

ADD

TP: Rs 600 | ▲ 14%

**MAHINDRA &
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Automobiles

11 February 2020

Healthy core performance; subsidiaries a drag again

M&M's (MM) Q3 EBITDA at Rs 17.9bn (+5% YoY) beat estimates by ~5% on a strong margin uptick led by cost control and a richer auto model mix. MM took a Rs 6bn impairment on investments in SYMC and MUSA due to their weak performance. Given aggressive pricing by competition on recent BS-VI diesel launches, MM may have to absorb some portion of the cost rise. Tractors are likely to see cyclical recovery. We largely maintain earnings estimates but cut our SOTP target to Rs 600 (from Rs 625) to reflect higher holdco discount for subsidiaries.

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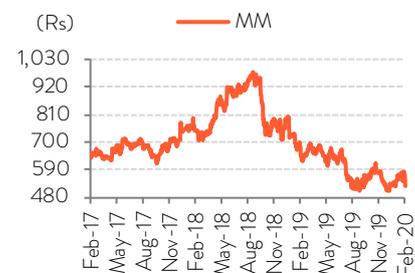
Margins ahead of estimates: Revenues for MM+MVML dipped 6% YoY to Rs 121bn, in line with estimates. Above-expected RM cost/sales was more than offset by lower opex cost/sales, aiding EBITDA growth of 5% YoY to Rs 17.9bn and EBITDA margin of 14.8% (+160bps YoY, +70bps QoQ). Auto EBIT margin improved by 150bps YoY/QoQ to 7.3% aided by cost-cutting efforts and a richer model mix. Tractor EBIT margin at 19.4% rose 20bps YoY/10bps QoQ. MM took a steep Rs 6bn provision for impairment of investments in Ssangyong (SYMC) and Mahindra USA (MUSA) to better align carrying value of assets.

Ticker/Price	MM IN/Rs 524
Market cap	US\$ 9.1bn
Shares o/s	1,242mn
3M ADV	US\$ 25.6mn
52wk high/low	Rs 704/Rs 503
Promoter/FPI/DII	20%/34%/24%

Source: NSE

Turnaround at subsidiaries still some time away: MM has initiated a three-year plan for turning around SYMC. Operational improvement will be led by 3-4% material cost reduction, renegotiation on wage cost and lower interest outgo. MM plans to raise KRW 450bn-500bn to pare debt at SYMC by ~KRW 250bn and for future product development programmes. It expects MUSA to turn profitable in CY21 with inventory reduction and efficiency improvement.

STOCK PERFORMANCE



Source: NSE

Maintain ADD: MM's core auto business is trading at 12x FY21E EPS which we believe prices in muted earnings expectations for FY20-FY22. While our estimates are largely unchanged, we raise the holding company discount to 45% (from 35%) to reflect continued weakness in operating subsidiaries.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	475,774	528,482	487,800	519,725	569,877
EBITDA (Rs mn)	70,434	75,301	68,667	67,587	76,880
Adj. net profit (Rs mn)	41,896	54,239	43,711	42,530	49,241
Adj. EPS (Rs)	33.7	43.7	35.2	34.2	39.6
Adj. EPS growth (%)	24.1	29.5	(19.4)	(2.7)	15.8
Adj. ROAE (%)	14.6	16.6	11.8	10.5	11.2
Adj. P/E (x)	15.5	12.0	14.9	15.3	13.2
EV/EBITDA (x)	9.0	8.3	8.9	9.0	7.9

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)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Net Revenues	121,203	128,925	(6.0)	109,351	10.8	358,608	390,403	(8.1)
Raw Materials	81,591	89,178	(8.5)	72,208	13.0	240,770	265,691	(9.4)
% of Net Sales	67.3	69.2	-	66.0	-	67.1	68.1	-
Personnel	8,300	8,528	(2.7)	8,131	2.1	25,110	25,262	(0.6)
% of Net Sales	6.8	6.6	-	7.4	-	7.0	6.5	-
Manufacturing & Other Exp	13,425	14,191	(5.4)	13,603	(1.3)	41,497	42,828	(3.1)
% of Net Sales	11.1	11.0	-	12.4	-	11.6	11.0	-
Total Expenditure	103,315	111,897	(7.7)	93,942	10.0	307,377	333,781	(7.9)
EBITDA	17,888	17,029	5.0	15,408	16.1	51,231	56,622	(9.5)
EBITDA Margin (%)	14.8	13.2	-	14.1	-	14.3	14.5	-
Depreciation	5,900	5,054	16.7	5,721	3.1	17,459	14,334	21.8
EBIT	11,988	11,975	0.1	9,688	23.7	33,772	42,289	(20.1)
Interest Expenses	254	353	(28.1)	331	(23.4)	886	1,163	(23.8)
Non-operating income	2,092	3,423	(38.9)	8,225	(74.6)	12,236	13,830	(11.5)
Extraordinary Expenses/ (Income)	6,006	800	NA	0	NA	(7,665)	(820)	NA
PBT	7,821	14,245	(45.1)	17,582	(55.5)	52,787	55,776	(5.4)
Tax-Total	4,019	285	1,308.2	4,034	(0.4)	12,840	11,457	12.1
Tax Rate (%) - Total	51.4	2.0	-	22.9	-	24.3	20.5	-
Reported PAT	3,802	13,960	(72.8)	13,548	(71.9)	39,947	44,319	(9.9)
Adj. PAT	9,808	14,520	(32.5)	13,548	(27.6)	32,282	43,499	(25.8)
PAT Margin	6.5	11.3	-	12.4	-	9.6	11.2	-

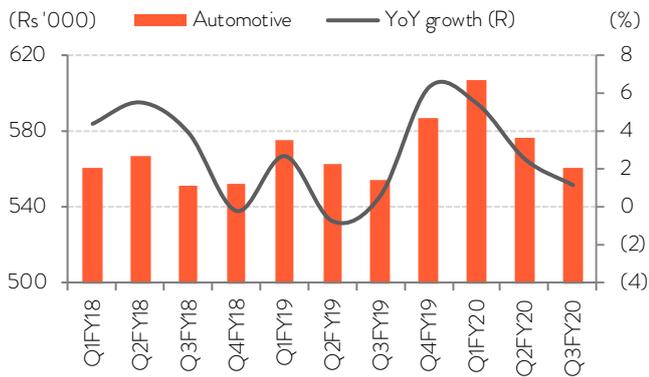
Source: Company, BOBCAPS Research

FIG 2 – SEGMENTAL PERFORMANCE – MM+MVML

Y/E Mar (Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Segment Revenue								
Automotive Segment	74,238	79,148	(6.2)	68,928	7.7	223,024	243,935	(8.6)
Farm Equipment Segment	42,778	46,338	(7.7)	36,315	17.8	122,915	136,688	(10.1)
Other Segments	4,757	4,448	6.9	4,873	(2.4)	14,859	12,555	18.4
(Less) Inter-segment revenues	571	1,009	(43.4)	766	(25.5)	2,190	2,774	(21.0)
Total	121,203	128,925	(6.0)	109,351	10.8	358,608	390,403	(8.1)
Segment EBIT (After Exceptional Item)								
Automotive Segment.	5,417	4,608	17.6	3,973	36.3	14,571	18,821	(22.6)
Farm Equipment Segment	8,309	8,881	(6.4)	7,019	18.4	23,775	27,464	(13.4)
Other Segments	168	141	19.4	183	(8.1)	636	432	47.3
Total	13,894	13,630	1.9	11,175	24.3	38,982	46,717	(16.6)
EBIT Margins (%)								
Automotive Segment.	7.3	5.8	-	5.8	-	6.5	7.7	-
Farm Equipment Segment	19.4	19.2	-	19.3	-	19.3	20.1	-
Other Segments	3.5	3.2	-	3.8	-	4.3	3.4	-

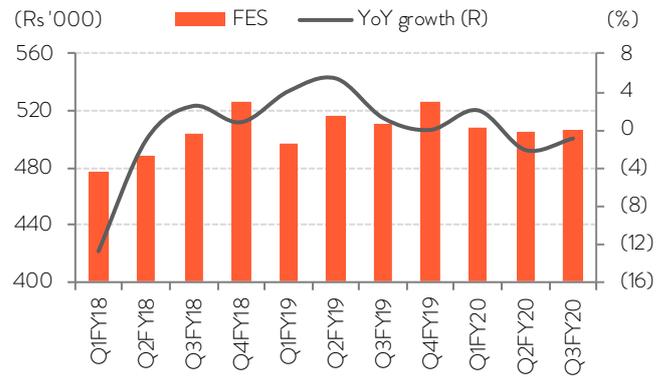
Source: Company, BOBCAPS Research

FIG 3 – AVERAGE SELLING PRICE (ASP) – AUTOMOTIVE



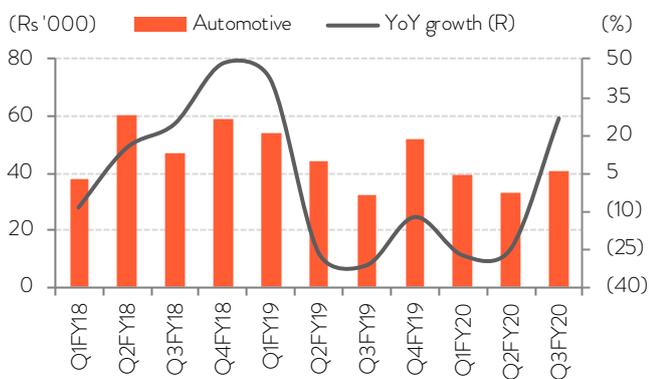
Source: Company, BOBCAPS Research

FIG 4 – AVERAGE SELLING PRICE (ASP) – FES



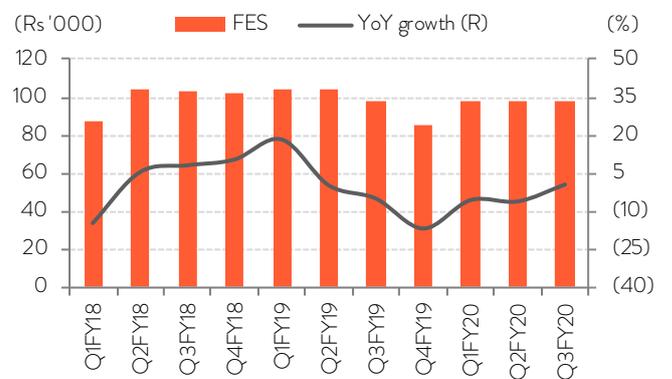
Source: Company, BOBCAPS Research

FIG 5 – EBIT TREND – AUTOMOTIVE



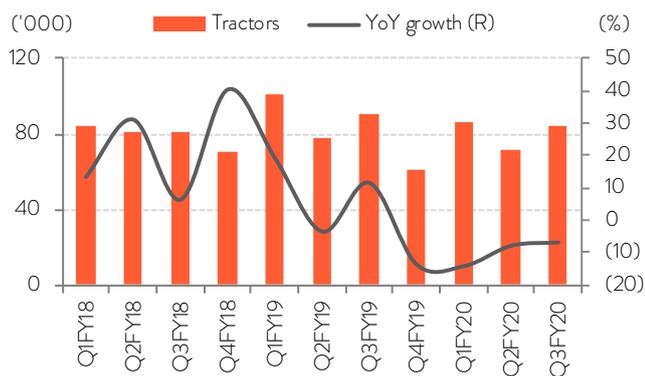
Source: Company, BOBCAPS Research

FIG 6 – EBIT TREND – FES



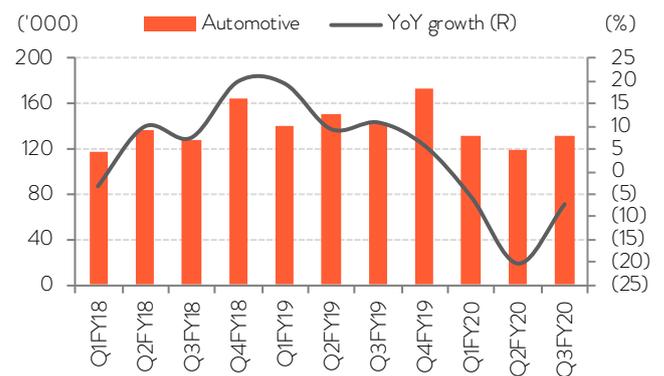
Source: Company, BOBCAPS Research

FIG 7 – VOLUME GROWTH – AUTOMOTIVE



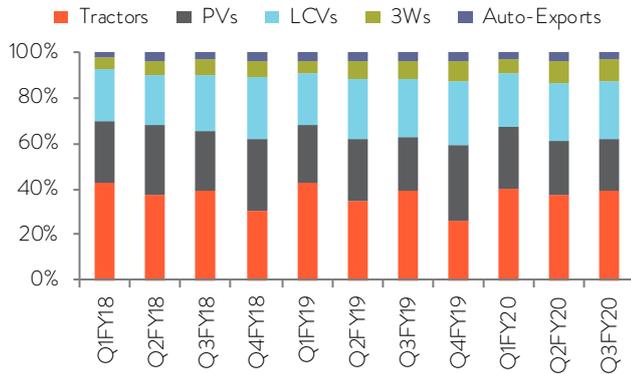
Source: SIAM, ET Autolytics, BOBCAPS Research

FIG 8 – VOLUME GROWTH – FES



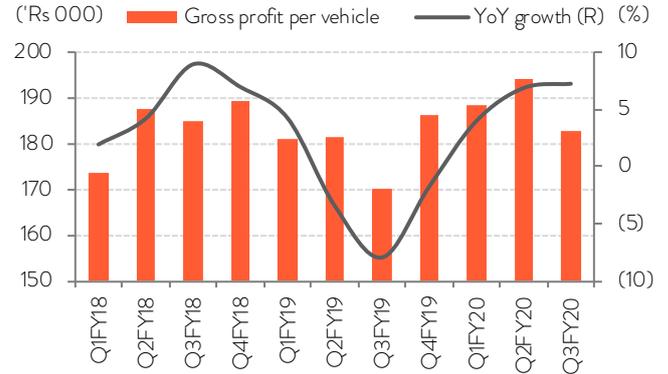
Source: SIAM, ET Autolytics, BOBCAPS Research

FIG 9 – VOLUME MIX – SEGMENT-WISE



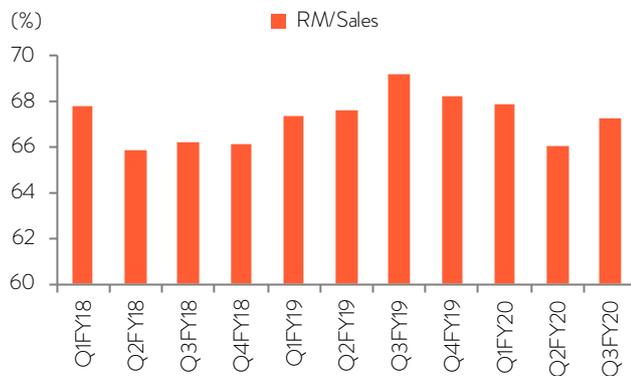
Source: SIAM, ET Autolytics, BOBCAPS Research

FIG 10 – GROSS PROFIT PER VEHICLE – MM+MVML



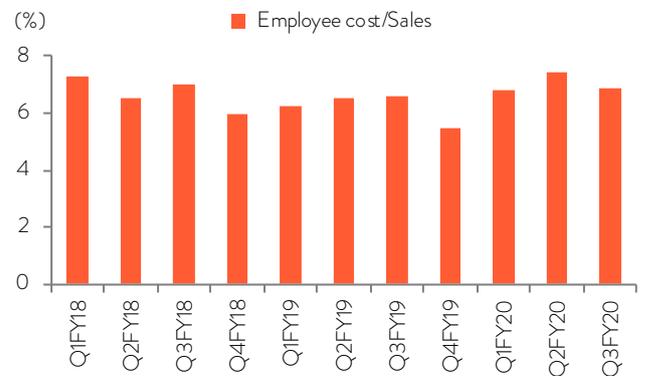
Source: Company, BOBCAPS Research

FIG 11 – RM COST/SALES – MM+MVML



Source: Company, BOBCAPS Research

FIG 12 – EMPLOYEE COST/SALES – MM+MVML



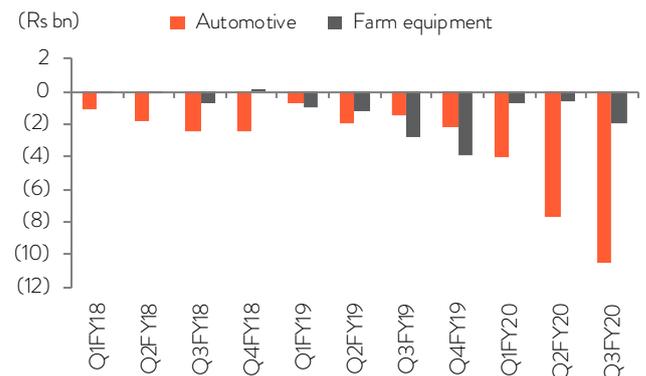
Source: Company, BOBCAPS Research

FIG 13 – OTHER EXPENSES/SALES – MM+MVML



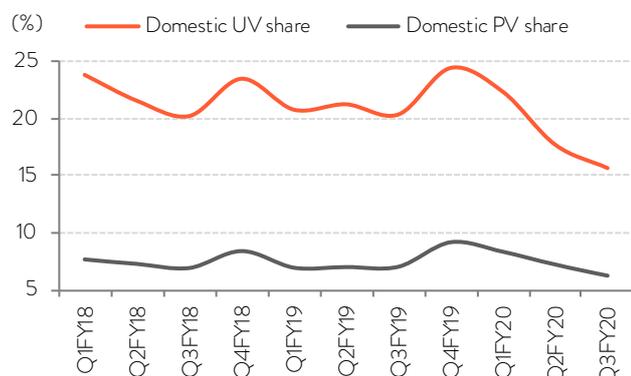
Source: Company, BOBCAPS Research

FIG 14 – IMPLIED EBIT TREND AT SUBSIDIARIES



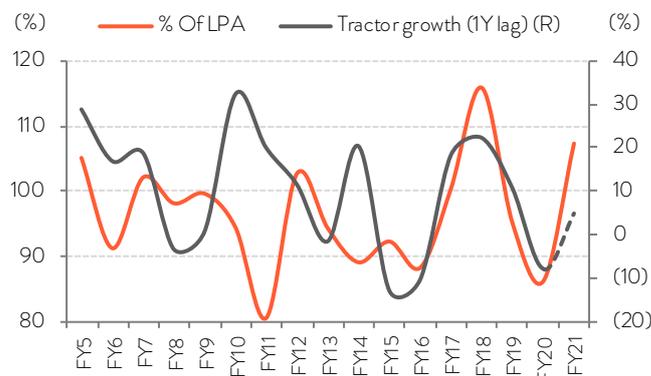
Source: Company, BOBCAPS Research | Note – Implied EBIT loss in Auto segment for Q3FY20 includes Rs 3.4bn impairment loss

FIG 15 – MM’S MARKET SHARE TRENDS



Source: SIAM, ET Autolytics, BOBCAPS Research

FIG 16 – CORRELATION BETWEEN TRACTOR GROWTH AND MONSOON SEASON



Source: SIAM, Indian MET dept., BOBCAPS Research | LPA – Long Period Avg

Earnings call highlights

- MM’s management is seeing some green shoots in the rural economy and also positive signals in urban markets. The company remains positive on future demand but full-fledged revival is still a few quarters away.
- As per SIAM, the domestic PV industry is estimated to grow 2-4% YoY in FY21, CVs at 4-6% and tractors at 3-7%.
- Auto business inventory for Q3FY20 was lower than expected while tractor inventory was in line.
- Upon transition to BS-VI, MM expects to take a price hike of Rs 15-20k for petrol PVs and Rs 50-70k for diesel vehicles. The company has already increased prices of its petrol cars KUV 100 and XUV 300 by Rs 20k which covers the increased cost of BS-VI and some margins. It could also adopt deferred cost hikes for a few diesel BS-VI models.
- Timelines for new launches are as follows: E-KUV100 in Q1FY21, New Thar in Q1FY21, Atom (mass mobility EV vehicle) in Q2FY21, W601 (SUV crossover) in Q4FY21, Z101 in Q1FY22 and E- XUV 300 in Q2FY22.
- MM is developing a new tractor platform (K2) in partnership with Mitsubishi Agri (Japan) that will build four different HP ranges of tractor for both domestic and export markets. This platform would launch new products from CY21.
- In the context of the Ford JV, MM plans to launch a connected vehicle solution soon. Development of the C-SUV and B-SUV platform is on track which would save Rs 10bn of investment on each platform. MM will make use of Ford’s spare plant capacity (~Rs 4bn savings in capex).

- Management believes 3Ws will lead the electrification of vehicles in India. It currently offers two products (with lead acid and Li-ion batteries) and has combined sales of 1.5k units per month (1k lead-acid, 500 Li-ion).
- MM expects Mahindra Electric to be EBITDA-positive in FY21.
- In Q3FY20, impairment testing of subsidiaries led to a one-off provision of Rs 6bn and a one-off gain of Rs 470mn. MUSA and SYMC were among the international subsidiaries that remain a drag on consolidated performance.
- MUSA update: The company altered its business model significantly last year and is in the midst of transformation. Inventory has reduced by 20% at the dealer level and 40% at the plant level; a further 10-20% reduction in dealer and plant inventory is targeted. MM expects MUSA to achieve breakeven in CY21.
- SYMC update: MM took an impairment charge of KRW 57bn in SYMC as domestic market conditions (in Korea) remain challenging and exports markets are weak. As per SYMC's recent three-year business plan, breakeven should occur in 2022. SYMC would require additional fund infusion of KRW 450bn-500bn (to be sourced through debt, third party investments and MM). Of the total funds infused, ~KRW 250bn would be used to repay debt and the balance for new product development programmes. Management clarified that including the above, overall investments for FY20-FY22 will be restricted ~Rs 170bn.

SYMC will look at reducing material costs (by ~3-4% per year) and cutting down the wage bill as agreed with the labour union. Other areas of focus will be to develop new export markets (Russia and Vietnam) and to build synergies with MM. MM has invested Rs 24.5bn in SYMC to date.

Valuation methodology

MM's core business (ex-value from subsidiaries) currently trades at 12x FY21E EPS. We think valuations are factoring in a sharp earnings decline led by a double-digit volume drop across operating segments in FY21, which we believe is unlikely. Cyclical recovery in PVs and an improving outlook for tractors should partly offset volume/margin pressures from BS-VI migration. However, margin concerns in the auto segment may emerge from potential absorption of BS-VI transition cost. Recovery in performance of key subsidiaries – SYMC and MUSA – also appears to be some time away.

We continue to value the core business at 12.5x FY22E EPS (Rs 424/sh) which is at -1 SD to the past five-year average. However, we raise the holding company discount for valuing MM's stake in listed subsidiaries to 45% (from 35%), translating to a value of Rs 176/sh (from Rs 201/sh), to reflect continued weakness and lack of predictability in performance of the lossmaking entities. Our revised SOTP-based target price stands at Rs 600 (from Rs 625). Maintain ADD.

FIG 17 – SOTP VALUATION

Business	Fair Value (Rs)	Comment
Core business	424	12.5x FY22E Core EPS
Value of subsidiaries	176	45% holdco discount
Total	600	

Source: Company, BOBCAPS Research

FIG 18 – REVISED ESTIMATES

Change (%)	FY20	FY21	FY22
Volume	0.0	0.0	0.0
Income	0.0	0.0	0.0
EBITDA	1.3	0.0	0.0
EBITDA Margin (bps)	18	0	0
Profit	0.7	0.0	0.0
EPS (Rs)	0.7	0.0	0.0

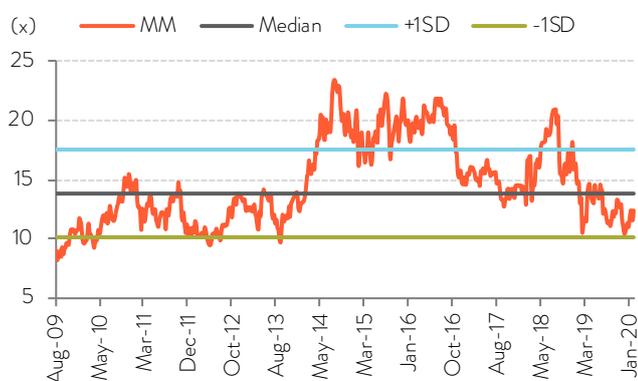
Source: Company, BOBCAPS Research

FIG 19 – KEY VOLUME ASSUMPTIONS

	FY19	FY20E	FY21E	FY22E
Total volumes	938,902	844,211	846,459	905,674
YoY growth	8	(10)	0	7
Automotive	608,466	539,996	527,033	570,276
YoY growth	11	(11)	(2)	8
Domestic	569,870	507,575	491,370	531,761
YoY growth	10	(11)	(3)	8
UVs+Cars	254,701	214,963	215,117	232,772
YoY growth	29	(55)	0	5
CVs	248,470	224,913	211,939	229,529
YoY growth	15	(9)	(6)	8
3Ws	66,699	67,699	64,315	69,460
YoY growth	22	1	(5)	8
Exports	38,596	32,421	35,663	38,516
YoY growth	37	(16)	10	8
Tractors	330,436	304,215	319,426	335,398
YoY growth	4	(8)	5	5
Domestic	316,742	292,986	307,636	323,017
YoY growth	5	(8)	5	5
Exports	13,694	11,229	11,791	12,380
YoY growth	(11)	(18)	5	5

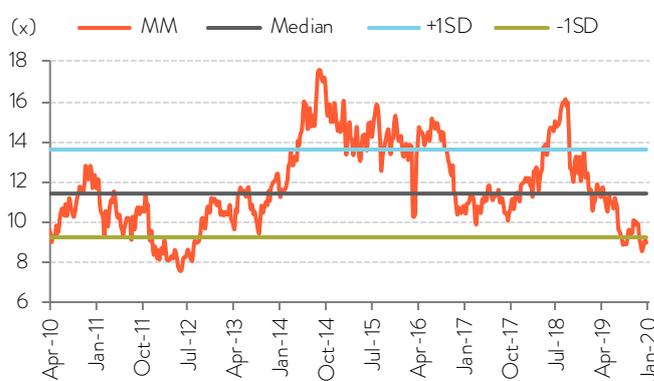
Source: Company, BOBCAPS Research

FIG 20 – P/E MULTIPLE



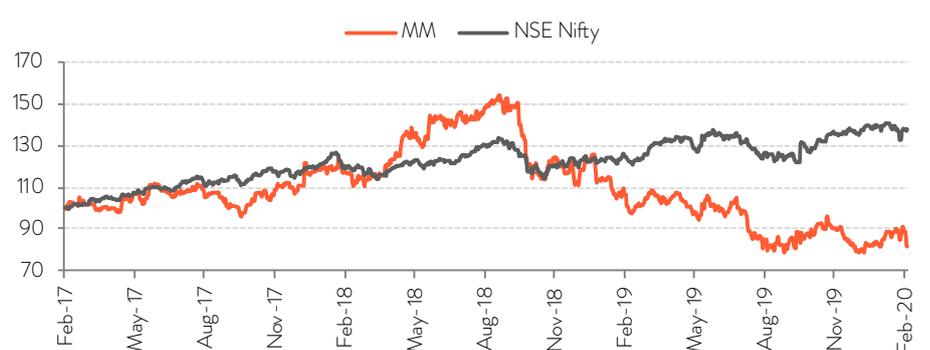
Source: Company, BOBCAPS Research

FIG 21 – EV/EBITDA MULTIPLE



Source: Company, BOBCAPS Research

FIG 22 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- A significant shift away from diesel vehicles even in higher powered engine segments (>1.5L) could dent MM's UV market share and volumes, at least in the short term.
- Continued high losses in subsidiaries and recurring investments therein will weaken consolidated earnings/return ratios and keep valuations depressed.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	475,774	528,482	487,800	519,725	569,877
EBITDA	70,434	75,301	68,667	67,587	76,880
Depreciation	16,254	20,030	23,658	25,467	27,354
EBIT	54,181	55,271	45,009	42,120	49,526
Net interest income/(expenses)	(1,882)	(1,467)	(1,287)	(1,287)	(1,287)
Other income/(expenses)	9,517	16,303	15,346	16,639	18,302
Exceptional items	4,336	(227)	7,665	0	0
EBT	61,816	70,106	59,069	57,472	66,542
Income taxes	19,919	15,867	15,358	14,943	17,301
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	46,232	54,012	51,376	42,530	49,241
Adjustments	(4,336)	227	(7,665)	0	0
Adjusted net profit	41,896	54,239	43,711	42,530	49,241

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	93,737	103,607	96,224	102,521	112,414
Other current liabilities	37,618	38,713	35,482	37,805	41,453
Provisions	15,687	16,151	14,634	15,592	17,096
Debt funds	32,142	26,802	26,802	26,802	26,802
Other liabilities	4,679	6,062	6,062	6,062	6,062
Equity capital	5,950	5,958	5,958	5,958	5,958
Reserves & surplus	298,924	343,979	383,319	415,229	452,435
Shareholders' fund	304,874	349,937	389,277	421,187	458,393
Total liabilities and equities	488,736	541,272	568,481	609,969	662,220
Cash and cash eq.	68,616	70,746	73,313	72,233	79,218
Accounts receivables	30,984	38,119	34,747	37,022	40,594
Inventories	33,271	47,631	44,102	46,989	51,523
Other current assets	47,693	48,700	43,902	46,775	51,289
Investments	154,624	173,836	193,836	213,836	233,836
Net fixed assets	130,070	144,967	161,309	175,842	188,488
CWIP	0	0	0	0	0
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(4,557)	(7,896)	(7,896)	(7,896)	(7,896)
Other assets	28,035	25,168	25,168	25,168	25,168
Total assets	488,736	541,272	568,481	609,969	662,220

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	62,486	74,042	75,034	67,996	76,595
Interest expenses	(1,882)	(1,467)	(1,287)	(1,287)	(1,287)
Non-cash adjustments	3,862	7,900	(6,378)	1,287	1,287
Changes in working capital	13,822	(11,074)	(432)	1,544	2,425
Other operating cash flows	4,113	1,156	7,665	0	0
Cash flow from operations	82,400	70,557	74,602	69,540	79,020
Capital expenditures	(28,564)	(34,928)	(40,000)	(40,000)	(40,000)
Change in investments	(23,389)	(19,212)	(20,000)	(20,000)	(20,000)
Other investing cash flows	(3,108)	6,949	0	0	0
Cash flow from investing	(55,062)	(47,190)	(60,000)	(60,000)	(60,000)
Equities issued/Others	2,982	8	0	0	0
Debt raised/repaid	(6,860)	(5,339)	0	0	0
Interest expenses	0	0	0	0	0
Dividends paid	(10,545)	(12,035)	(12,035)	(10,620)	(12,035)
Other financing cash flows	(1,006)	3,078	0	0	0
Cash flow from financing	(15,430)	(14,288)	(12,035)	(10,620)	(12,035)
Changes in cash and cash eq.	11,909	9,079	2,567	(1,080)	6,985
Closing cash and cash eq.	65,509	77,695	73,313	72,233	79,218

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	37.2	43.5	41.4	34.2	39.6
Adjusted EPS	33.7	43.7	35.2	34.2	39.6
Dividend per share	7.5	8.5	8.5	7.5	8.5
Book value per share	245.5	281.7	313.4	339.1	369.1

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	1.3	1.2	1.3	1.2	1.1
EV/EBITDA	9.0	8.3	8.9	9.0	7.9
Adjusted P/E	15.5	12.0	14.9	15.3	13.2
P/BV	2.1	1.9	1.7	1.5	1.4

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	74.8	77.0	87.0	74.0	74.0
Interest burden (PBT/EBIT)	114.1	126.8	131.2	136.4	134.4
EBIT margin (EBIT/Revenue)	11.4	10.5	9.2	8.1	8.7
Asset turnover (Revenue/Avg TA)	97.3	97.6	85.8	85.2	86.1
Leverage (Avg TA/Avg Equity)	1.6	1.5	1.5	1.4	1.4
Adjusted ROAE	14.6	16.6	11.8	10.5	11.2

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	15.0	11.1	(7.7)	6.5	9.6
EBITDA	30.3	6.9	(8.8)	(1.6)	13.8
Adjusted EPS	24.1	29.5	(19.4)	(2.7)	15.8
Profitability & Return ratios (%)					
EBITDA margin	14.8	14.2	14.1	13.0	13.5
EBIT margin	11.4	10.5	9.2	8.1	8.7
Adjusted profit margin	8.8	10.3	9.0	8.2	8.6
Adjusted ROAE	14.6	16.6	11.8	10.5	11.2
ROCE	19.8	20.1	15.2	13.6	14.5
Working capital days (days)					
Receivables	23	26	26	26	26
Inventory	32	41	41	40	41
Payables	84	83	84	83	83
Ratios (x)					
Gross asset turnover	3.8	3.8	3.2	3.1	3.1
Current ratio	1.2	1.3	1.3	1.3	1.3
Net interest coverage ratio	28.8	37.7	35.0	32.7	38.5
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%

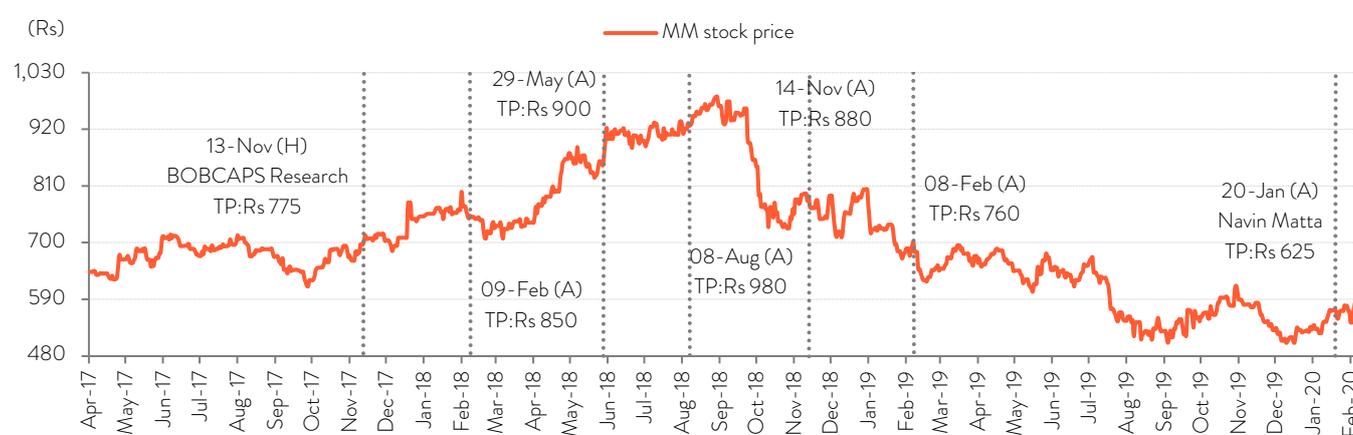
ADD – Expected return from >+5% to +15%

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)

HISTORICAL RATINGS AND TARGET PRICE: MAHINDRA & MAHINDRA (MM IN)



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

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