

**ADD**

TP: Rs 60,750 | ▲ 14%

**MRF**

| Auto Components

| 03 May 2019

## Operating margins continue to slide

**MRF's Q3FY19 revenue grew 5% YoY to Rs 40.7bn, but a 170bps contraction in gross margin and 200bps rise in other expense/sales prompted a 17% YoY drop in EBITDA to Rs 5.7bn and 370bps decline in operating margin to 14%. A below-expected tax rate limited the fall in adj. PAT to 24% YoY at Rs 2.9bn. We prune our FY20/FY21 EPS estimates by ~9% each assuming lower gross margins and weaker demand outlook going ahead and roll over to a Mar'20 TP of Rs 60,750 (vs. Rs 67,500 previously).**

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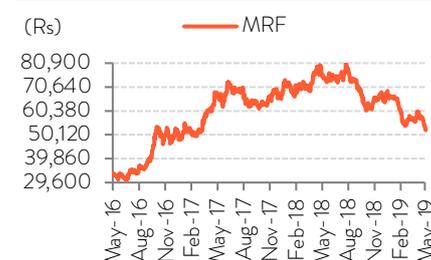
**Operating performance stays weak:** MRF's revenue met expectations at Rs 40.7bn (+5.4% YoY) but EBITDA declined 16.7% YoY to Rs 5.7bn, with softer operating margins of 14% (-370bps YoY, +30bps QoQ). The lower operating profits stemmed from a 170bps YoY gross margin contraction coupled with a sharp 200bps increase in other expense/sales ratio. However, aided by a below-expected tax rate, the fall in adj. PAT was limited to 24% YoY at Rs 2.9bn.

Ticker/Price	MRF IN/Rs 53,110
Market cap	US\$ 3.2bn
Shares o/s	4mn
3M ADV	US\$ 6.6mn
52wk high/low	Rs 69,900/Rs 51,586
Promoter/FPI/DII	28%/6%/15%

Source: NSE

**Subdued FY19:** MRF posted consolidated revenue growth of 7.4% YoY for the year to Rs 160.6bn. FY19 EBITDA improved a mere 1% YoY while operating margins shrank 90bps to 14.4% as higher other expenses/sales (+140bps) more than offset gross margin improvement of 50bps, while staff costs/sales remained stable. Adj. PAT was flat at Rs 11.3bn supported by a 27% rise in other income.

## STOCK PERFORMANCE



Source: NSE

**Maintain ADD:** We cut FY20/FY21 earnings estimates by 8.7%/9.1% to factor in lower gross margins owing to rise in crude prices and weaker demand outlook. Rolling valuations forward, we have a revised Mar'20 TP of Rs 60,750 (vs. Rs 67,500 for Dec'19), set at an unchanged P/E multiple of 18x one-year forward earnings.

## KEY FINANCIALS

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	14,862	11,316	11,306	13,928	14,312
Adj. EPS (Rs)	3,505.2	2,668.9	2,666.5	3,285.0	3,375.5
Adj. EPS growth (%)	(40.8)	(23.9)	(0.1)	23.2	2.8
Adj. ROAE (%)	17.2	11.6	10.4	11.4	10.5
Adj. P/E (x)	15.2	19.9	19.9	16.2	15.7
EV/EBITDA (x)	8.5	9.9	9.8	8.4	8.1

Source: Company, BOBCAPS Research

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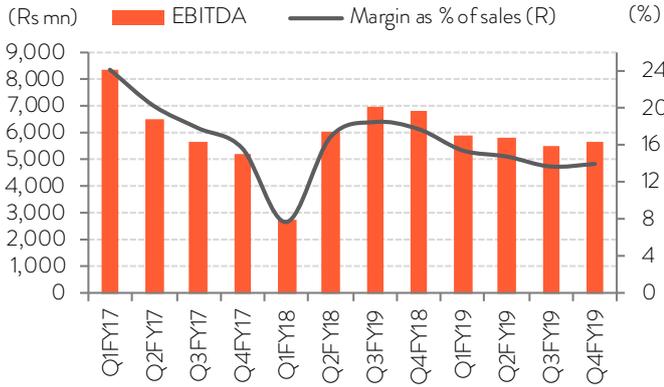


**FIG 1 – QUARTERLY PERFORMANCE**

Y/E Mar (Rs mn)	Q4FY19	Q4FY18	YoY (%)	Q3FY19	QoQ (%)
<b>Net Revenues</b>	<b>40,735</b>	<b>38,654</b>	<b>5.4</b>	<b>40,338</b>	<b>1.0</b>
Raw Materials	24,817	22,872	8.5	24,736	0.3
% of Net Sales	60.9	59.2	-	61.3	-
Personnel	2,864	2,719	5.3	2,979	(3.9)
% of Net Sales	7.0	7.0	-	7.4	-
Manufacturing & Other Exp	7,342	6,203	18.4	7,104	3.4
% of Net Sales	18.0	16.0	-	17.6	-
Total Expenditure	35,022	31,794	10.2	34,819	0.6
<b>EBITDA</b>	<b>5,712</b>	<b>6,860</b>	<b>(16.7)</b>	<b>5,518</b>	<b>3.5</b>
EBITDA Margin (%)	14.0	17.7	-	13.7	-
Depreciation	2,146	1,867	14.9	2,052	4.6
<b>EBIT</b>	<b>3,567</b>	<b>4,993</b>	<b>(28.6)</b>	<b>3,466</b>	<b>2.9</b>
Interest Expenses	573	648	(11.6)	631	(9.2)
Non-operating income	1,095	794	37.9	1,258	(12.9)
<b>PBT</b>	<b>4,088</b>	<b>5,139</b>	<b>(20.4)</b>	<b>4,093</b>	<b>(0.1)</b>
Tax-Total	1,150	1,285	(10.5)	1,300	(11.5)
Tax Rate (%) - Total	28.1	25.0	12.5	31.8	-
<b>Reported PAT</b>	<b>2,938</b>	<b>3,853</b>	<b>(23.7)</b>	<b>2,793</b>	<b>5.2</b>
<b>Adj. PAT</b>	<b>2,938</b>	<b>3,853</b>	<b>(23.7)</b>	<b>2,793</b>	<b>5.2</b>
<b>PAT Margin</b>	<b>7.2</b>	<b>10.0</b>	<b>-</b>	<b>6.9</b>	<b>-</b>

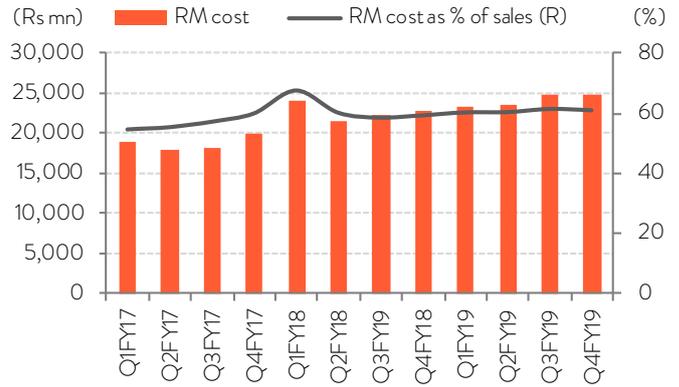
Source: Company, BOBCAPS Research

**FIG 2 – EBITDA MARGIN TREND**



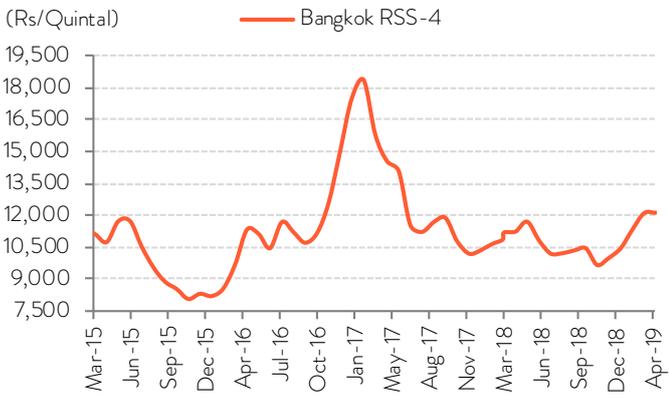
Source: Company, BOBCAPS Research

**FIG 3 – RAW MATERIAL COST TREND**



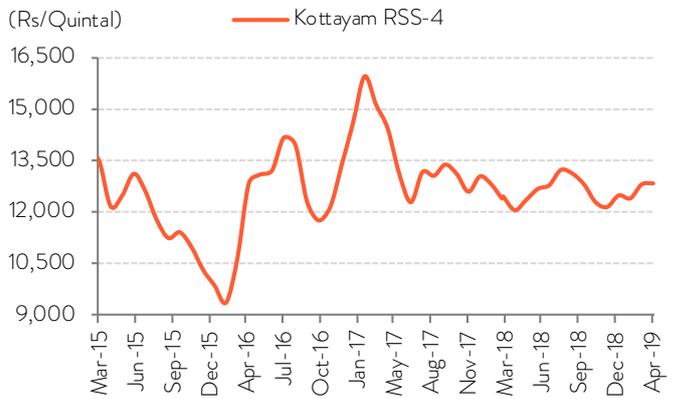
Source: Company, BOBCAPS Research

**FIG 4 – BANGKOK RSS-4 RUBBER PRICE TREND**



Source: Company, BOBCAPS Research

**FIG 5 – KOTTAYAM RSS-4 RUBBER PRICE TREND**



Source: Company, BOBCAPS Research

## Valuation methodology

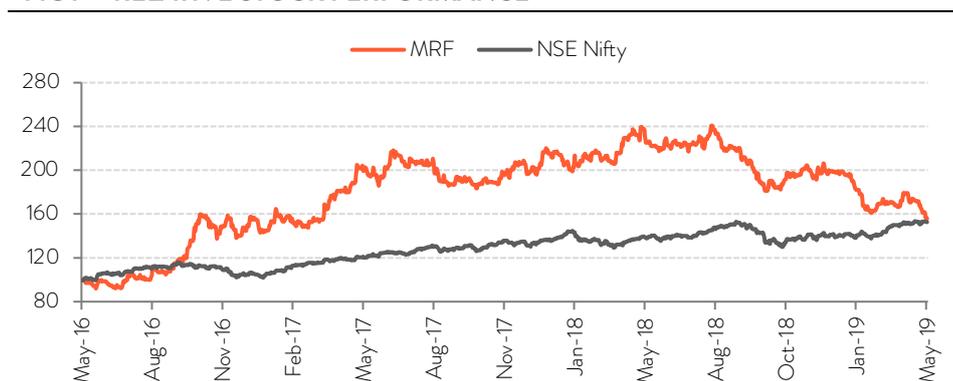
We cut FY20/FY21 earnings estimates by 8.7%/9.1% to factor in lower gross margins owing to rise in crude prices and weaker demand outlook. We expect MRF to register an 8%/8.1% consolidated revenue/EPS CAGR over FY18-FY21. Rolling valuations forward, we have a revised Mar'20 target price of Rs 60,750 (vs. Rs 67,500 for Dec'19). Our target is set at an unchanged P/E multiple of 18x one-year forward earnings, a 35% premium to the stock's past five-year average. Maintain ADD.

**FIG 6 – REVISED ESTIMATES**

Change (%)	FY20E	FY21E
Income	(2.8)	(3.3)
EBITDA	(10.4)	(10.9)
EBITDA Margin (bps)	(128)	(126)
Profit	(8.7)	(9.1)
EPS	(8.7)	(9.1)

Source: Company, BOBCAPS Research

**FIG 7 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

- Ramp-up of capacities and commencement of the Gujarat greenfield project can have an adverse impact in terms of high start-up costs and low utilisation.
- Delays in the capex programme or a decision to opt for an acquisition may entail higher debt or additional fund raising.
- Being a net exporter, an appreciating rupee can pose a risk to profitability.
- As most peers are also increasing tyre capacity, competitive intensity in the market could rise.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Total revenue</b>	<b>134,122</b>	<b>149,544</b>	<b>160,625</b>	<b>178,603</b>	<b>188,791</b>
EBITDA	26,456	22,818	23,054	26,899	27,843
EBIT	20,350	15,751	14,978	17,935	17,983
Net interest income/(expenses)	2,566	2,531	2,673	2,435	2,404
Other income/(expenses)	3,310	3,307	4,217	4,748	5,223
Exceptional items	24	0	0	0	0
EBT	21,118	16,527	16,522	20,248	20,803
Income taxes	6,232	5,210	5,216	6,319	6,491
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>14,887</b>	<b>11,316</b>	<b>11,306</b>	<b>13,928</b>	<b>14,312</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>14,862</b>	<b>11,316</b>	<b>11,306</b>	<b>13,928</b>	<b>14,312</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Accounts payables	14,084	15,685	17,094	18,105	19,138
Other current liabilities	19,773	22,325	26,342	27,942	29,542
Provisions	1,871	1,557	3,176	3,326	3,476
Debt funds	23,328	21,636	21,024	20,824	21,024
Other liabilities	0	0	0	0	0
Equity capital	42	42	42	42	42
Reserves & surplus	86,365	97,340	108,331	121,984	135,999
Shareholders' fund	86,405	97,380	108,373	122,026	136,043
<b>Total liabilities and equities</b>	<b>145,461</b>	<b>158,584</b>	<b>176,009</b>	<b>192,223</b>	<b>209,222</b>
Cash and cash eq.	3,426	2,337	1,045	996	676
Accounts receivables	19,690	21,499	23,827	26,423	27,413
Inventories	24,253	21,973	29,932	33,282	34,655
Other current assets	5,786	5,809	9,165	9,431	9,697
Investments	33,821	41,450	38,547	43,547	51,047
Net fixed assets	55,022	60,922	67,860	77,146	84,536
CWIP	8,479	10,789	14,035	10,000	10,000
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(5,017)	(6,196)	(8,402)	(8,602)	(8,802)
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>145,461</b>	<b>158,584</b>	<b>176,009</b>	<b>192,223</b>	<b>209,222</b>

Source: Company, BOBCAPS Research

### Cash Flows

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Net income + Depreciation	20,992	18,383	19,382	22,892	24,172
Interest expenses	2,566	2,531	2,673	2,435	2,404
Non-cash adjustments	1,492	1,179	2,206	200	200
Changes in working capital	(4,410)	3,134	(6,598)	(3,451)	354
Other operating cash flows	24	0	0	0	0
<b>Cash flow from operations</b>	<b>20,664</b>	<b>25,227</b>	<b>17,664</b>	<b>22,076</b>	<b>27,130</b>
Capital expenditures	(12,932)	(15,276)	(18,260)	(14,215)	(17,250)
Change in investments	(2,442)	(7,629)	2,903	(5,000)	(7,500)
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(15,374)</b>	<b>(22,905)</b>	<b>(15,357)</b>	<b>(19,215)</b>	<b>(24,750)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(1,311)	(1,692)	(612)	(200)	200
Interest expenses	(2,566)	(2,531)	(2,673)	(2,435)	(2,404)
Dividends paid	424	255	254	276	297
Other financing cash flows	346	584	1,638	(350)	(393)
<b>Cash flow from financing</b>	<b>(3,106)</b>	<b>(3,385)</b>	<b>(1,393)</b>	<b>(2,710)</b>	<b>(2,300)</b>
<b>Changes in cash and cash eq.</b>	<b>2,184</b>	<b>(1,063)</b>	<b>915</b>	<b>151</b>	<b>80</b>
<b>Closing cash and cash eq.</b>	<b>3,426</b>	<b>2,363</b>	<b>3,251</b>	<b>1,196</b>	<b>1,076</b>

### Per Share

Y/E 31 Mar (Rs)	FY17A	FY18A	FY19E	FY20E	FY21E
Reported EPS	3,505.2	2,668.9	2,666.5	3,285.0	3,375.5
Adjusted EPS	3,505.2	2,668.9	2,666.5	3,285.0	3,375.5
Dividend per share	100.0	60.0	60.0	65.0	70.0
Book value per share	20,378.2	22,966.7	25,559.3	28,779.5	32,085.2

### Valuations Ratios

Y/E 31 Mar (x)	FY17A	FY18A	FY19E	FY20E	FY21E
EV/Sales	1.7	1.5	1.4	1.3	1.2
EV/EBITDA	8.5	9.9	9.8	8.4	8.1
Adjusted P/E	15.2	19.9	19.9	16.2	15.7
P/BV	2.6	2.3	2.1	1.8	1.7

### DuPont Analysis

Y/E 31 Mar (%)	FY17A	FY18A	FY19E	FY20E	FY21E
Tax burden (Net profit/PBT)	70.5	68.5	68.4	68.8	68.8
Interest burden (PBT/EBIT)	103.7	104.9	110.3	112.9	115.7
EBIT margin (EBIT/Revenue)	15.2	10.5	9.3	10.0	9.5
Asset turnover (Revenue/Avg TA)	124.7	124.6	122.1	123.5	119.0
Leverage (Avg TA/Avg Equity)	1.4	1.3	1.3	1.3	1.2
Adjusted ROAE	17.2	11.6	10.4	11.4	10.5

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

### Ratio Analysis

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
<b>YoY growth (%)</b>					
Revenue	(33.5)	11.5	7.4	11.2	5.7
EBITDA	(40.3)	(13.7)	1.0	16.7	3.5
Adjusted EPS	(40.8)	(23.9)	(0.1)	23.2	2.8
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	19.7	15.3	14.4	15.1	14.7
EBIT margin	15.2	10.5	9.3	10.0	9.5
Adjusted profit margin	11.1	7.6	7.0	7.8	7.6
Adjusted ROAE	17.2	11.6	10.4	11.4	10.5
ROCE	20.6	15.2	13.9	15.0	14.0
<b>Working capital days (days)</b>					
Receivables	54	52	54	54	53
Inventory	66	54	68	68	67
Payables	38	38	39	37	37
<b>Ratios (x)</b>					
Gross asset turnover	1.2	1.2	1.2	1.2	1.1
Current ratio	1.5	1.3	1.4	1.4	1.4
Net interest coverage ratio	7.9	6.2	5.6	7.4	7.5
Adjusted debt/equity	0.3	0.2	0.2	0.2	0.2

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

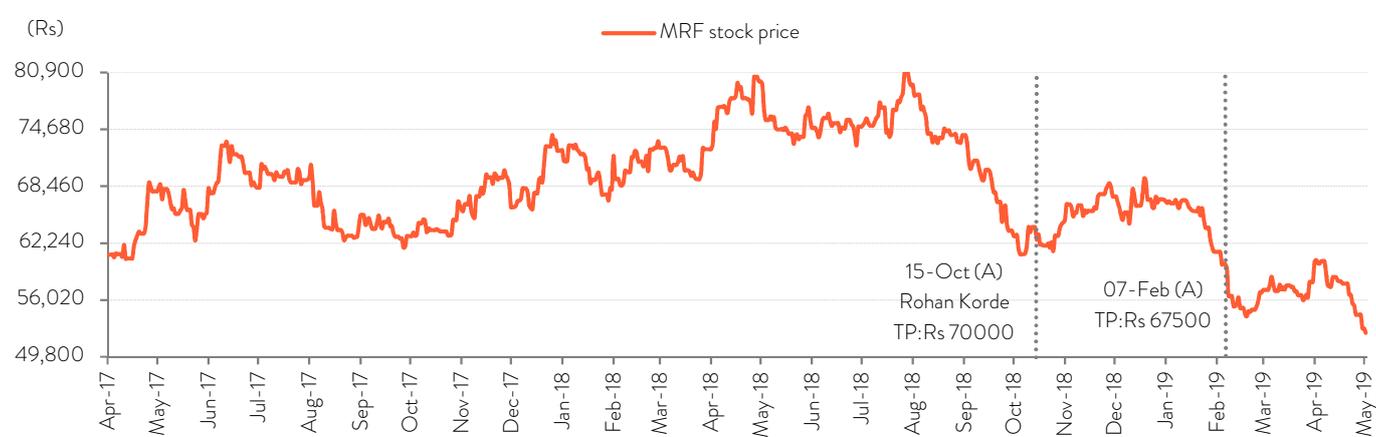
**ADD** – Expected return from >+5% to +15%

**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)

### HISTORICAL RATINGS AND TARGET PRICE: MRF (MRF IN)



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

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