

SELL

TP: Rs 510 | ▼ 18%

**MAHINDRA &
MAHINDRA**

Automobiles

10 November 2020

Tractor sales upbeat; valuations expensive – maintain SELL

M&M's (MM) Q2FY21 revenue grew 6% YoY to Rs 115.9bn and EBITDA margin was above our estimate at 17.8%. EBITDA increased 33% to Rs 20.6bn but PAT fell 3% to Rs 13.1bn. Tractors performed well with EBIT margin at 24.4% (+510bps YoY); auto margins also improved 70bps. We expect MM's tractor/auto segments to log a volume CAGR of 5%/1% over FY20-FY23, with overall EBITDA margin reviving to 14% levels from FY22. We continue to value the core business at 13x Sep'22E EPS and maintain our TP of Rs 510. SELL.

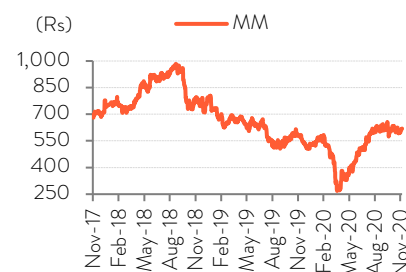
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Healthy operating performance: Revenues for MM+MVML grew 6% YoY to Rs 115.9bn, marginally above estimates. Above-expected RM cost/sales was more than offset by better operating efficiencies, resulting in EBITDA growth of 33% YoY to Rs 20.6bn (Rs 15.6bn est.) and an EBITDA margin of 17.8% (+370bps YoY). A significant jump in interest burden and fall in other income weighed on adj. PAT which declined 3% YoY to Rs 13.1bn. MM reported one-off impairment charges of Rs 11.5bn in Q2.

| | |
|------------------|---------------|
| Ticker/Price | MM IN/Rs 620 |
| Market cap | US\$ 10.4bn |
| Shares o/s | 1,242mn |
| 3M ADV | US\$ 46.9mn |
| 52wk high/low | Rs 667/Rs 245 |
| Promoter/FPI/DII | 20%/34%/24% |

Source: NSE

Strong tractor performance but auto remains a drag: We expect MM's tractor segment to witness 4% YoY volume growth in FY21 and post a 5% CAGR over FY20-FY23. However, the pain in its auto segments – UVs, CVs and 3Ws – will continue to mar the overall picture. We model for a mere 1% volume CAGR in the auto business through to FY23.

STOCK PERFORMANCE

Source: NSE

Maintain SELL: We estimate a 4% revenue CAGR for MM over FY20-FY23 coupled with expansion in operating margins, supporting higher 7% earnings growth. We continue to value the core business at 13x Sep'22E EPS and assign a 30% holding company discount for subsidiaries. Maintain SELL as we find current valuations rich at 24x FY22E core EPS (adj. for value of subsidiaries).

KEY FINANCIALS

| Y/E 31 Mar | FY19A | FY20A | FY21E | FY22E | FY23E |
|-------------------------|---------|---------|---------|---------|---------|
| Total revenue (Rs mn) | 528,482 | 448,655 | 379,868 | 463,238 | 511,660 |
| EBITDA (Rs mn) | 75,301 | 63,506 | 49,466 | 65,415 | 73,572 |
| Adj. net profit (Rs mn) | 54,239 | 35,509 | 29,918 | 40,535 | 45,525 |
| Adj. EPS (Rs) | 43.7 | 28.6 | 24.1 | 32.6 | 36.7 |
| Adj. EPS growth (%) | 29.5 | (34.5) | (15.7) | 35.5 | 12.3 |
| Adj. ROAE (%) | 16.6 | 10.2 | 8.4 | 10.6 | 11.1 |
| Adj. P/E (x) | 14.2 | 21.7 | 25.7 | 19.0 | 16.9 |
| EV/EBITDA (x) | 9.9 | 11.5 | 14.8 | 11.4 | 10.1 |

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

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



FIG 1 – QUARTERLY PERFORMANCE – MM +MVML

| Y/E Mar (Rs mn) | Q2FY21 | Q2FY20 | YoY (%) | Q1FY21 | QoQ (%) | H1FY21 | H1FY20 | YoY (%) |
|----------------------------------|----------------|----------------|---------------|---------------|----------------|----------------|----------------|---------------|
| Net Revenues | 115,903 | 109,351 | 6.0 | 55,894 | 107.4 | 171,798 | 237,405 | (27.6) |
| Raw Materials | 76,979 | 72,208 | 6.6 | 36,240 | 112.4 | 113,219 | 159,179 | (28.9) |
| % of Net Sales | 66.4 | 66.0 | - | 64.8 | - | 65.9 | 67.0 | - |
| Personnel | 7,920 | 8,131 | (2.6) | 7,704 | 2.8 | 15,624 | 16,810 | (7.1) |
| % of Net Sales | 6.8 | 7.4 | - | 13.8 | - | 9.1 | 7.1 | - |
| Manufacturing & Other Exp | 10,432 | 13,603 | (23.3) | 6,219 | 67.7 | 16,650 | 28,073 | (40.7) |
| % of Net Sales | 9.0 | 12.4 | - | 11.1 | - | 9.7 | 11.8 | -- |
| Total Expenditure | 95,330 | 93,942 | 1.5 | 50,163 | 90.0 | 145,493 | 204,062 | (28.7) |
| EBITDA | 20,573 | 15,408 | 33.5 | 5,732 | 258.9 | 26,305 | 33,344 | (21.1) |
| EBITDA Margin (%) | 17.8 | 14.1 | - | 10.3 | - | 15.3 | 14.0 | |
| Depreciation | 5,870 | 5,721 | 2.6 | 5,813 | 1.0 | 11,683 | 11,559 | 1.1 |
| EBIT | 14,703 | 9,688 | 51.8 | (81) | (18,274.4) | 14,622 | 21,784 | (32.9) |
| Interest Expenses | 1,179 | 331 | 256.0 | 768 | 53.4 | 1,947 | 633 | 207.7 |
| Non-operating income | 3,839 | 8,225 | (53.3) | 1,338 | 187.0 | 5,177 | 10,144 | (49.0) |
| Extraordinary Expenses/ (Income) | 11,495 | 0 | NA | (288) | NA | 11,206 | (13,671) | NA |
| PBT | 5,869 | 17,582 | (66.6) | 777 | 655.5 | 6,646 | 44,966 | (85.2) |
| Tax-Total | 4,252 | 4,034 | 5.4 | 99 | 4,198.8 | 4,350 | 8,821 | (50.7) |
| Tax Rate (%) - Total | 72.4 | 22.9 | | 12.7 | - | 65.5 | 19.6 | |
| Reported PAT | 1,618 | 13,548 | (88.1) | 678 | 138.6 | 2,295 | 36,145 | (93.6) |
| Adj. PAT | 13,112 | 13,548 | (3.2) | 389 | 3,266.4 | 13,502 | 22,475 | (39.9) |
| PAT Margin | 11.3 | 12.4 | - | 0.7 | - | 7.9 | 9.5 | - |

Source: Company, BOBCAPS Research

FIG 2 – KEY PARAMETERS

| Y/E Mar (Rs) | Q2FY21 | Q2FY20 | YoY (%) | Q1FY21 | QoQ (%) | H1FY21 | H1FY20 | YoY (%) |
|-------------------------|---------|---------|---------|---------|---------|---------|---------|---------|
| Sales Volume (nos) | 185,270 | 191,390 | (3.2) | 95,308 | 94.4 | 280,578 | 409,429 | (31.5) |
| Net Realisation/Vehicle | 625,591 | 571,349 | 9.5 | 586,460 | 6.7 | 612,299 | 579,845 | 5.6 |
| Material Cost/Vehicle | 415,495 | 377,283 | 10.1 | 380,244 | 9.3 | 403,521 | 388,784 | 3.8 |
| Gross Profit/Vehicle | 210,096 | 194,066 | 8.3 | 206,216 | 1.9 | 208,778 | 191,061 | 9.3 |
| Employee Cost/Vehicle | 42,747 | 42,484 | 0.6 | 80,831 | (47.1) | 55,684 | 41,056 | 35.6 |
| Other Expenses/Vehicle | 56,304 | 71,076 | (20.8) | 65,246 | (13.7) | 59,342 | 68,565 | (13.5) |
| EBITDA/Vehicle | 111,044 | 80,506 | 37.9 | 60,139 | 84.6 | 93,753 | 81,439 | 15.1 |
| Net Profit/Vehicle | 70,773 | 70,787 | (0.0) | 4,087 | 1,631.8 | 48,121 | 54,893 | (12.3) |

Source: Company, BOBCAPS Research

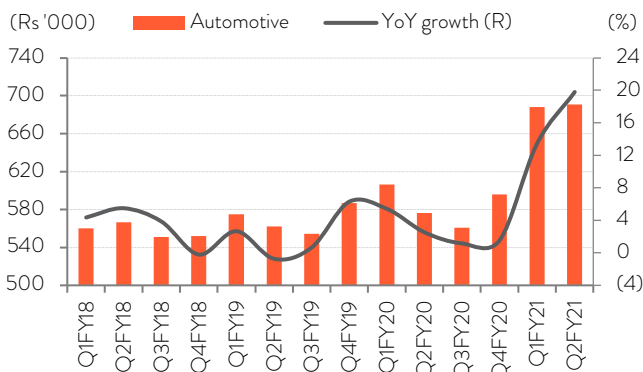
FIG 3 – SEGMENT-WISE PERFORMANCE

| Y/E Mar (Rs mn) | Q2FY21 | Q2FY20 | YoY (%) | Q1FY21 | QoQ (%) | H1FY21 | H1FY20 | YoY (%) |
|-------------------------------|----------------|----------------|------------|---------------|--------------|----------------|----------------|---------------|
| Segment Revenue | | | | | | | | |
| Automotive Segment | 63,565 | 68,928 | (7.8) | 20,395 | 211.7 | 83,960 | 148,786 | (43.6) |
| Farm Equipment Segment | 48,354 | 36,315 | 33.2 | 33,408 | 44.7 | 81,762 | 80,136 | 2.0 |
| Other Segments | 4,455 | 4,873 | (8.6) | 2,205 | 102.0 | 6,660 | 10,102 | (34.1) |
| (Less) Inter-segment revenues | 471 | 766 | (38.5) | 114 | 313.4 | 585 | 1,620 | (63.9) |
| Total | 115,903 | 109,351 | 6.0 | 55,894 | 107.4 | 171,798 | 237,405 | (27.6) |

| Y/E Mar (Rs mn) | Q2FY21 | Q2FY20 | YoY (%) | Q1FY21 | QoQ (%) | H1FY21 | H1FY20 | YoY (%) |
|--------------------------------------|---------------|---------------|-------------|------------|---------------|---------------|---------------|---------------|
| EBIT (After Exceptional Item) | | | | | | | | |
| Automotive Segment. | 4,117 | 3,973 | 3.6 | (6,192) | (166.5) | (2,076) | 9,153 | (122.7) |
| Farm Equipment Segment | 11,795 | 7,019 | 68.1 | 6,823 | 72.9 | 18,618 | 15,466 | 20.4 |
| Other Segments | 127 | 183 | (30.7) | (54) | (335.7) | 73 | 468 | (84.4) |
| Total | 16,039 | 11,175 | 43.5 | 577 | 2681.2 | 16,616 | 25,088 | (33.8) |
| EBIT Margins (%) | | | | | | | | |
| Automotive Segment. | 6.5 | 5.8 | - | (30.4) | - | (2.5) | 6.2 | - |
| Farm Equipment Segment | 24.4 | 19.3 | - | 20.4 | - | 22.8 | 19.3 | - |
| Other Segments | 2.8 | 3.8 | - | (2.4) | - | 1.1 | 4.6 | - |

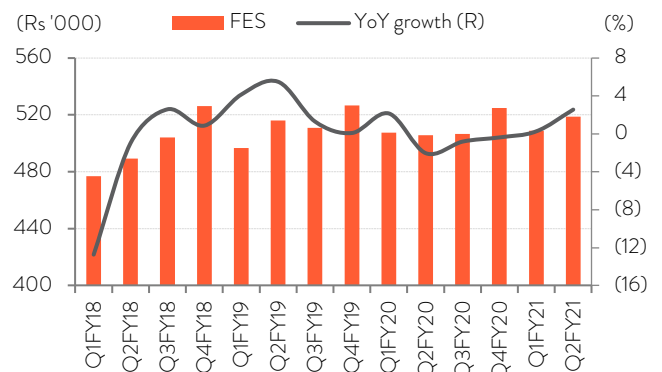
Source: Company, BOBCAPS Research

FIG 4 – AVERAGE SELLING PRICE (ASP) –AUTOMOTIVE



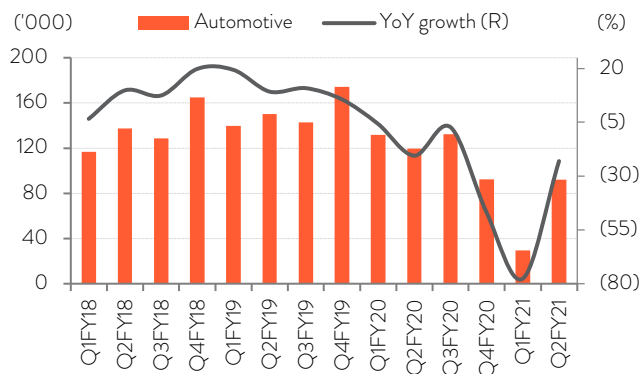
Source: Company, BOBCAPS Research

FIG 5 – AVERAGE SELLING PRICE (ASP) – FES



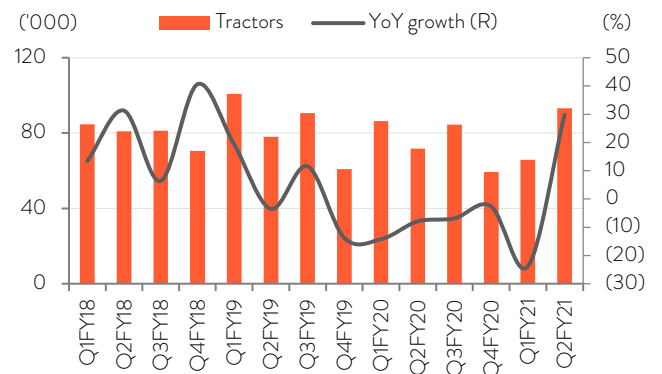
Source: Company, BOBCAPS Research

FIG 6 – VOLUME GROWTH – AUTOMOTIVE



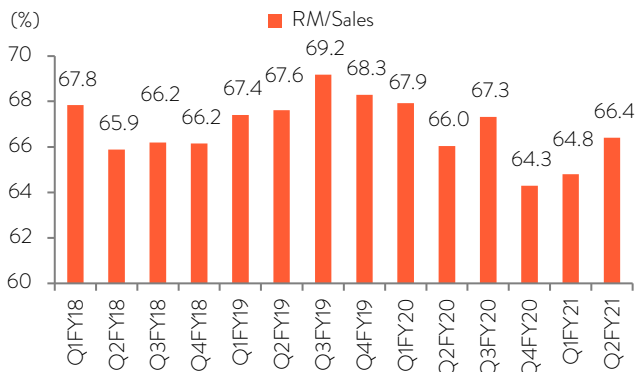
Source: Company, BOBCAPS Research

FIG 7 – VOLUME GROWTH – FES



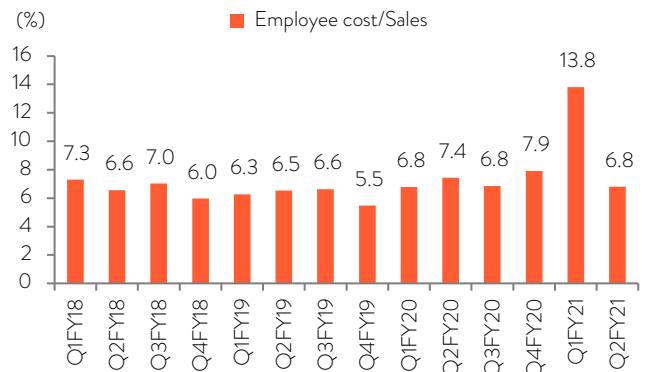
Source: Company, BOBCAPS Research

FIG 8 – RM COST/SALES – MM+MVML



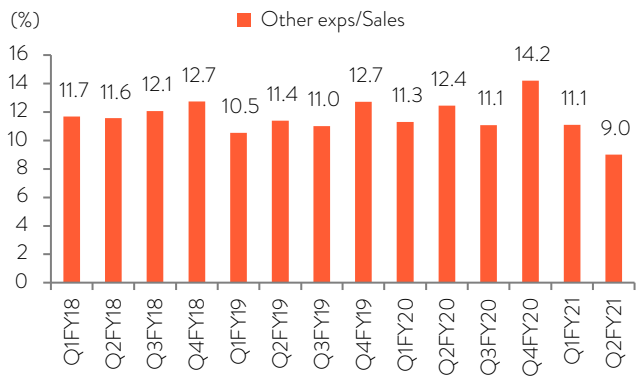
Source: Company, BOBCAPS Research

FIG 9 – EMPLOYEE COST/SALES – MM+MVML



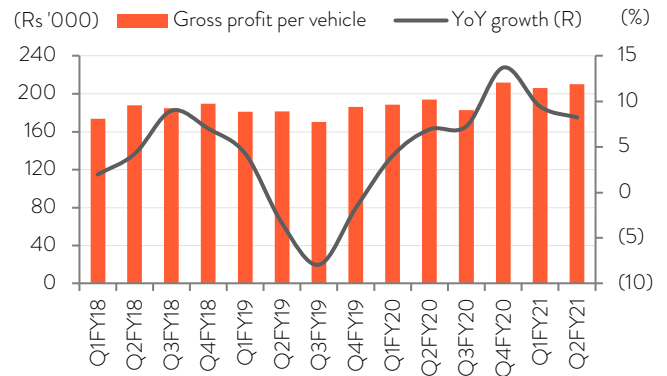
Source: Company, BOBCAPS Research

FIG 10 – OTHER EXPENSES / SALES – MM+MVML



Source: Company, BOBCAPS Research

FIG 11 – GROSS PROFIT/VEHICLE



Source: Company, BOBCAPS Research

Valuation methodology

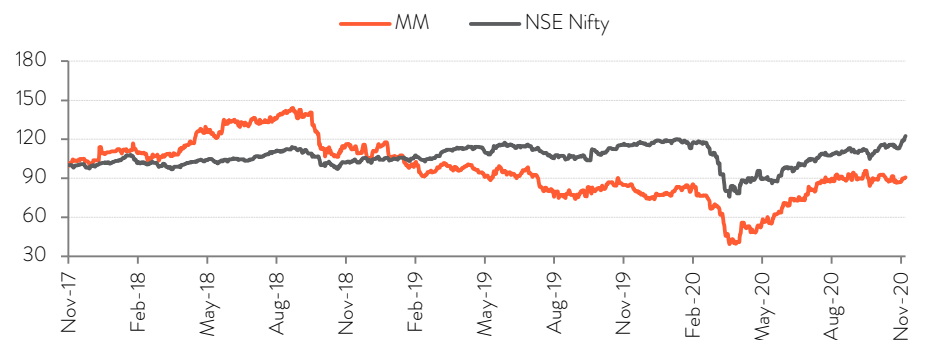
We estimate a 4% revenue CAGR for MM over FY20-FY23 coupled with expansion in operating margins, supporting higher 7% earnings growth. We continue to value the core business at 13x Sep'22E EPS and assign a 30% holding company discount for subsidiaries. Maintain SELL as we find current valuations rich at 24x FY22E core EPS (adj. for value of subsidiaries). Our Sep'21 SOTP-based target price remains at Rs 510.

FIG 12 – SOTP VALUATION

| Business | Fair Value (Rs) | Comment |
|-----------------------|-----------------|----------------------|
| Core business | 360 | 13x Sep'22E Core EPS |
| Value of subsidiaries | 150 | 30% hold-co discount |
| Total | 510 | |

Source: Company, BOBCAPS Research

FIG 13 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Significant increase in MM's UV market share led by its upcoming launches can pose upside risks to our estimates.
- Control over losses in subsidiaries and recurring investments therein will help MM's consolidated earnings and return ratios to improve.
- Softening of raw material prices from current levels can provide a boost to operating margins.

FINANCIALS

Income Statement

| Y/E 31 Mar (Rs mn) | FY19A | FY20A | FY21E | FY22E | FY23E |
|--------------------------------|----------------|----------------|----------------|----------------|----------------|
| Total revenue | 528,482 | 448,655 | 379,868 | 463,238 | 511,660 |
| EBITDA | 75,301 | 63,506 | 49,466 | 65,415 | 73,572 |
| Depreciation | 20,030 | 23,631 | 20,008 | 24,552 | 27,118 |
| EBIT | 55,271 | 39,875 | 29,458 | 40,863 | 46,454 |
| Net interest income/(expenses) | (1,467) | (1,245) | (1,513) | (1,513) | (1,513) |
| Other income/(expenses) | 16,303 | 15,391 | 12,053 | 14,841 | 15,921 |
| Exceptional items | (227) | (28,112) | 0 | 0 | 0 |
| EBT | 70,106 | 54,021 | 39,998 | 54,191 | 60,862 |
| Income taxes | 15,867 | 18,513 | 10,079 | 13,656 | 15,337 |
| Extraordinary items | 0 | 0 | 0 | 0 | 0 |
| Min. int./Inc. from associates | 0 | 0 | 0 | 0 | 0 |
| Reported net profit | 54,012 | 7,397 | 29,918 | 40,535 | 45,525 |
| Adjustments | 227 | 28,112 | 0 | 0 | 0 |
| Adjusted net profit | 54,239 | 35,509 | 29,918 | 40,535 | 45,525 |

Balance Sheet

| Y/E 31 Mar (Rs mn) | FY19A | FY20A | FY21E | FY22E | FY23E |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|
| Accounts payables | 103,607 | 72,006 | 74,933 | 91,379 | 102,332 |
| Other current liabilities | 38,713 | 30,229 | 23,833 | 33,696 | 35,816 |
| Provisions | 16,151 | 15,781 | 11,396 | 13,897 | 15,350 |
| Debt funds | 26,802 | 31,530 | 31,530 | 31,530 | 31,530 |
| Other liabilities | 6,062 | 7,274 | 7,274 | 7,274 | 7,274 |
| Equity capital | 5,958 | 5,965 | 5,965 | 5,965 | 5,965 |
| Reserves & surplus | 343,979 | 340,326 | 361,748 | 391,664 | 414,595 |
| Shareholders' fund | 349,937 | 346,291 | 367,713 | 397,629 | 420,561 |
| Total liabilities and equities | 541,272 | 503,111 | 516,679 | 575,404 | 612,863 |
| Cash and cash eq. | 70,746 | 64,262 | 52,081 | 66,459 | 61,047 |
| Accounts receivables | 38,119 | 29,012 | 29,141 | 32,998 | 37,849 |
| Inventories | 47,631 | 40,408 | 34,344 | 41,882 | 47,662 |
| Other current assets | 48,700 | 37,496 | 34,188 | 41,691 | 46,049 |
| Investments | 173,836 | 153,433 | 173,433 | 193,433 | 213,433 |
| Net fixed assets | 144,967 | 169,093 | 184,086 | 189,534 | 197,416 |
| CWIP | 0 | 0 | 0 | 0 | 0 |
| Intangible assets | 0 | 0 | 0 | 0 | 1 |
| Deferred tax assets, net | (7,896) | (15,068) | (15,068) | (15,068) | (15,068) |
| Other assets | 25,168 | 24,475 | 24,475 | 24,475 | 24,475 |
| Total assets | 541,272 | 503,111 | 516,679 | 575,404 | 612,864 |

Source: Company, BOBCAPS Research

Cash Flows

| Y/E 31 Mar (Rs mn) | FY19A | FY20A | FY21E | FY22E | FY23E |
|-------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Net income + Depreciation | 74,042 | 31,028 | 49,926 | 65,086 | 72,643 |
| Interest expenses | (1,467) | (1,245) | (1,513) | (1,513) | (1,513) |
| Non-cash adjustments | 7,900 | 37,221 | 1,513 | 1,513 | 1,513 |
| Changes in working capital | (11,074) | (12,920) | 1,389 | 9,912 | (462) |
| Other operating cash flows | 1,156 | (26,899) | 0 | 0 | 0 |
| Cash flow from operations | 70,557 | 27,184 | 51,315 | 74,998 | 72,181 |
| Capital expenditures | (34,928) | (47,756) | (35,000) | (30,000) | (35,000) |
| Change in investments | (19,212) | 20,403 | (20,000) | (20,000) | (20,000) |
| Other investing cash flows | 6,949 | 10,529 | 0 | 0 | 0 |
| Cash flow from investing | (47,190) | (16,824) | (55,000) | (50,000) | (55,000) |
| Equities issued/Others | 8 | 7 | 0 | 0 | 0 |
| Debt raised/repaid | (5,339) | 4,728 | 0 | 0 | 0 |
| Interest expenses | 0 | 0 | 0 | 0 | 0 |
| Dividends paid | (12,035) | (3,327) | (8,496) | (10,620) | (22,593) |
| Other financing cash flows | 3,078 | (7,723) | 0 | 0 | 0 |
| Cash flow from financing | (14,288) | (6,316) | (8,496) | (10,620) | (22,593) |
| Changes in cash and cash eq. | 9,079 | 4,045 | (12,181) | 14,379 | (5,412) |
| Closing cash and cash eq. | 77,695 | 74,791 | 52,081 | 66,459 | 61,047 |

Per Share

| Y/E 31 Mar (Rs) | FY19A | FY20A | FY21E | FY22E | FY23E |
|----------------------|-------|-------|-------|-------|-------|
| Reported EPS | 43.5 | 6.0 | 24.1 | 32.6 | 36.7 |
| Adjusted EPS | 43.7 | 28.6 | 24.1 | 32.6 | 36.7 |
| Dividend per share | 8.5 | 2.4 | 6.0 | 7.5 | 8.5 |
| Book value per share | 281.7 | 278.8 | 296.1 | 320.1 | 338.6 |

Valuations Ratios

| Y/E 31 Mar (x) | FY19A | FY20A | FY21E | FY22E | FY23E |
|----------------|-------|-------|-------|-------|-------|
| EV/Sales | 1.4 | 1.6 | 1.9 | 1.6 | 1.5 |
| EV/EBITDA | 9.9 | 11.5 | 14.8 | 11.4 | 10.1 |
| Adjusted P/E | 14.2 | 21.7 | 25.7 | 19.0 | 16.9 |
| P/BV | 2.2 | 2.2 | 2.1 | 1.9 | 1.8 |

DuPont Analysis

| Y/E 31 Mar (%) | FY19A | FY20A | FY21E | FY22E | FY23E |
|---------------------------------|-------|-------|-------|-------|-------|
| Tax burden (Net profit/PBT) | 77.0 | 13.7 | 74.8 | 74.8 | 74.8 |
| Interest burden (PBT/EBIT) | 126.8 | 135.5 | 135.8 | 132.6 | 131.0 |
| EBIT margin (EBIT/Revenue) | 10.5 | 8.9 | 7.8 | 8.8 | 9.1 |
| Asset turnover (Revenue/Avg TA) | 97.6 | 89.2 | 73.5 | 80.5 | 83.5 |
| Leverage (Avg TA/Avg Equity) | 1.5 | 1.5 | 1.4 | 1.4 | 1.5 |
| Adjusted ROAE | 16.6 | 10.2 | 8.4 | 10.6 | 11.1 |

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

Ratio Analysis

| Y/E 31 Mar | FY19A | FY20A | FY21E | FY22E | FY23E |
|--|-------|--------|--------|-------|-------|
| YoY growth (%) | | | | | |
| Revenue | 11.1 | (15.1) | (15.3) | 21.9 | 10.5 |
| EBITDA | 6.9 | (15.7) | (22.1) | 32.2 | 12.5 |
| Adjusted EPS | 29.5 | (34.5) | (15.7) | 35.5 | 12.3 |
| Profitability & Return ratios (%) | | | | | |
| EBITDA margin | 14.2 | 14.2 | 13.0 | 14.1 | 14.4 |
| EBIT margin | 10.5 | 8.9 | 7.8 | 8.8 | 9.1 |
| Adjusted profit margin | 10.3 | 7.9 | 7.9 | 8.8 | 8.9 |
| Adjusted ROAE | 16.6 | 10.2 | 8.4 | 10.6 | 11.1 |
| ROCE | 20.1 | 14.6 | 10.7 | 13.4 | 14.2 |
| Working capital days (days) | | | | | |
| Receivables | 26 | 24 | 28 | 26 | 27 |
| Inventory | 41 | 41 | 41 | 41 | 42 |
| Payables | 83 | 68 | 83 | 84 | 85 |
| Ratios (x) | | | | | |
| Gross asset turnover | 3.8 | 2.9 | 2.2 | 2.5 | 2.6 |
| Current ratio | 1.3 | 1.5 | 1.4 | 1.3 | 1.3 |
| Net interest coverage ratio | 37.7 | 32.0 | 19.5 | 27.0 | 30.7 |
| Adjusted debt/equity | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

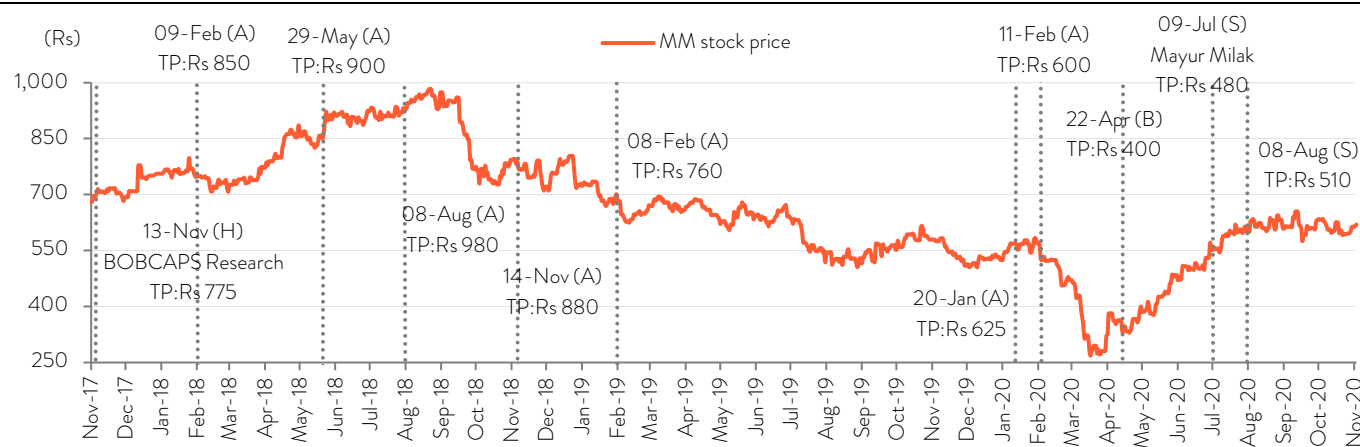
ADD – Expected return from >+5% to +15%

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): MAHINDRA & MAHINDRA (MM IN)



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

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