

**SELL**

TP: Rs 67,000 | ▼16%

**MRF**

| Auto Components

| 09 August 2021

### Margins to remain under pressure

- Q1 revenue fell 13% QoQ, EBITDA margin shrank 400bps on gross margin pressure and adj. PAT fell 49% QoQ to Rs 1.6bn
- EBITDA margin likely to remain stressed led by RM inflation, a higher share of CV tyres and rising OEM share in sales
- Our Mar'22 TP remains at Rs 67,000 based on 22x FY23E P/E – reiterate **SELL**

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**Gross margin downtrend continues:** MRF's Q1FY22 revenue was 8% lower than our estimate at Rs 41.3bn (-13% QoQ). Gross margin declined by 60bps QoQ (-250bps est.) but was offset by flattish staff and other expenses despite lower volumes. EBITDA margin came in at 11.8% (13.1% est.) and EBITDA fell 35% QoQ to Rs 4.9bn. Adj. PAT declined 49% QoQ to Rs 1.6bn.

**Margin headwinds ahead:** Natural rubber prices have increased from Rs 120/kg in Q2FY21 to Rs 175/kg currently while crude derivatives have moved up ~40% over same period. This has resulted in gross margin contraction of ~600bps from Q2FY21 levels. The increase in rubber prices appears structural in nature, and we expect a further rise to Rs 200-210/kg as the economy revives. Crude price is forecast to remain rangebound at US\$ 65-70/bbl.

**Adverse sales mix to further dampen profitability:** We believe MRF's product mix will weaken as the share of OEM sales rises. Expected strong growth in the CV segment may help volumes but will be EBITDA margin-dilutive.

**Expect muted 6% EPS CAGR:** We maintain our revenue and earnings estimates for FY22/FY23 and introduce forecasts for FY24, projecting a revenue/EBITDA/adj. PAT CAGR of +14%/+8%/+6% over FY21-FY24. Our FY22/FY23 EPS estimates stand at Rs 2,769/Rs 3,080. While our revenue estimates for these years are in line with consensus, we are ~12% below on EBITDA as we bake in 200bps lower gross margins due to raw material cost pressure and the inability of tyre companies to fully pass on the cost. Our EPS estimates remain 25-30% below the street.

**Maintain SELL:** We maintain our Mar'22 TP at Rs 67,000, based on an unchanged 22x FY23E P/E. Our target multiple is in line with the stock's long-term average as well as the premium it has historically commanded against peers. Historically, input cost pressures have caused a derating in the Indian tyre industry and we believe this risk is elevated at present. **SELL**.

### Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	MRF IN/Rs 80,051
Market cap	US\$ 4.5bn
Free float	72%
3M ADV	US\$ 15.4mm
52wk high/low	Rs 98,600/Rs 55,300
Promoter/FPI/DII	28%/5%/14%

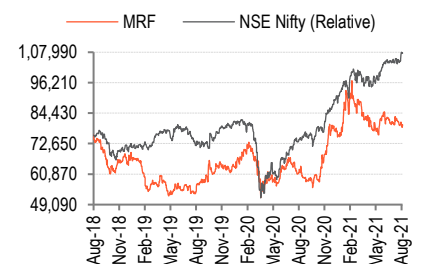
Source: NSE | Price as of 9 Aug 2021

### Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	159,214	192,643	213,721
EBITDA (Rs mn)	28,947	28,662	32,381
Adj. net profit (Rs mn)	12,491	11,741	13,060
Adj. EPS (Rs)	2,945.9	2,769.2	3,080.1
Consensus EPS (Rs)	2,945.9	3,514.0	4,332.0
Adj. ROAE (%)	9.5	8.2	8.4
Adj. P/E (x)	27.2	28.9	26.0
EV/EBITDA (x)	11.9	11.8	10.6
Adj. EPS growth (%)	(10.5)	(6.0)	11.2

Source: Company, Bloomberg, BOBCAPS Research

### Stock performance



Source: NSE



**Fig 1 – Quarterly performance**

(Rs mn)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)	FY21	FY20	YoY (%)
Net Revenues	41,277	24,306	69.8	47,377	(12.9)	159,214	159,911	(0.4)
<b>Total Income (A)</b>	<b>41,277</b>	<b>24,306</b>	<b>69.8</b>	<b>47,377</b>	<b>(12.9)</b>	<b>159,214</b>	<b>159,911</b>	<b>(0.4)</b>
<b>Operating Expenses:</b>								
Raw materials consumed	25,629	14,585	75.7	29,139	(12.0)	92,288	95,089	(2.9)
Employee Expenses	3,544	3,098	14.4	3,521	0.7	13,879	13,205	5.1
Other Expenses	7,232	3,309	118.6	7,261	(0.4)	24,100	28,380	(15.1)
<b>Total Expenditure (B)</b>	<b>36,405</b>	<b>20,991</b>	<b>73.4</b>	<b>39,921</b>	<b>(8.8)</b>	<b>130,267</b>	<b>136,674</b>	<b>(4.7)</b>
<b>EBITDA (A-B)</b>	<b>4,872</b>	<b>3,315</b>	<b>47.0</b>	<b>7,456</b>	<b>(34.7)</b>	<b>28,947</b>	<b>23,237</b>	<b>24.6</b>
Other Income	924	430	114.6	565	63.4	2,072	3,305	(37.3)
Depreciation	3,007	2,730	10.2	2,970	1.3	11,369	9,806	29
EBIT	2,788	1,016	174.4	5,051	(44.8)	19,650	16,736	17.4
Finance Costs	621	737	(15.8)	745	(16.7)	2,647	2,743	0
PBT before excep items	2,168	279	677.0	4,306	(49.7)	17,003	13,993	21.5
PBT after excep items	2,168	279	677.0	4,306	(49.7)	17,003	13,993	21.5
Tax expense	555	109	411.1	1,134	(51.1)	4,512	43	10296.5
Reported PAT	1,613	171	846.2	3,173	(49.1)	12,491	13,950	(10.5)
<b>Adjusted PAT</b>	<b>1,613</b>	<b>171</b>	<b>846.2</b>	<b>3,173</b>	<b>(49.1)</b>	<b>12,491</b>	<b>13,950</b>	<b>(10.5)</b>

Source: Company, BOBCAPS Research

**Fig 2 – Key parameters**

(%)	Q1FY22	Q1FY21	YoY (bps)	Q4FY21	QoQ (bps)	FY21	FY20	YoY (bps)
Gross margin	37.9	40.0	(208)	38	(58)	42.0	40.5	150
EBITDA margin	11.8	13.6	(184)	16	(393)	18.2	14.5	365
EBIT margin	6.8	4.2	258	11	(391)	12.3	10.5	188
PBT margin	5.3	1.1	410	9	(384)	10.7	8.8	193
Tax rate	25.6	38.9	(1331)	26	(75)	26.5	0.3	2623
Adj PAT margin	3.9	0.7	321	7	(279)	7.8	8.7	(88)

Source: Company, BOBCAPS Research

## Valuation methodology

We maintain our revenue and earnings estimates for FY22/FY23 and introduce forecasts for FY24, projecting a revenue/EBITDA/adj. PAT CAGR of +14%/+8%/+6% over FY21-FY24. Our FY22/FY23 EPS estimates stand at Rs 2,769/Rs 3,080. While our revenue estimates for these years are in line with consensus, we are ~12% below on EBITDA as we bake in 200bps lower gross margins due to raw material cost pressure and the inability of tyre companies to fully pass on the cost. Our EPS estimates remain 25-30% below the street

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**Fig 3 – Key assumptions**

(Rs mn)	FY21	FY22E	FY23E	FY24E
Revenues	159,214	192,643	s 213,721	234,554
EBITDA	28,947	28,662	32,381	36,377
OPM (%)	18.18	14.9	15	15.51
Adj. PAT	12,491	11,741	13,060	15,051
EPS (Rs)	2,946	2,769	3,080	3,550

Source: Company, BOBCAPS Research

**Fig 4 – Peer comparison**

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY21-23E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
					FY22E	FY23E	FY22E	FY23E	
CEAT	CEAT IN	SELL	840	15.7	57.5	59.9	7.0	6.8	14
Apollo Tyres	APTY IN	SELL	140	11.3	7.9	9.0	4.0	4.2	16
Balkrishna Industries	BIL IN	SELL	1,550	12.4	64.8	70.3	17.9	16.8	22
MRF	MRF IN	SELL	67,000	15.9	2,769.2	3,080.1	7.7	7.9	22
TVS Srichakra	SRTY IN	SELL	1,200	15.2	78.3	85.2	6.8	7.1	14
JK Tyres	JKI IN	SELL	90	12.8	8.0	12.6	6.6	9.6	7

Source: BOBCAPS Research

## Key risks

Key upside risks to our estimates are:

- above-expected volume growth,
- softening raw material prices, and
- market share gains.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Apollo Tyres	APTY IN	1.7	223	140	SELL
Balkrishna Industries	BIL IN	6.1	2,344	1,550	SELL
Ceat	CEAT IN	0.7	1,327	840	SELL
Eicher Motors	EIM IN	10.0	2,729	2,200	SELL
Escorts	ESC IN	2.0	1,194	1,350	BUY
GNA Axles	GNA IN	0.1	734	540	HOLD
JK Tyre & Industries	JKI IN	0.5	152	90	SELL
Minda Corporation	MDA IN	0.4	133	140	BUY
MRF	MRF IN	4.5	80,051	67,000	SELL
Swaraj Engines	SWE IN	0.3	1,781	1,600	SELL
TVS Srichakra	SRTY IN	0.2	2,133	1,200	SELL

Source: BOBCAPS Research, NSE | Price as of 9 Aug 2021

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Total revenue</b>	<b>159,911</b>	<b>159,214</b>	<b>192,643</b>	<b>213,721</b>	<b>234,554</b>
EBITDA	23,237	28,947	28,662	32,381	36,377
Depreciation	9,806	11,369	13,432	15,668	17,474
EBIT	16,736	19,650	17,146	18,909	21,572
Net interest inc./(exp.)	(2,743)	(2,647)	(1,449)	(1,449)	(1,449)
Other inc./(exp.)	3,305	2,072	1,917	2,197	2,669
Exceptional items	0	0	0	0	0
EBT	13,993	17,003	15,697	17,460	20,122
Income taxes	43	4,512	3,956	4,400	5,071
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
<b>Reported net profit</b>	<b>13,950</b>	<b>12,491</b>	<b>11,741</b>	<b>13,060</b>	<b>15,051</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>13,950</b>	<b>12,491</b>	<b>11,741</b>	<b>13,060</b>	<b>15,051</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	23,401	42,449	49,803	52,570	57,476
Other current liabilities	24,404	26,970	35,468	38,100	41,612
Provisions	3,422	4,110	4,110	4,110	4,110
Debt funds	10,210	8,526	8,526	8,526	8,526
Other liabilities	5,781	4,969	4,969	4,969	4,969
Equity capital	42	42	42	42	42
Reserves & surplus	120,001	131,746	143,211	155,962	170,659
Shareholders' fund	120,044	131,789	143,253	156,005	170,701
<b>Total liab. and equities</b>	<b>187,263</b>	<b>218,811</b>	<b>246,127</b>	<b>264,279</b>	<b>287,394</b>
Cash and cash eq.	11,069	1,053	1,150	1,131	1,532
Accounts receivables	22,570	22,205	26,970	29,921	32,838
Inventories	28,527	28,803	36,602	38,470	42,220
Other current assets	151	94	193	214	235
Investments	15,402	58,762	54,762	62,762	76,262
Net fixed assets	88,492	93,911	110,479	116,811	119,337
CWIP	17,346	10,010	12,000	11,000	11,000
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(4,278)	(3,785)	(3,785)	(3,785)	(3,785)
Other assets	7,985	7,756	7,756	7,756	7,756
<b>Total assets</b>	<b>187,263</b>	<b>218,811</b>	<b>246,127</b>	<b>264,279</b>	<b>287,394</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Cash flow from operations</b>	<b>33,778</b>	<b>46,187</b>	<b>27,896</b>	<b>25,642</b>	<b>30,138</b>
Capital expenditures	(33,937)	(9,453)	(31,990)	(21,000)	(20,000)
Change in investments	23,082	(43,360)	4,000	(8,000)	(13,500)
Other investing cash flows	3,305	2,072	1,917	2,197	2,669
<b>Cash flow from investing</b>	<b>(7,549)</b>	<b>(50,741)</b>	<b>(26,073)</b>	<b>(26,803)</b>	<b>(30,831)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(8,465)	(1,684)	0	0	0
Interest expenses	(2,743)	(2,647)	(1,449)	(1,449)	(1,449)
Dividends paid	(509)	(636)	(277)	(308)	(355)
Other financing cash flows	(4,044)	(493)	0	0	0
<b>Cash flow from financing</b>	<b>(15,761)</b>	<b>(5,461)</b>	<b>(1,726)</b>	<b>(1,757)</b>	<b>(1,804)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>10,468</b>	<b>(10,015)</b>	<b>97</b>	<b>(2,918)</b>	<b>(2,497)</b>
<b>Closing cash &amp; cash eq.</b>	<b>11,069</b>	<b>1,053</b>	<b>1,150</b>	<b>1,131</b>	<b>1,131</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	3,290.0	2,945.9	2,769.2	3,080.1	3,549.9
Adjusted EPS	3,290.0	2,945.9	2,769.2	3,080.1	3,549.9
Dividend per share	100.0	150.0	65.3	72.6	83.7
Book value per share	28,312.1	31,082.2	33,786.1	36,793.6	40,259.7

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	2.2	2.2	1.8	1.6	1.5
EV/EBITDA	15.2	11.9	11.8	10.6	9.4
Adjusted P/E	24.3	27.2	28.9	26.0	22.6
P/BV	2.8	2.6	2.4	2.2	2.0

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	99.7	73.5	74.8	74.8	74.8
Interest burden (PBT/EBIT)	83.6	86.5	91.5	92.3	93.3
EBIT margin (EBIT/Revenue)	10.5	12.3	8.9	8.8	9.2
Asset turnover (Rev./Avg TA)	121.3	113.2	127.6	131.0	132.6
Leverage (Avg TA/Avg Equity)	1.2	1.1	1.1	1.1	1.1
Adjusted ROAE	12.3	9.9	8.5	8.7	9.2

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	1.0	(0.4)	21.0	10.9	9.7
EBITDA	3.3	24.6	(1.0)	13.0	12.3
Adjusted EPS	27.2	(10.5)	(6.0)	11.2	15.2
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	14.5	18.2	14.9	15.2	15.5
EBIT margin	10.5	12.3	8.9	8.8	9.2
Adjusted profit margin	8.7	7.8	6.1	6.1	6.4
Adjusted ROAE	11.6	9.5	8.2	8.4	8.8
ROCE	12.0	9.9	8.3	8.4	8.9
<b>Working capital days (days)</b>					
Receivables	53	51	47	49	49
Inventory	66	66	62	64	63
Payables	90	130	142	142	140
<b>Ratios (x)</b>					
Gross asset turnover	0.8	0.9	0.9	0.9	0.9
Current ratio	1.2	0.7	0.7	0.7	0.7
Net interest coverage ratio	6.1	7.4	11.8	13.0	14.9
Adjusted debt/equity	0.1	0.1	0.1	0.1	0.0

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

## Disclaimer

### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

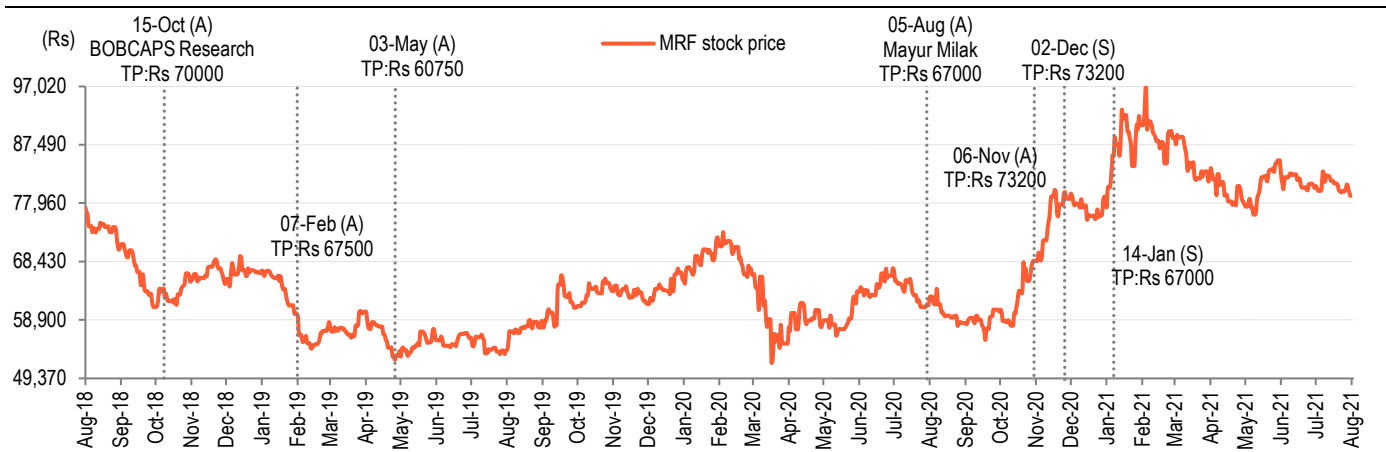
**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

### Ratings and Target Price (3-year history): MRF (MRF IN)



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

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