November 02, 2022

Eicher Motors Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term/ Short-term Fund-based Facilities	100.0	100.0	[ICRA]AAA (Stable)/[ICRA]A1+; reaffirmed
Long-term/ Short-term Non-fund Based Facilities	50.0	50.0	[ICRA]AAA (Stable)/[ICRA]A1+; reaffirmed
Long-term Unallocated Limits	30.0	30.0	[ICRA]AAA (Stable); reaffirmed
Total	**180.0**	**180.0**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of ratings of Eicher Motors Limited (EML) continues to factor in its strong business profile, as evidenced by its market leadership (more than 90% share) in the premium middle-weight motorcycle segment (>250cc-800cc) in India, its established Royal Enfield (RE) brand, a strong product portfolio and an expansive dealership and aftersales network. The ratings also favourably factor in the company's strong financial profile, reflected in its healthy return indicators, credit metrices and a superior liquidity position.

The Indian two-wheeler (2W) industry witnessed a third consecutive year of contraction in FY2022; however, unlike FY2021, the impact of the second pandemic wave was limited in urban markets (vis-à-vis rural) and supported the recovery in domestic demand for the premium 2W sub-segment. This reflected in volumes of >250cc motorcycles sub-segment contracting by only 6% vis-à-vis 10% for the overall domestic motorcycle segment in FY2022. Despite the recovery in demand, the semiconductor chip shortages impacted the production of >150cc 2Ws (viz. 100% of EML's addressable market) and led to 2% YoY contraction in EML's consolidated sales volumes in the last fiscal year (although international business grew 108% YoY in FY2022). Nonetheless, supply constraints have eased to a large extent in YTD FY2023, and the company has reported a 60% YoY improvement in its volumes in H1 FY2023 vis-à-vis 14% growth posed by the overall motorcycle segment (domestic and exports; conventional 2W only). Supported by timely price escalations, EML reported best-ever quarterly performance in Q4 FY2022 and Q1 FY2023, with operating margins touching 24-25%, respectively (over ~20% margins in the previous four quarters). Going forward, the improving macro-economic environment, increasing financing penetration, scale-up of its newly launched models as well as increasing exports augur well for the company's revenue growth prospects. Additionally, ICRA expects EML's better product mix, easing commodity prices and supply chain issues to support its profits and aid in drawing a balance between growth and profitability.

The ratings continue to factor in the strong financial profile of the company, evidenced by its healthy profitability (average OPBDITA and ROCE of ~25% and ~30%, respectively, over FY2018-FY2022, despite three consecutive years of volume contraction) and cash accruals, negative net debt position and robust liquidity profile (cash, cash equivalents and investments of ~Rs. 8,500 crore as on March 31, 2022). The company is expected to fund any capacity expansion/ new product development plans from internal accruals and cash surplus in hand, thereby keeping its dependence on external borrowings negligible.

ICRA notes that EML's performance remains exposed to challenges, such as increasing regulatory interventions (emission norms, safety norms) and fierce competition in the domestic 2W market (led by growing participation of global as well as Indian OEMs in the >250–500-cc sub-segment). While the company's efforts to increase its presence in the export markets (European, American, and Southeast Asian) have witnessed significant traction over the past three years, it will need time to

scale-up to meaningful volumes and help reduce RE's dependence on the Indian market. A structural shift in preference for electric 2Ws (e-2W) (as opposed to conventional 2Ws) also remains a medium-to-long-term challenge.
EML's commercial vehicle (CV) business under VE Commercial Vehicles Limited (or VECV, a 54.4% Joint venture of EML with AB Volvo, rated [ICRA]AA+(Stable)/[ICRA]A1+) has improved its presence in the domestic market over the last few years, despite operating in a highly cyclical industry, prone to stiff competition. This had been aided by continuous product launches/ refreshes, technology advancements, expanding dealer and after-sales networks, and targeted marketing efforts. However, its earnings and return indicators weakened sharply in FY2020-FY2021, as the domestic CV industry underwent a period of sharp volume contraction. Nevertheless, even as FY2022 started on a weak note, owing to the second wave of the pandemic and related uncertainties, VECV reported optically high growth in sales volumes (and revenues), on the back of improvement in economic activity and a low base of the previous year. While the company's operating profit margin weakened because of commodity hardening, the credit metrics remained strong, supported by its unleveraged balance sheet. In YTD FY2023, tailwinds such as macro-economic improvement, increased Government spend on infrastructure, replacement demand, back-to-office and back-to-school trends and traction in the e-commerce industry have been driving the company's (and the overall CV industry's) performance. Over the medium term, ICRA expects the industry to post healthy growth, supported by steady freight demand, economic recovery, continued Government focus on infrastructure spending and e-commerce boom, which auger well for VECV's growth prospects. The company continues to maintain a strong liquidity position, which is likely to limit any funding support requirements from EML.

The Stable outlook on EML's long-term rating reflects ICRA's expectation that it will continue to maintain its leadership position in the Indian premium motorcycle sub-segment, aided by its established brand and product portfolio, regular investments in new model launches and extensive dealership network. The same is likely to help the company successfully navigate through the uncertainties caused by the structural shifts in the industry or any other exogenous shocks, while maintaining a robust credit profile.

Key rating drivers and their description

Credit strengths

Established and niche brand positioning; continued leadership position in mid-weight premium sub-segment - EML's RE brand has over 90% market share in the >250cc displacement sub-segment of motorcycles (domestic) and has maintained its leadership position for over a decade. The niche positioning and aspirational status of the brand has helped it in garnering volumes and outperform the motorcycle industry in the last few years. The company's volumes grew at a CAGR of ~17% over the last decade (FY2013-FY2022) vis-à-vis 1% for the overall motorcycle segment (domestic and exports combined). Despite the increasing competition from domestic and international OEMs, EML is expected to maintain its stronghold in the target sub-segment over the medium term, backed by its niche brand and value proposition, expansive dealership, and after-sales service network.

Robust financial risk profile - The company's investments stood at Rs. 8,500 crore as on March 31, 2022, up from ~Rs. 7,800 crore as on March 31, 2021. With negligible debt, EML continues to maintain a negative net debt position and coverage indicators remain robust. Despite decline in volumes, earnings posted moderate growth in FY2022 leading to improvement in ROCE to 18% with core-ROCE at 112%. Overall, the company continues to maintain a strong financial risk profile.

Expanding product range and improving technical capability - Regular new launches and product variations underpin EML's technical prowess. With the launch of its 'Himalayan' (in early 2016), 'the twins' (in FY2019), 'Meteor' (in FY2021) and 'Hunter' (in FY2022) models, the company has demonstrated its capability to develop new models from the ground up, incorporating a new engine as well as platform. This has given existing RE users a chance to upgrade and has also aided the company's efforts to ramp up its presence in export markets.

Credit challenges

Lack of segment diversification and rising competition in premium segment - The company's product portfolio is concentrated in the >250–800cc sub-segment, which caters to a niche clientele. Despite YoY improvement over the years, the sub-segment constitutes less than 7% of the total 2W market in India. Further, within the sub-segment, the company relies heavily on the 'Classic' brand/models, which accounted for ~50% of motorcycles sold in FY2022 (56% in Q1 FY2023). While this dependence remains high, healthy scale-up of some of the company's newly launched brands, viz. Meteor and Himalayan (within the same sub-segment), is a positive factor. However, lack of segment diversification remains a credit sensitivity for the company. Meanwhile, several domestic and international players have entered the premium sub-segment with new products in the past few years. The increase in competition could limit the pricing power of the company to some extent.

Geographical concentration of revenues, although efforts to diversify have shown growth offshoots – RE's export volumes increased by over 100% on a YoY basis in FY2022 and accounted for ~12% of total volumes sold during the period (PY: 6%). However, the sustenance of the export momentum remains to be seen. Even as the company has expanded its distribution network to over 65 international markets and has set-up assembly operations in Argentina, Thailand, and Columbia in recent years, with ~83% of revenues emanating from domestic market (FY2022), the company remains exposed to geographical concentration risk. The company's ability to consistently increase exports could offer significant scope of market expansion and mitigate the impact of any slow-down in the domestic market.

Environmental and Social Risks

Environmental considerations: Two-wheeler OEMs in India, like their global counterparts, remain exposed to climate transition risks emanating from a likelihood of tightening emission control requirements, with the Government focused on reducing the adverse impact of automobile emissions. Accordingly, EML's prospects remain linked to its ability to meet tightening emission requirements. EML (and the 2W industry as a whole) may need to invest materially to develop products to meet regulatory thresholds or expected transition to alternative fuel vehicles (2Ws expected to be at the forefront of such a shift), which may have a moderating impact on their return and credit metrics. The exposure to litigation/ penalties arising from issues related to waste and water management for manufacturers remains relatively low.

Social consideration: EML has a healthy dependence on human capital and, hence, retaining human capital, maintaining healthy employee relationships as well as its supplier ecosystem remain essential for disruption free operations. Another social risk that automotive OEMs like EML face pertains to product safety and quality, wherein instances of product recalls and high warranty costs may not only lead to a financial implication but could also harm its reputation and create a more long-lasting adverse impact on demand. EML also remains exposed to any major shift in consumer preferences/ demographics, which are a key driver for demand, and accordingly may need to make material investments to realign its product portfolio.

Liquidity position: Superior

EML's liquidity position is expected to remain **superior**, with improving cash flows from operations, supported by cash and liquid investments of Rs. 3,160 crore and marketable non-current investments (in FMPs, MFs, debentures, etc) of Rs. 5,340 crore as on March 31, 2022. The company does not have any long-term loans on its balance sheet. Steady cash flows from operations coupled with negligible debt obligations and favourable working capital cycle, have enabled EML to maintain a superior liquidity profile, despite large capex undertaken in the last few years. Over the next 12-15 months, the entire planned investments and capex is expected to be funded through internal accruals. Despite prevailing demand uncertainties, ICRA expects the company to continue maintaining its superior liquidity profile.

Rating sensitivities

Positive factors – NA

Negative factors – Pressure on EML's rating could arise for reasons including significant and sustained decline in its sales volumes, market share and profitability due to *inter alia* increasing competition, inability to consistently introduce new models or refresh its product portfolio and/or shrinkage in the premium motorcycle segment. Further, any sizeable debt-funded inorganic or organic growth plan, which can lead to deterioration in credit metrics or any sizeable cash outflow in the form of dividends or buybacks that sharply depletes the currently robust liquidity, could be factors for a downward rating review.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Two-Wheeler Manufacturers Rating approach – Consolidation
Parent/Group support	Not applicable
Consolidation/Standalone	The rating is based on consolidated financial statements of the issuer. The consolidated list of entities is shared in Annexure-2.

About the company

EML, incorporated in 1982, is the flagship company of the Eicher Group in India and a leading player in the Indian automobile industry. On a standalone basis, EML is engaged in the manufacturing and marketing of motorcycles under the 'Royal Enfield' brand with manufacturing facilities in Chennai, Vallam Vadagal and Oragadam (Tamil Nadu). With a diverse portfolio with many established brands and sales of 5.95 lakh units (in FY2022, at a consolidated level), EML is positioned as a market leader in the niche (250cc+) motorcycle segment in India. Additionally, the company operates as a holding company for VECV. A joint venture (JV) of EML (54.4%) and AB Volvo (45.6%), VECV came into existence with effect from July 1, 2008. The JV is engaged in—(a) EML's truck and bus operations, auto components business and technical consulting services business; (b) Volvo Group's Indian truck sales and marketing functions; and (c) service and spares network operations for both Volvo trucks as well as buses. In 2020, VECV signed definitive agreements to integrate Volvo Buses India into VECV, including manufacture, assembly, distribution, and sale of Volvo buses in India.

Key financial indicators (audited)

EML Consolidated	FY2021	FY2022	Q1 FY2023
Operating income (Rs. crore)	8,720.4	10,297.8	3,397.5
PAT (Rs. crore)	1,315.8	1,616.5	576.9
PAT including share of profit/loss from JVs (Rs. crore)	1,346.9	1,676.6	610.7
OPBDIT/OI (%)	20.4%	21.1%	24.5%
PAT/OI (%)	15.1%	15.7%	17.0%
Total outside liabilities/Tangible net worth (times)	0.3	0.3	-
Total debt/OPBDIT (times)	0.1	0.0	-
Interest coverage (times)	108.9	116.0	159.2

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Source: Company results, ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as Sep 30, 2022 (Rs. crore)	Date & Rating in	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					Nov 2, 2022	Sep 1, 2021	Feb 22, 2021	Nov 18, 2019
1	**Overdraft**	Long-term/ Short-term	100.0	--	[ICRA]AAA (stable)/ [ICRA]A1+	[ICRA]AAA (stable)/ [ICRA]A1+	-	-
2	**Letter of Credit**	Long-term/ Short-term	50.0	--	[ICRA]AAA (stable)/ [ICRA]A1+	[ICRA]AAA (stable)/ [ICRA]A1+	[ICRA]AAA (stable)/ [ICRA]A1+	[ICRA]AAA (stable)/ [ICRA]A1+
3	**Unallocated**	Long-term	30.0	--	[ICRA]AAA (stable)	[ICRA]AAA (stable)	[ICRA]AAA (stable)	[ICRA]AAA (stable)
4	**Fund Based Facilities**	Long-term	--	--	--	--	[ICRA]AAA (stable)	[ICRA]AAA (stable)

Complexity level of the rated instrument

Instrument	Complexity Indicator
Overdraft Limit	Simple
Letter of Credit	Very Simple
Unallocated limits	NA

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, are available on ICRA's website: www.icra.in

Annexure-I: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Overdraft Limits	Feb-2021	-	-	100.0	[ICRA]AAA (Stable)/ [ICRA]A1+
NA	Letter of Credit	Feb-2021	-	-	50.0	[ICRA]AAA (Stable)/ [ICRA]A1+
NA	Unallocated	-	-	-	30.0	[ICRA]AAA (Stable)

Source: Companyy

Annexure-II: List of entities considered for consolidated analysis

Company Name	EML Ownership	Consolidation Approach
Royal Enfield North America Limited (RENA)	100.0%	Full Consolidation
Royal Enfield Canada Limited (subsidiary of RENA)	100.0%	Full Consolidation
Royal Enfield Brasil Comercio de Motocicletas Ltda	99.99%	Full Consolidation
Royal Enfield (Thailand) Limited	99.99%	Full Consolidation
Royal Enfield (UK) Ltd	100.0%	Full Consolidation
Eicher Group Foundation	50.0%	Full Consolidation
VE Commercial Vehicles Ltd (VECV)	54.4%	Equity Method
Eicher Polaris Private Limited*	50.0%	Equity Method

*Source: Company Annual report FY2022; * Under liquidation*

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