-FY18E



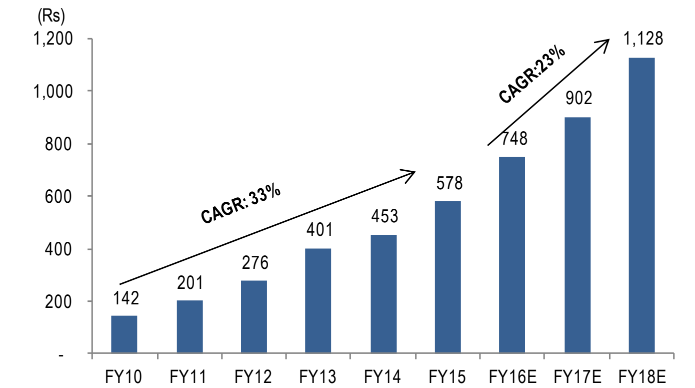
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 42: Yearly net sales – Following strong volume growth, we expect a 16% CAGR over FY16-FY18E



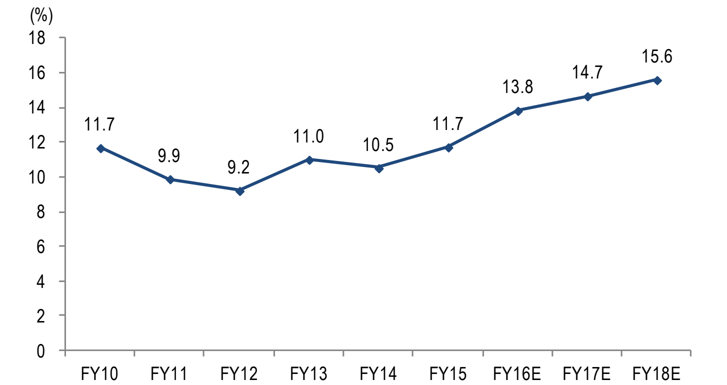
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 43: Yearly EBITDA



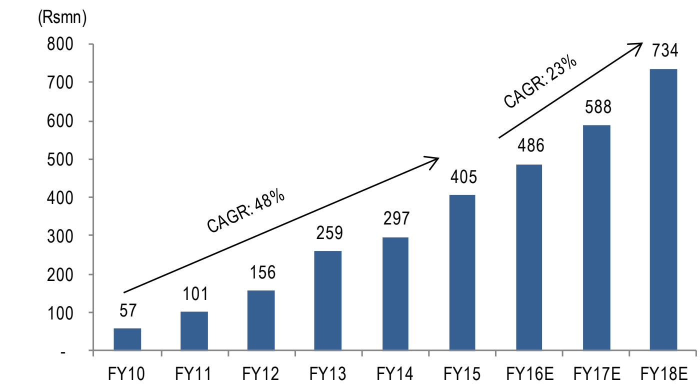
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 44: Yearly EBITDA margin (%) – Expected to improve 390bps over FY15-FY18E



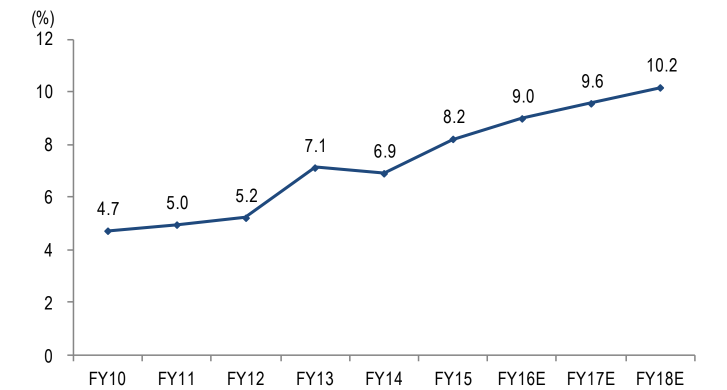
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 45: Yearly PAT



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 46: Yearly PAT margin (%)

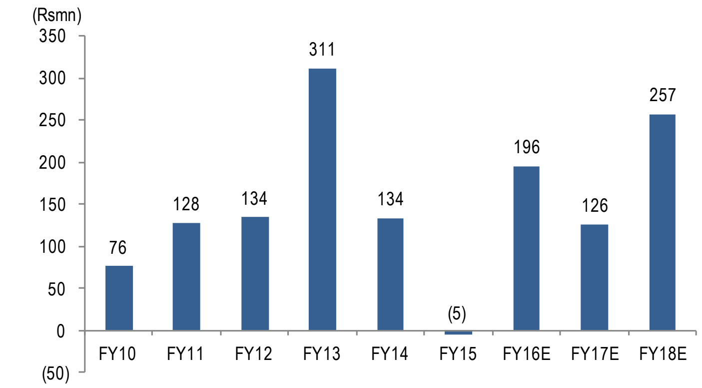


Source: Company, Nirmal Bang Institutional Equities Research

AAL's excellent operating capabilities offer a high margin of safety

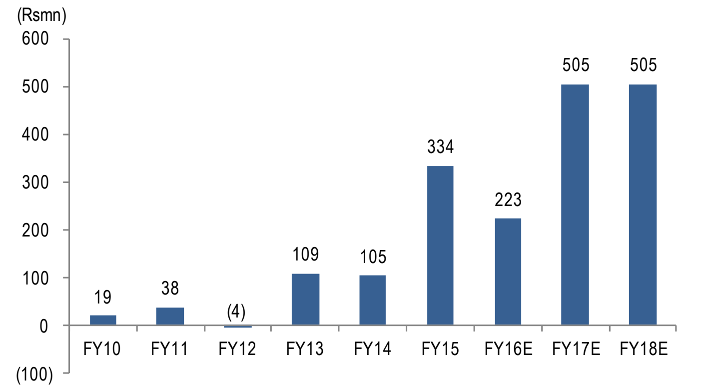
AAL's management remains extremely prudent in balancing liquidity on the balance sheet and earning adequate returns as well as covering financial and business risks. AAL has been a healthy free cash flow generator and maintained a debt-free status since 2013. Internal cash flow of the company has more than adequately covered working capital requirements, capital expenditure and dividend payment. The company has completed the process of acquiring 54 acres of land in Ahmedabad for its future expansion. Total expenses incurred on this expansion plan as of 1HFY16-end was ~Rs.510mn, while another ~Rs1.15bn will be spent over FY16- FY18E. Despite heavy capex requirement, AAL will still be able to generate healthy FCF over FY16E-FY18E.

Exhibit 47: Free cash flow



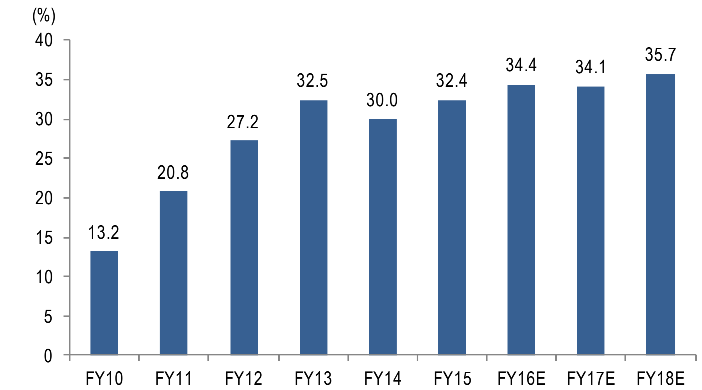
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 48: Capital expenditure



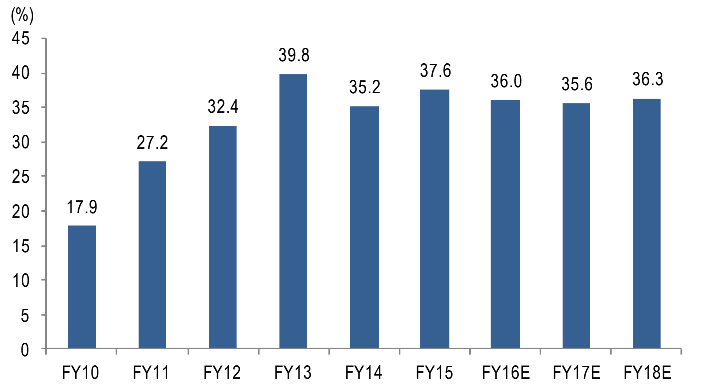
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 49: Return on capital employed



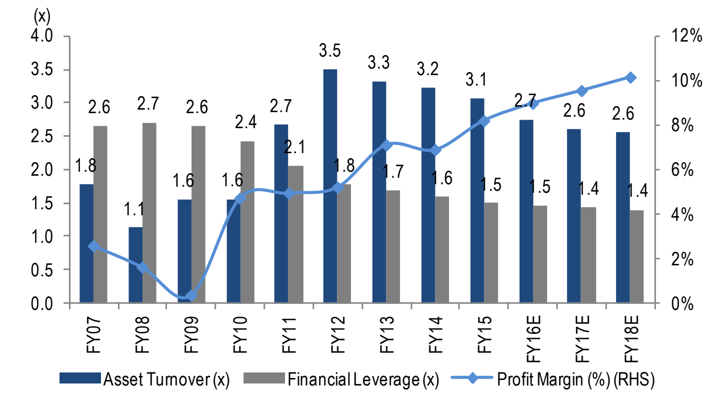
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 50: Return on equity



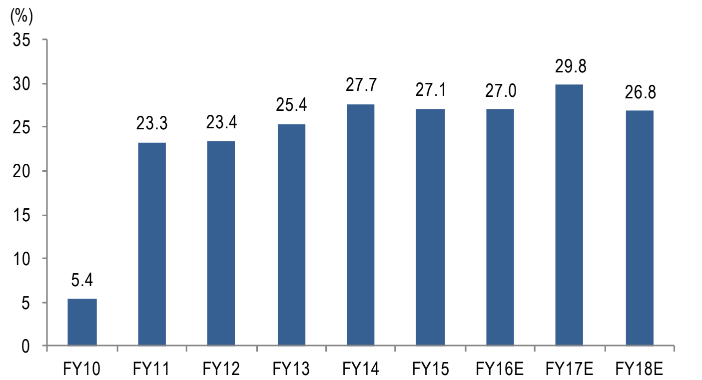
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 51: Return on equity-DuPont analysis



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 52: Dividend payout ratio



Source: Company, Nirmal Bang Institutional Equities Research

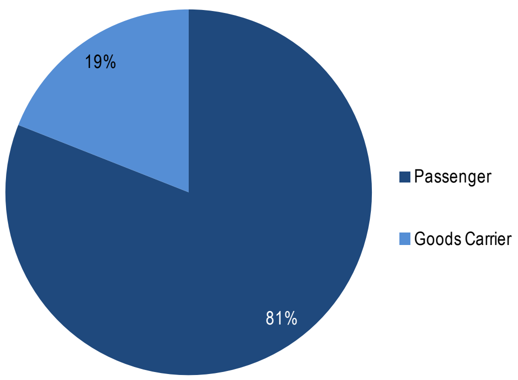
AAL has strong return ratios (30 %+) and it generated PAT at a staggering rate of 48% over FY10-FY15. PAT margin also increased from 3.8% in FY10 to 8.2% in FY15. We expect PAT margin to touch 10% by FY18.

The company has consistently improved its RoE from 14.0% in FY10 to 37.6% in FY15. We expect RoE to remain in higher 30s and expect it to be ~36% in FY18E.

Indian three-wheeler industry - Overview

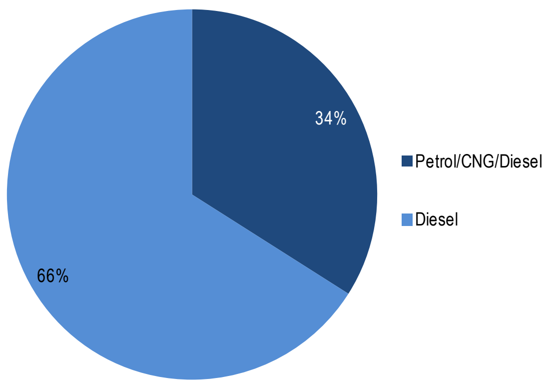
India is the world's foremost producer, user and exporter of three-wheelers with domestic sales at 532,093 units and export volume at 408,181 units in FY15. Three-wheelers are one of the most affordable means for short-to-medium distance public transportation and also reliable means of last mile connectivity for goods transportation. Apart from domestic demand, India has emerged as an export hub for three-wheeler exports to some parts of Africa, Latin America and South Asia. Demand in these export markets is increasing mainly because of rising disposable income of the population, lack of road infrastructure and general acceptability of Indian three-wheelers with petrol/alternative fuel engines. Domestic volume grew at a moderate pace over FY07- FY15 with a CAGR of 4%. Domestic cargo three-wheeler volume declined 6% while passenger three-wheeler volume posted a 8% CAGR over the same period. Export markets have been a huge relief for the slowing Indian three-wheeler industry, a market where volume growth has been robust with a CAGR of 14% over same period. Overall, Indian three-wheeler industry grew 7% in volume terms over FY07 – FY15. India's three-wheeler industry is largely dominated by passenger vehicles with ~81% of total volume coming from it and the rest from cargo vehicles. As much as 34% of domestic three-wheelers have petrol/CNG/LPG engines while 66% use diesel engines. On the other hand, export volume mainly constitutes passenger vehicles, accounting for ~99% of total volume. Around 93% of three-wheelers meant for exports use petrol engines while the remaining use diesel engines. Tonnage-wise, 94% of total three-wheelers exported are of 0.35tn and the rest are of 0.50tn, while the domestic market is more evenly split with 53% being 0.35tn and 47% being 0.50tn.

Exhibit 53: Domestic three-wheelers - Application



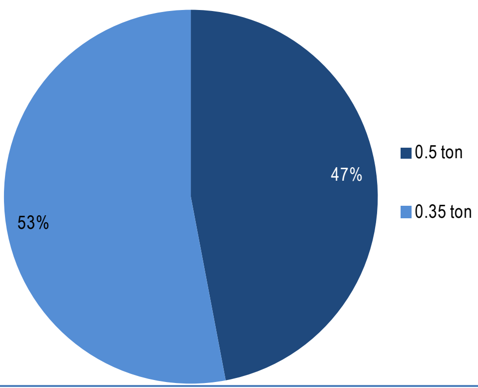
Source: Company

Exhibit 54: Domestic three-wheelers – Fuel type



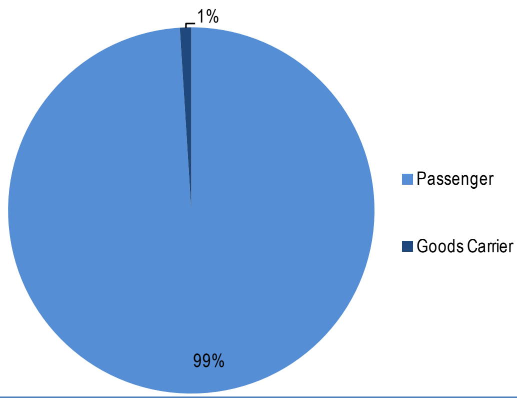
Source: Company

Exhibit 55 : Domestic three-wheelers – Tonnage



Source: Company

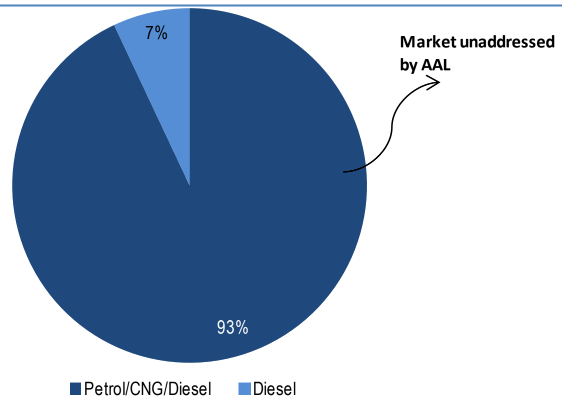
Exhibit 56: Three-wheeler exports - Application



Source: Company

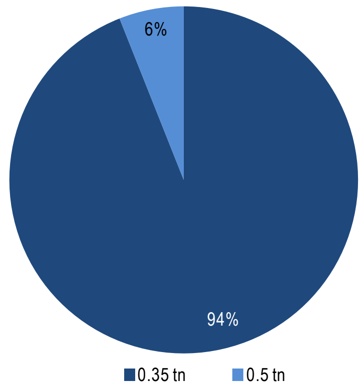
Domestic three-wheeler industry faced headwinds over FY12-FY14, a period characterised by high interest rates, high fuel and commodity prices and low GDP growth. As a result, domestic vehicle sales volume remained flattish, growing by a meager 1.3% over FY12-FY15. Last financial year was extremely good for domestic three-wheeler industry. Interest rates declined 125bps from a high of 8.00% in January 2014 to 6.75% in November 2015, global crude oil prices (Brent) per barrel declining from a high of US$107/bbl in March 2014 to a low of US$37/bbl in November 2015, GDP growing from 4.4% in March 2014 to a high of 7.5% in FY15 and global commodity prices languishing at low levels. Better macro-economic factors coupled with a good monsoon led to robust domestic volume growth of 10.9% in FY14-FY15.

Exhibit 57: Three-wheeler exports – Fuel type



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 58: Three-wheeler exports – Tonnage



Source: Company

Exhibit 59: Three-wheeler industry's sales

Market segment	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY14-15
Domestic: 3W passenger carriers	237,175	234,774	268,463	349,868	428,522	406,242	441,096	384,999	432,093	12.2%
Domestic: 3W goods carriers	166,735	130,007	81,264	90,524	97,499	105,894	97,197	94,698	99,691	5.3%
Total: Domestic	***403,910***	***364,781***	***349,727***	***440,392***	***526,021***	***512,136***	***538,293***	***479,697***	***531,784***	**10.9%**
Exports: 3W passenger carriers	142,944	140,406	146,914	172,468	268,435	360,736	300,473	351,442	405,594	15.4%
Exports: 3W goods carriers	952	819	1,152	746	1,533	1,939	2,615	1,950	2,587	32.7%
Total: Exports	***143,896***	***141,225***	***148,066***	***173,214***	***269,968***	***362,675***	***303,088***	***353,392***	***408,181***	**15.5%**
Total 3W sales	***547,806***	***506,006***	***497,793***	***613,606***	***795,989***	***874,811***	***841,381***	***833,089***	***939,965***	**12.8%**
Total: 3W passenger carriers	**380,119**	**375,180**	**415,377**	**522,336**	**696,957**	**766,978**	**741,569**	**736,441**	**837,687**	**13.7%**
Total: 3W goods carriers	**167,687**	**130,826**	**82,416**	**91,270**	**99,032**	**107,833**	**99,812**	**96,648**	**102,278**	**5.8%**
Export: Domestic	**26%**	**28%**	**30%**	**28%**	**34%**	**41%**	**36%**	**42%**	**43%**	-
Export contribution	26.3%	27.9%	29.7%	28.2%	33.9%	41.5%	36.0%	42.4%	43.4%	-
3W goods carriers' contribution	30.6%	25.9%	16.6%	14.9%	12.4%	12.3%	11.9%	11.6%	10.9%	-

Source: SIAM, Nirmal Bang Institutional Equities Research

Export markets to remain key growth lever for Indian three-wheeler industry, especially Africa and Latin America

Lack of proper public transportation system, underdeveloped transportation and logistics infrastructure, lower per capita income, rising unemployment etc. are some key factors which contributed to the growth of three-wheeler sales in developing and underdeveloped countries. Underdeveloped countries in Africa like Nigeria, Tanzania, Mozambique and Egypt and Asian counterparts like Nepal, Bangladesh, etc. are therefore emerging as favourite markets for leading three-wheeler manufacturers. Three-wheelers offer an efficient, quick and economical way of transportation especially in areas where buses, taxis, trucks etc, cannot penetrate.

Export markets have become key growth lever for India's three-wheeler industry in the past 10 years. Except for FY08 and FY13, which saw YoY decline of 2% and 16%, respectively, FY07-FY15 showed positive growth in export markets. Export volume posted a robust CAGR of ~14% over FY07-FY15. Contribution of exports to total volume steadily increased from 26% in FY07 to 49% in 1HFY16. The key demand drivers in export markets include rising disposable income, improved road infrastructure and increased demand for motorised transport. Three-wheeler manufacturers, mainly Bajaj Auto, TVS Motor Company and Piaggio have established themselves as strong brands with a good product portfolio. Passenger three-wheelers contribute the most (>99% of three-wheeler exports comprise passenger vehicles) to total export volume, while cargo three-wheelers are in nascent stage.

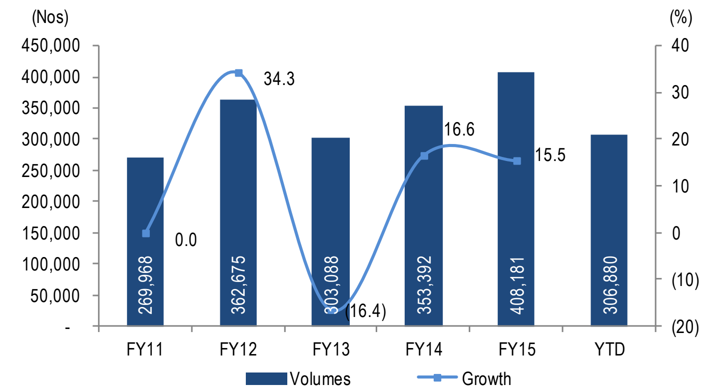
Bajaj Auto and TVS Motor Company remain two of the biggest players in export markets with 70% and 22% market share, respectively, in FY15. India and China are the only manufacturers of three-wheelers in the world. Chinese three-wheeler manufacturers compete with Indian counterparts purely on cost basis, but Indian three-wheelers are far better than Chinese ones in terms of quality. As a result, Indian manufacturers face little international competition in passenger three-wheeler segment.

Within export markets, Africa has remained one of the biggest markets accounting for 45-50% of total three-wheeler exports. Rising population, improved road infrastructure and complete lack of public transportation systems increased the demand for Indian three-wheelers significantly in the recent past in Africa. Nigeria, Kenya, Egypt and Tanzania remain key three-wheeler markets in Africa.

Latin America market is one of the other key markets for Indian three-wheelers. Three-wheelers accounted for US$63mn of total US$1.82bn of automobile exports by India to Latin American countries in FY15. Peru is the leading destination for three-wheeler exports at US$35mn. Other export markets include Mexico, Colombia and Central America. Bajaj Auto TVS Motor Company and Piaggio have established their brands successfully in these regions. As millions of people are coming out of the poverty line, mainly because of pro-poor government policies such as cash transfers, there will be incremental demand for Indian three-wheelers from these markets. Brazil, Argentina and Venezuela still remain virgin markets for Indian automobile exporters because of import restrictions. With less restrictive import regulations and improving economies, there is significant scope for Indian three-wheeler exporters. Overall, African and Latin American markets provide a promising long-term opportunity and possess the capability to replicate the same three-wheeler growth trajectory witnessed in India over the past few decades.

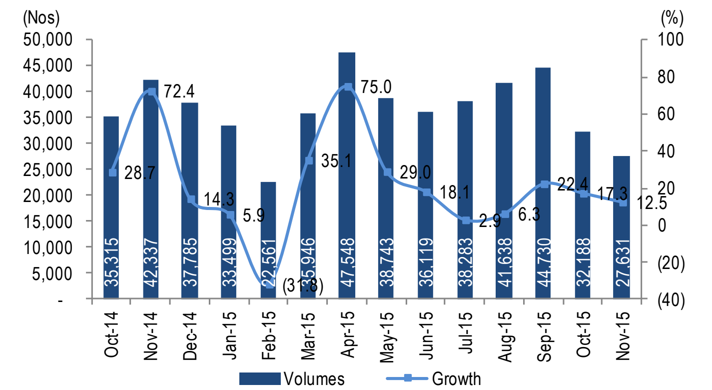
Apart from Africa and Latin America, Sri Lanka has witnessed rapid development and seen a surge in three-wheeler sales because of strong pent-up demand. Bangladesh, Indonesia and Philippines migrated from two-stroke to four-stroke vehicles because of increased environmental awareness. As a result of this, these markets are growing at a decent pace.

Exhibit 60: Industry Three-wheeler exports-Yearly



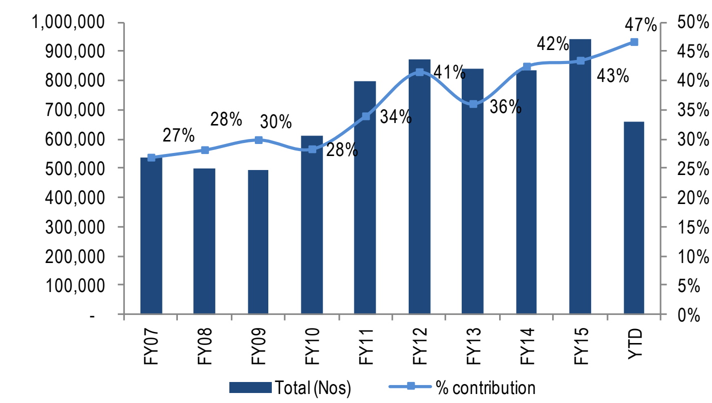
Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 61: Industry Three-wheeler exports -Monthly



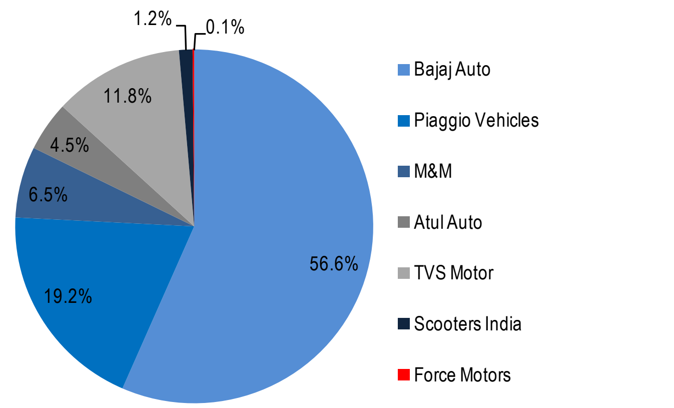
Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 62: Export contribution to total volume



Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 63: Three Wheeler Industry market share (Domestic + Export) – FY15



Source: SIAM, Nirmal Bang Institutional Equities Research

Sound business economics of three-wheeler goods carrier than four-wheeler LCV should keep three-wheeler goods carriers relevant in the market

Domestic three-wheeler goods carriers do not require permits to be on road and hence this segment is much more dynamic than passenger three-wheelers which, to a certain extent, is regulated through state permits. Restriction on entrance of heavy commercial vehicles in certain cities led to Hub and Spoke model, wherein heavy trucks transport goods to the outskirts of the city and light trucks (three-wheelers/four-wheelers) redistribute goods within the city. Rapid economic growth, improved road infrastructure and growth in FMCG, consumer and retail sectors, accompanied by the need for last mile delivery of goods, and capability to easily maneuver the vehicles across narrow lanes to the final destination led to robust growth in three-wheeler goods carriers over FY02-FY07 (32% CAGR). However, global financial meltdown, slowdown in domestic economy and competition from new segment i.e. four-wheeler LCV, led to a decline in three-wheeler goods carrier sales over FY07-FY09. Volume declined from ~167,000 units in FY07 to ~81,200 units in FY09.

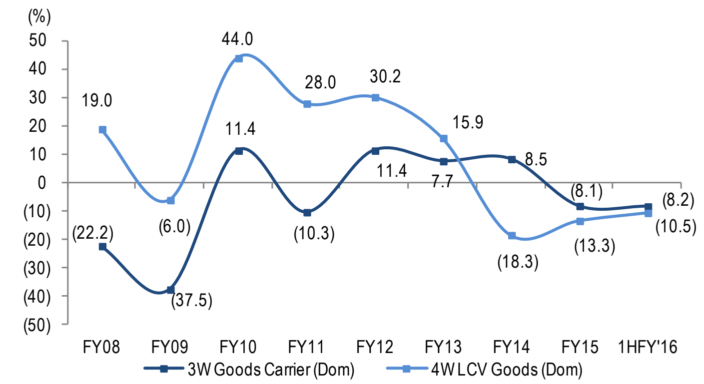
In May 2005, Tata Motors launched Tata Ace, India's first four-wheeler mini truck under sub-1tn category. Tata Motors sold as many as 30,000 and 70,000 Tata Ace vehicles during the first and second year, respectively. By 2012, there were ~1mn Tata Ace vehicles on the roads. As a result of growing popularity and strong growth of Tata Ace vehicles, many three-wheeler manufacturers such as M&M (Gio, Maxx, Maxximo), Piaggio (Ape Truck, Mini) and Force Motors (Trump 15 and 40) entered this segment since 2009-10. The LCV segment witnessed a sharp spike in vehicles sold post launch of Tata Zip in 2011.Four-wheeler LCVs continued their robust growth YoY until FY13, but since then the volume halved. Mahindra & Mahindra or M&M's Gio launched in this segment has also witnessed a sharp reduction in overall volume.

The fast growth in four-wheeler LCVs and the decline in three-wheeler good carriers developed a myth that Tata Ace killed three-wheelers. However, three-wheeler goods carriers had registered a growth of 26.5% in 2006, when Tata Ace was launched. Three-wheeler goods carrier sales did decline during FY07-FY09, hitting a low of 82,390 units in FY09. However, growth picked up in FY10- FY12 and the segment grew ~9%. The market since then has been lackluster except for the period FY14- FY15, which witnessed a growth of 5.8%.

Initial purchase price of a four-wheeler LCV is much higher than that of a three-wheeler goods carrier. Three-wheeler cargo vehicles come in the range of Rs 1,80,000-Rs2,00,000 per vehicle while four-wheeler LCVs come in the range of Rs3,50,000-Rs5,00,000. Mileage of three-wheelers is ~30 km/litre while in case of four-wheeler LCVs it is in the range of 22-24 km/litre. Cost to maintain four-wheeler LCV ends up being on the higher side compared to three-wheelers. Also, for short haulage, vehicles with a loading capacity of less than 1tn are preferred. Thus, the ownership cost to consumers - who belong to lower economic strata and to whom cost is a major factor in owning a new vehicle - a three-wheeler goods carrier makes much more economic sense over a four-wheeler LCV.

In a nutshell, we believe three-wheeler goods carrier manufacturers are not clutching their hearts collectively and dying in a hurry. Somewhere in the middle of hinterlands, there is a class of people and a set of businesses which still prefer three-wheelers over micro trucks. Hence, we believe this segment to co-exist with four-wheeler LCV segment.

Exhibit 64: Three-wheeler domestic goods carrier versus four-wheeler LCV volume growth



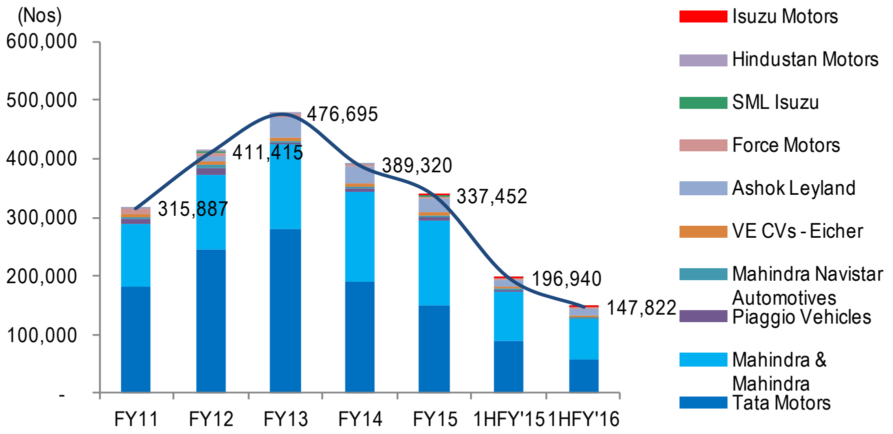
Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 65: LCVs competing with three-wheeler goods carriers

Company	Cargo Segment	Passenger Segment
Tata Motors	Tata Ace, Super Ace, Zip	Tata Magic, Iris, Winger
M&M	Maxximo, Gio, Maxx	Maxximo mini-van
Piaggio	Ape Truck, Ape Mini	-
Ashok Leyland	Dost	-
Force	Trump	Traveller, Trax
Bajaj	-	RE60

Source: Nirmal Bang Institutional Equities Research

Exhibit 66: Four-wheeler LCV goods carrier volume growth YoY



Source: SIAM, Nirmal Bang Institutional Equities Research

After showing overall robust growth in the past decade, domestic sales of three-wheeler passenger carriers slowed down in the past few years. FY15 was surprisingly positive and we expect this segment to grow robustly.

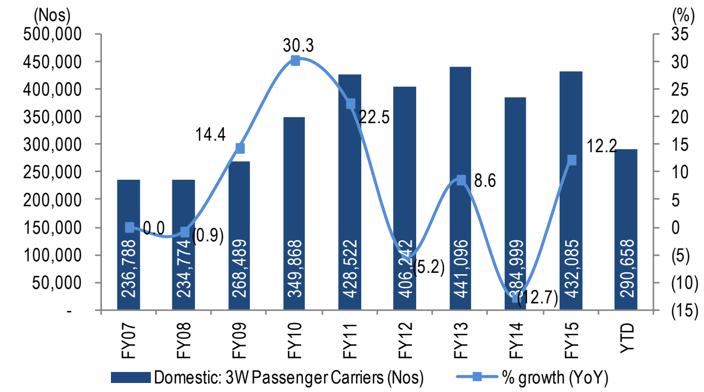
The vast majority of people in urban India do not have an organised public transport system as compared to the one in developed nations. Of the 78 cities with a population of more than 1mn, only 25 have public city buses and only 7 metropolitan cities such as Mumbai, Delhi, Chennai, Kolkata, Bengalaru, Hyderabad and Pune have commuter rail services. In addition, some urban areas are partially served by state road transport corporation bus routes that pass through. Lack of mass public transport led to a range of make-shift solutions called Intermediate Public Transport (IPT) or 'para transit' of which passenger three-wheelers account for a huge chunk.

Passenger three-wheeler carriers classified as contract carriers (auto-rickshaws, 3+1) and stage carriers (6+1) have witnessed robust growth of ~8% over FY07-FY15. Contract carriers remained one of the most affordable and convenient means for last mile connectivity, especially in rural and semi-urban areas. Auto-rickshaws provide a means for self-employment with a relatively low capital investment (~Rs1,60,000) and ease of availability of finance. Stage carriers, on the other hand, are used for inter-city commuting to ply passengers between common pick-up points up to 25km-30km apart. Contract carriers face relatively less competitive pressure as compared to stage carriers which face competition from four-wheeler LCVs such as Tata Motor's Magic, Iris, and Winger, M&M's Maxximo minivan and Force Motors' Tempo Traveller.

The key growth driver for this segment has come from first-time users (FTUs) and replacement demand. Replacement demand for three-wheeler passenger carriers has shortened over the time (~ seven years) and has been mainly because of technological advancement (two-stroke to four-stroke, front engine to rear engine, and petrol to CNG/LPG). Demand from FTUs in rural and semi-urban areas remained healthy because of the ease of getting new permits, improvement in rural road infrastructure, and rising demand in the wake of improved economic conditions. Demand from FTUs from urban areas remained restricted because of the freeze on fresh permits by state governments in order to control pollution. Recently, Maharashtra government announced the issuance of 1,00,000 new permits for auto-rickshaws in Mumbai Metropolitan Region, and also increase the number of three-wheelers by 25% in cities like Pune, Solapur, Nagpur, Nashik and Aurangabad. As a result of this, we expect the demand in urban areas to remain steady now and moderate in the medium term.

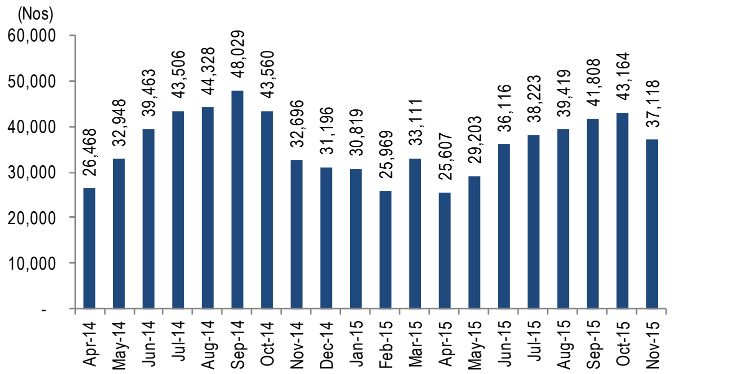
FY11 to FY14 was a lull period for domestic passenger segment, mainly because of unfavourable macro-economic conditions. During the period, India's GDP growth declined significantly, fuel prices went sky high, repo rates increased and other commodity prices went up, thereby creating unfavourable economic conditions for consumers to purchase new vehicles. However, domestic passenger three-wheeler segment witnessed a robust growth of 8.0% over FY07-FY15, including 12.2% growth in FY15. Given the improving macro-economic conditions and new permit issuance by state governments, we expect higher single-digit growth in this segment.

Exhibit 67: Domestic three-wheeler passenger volume -Yearly



Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 68: Domestic three-wheeler passenger volume - Monthly



Source: SIAM, Nirmal Bang Institutional Equities Research

India's three-wheeler industry - competitive landscape

The threat of new entrants is low

The threat of new entrants in three-wheeler vehicle segment in India is extremely low. The three-wheeler manufacturing industry is characterised by high capital investments (manufacturing plants, bigger warehouses and expanded capacity), strong brand loyalty, good relationships with automobile parts suppliers, and wide distribution network. Three-wheeler market in India is oligopolistic in nature with Bajaj Auto and Piaggio India accounting for ~76% of total market pie. Other well-established players include Mahindra & Mahindra, TVS Motor Company and Atul Auto.

The industry is also characterised by environmental regulations and any new vehicle model needs Automotive Research Association of India's Bharat Stage III approval. The government is in fact pushing for even stricter environmental norms and has asked three-wheeler manufacturers to meet Bharat Stage V and Bharat Stage VI norms by 2019 and 2023, respectively. Abiding to new norms requires additional capital for investment in technology, thereby increasing entry barriers for a new entrant.

Two of the key factors in making purchase of a three-wheeler are strong brand name and financing option. Customers of three-wheelers come from lower economic strata and have little educational background. Hence, they prefer three-wheelers having popular brand names and also a strong association with customers. Financing provided by automobile manufacturers is also a key factor in making a purchase decision. If an automobile maker is not able to provide financing option and that too in a non-cumbersome manner, the customer can easily switch to another brand. For a new entrant, providing financing to customers can be difficult.

Well entrenched dealer/distributor network is another entry barrier for a new player. Many of the established players in this sector have at least more than 200 dealers spread across India. Establishing a distribution network from scratch in this highly competitive space is extremely challenging for a new player.

Power of suppliers is low

The three-wheeler spare part supplier market is quite fragmented. There are many suppliers for any given component, except for engines, which are usually sourced from Greaves Cotton (barring Bajaj Auto which does in-house manufacturing of engines). Rest of the automobile parts such as tyres, batteries, gears, gearbox, shock absorbers, bearings etc can be easily sourced from multiple suppliers. As a result, suppliers hold little pricing power and are susceptible to demand scenario and requirement of automobile manufacturers.

The power of customers is high

Little product differentiation, similar pricing and availability of financing options from major players make switching cost for buyers very low. In case of passenger vehicles, buyers' purchase decision is mainly dependent on the financing option available to them through dealers, brand popularity of a three-wheeler and ease of availability of servicing and also spare part availability for the vehicle.

In terms of financing options, all five major players in domestic passenger three-wheeler segment – Bajaj Auto, Piaggio India, TVS Motor Company, M&M and Atul Auto have either their own financing arms or have tie-ups with banks and non-banking financial companies or NBFCs. Although Bajaj Auto and Piaggio are more popular than their counterparts across India, Atul Auto's brand awareness is on par, if not higher in certain pockets of India (Gujarat, Punjab, Jharkhand and Rajasthan). While in terms of availability of servicing and spare parts, all big players are almost on par with each other. Although there is no substitute for passenger three-wheelers, given the similarity in product and service offerings, we believe the power of buyers is high in this segment.

Like passenger three-wheeler segment, cargo three-wheeler segment is also dominated by three big players – Piaggio, Mahindra & Mahindra and Atul Auto. Although Atul Auto brings certain product differentiation through increased overload capacity, strong chassis, better mileage and good design, we do not see it reducing buyers' power. Customers are still left with quite a few choices to select from.

Apart from this, customers who buy three-wheelers are highly price-sensitive, giving little pricing power to automobile manufacturers.

Medium threat from substitutes

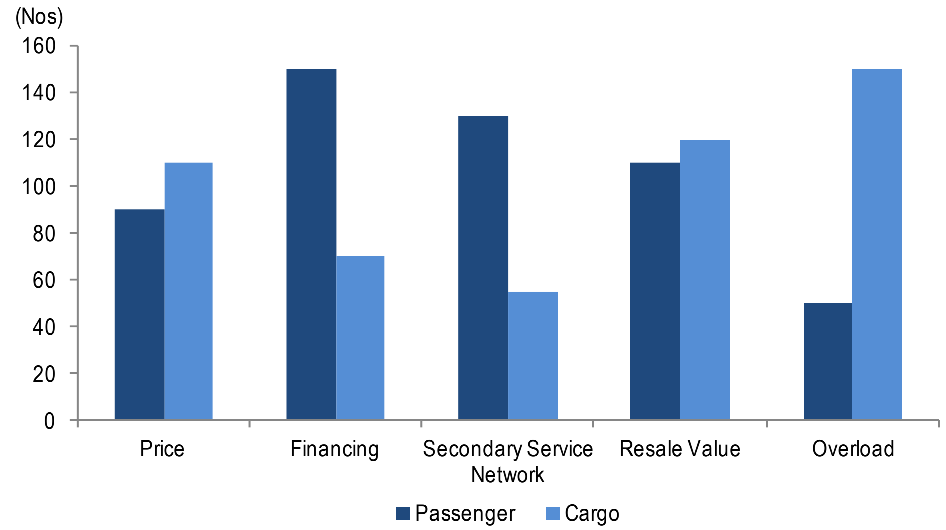
Threat from substitutes is low for passenger three-wheeler segment while it is medium for cargo three-wheeler segment. Three-wheelers offer superior cost economics compared to their four-wheeler substitutes. The closest substitute for a three-wheeler passenger vehicle is either a two-wheeler or a four-wheeler. However, one of the major reasons to buy a three-wheeler is self-employment. Two-wheelers cannot meet the need of self-employment. On the other hand, four-wheelers can be used for self-employment (Uber and Ola cab services), but there is a wide difference between on-road prices of three-wheeler and four-wheeler vehicles.

For a three-wheeler cargo vehicle, the close substitutes are four-wheeler Cargo Paxx (ULCV) and four-wheeler Cargo Paxx (LCV). However, a three-wheeler cargo vehicle beats its two substitutes in terms of initial investment, on-road price and mileage per litre of fuel. Spare part prices of a three-wheeler cargo vehicle are much less compared to its two substitutes, thereby reducing maintenance costs. Also, a three-wheeler cargo vehicle is easier to maintain compared to a four-wheeler cargo vehicle. However, there is a section of customers, mainly owners of small scale businesses such as poultry farms, cement dealers, grocery shop owners etc, having higher purchasing power who may prefer four-wheeler LCVs as against three-wheeler cargo vehicles. Hence, we believe the threat from substitutes of goods carrier three-wheeler is only medium in nature.

Intensity of competition is high

The three-wheeler industry is highly competitive with four to five major players competing against each other. Given the high capex requirement for the business, exit barriers are very high. Product differentiation is not huge and therefore players cannot command higher pricing. Hence, in order to increase market share, companies have to aggressively compete through better marketing strategy, strong dealership network and higher warranty period offering.

Exhibit 69: Criteria behind vehicle purchase



Source: Purchase Trend in India – ACG Report, Nirmal Bang Institutional Equities Research

Company background

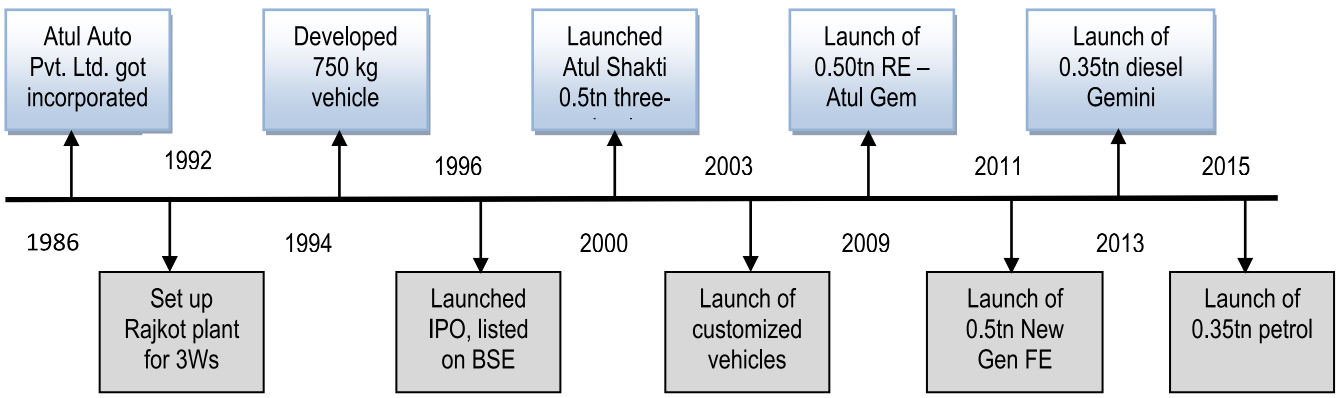
From Chhakaras to one among the dominant market players, Atul Auto is one the youngest and fastest-growing, pure-play three-wheeler commercial vehicle company with its manufacturing facility in Rajkot, India. It was promoted by Mr. J.J. Chandra. The company manufactures three-wheelers in the sub-1tn category targeting the passenger and cargo segments. In passenger segment, the company manufactures diesel and compressed natural gas or CNG-powered carriers for carrying three to six passengers. In cargo segment, the company manufactures vehicles with rated carrying capacity of 0.5tn. Both these vehicles have Automotive Research Association of India's approval under Bharat Stage – III norms. The plant at Rajkot has current capacity of manufacturing 60,000 vehicles per annum with utilisation level of ~90%.

The company started its operations by manufacturing Chhakaras (rural transportation vehicle or RTV) back in 1970s in rural areas of Saurashtra. It got incorporated as a private limited company in 1986 in Maharashtra and later shifted the registered office to Jamnagar in Gujarat in 1992. Then it shifted to Rajkot, also in Gujarat, in 1997. The company got listed on stock exchanges in March 1996. Year 2000 was an inflection point for Atul Auto when it started manufacturing three-wheelers with front engines or FEs. After manufacturing different variants of FEs, 2009 was another transitional year for the company when it started manufacturing rear engine or *RE three-wheelers. The company has launched a three-wheeler petrol variant, in November 2015. Atul Auto carved its niche in the Indian three-wheeler market through local-level innovations and process re-engineering. The company's key strengths are consistent delivery of enduring products and excellent after-sales service. In the past 23 years, it has created a well-diversified portfolio comprising 45 models and their variants, with an extremely strong brand identity, integrated manufacturing plant and a presence across key markets in India.*

As of FY15-end, the company had 200 exclusive dealers and 120 secondary dealers, more than 320 customer touch-points, 17 regional offices and 3 training centres across 17 states in India. It has an associate company called Khusbhu Auto Finance (49.9% share). Atul Auto's major brands are Atul Shakti, Atul Smart, Atul Gem and Atul Gemini Dz. The company exports its products to Nigeria, Kenya, Egypt, Tanzania and some African countries.

In FY15, the company generated annual net revenue of Rs4.93bn by selling 41,598 vehicles which includes 40,134 in domestic market and 1,464 in international markets. The company has slowly and steadily increased its market share from 3.8% in FY11 to 7.8% in FY15 in domestic market. It did especially well in domestic goods carrier segment and has become the third-largest player after Piaggio and Mahindra & Mahindra, with a market share of 18% in FY15.

Exhibit 70: History of Atul Auto

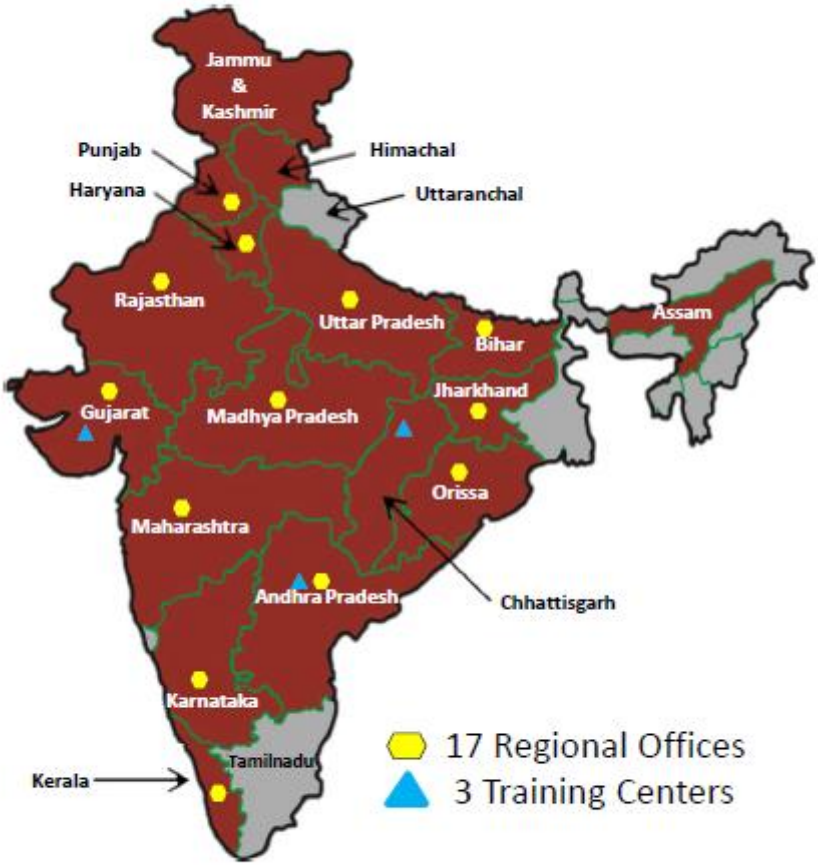


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 71: Company's products

Source: Company

Exhibit 72: Distribution network



Source: Company

Financials

Exhibit 73: Income statement

Y/E March (Rsmn)	FY14	FY15	FY16E	FY17E	FY18E
Net sales	**4,301**	**4,928**	**5,408**	**6,144**	**7,222**
% growth	*18.3*	*14.2*	*10.0*	*13.6*	*17.5*
Raw material costs	3,316	3,722	3,978	4,493	5,249
Staff costs	274	324	374	393	433
Other expenses	258	304	308	356	412
Total expenditure	3,848	4,350	4,660	5,242	6,094
EBITDA	**453**	**578**	**748**	**902**	**1,128**
% growth	*13.0*	*27.7*	*29.3*	*20.6*	*25.1*
EBITDA margin (%)	***10.5***	***11.7***	***13.8***	***14.7***	***15.6***
Other income	29	59	32	45	53
Interest costs	3	6	6	6	6
Depreciation	52	56	70	95	118
Profit before tax	427	592	705	847	1,058
% growth	*14.6*	*38.6*	*19.1*	*20.1*	*25.0*
Tax	130	187	218	259	324
Effective tax rate (%)	*30.4*	*31.6*	*31.0*	*30.6*	*30.6*
Net profit	**297**	**405**	**486**	**588**	**734**
% growth	*14.6*	*36.2*	*20.2*	*20.8*	*25.0*
EPS (Rs)	**13.6**	**18.5**	**22.2**	**26.8**	**33.5**
DPS (Rs)	3.8	5.0	6.0	8.0	9.0
Payout (%)	*27.7*	*27.1*	*27.0*	*29.8*	*26.8*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 74: Cash flow

Y/E March (Rsmn)	FY14	FY15	FY16E	FY17E	FY18E
EBIT	427	593	711	853	1,064
(Inc.)/dec. in working capital	(106)	(128)	(143)	(57)	(96)
Cash flow from operations	321	465	567	795	968
Other income	(0)	0	(32)	(45)	(53)
Depreciation	52	56	70	95	118
Tax paid	(134)	(165)	(218)	(259)	(324)
Net cash from operations	**240**	**358**	**386**	**585**	**709**
Capital expenditure	(106)	(363)	(223)	(505)	(505)
Net cash after capex	134	(5)	163	81	204
Other investing activities	-	-	32	45	53
Cash from financial activities	(128)	(111)	(164)	(216)	(242)
Opening cash balance	368	374	258	290	200
Closing cash balance	374	258	290	200	215
Change in cash balance	6	(116)	32	(90)	15

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 75: Balance sheet

Y/E March (Rsmn)	FY14	FY15	FY16E	FY17E	FY18E
Equity	112	112	112	112	112
Reserves	833	1,099	1,378	1,696	2,121
Net worth	945	1,211	1,490	1,808	2,233
Net Deffered Tax Liab	61	52	58	58	58
LT Liabilities/provisions	5	5	12	12	12
Total Loans	-	-	-	-	-
Liabilities	**1,011**	**1,268**	**1,560**	**1,878**	**2,303**
Gross Block	834	1,170	1,392	1,897	2,402
Depreciation	307	375	441	531	646
Net Block	527	794	952	1,366	1,756
Capital work-in-progress	6	5	5	5	5
LT Investments	12	10	10	10	10
Other long-term assets	50	74	74	74	74
Inventories	234	260	341	354	416
Debtors	131	322	415	471	534
Cash	451	274	290	200	215
Cash and Cash Equivalents	374	258	290	200	215
Other Bank Balances	77	16	-	-	-
Other Current assets	35	36	83	83	83
Total Current assets	851	892	1,129	1,108	1,248
Trade payables	272	267	338	382	452
Other current liabilities/provisions	163	239	271	303	338
Total current liabilities	435	507	609	684	790
Net current assets	416	385	520	424	458
Total Assets	**1,011**	**1,268**	**1,560**	**1,878**	**2,303**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 76: Key ratios

Y/E March	FY14	FY15	FY16E	FY17E	FY18E
Profitability & return ratios					
EBITDA margin (%)	10.5	11.7	13.8	14.7	15.6
EBIT margin (%)	9.3	10.6	12.5	13.1	14.0
Net profit margin (%)	6.9	8.2	9.0	9.6	10.2
RoE (%)	35.2	37.6	36.0	35.6	36.3
RoCE (%)	30.0	32.4	34.4	34.1	35.7
Working capital & liquidity ratios					
Receivables (days)	11	24	28	28	27
Inventory (days)	20	19	23	21	21
Payables (days)	30	26	31	31	31
WC days	1	17	20	18	17
Current ratio (x)	2.0	1.8	1.9	1.6	1.6
Quick ratio (x)	1.4	1.2	1.3	1.1	1.1
Valuation ratios					
EV/sales (x)	2.7	2.4	2.1	1.9	1.6
EV/EBITDA (x)	25.2	20.0	15.5	12.9	10.3
P/E (x)	39.9	29.3	24.4	20.2	16.1
P/BV (x)	12.6	9.8	8.4	8.0	6.6

Source: Company, Nirmal Bang Institutional Equities Research

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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