TVS Motor Company

Reco: Buy

Stock Update

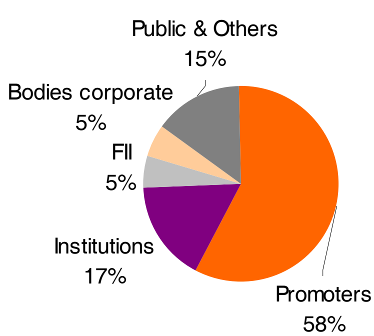
Annual report review; maintain Buy with a revised price target of Rs175

CMP: Rs144

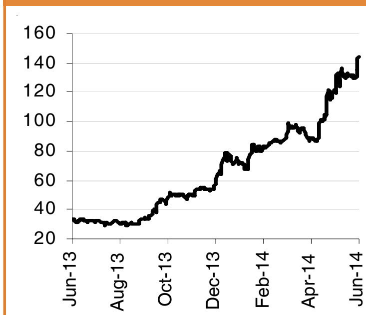
Company details

Price target:	Rs175
Market cap:	Rs6,859 cr
52-week high/low:	Rs148/28
NSE volume: (No of shares)	22.1 lakh
BSE code:	532343
NSE code:	TVSMOTOR
Sharekhan code:	TVSMOTOR
Free float: (No of shares)	20.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	22.0	61.0	147.4	325.1
Relative to Sensex	15.9	38.2	102.5	218.4

Key points

- TVS Motor Company (TVS)'s annual report for FY2014 highlights the category shift in the two-wheeler industry from motorcycles to scooters. The report states that with more male buyers coming in the scooter market, there is a preference for larger scooters. TVS witnessed a fall in demand for its *Scooty* range and addressed the gap in its offerings by launching the *Jupiter*.
- The TVS management is looking to leverage on a complete scooter portfolio in FY2015. It also expects motorcycle volumes, which were lacklustre in FY2014, to pick up in FY2015 aided especially by the launch of the *TVS StaR City* +. The momentum in three-wheeler exports is expected to continue and the company's domestic three-wheeler volumes are expected to rise with the launch of the diesel variant.
- Since our initiation on TVS (on May 2, 2013) the stock has delivered an impressive return of 55%. Our positive stance on the company was due to its strong product offering in the scooter segment and an expectation of margin improvement going forward. We remain positive on the stock and expect the company to deliver earnings CAGR of 28% over FY2014-17. We are taking a long-term view on the stock and retaining a Buy recommendation on it with an 18-month revised price target of Rs175 (vs Rs142 earlier) based on 15x FY2017E earnings.
- **Risk to our rating:** TVS' Indonesian subsidiary continues to make losses. The performance of the Indonesian subsidiary remains an overhang on the consolidated performance and balance sheet of the company.

Valuations

Particulars	FY2012	FY2013	FY2014	FY2015E	FY2016E
Net sales (Rs cr)	7,141.5	7,169.3	7,961.9	9,725.3	11,261.5
Growth (%)	13.6	0.4	11.1	22.1	15.8
EBITDA (Rs cr)	494.8	422.9	480.3	617.4	741.7
OPM (%)	6.9	5.9	6.0	6.3	6.6
PAT (Rs cr)	246.2	206.9	260.4	361.5	449.0
Growth (%)	26.5	-16.0	25.9	38.9	24.2
FD EPS (Rs)	5.2	4.4	5.5	7.6	9.5
P/E (x)	27.9	33.2	26.4	19.0	15.3
P/B (x)	5.9	5.6	4.8	4.1	3.4
EV/EBITDA (x)	15.5	17.6	15.2	11.6	9.4
RoE (%)	22.7	17.3	19.7	23.3	24.0
RoCE (%)	18.2	14.5	18.2	22.6	24.7

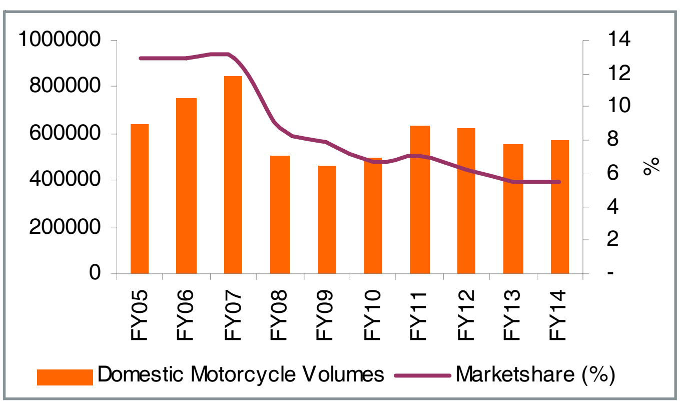
Domestic two-wheeler market

In contrast to the decline in the passenger and commercial vehicle segments, the domestic two-wheeler segment was more resilient and posted a 7.3% growth in volumes to 1.48 crore units. The good monsoon rainfall during the year kept the rural demand for two-wheelers strong. Additionally, the scooter segment continued to outperform on the growing acceptance of scooters and increased its share in the domestic two-wheeler pie.

Motorcycles

The domestic motorcycle segment was subdued in FY2014 as consumer sentiment especially in urban India remained weak. The motorcycle segment grew by 3.9% in FY2014 to 1.05 crore units primarily due to a robust demand in rural areas. This was evident from the fact the entry level motorcycle, ie 75-110 cc, outperformed with a growth of 4.8%. TVS' domestic motorcycle volumes rose by 2.6% to 5.73 lakh units and the company's market share remained stagnant at 5.5%. The only bright spot for the company was that the sales of its premium motorcycle Apache rose by 19.3%. During the year TVS launched the *TVS Sport* and the *Phoenix 125* in the executive category.

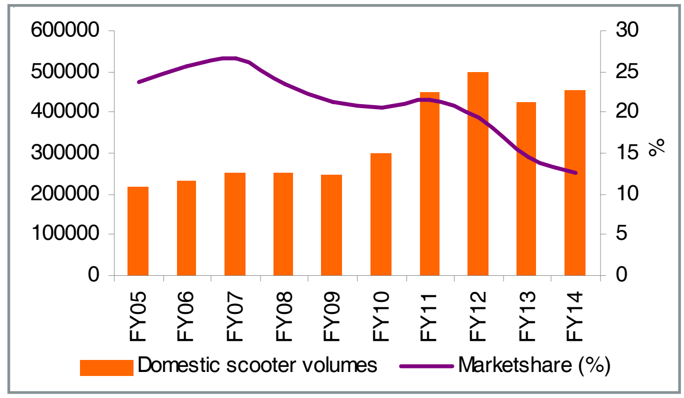
TVS' domestic motorcycle sales



Scooters

The scooter segment has consistently outperformed the overall two-wheeler industry. The increasing acceptance of scooters as a family vehicle, the flexibility of usage and the reducing gap in fuel efficiency vis-à-vis motorcycles have contributed to the growth in scooters. Also, the product offerings in the segment have increased as most original equipment manufacturers with the exception of Bajaj Auto have entered the segment. TVS has been a significant player in the two-wheeler segment but it has witnessed a market share contraction over the past few years. This happened primarily because scooter, which used to be a female oriented product, started finding acceptance among the male consumers, thereby resulting in a demand for larger more powerful scooters. TVS addressed this gap in its product line with the launch of the *Jupiter* in Q3FY2014. As a result, the company witnessed a steady increase in its scooter volumes in Q4FY2014 and a market share expansion of 90 basis points (BPS) quarter on quarter (QoQ).

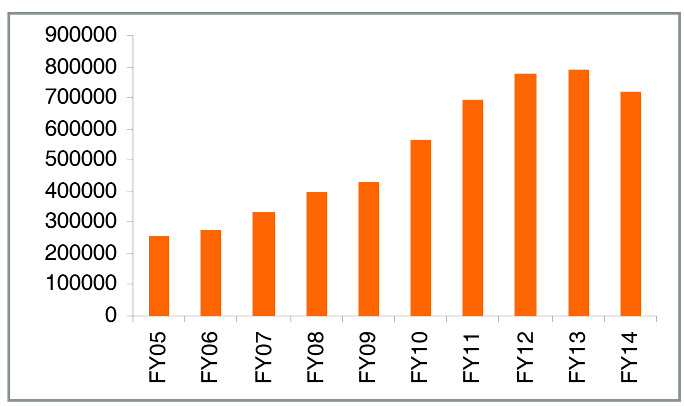
TVS' domestic scooter sales



Mopeds

During the year the demand for mopeds was affected by a poor monsoon in the state of Tamil Nadu, which is the largest market for mopeds. In FY2014, the moped volumes declined by 8.3% to 7.2 lakh units. Mopeds contribute roughly one-third of the overall volumes for TVS.

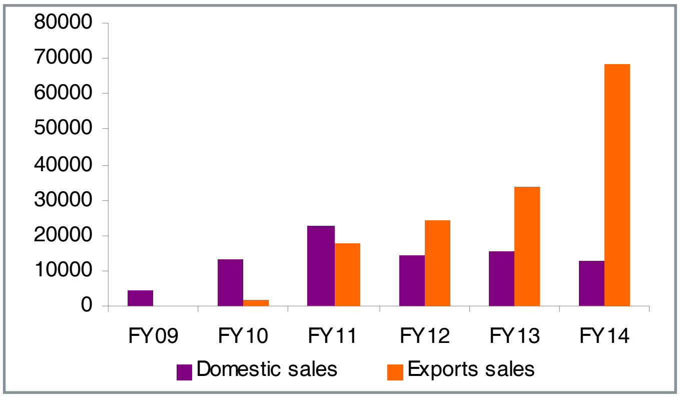
TVS' domestic moped sales



Three-wheelers

As per the annual report, the domestic petrol passenger three-wheelers segment declined by 23% as new permits were not released by state governments. In FY2014, TVS' domestic three-wheeler volumes declined by 19.9% to 12,515 units. During the year, the company test marketed its diesel three-wheeler variant, which is expected to be launched in the current year.

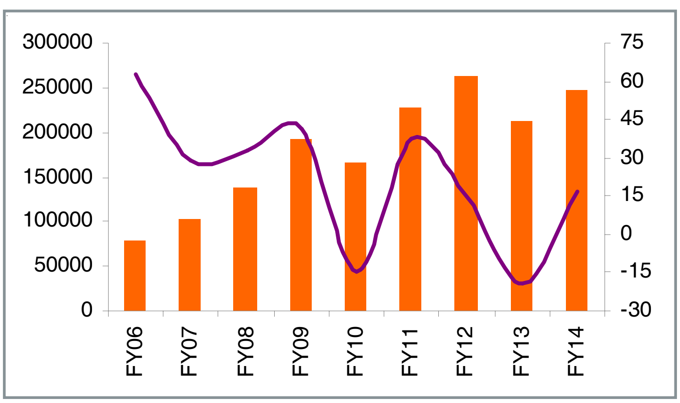
TVS' three-wheeler sales



Exports

TVS had an excellent year on the export front as it witnessed a volume growth across categories. Its motorcycle exports grew by 15.6% to 2.2 lakh units. This was largely due to the demand expansion and improvement in the distribution network in some major export markets. Its three-wheeler exports more than doubled to 68,327 units. Additionally benefitted by the rupee's depreciation during the year, free-on-board value of exports rose 48% to Rs1,716 crore.

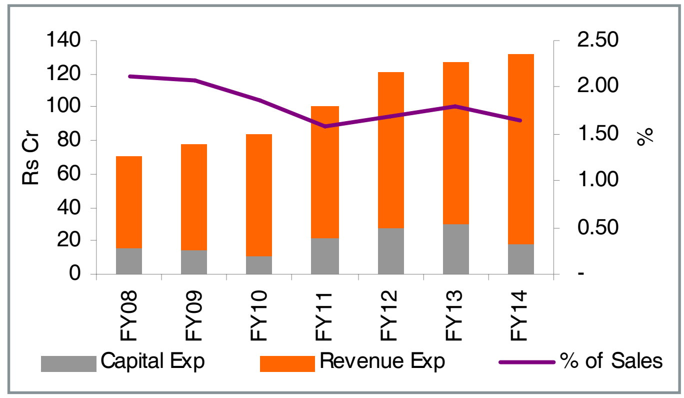
TVS' two-wheeler exports



R&D expenditure

During the year, TVS' research and development (R&D) expenditure rose by 3.6% to Rs132 crore. However, the mix was in favour of revenue expenditure, which rose by 16.9% to Rs113 crore, while the capital expenditure declined by 39% to Rs18 crore. The R&D expenditure as a percentage of sales declined marginally from 1.79% in FY2013 to 1.65% in FY2014. During the year the company launched the scooter Jupiter, which is its first product in the large scooter (targeted at males) category. TVS also launched its first skubek model, *TVS Dazz*, in the Indonesian market. TVS' R&D team is currently working on a hybrid scooter (showcased at the Auto Expo, Delhi) and a performance motorcycle in joint development with BMW as well as on products for the export markets.

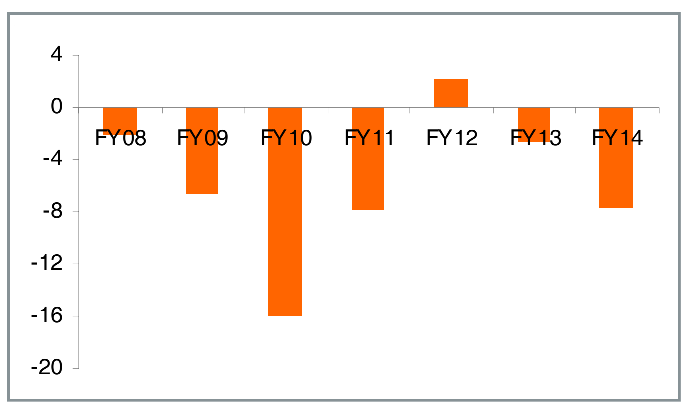
TVS' R&D expenditure



Working capital levels

TVS reported a 13.6% increase in its operating profit due a combination of higher revenues and a marginal expansion in the margins during the year. The profit before tax (PBT) was higher by 76% as the interest cost reduced with a lowering of the debt burden. Additionally, there was a significant reduction in TVS' working capital level. The company has been able to lower its working capital needs by about Rs300 crore over a three-year period of FY2012-14. As a result, the cash flow from operations increased by 76% in FY2014.

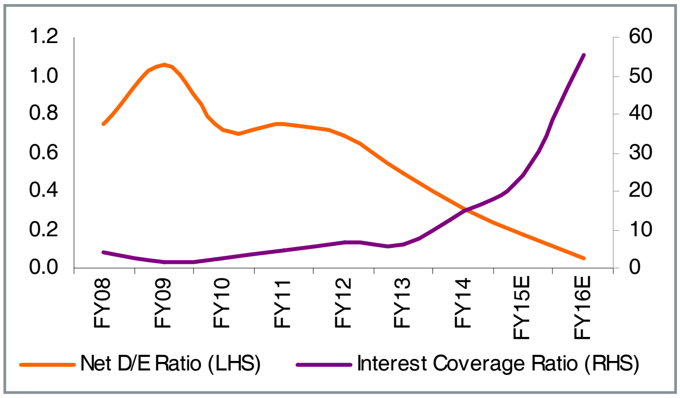
TVS' net working capital (days)



Debt levels

TVS continued to reduce its debt burden and during the year the gross debt for the company reduced from Rs635 crore in FY2013 to Rs528 crore. The total debt/equity ratio declined from 0.52 to 0.37 in FY2014. The management has re-iterated its aim to be debt-free at net level by FY2015-16.

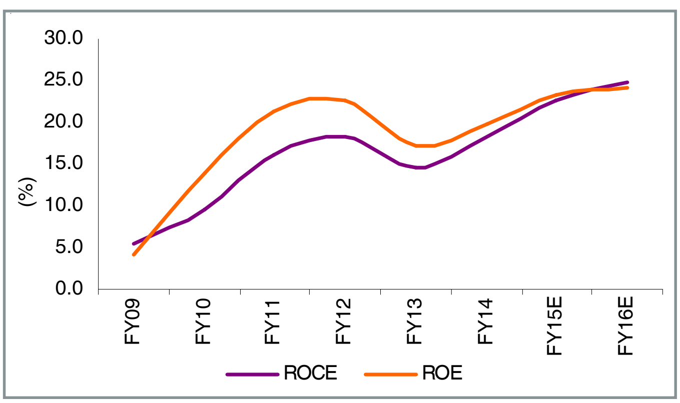
Net D/E ratio



Improvement in return ratios

Given the improvement in the profitability of TVS and its lower debt burden, the return ratios of the company showed an improvement too in FY2014. The return on capital employed (RoCE) for the company rose from 14.5% in FY2013 to 18.2% in FY2014 while the return on equity (RoE) increased from 17.3% in FY2013 to 19.7% in FY2014. Further, with an improvement in the margins going forward, we expect the company to post both RoCE and RoE in excess of 20% in the next couple of years.

Return ratios



Investments

In FY2014 TVS made an additional investment of Rs49.8 crore in preference shares of its Indonesian subsidiary. The company also made an investment of Rs75 crore in preference shares of TVS Motor Service. TVS divested 90% of its stake in TVS Energy which resulted in a gain of Rs30.3 crore and as a result TVS Energy ceased to be a subsidiary of TVS. TVS also took an exceptional hit of Rs33.1 crore (Rs91.6 crore in FY2013) on account of diminution in value of investment in its wholly owned subsidiary, TVS Motor Company (Europe) B.V Amsterdam.

Performance of subsidiaries

PT TVS Motor Indonesia

The losses of TVS' Indonesian subsidiary, ie PT TVS Motor Indonesia, aggravated during the year. The sales volume of the company rose by 3.2% to 19,200 units in FY2014. However, owing to an inferior product mix the net sales showed a drop of 4% to Rs96.5 crore. In FY2014 the company reported a net loss of Rs140 crore as against an adjusted loss of Rs110 crore in FY2013.

The Indonesian market, which was earlier dominated by *Bebeks*, is continuously shifting towards *Skubeks*, given their greater convenience and image. Skubeks now account for 63% of the two-wheeler market in Indonesia. A lack of a skubek in its product portfolio had hampered TVS' growth in the Indonesian market. In FY2014 the company launched its first skubek model, *TVS Dazz*, which sold 5,000 units. This will be followed by a superior 125cc skubek in FY2015.

The company successfully made an entry into the Myanmar market and plans to expand its presence in new markets like Laos, Cambodia, Malaysia and Turkey in FY2015.

Sundaram Auto Components

Sundaram Auto Components Ltd (SACL)'s FY2014 turnover increased by an impressive 37.2% from Rs1,368 crore in FY2013 to Rs1,877 crore. The growth was driven by the plastic business as its customer base increased with new business for producing air bag covers, fuel filters and other interior parts for four-wheelers. However, the net profit declined by 21.6% to Rs10.7 crore. SACL declared a dividend of Rs2.5 per share for the year.