

SELL

TP: Rs 73,200 | ▼ 8%

MRF

| Auto Components

| 02 December 2020

Rising input cost a key concern amid rich valuations; cut to SELL

MRF Tyres (MRF) has rallied ~30% in the last three months and is currently trading at 25x Sep'22E EPS. Even with optimistic earnings projections post the Q2 beat, we find valuations expensive and hence cut the stock from ADD to SELL. Our Sep'21 TP remains at Rs 73,200. In our view, positives from domestic volume visibility, lower imports and a steady margin outlook are in the price. Further, rising prices of natural rubber (up ~30% in three months) and the sudden spike in crude derivatives are likely to weigh on margins.

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Strong volume growth factored in; rising input cost a key concern: We build in volume growth of 13% each in MRF's MHCV, LCV & 2W/3W tyres and 16% in its PV tyres over FY21-FY23. The spike in natural rubber prices from Rs 120/kg to >Rs 160/kg over the last three months and more recently in crude derivatives from US\$ 40 to US\$ 48 due to the sudden jump in crude prices will clearly have an adverse impact on gross margins (300-400bps QoQ).

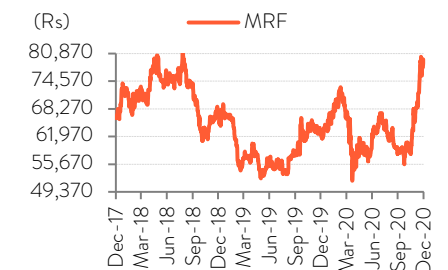
Leadership premium also in the price: MRF's product profile spanning MHCV, LCV, PV and 2/3W tyres, strong branding and high exposure to the domestic replacement market make for a healthy growth outlook. We also pencil in 50-100bps improvement in ROE and ROCE over FY21-FY23 along with a near-zero net debt/equity ratio. That said, we believe most optimism is in the price.

Valuations full, downgrade to SELL: After the recent 30% rally, MRF now trades at an expensive 25x Sep'22E EPS. We factor in strong volume growth led by domestic demand and lower imports but believe margins could come under significant pressure due to the sudden jump in input costs. Revenue/EBITDA/PAT are forecast to post a 16%/14%/15% CAGR over FY21-FY23. Our Sep'21 TP remains at 23x Sep'22E EPS – downgrade to SELL (from ADD).

Ticker/Price	MRF IN/Rs 79,564
Market cap	US\$ 4.5bn
Shares o/s	4mn
3M ADV	US\$ 30.7mn
52wk high/low	Rs 81,249/Rs 49,915
Promoter/FPI/DII	28%/5%/14%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	158,370	159,911	154,695	188,628	208,497
EBITDA (Rs mn)	22,504	23,237	24,959	29,060	32,483
Adj. net profit (Rs mn)	10,969	13,950	10,689	12,792	14,222
Adj. EPS (Rs)	2,587.0	3,290.0	2,520.9	3,017.0	3,354.3
Adj. EPS growth (%)	0.4	27.2	(23.4)	19.7	11.2
Adj. ROAE (%)	10.3	11.6	8.2	8.9	9.1
Adj. P/E (x)	30.8	24.2	31.6	26.4	23.7
EV/EBITDA (x)	15.6	15.1	13.7	11.6	10.5

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
Net Revenues	41,864	39,476	6.0	24,306	72.2	66,169	83,571	(20.8)
Total Income (A)	41,864	39,476	6.0	24,306	72.2	66,169	83,571	(20.8)
Operating Expenses:								
Raw materials consumed	23,334	23,470	(0.6)	14,585	60.0	37,919	50,432	(24.8)
Employee Expenses	3,331	3,300	0.9	3,098	7.5	6,429	6,385	0.7
Other Expenses	6,654	7,299	(8.8)	3,309	101.1	9,962	15,318	(35.0)
Total Expenditure (B)	33,319	34,068	(2.2)	20,991	58.7	54,310	72,135	(24.7)
EBITDA (A-B)	8,544	5,408	58.0	3,315	157.7	11,860	11,436	3.7
Other Income	443	948	(53.3)	430	2.9	873	1,997	(56.3)
Depreciation	2,839	2,372	19.7	2,730	4.0	5,569	4,652	19.7
EBIT	6,148	3,984	54.3	1,016	505.1	7,164	8,781	(18.4)
Finance Costs	528	665	(20.6)	737	(28.4)	1,265	1,347	(6.1)
PBT before excep items	5,620	3,319	69.4	279	1,914.4	5,899	7,434	(20.6)
PBT after excep items	5,620	3,319	69.4	279	1,914.4	5,875	7,422	(20.8)
Tax expense	1,590	1,115	42.6	109	1,365.4	1,699	2,545	(33.3)
Reported PAT	4,030	2,204	82.9	171	2,263.8	4,177	4,877	(14.3)
Adjusted PAT	4,030	2,204	82.9	171	2,263.8	4,201	4,889	(14.1)

Source: Company, BOBCAPS Research

FIG 2 – KEY PARAMETERS

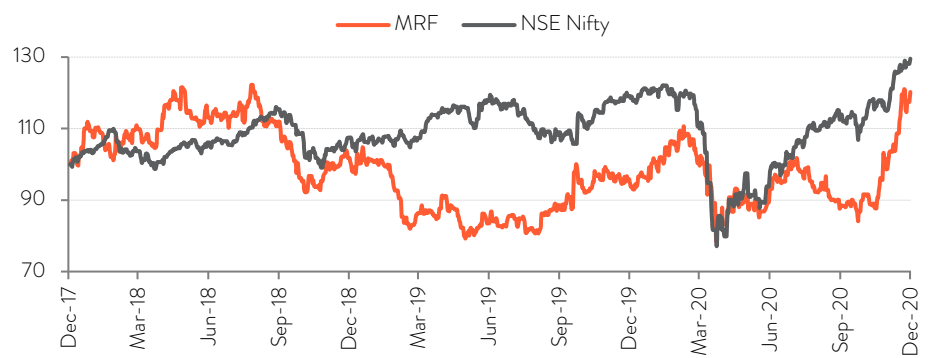
(%)	Q2FY21	Q2FY20	YoY (bps)	Q1FY21	QoQ (bps)	H1FY21	H1FY20	YoY (bps)
Gross Margin	44.3	40.5	371	40	427	42.7	39.7	304
EBITDA Margin	20.4	13.7	671	14	677	17.9	13.7	424
EBIT Margin	14.7	10.1	459	4	1,051	10.8	10.5	32
PBT Margin	13.4	8.4	502	1	1,228	8.9	8.9	2
Tax Rate	28.3	33.6	(531)	39	(1,060)	28.9	34.3	(538)
Adj PAT Margin	9.6	5.6	405	1	893	6.3	5.8	50

Source: Company, BOBCAPS Research

Valuation methodology

Restrictions on Chinese tyre imports should fuel strong replacement demand, aiding margins. We factor in strong volume growth led by domestic demand and lower imports but believe margins could come under significant pressure due to the sudden jump in input costs. Revenue/EBITDA/PAT are forecast to post a 16%/14%/15% CAGR over FY21-FY23. After the recent 30% rally, MRF now trades at 25x Sep'22E EPS. Our Sep'21 target price remains at 23x Sep'22E EPS – downgrade to SELL (from ADD) on rich valuations.

FIG 3 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- A faster-than-expected recovery in OE demand may favourably impact revenues.
- A fall in prices of natural rubber or crude derivatives could enhance margins.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	158,370	159,911	154,695	188,628	208,497
EBITDA	22,504	23,237	24,959	29,060	32,483
Depreciation	8,063	9,806	11,420	13,545	15,882
EBIT	18,616	16,736	16,536	18,939	20,579
Net interest income/(expenses)	(2,528)	(2,743)	(2,246)	(1,838)	(1,566)
Other income/(expenses)	4,175	3,305	2,996	3,424	3,978
Exceptional items	(1,356)	0	0	0	0
EBT	14,733	13,993	14,290	17,102	19,014
Income taxes	5,120	43	3,601	4,310	4,791
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	9,613	13,950	10,689	12,792	14,222
Adjustments	1,356	0	0	0	0
Adjusted net profit	10,969	13,950	10,689	12,792	14,222

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	23,276	23,401	23,300	31,448	29,764
Other current liabilities	21,389	24,404	23,405	35,570	33,601
Provisions	1,571	3,422	3,422	3,422	3,422
Debt funds	18,675	10,210	10,210	10,210	8,210
Other liabilities	2,441	5,781	5,781	5,781	5,781
Equity capital	42	42	42	42	42
Reserves & surplus	106,491	120,001	130,614	143,104	156,991
Shareholders' fund	106,533	120,044	130,656	143,147	157,034
Total liabilities and equities	173,885	187,263	196,775	229,579	237,812
Cash and cash eq.	601	11,069	3,987	3,699	4,733
Accounts receivables	23,616	22,570	24,751	32,067	31,275
Inventories	29,509	28,527	29,392	39,612	37,530
Other current assets	1,775	151	464	566	521
Investments	38,484	15,402	21,402	21,402	23,402
Net fixed assets	67,675	88,492	97,072	113,527	122,645
CWIP	14,032	17,346	16,000	15,000	14,000
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(8,392)	(4,278)	(4,278)	(4,278)	(4,278)
Other assets	6,585	7,985	7,985	7,985	7,985
Total assets	173,885	187,263	196,775	229,579	237,812

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	17,676	23,756	22,108	26,337	30,104
Interest expenses	2,528	2,743	2,246	1,838	(1,566)
Non-cash adjustments	(4,175)	(3,305)	(2,996)	(3,424)	(3,978)
Changes in working capital	(7,962)	10,584	(4,460)	2,677	(734)
Other operating cash flows	1,356	0	0	0	0
Cash flow from operations	9,422	33,778	16,899	27,427	23,826
Capital expenditures	(18,228)	(33,937)	(18,654)	(29,000)	(24,000)
Change in investments	2,980	23,082	(6,000)	0	(2,000)
Other investing cash flows	4,175	3,305	2,996	3,424	3,978
Cash flow from investing	(11,073)	(7,549)	(21,658)	(25,576)	(22,022)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	1,669	(8,465)	0	0	(2,000)
Interest expenses	(2,528)	(2,743)	(2,246)	(1,838)	(1,566)
Dividends paid	0	(509)	(76)	(302)	(335)
Other financing cash flows	1,724	(4,044)	0	0	0
Cash flow from financing	866	(15,761)	(2,322)	(2,140)	(3,901)
Changes in cash and cash eq.	(786)	10,468	(7,081)	(288)	(2,097)
Closing cash and cash eq.	601	11,069	3,987	3,699	4,733

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	2,587.0	3,290.0	2,520.9	3,017.0	3,354.3
Adjusted EPS	2,587.0	3,290.0	2,520.9	3,017.0	3,354.3
Dividend per share	0.0	100.0	17.8	71.2	79.1
Book value per share	25,125.7	28,312.1	30,815.2	33,761.0	37,036.2

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	2.2	2.2	2.2	1.8	1.6
EV/EBITDA	15.6	15.1	13.7	11.6	10.5
Adjusted P/E	30.8	24.2	31.6	26.4	23.7
P/BV	3.2	2.8	2.6	2.4	2.1

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	74.4	99.7	74.8	74.8	74.8
Interest burden (PBT/EBIT)	79.1	83.6	86.4	90.3	92.4
EBIT margin (EBIT/Revenue)	11.8	10.5	10.7	10.0	9.9
Asset turnover (Revenue/Avg TA)	130.5	121.3	109.4	123.4	126.3
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.1	1.1	1.1
Adjusted ROAE	10.8	12.3	8.5	9.3	9.5

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	7.2	1.0	(3.3)	21.9	10.5
EBITDA	1.0	3.3	7.4	16.4	11.8
Adjusted EPS	0.4	27.2	(23.4)	19.7	11.2
Profitability & Return ratios (%)					
EBITDA margin	14.2	14.5	16.1	15.4	15.6
EBIT margin	11.8	10.5	10.7	10.0	9.9
Adjusted profit margin	6.9	8.7	6.9	6.8	6.8
Adjusted ROAE	10.3	11.6	8.2	8.9	9.1
ROCE	9.4	12.0	8.5	9.0	9.1
Working capital days (days)					
Receivables	52	53	56	55	55
Inventory	59	66	68	67	68
Payables	76	90	95	89	90
Ratios (x)					
Gross asset turnover	0.6	0.8	0.9	0.9	1.0
Current ratio	1.2	1.2	1.2	1.1	1.1
Net interest coverage ratio	7.4	6.1	7.4	10.3	13.1
Adjusted debt/equity	0.2	0.1	0.1	0.1	0.1

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

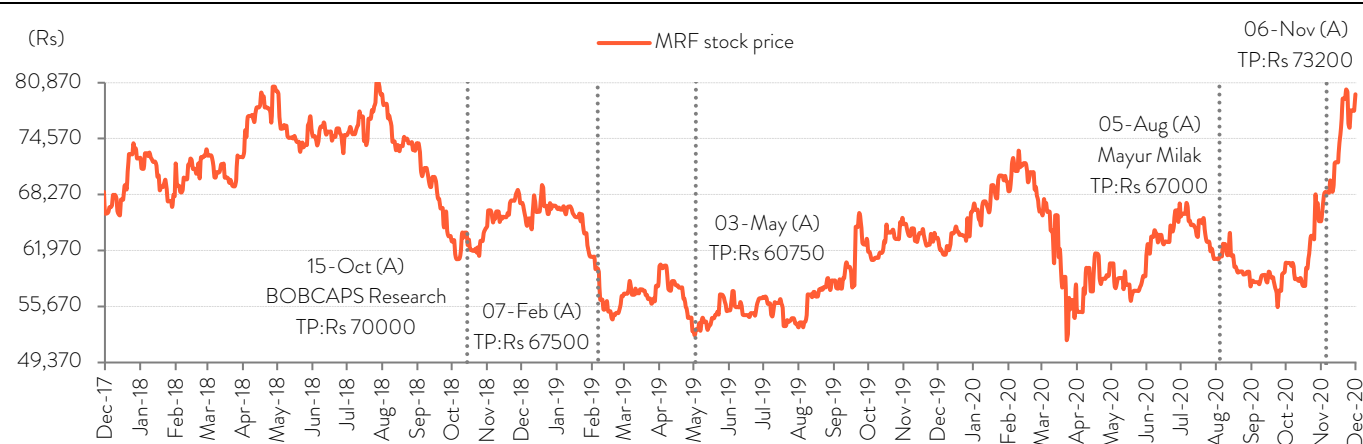
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): MRF (MRF IN)



B – Buy, A – Add, R – Reduce, S – Sell

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