

Mahindra & Mahindra

11 November 2019

Reuters: MAHM.BO; Bloomberg: MM IN

Auto demand uncertainty remains, tractor demand to be better in 2H

MM+MVML reported a beat on the PAT level. PAT came in at Rs13.55bn, down 17.5% YoY and ahead of our estimate of Rs9bn. Beat was mainly on account of higher than expected non operating income (Rs8.2bn vs. NBIE est of Rs3bn) and better than expected EBITDA margin Revenue was reported at Rs109.35bn, down 14.5% YoY. It was below our expected revenue of Rs113.21bn mainly due to lower Auto segment realization. EBITDA margin was reported at 14.1%, ahead of our estimate of 13.6%. Beat was mainly due to better margin in the Farm Equipment segment. EBITDA margin improved sequentially by 10bps. Auto segment revenue was Rs68.93bn, down 18.4% YoY, led by volume decline of 20.6% YoY. EBIT margin of the segment was 5.8% (NBIE Est 6.5%), which is down 70bps QoQ and 210 bps YoY. Farm Equipment segment revenue was Rs36.31bn, down 9.8% YoY, led by volume decline of 8% YoY. EBIT margin of the segment was 19.3% (NBIE est 18.5%), which is down 90bps YoY and flat QoQ. In the concall, management indicated that the worst is behind for the Tractor segment after getting best monsoon rains in 25 years. Good water reservoir levels and soil moisture augurs well for next sowing season. Although, lower than company expected sales in 2Q have prompted it to lower the full year tractor sales guidance from flat YoY sales growth to 7-8% decline. Auto sector demand scenario remains bleak for the rest of the year and for 1HFY21 with the onset of BS-VI. Company is still expecting a potential pre-buying before the transition but is not counting on it. Like the industry, M&M too has used the opportunity of better festival sales to bring the inventories at comfortable levels. We have cut our forecasts as management has lowered the guidance for FY20 and given the uncertainties in the auto segment demand post BS-VI. Our volume estimates are now 5%/4%/2% lower for FY20/21/22E vs earlier and MM+MVML earnings by 5%/5%/2%. Our volume CAGR is now flat over FY19-22 vs 1% earlier. EPS growth estimate is 2.2% CAGR over FY19-22. Our SoTP-based target price (TP) comes to Rs686. We reiterate our Buy rating.

Auto segment demand outlook remains bleak, tractor demand to be better in 2HFY20: Management indicated that Auto industry would remain in negative growth rate for 2H as well albeit better than 1H. In Passenger Vehicles, UV segment will continue to gain share due to new products and is expected to grow in 2HFY20 whereas the car segment could decline. HCV segment is likely to decline in 2H at the same rate as 1H. Tractor sales in 2QFY20 were worse than expected by management hence the full year Auto demand uncertainty remains, while tractor demand will be better in 2H. Management indicated that the worst is behind for the Tractor segment after getting best monsoon rains in 25 years. Good water reservoir levels and soil moisture augurs well for next sowing season. We expect 7% decline in tractor segment for FY20 followed by a 5%/8% growth in FY21/22. For Auto segment, we expect an 8% YoY decline in FY20 followed by 1.4%/7.4% decline in FY21/22.

Better demand of UV segment, tractor demand revival and pre-buying should help M&M: We believe that M&M will be the prime beneficiary of pre-buying before the BS-VI transition, owing to its diesel portfolio. Post BS-VI, we expect its petrol engines to do well in the sub-4 meter UVs as we can see that the petrol mix in its new XUV300 is already ~30% now which indicates the acceptance of their petrol engines. This gives us confidence in its upcoming petrol engines with BS-VI technology. Our volume CAGR is now flat over FY19-22 vs 1% earlier. EPS growth estimate is 2.2% CAGR over FY19-22. Our SoTP-based target price (TP) comes to Rs686. We reiterate our Buy rating.

BUY

Sector: Automobile

CMP: Rs582

Target Price: Rs686

Upside: 18%

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Key Data

Current Shares O/S (mn)	1,243.2
Mkt Cap (Rsbn/US\$bn)	723.4/10.2
52 Wk H / L (Rs)	814/503
Daily Vol. (3M NSE Avg.)	4,095,489

Price Performance (%)

	1 M	6 M	1 Yr
M&M	5.2	(6.4)	(26.6)
Nifty Index	7.0	4.8	12.4

Source: Bloomberg

Y/E March (Rsmn)	2QFY19	1QFY20	2QFY20	YoY (%)	QoQ (%)	FY19YTD	FY20YTD	YoY (%)
Net sales	127,902	128,055	109,351	(14.5)	(14.6)	261,478	237,405	(9.2)
COGS	86,478	86,971	72,208	(16.5)	(17.0)	176,513	159,179	(9.8)
% of sales	67.6	67.9	66.0	(1.6)	(1.9)	67.5	67.0	(0.5)
Gross margin %	32.4	32.1	34.0	160bps	190bps	32.5	33.0	50bps
Employee costs	8,355	8,679	8,131	(2.7)	(6.3)	16,734	16,810	0.4
% of sales	6.5	6.8	7.4	0.9	0.7	6.4	7.1	0.7
Other expenses	14,576	14,469	13,603	(6.7)	(6.0)	28,637	28,073	(2.0)
% of sales	11.4	11.3	12.4	1.0	1.1	11.0	11.8	0.9
EBITDA	18,493	17,936	15,408	(16.7)	(14.1)	39,594	33,344	(15.8)
EBITDA margin %	14.5	14.0	14.1	(40bps)	10bps	15.1	14.0	(110bps)
Depreciation	4,986	5,839	5,721	14.7	(2.0)	9,280	11,559	24.6
EBIT	13,508	12,097	9,688	(28.3)	(19.9)	30,314	21,784	(28.1)
EBIT margin %	10.6	9.4	8.9	(170bps)	(50bps)	11.6	9.2	(240bps)
Interest expenses	379	302	331	(12.8)	9.7	810	633	(21.9)
Other income	8,478	1,919	8,225	(3.0)	328.6	10,407	10,144	(2.5)
Exceptional items	(1,375)	(13,671)	-	-	-	(1,620)	(13,671)	-
PBT	22,981	27,384	17,582	(23.5)	(35.8)	41,531	44,966	8.3
Tax	5,194	4,787	4,034	(22.3)	(15.7)	11,171	8,821	(21.0)
Effective tax rate %	22.6	17.5	22.9	0.3	5.5	26.9	19.6	(7.3)
Adj PAT	16,412	8,927	13,548	(17.5)	51.8	28,739	22,475	(21.8)
PAT margin %	12.8	7.0	12.4	(40bps)	540bps	11.0	9.5	(150bps)
EPS	13.7	7.5	11.3	(17.5)	51.8	24.0	18.8	(21.8)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Automotive Volume	549,153	608,596	559,964	552,280	592,982
YoY growth (%)	8.4	10.8	-8.0	-1.4	7.4
Farm Equipment Volume	319,623	330,436	307,211	322,572	347,990
YoY growth (%)	21.5	3.4	-7.0	5.0	7.9
Net sales	475,774	528,482	503,621	522,117	576,561
YoY growth (%)	13.3	11.1	-4.7	3.7	10.4
EBITDA	70,434	75,301	72,400	76,625	85,192
EBITDA margin (%)	14.8	14.2	14.4	14.7	14.8
Adjusted PAT	43,414	54,239	48,837	51,874	57,980
YoY change (%)	14.0	24.9	(10.0)	6.2	11.8
RoCE (%)	18.6	18.6	16.0	15.6	16.0
RoE (%)	14.2	15.5	12.7	12.3	12.5
P/E (x)	16.1	12.9	14.3	13.5	12.1
EV/Sales (x)	1.1	0.9	0.9	0.9	0.7
EV/EBITDA (x)	7.2	6.4	6.5	5.9	5.0

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Segment-wise performance

Segment-wise results	2QFY19	1QFY20	2QFY20	YoY (%)	QoQ (%)	FY19YTD	FY20YTD	YoY (%)
Segment-wise revenue								
Automotive Segment	84,461	79,858	68,928	(18.4)	(13.7)	164,787	148,786	(9.7)
Farm Equipment Segment	40,281	43,822	36,315	(9.8)	(17.1)	90,350	80,136	(11.3)
Other Segment	4,052	5,229	4,873	20.3	(6.8)	8,107	10,102	24.6
Total	128,794	128,909	110,116	(14.5)	(14.6)	263,243	239,025	(9.2)
Intersegment	892	854	766	(14.2)	(10.3)	1,765	1,620	(8.2)
Total Revenue	127,902	128,055	109,351	(14.5)	(14.6)	261,478	237,405	(9.2)
Revenue proportion %								
Automotive Segment	65.6	61.9	62.6	(3.0)	0.6	62.6	62.2	(0.4)
Farm Equipment Segment	31.3	34.0	33.0	1.7	(1.0)	34.3	33.5	(0.8)
Other Segment	3.1	4.1	4.4	1.3	0.4	3.1	4.2	1.1
Segment-wise results								
Automotive Segment	6,638	5,180	3,973	(40.1)	(23.3)	14,213	9,153	(35.6)
Farm Equipment Segment	8,129	8,447	7,019	(13.7)	(16.9)	18,583	15,466	(16.8)
Other Segment	157	285	183	16.5	(35.8)	291	468	60.9
Total EBIT	14,924	13,913	11,175	(25.1)	(19.7)	33,087	25,088	(24.2)
EBIT margin %								
Automotive Segment	7.9	6.5	5.8	(2.1)	(0.7)	8.6	6.2	(2.5)
Farm Equipment Segment	20.2	19.3	19.3	(0.9)	0.1	20.6	19.3	(1.3)
Other Segment	3.9	5.5	3.8	(0.1)	(1.7)	3.6	4.6	1.0
Total EBIT Margin	11.7	10.9	10.2	(1.4)	(0.6)	12.7	10.6	(2.1)
EBIT composition %								
Automotive Segment	44.5	37.2	35.6	(8.9)	(1.7)	43.0	36.5	(6.5)
Farm Equipment Segment	54.5	60.7	62.8	8.3	2.1	56.2	61.6	5.5
Other Segment	1.1	2.0	1.6	0.6	(0.4)	0.9	1.9	1.0

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Deviation of our estimates from actual performance in 2QFY20

(Rsmn)	Actual	Our estimate	Deviation
	2QFY20	2QFY20	%
Net sales	109,351	113,212	-3.4
EBITDA	15,408	15,397	0.1
EBITDA (%)	14.1	13.6	50bps
Adj PAT	13,548	9,045	49.8

Source: Nirmal Bang Institutional Equities Research

Exhibit 4: Change in our estimates

Y/E March (Rsmn)	New estimate			Old estimate			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Volume	867,175	874,852	940,971	910,039	915,776	963,025	(4.7)	(4.5)	(2.3)
Net sales	503,621	522,117	576,561	526,956	545,274	589,298	(4.4)	(4.2)	(2.2)
EBITDA	72,400	76,625	85,192	75,754	80,023	87,074	(4.4)	(4.2)	(2.2)
EBITDA margin (%)	14.4	14.7	14.8	14.4	14.7	14.8	-	-	-
PAT	48,837	51,874	57,980	51,347	54,417	59,388	(4.9)	(4.7)	(2.4)

Source: Company, Nirmal Bang Institutional Equities Research

Valuation

Exhibit 5: SOTP Valuation

	Basis of valuation	Per share value
Core business	15x Sept'21 core EPS	411
Tech Mahindra	CMP	108
MMFS	CMP	52
Mahindra Lifespace	CMP	5
Mahindra Holidays	CMP	7
MCIE (including stake in CIE, Spain)	CMP	18
SsangYong	CMP	25
Swaraj Engines	CMP	4
Other Investment Book (incl cash in hand)	Book value	56
Price (INR)		686

Source: Nirmal Bang Institutional Equities Research

Conference-call key takeaways

Demand outlook: Management expects UV segment to see positive growth in 2H due to new launches. PV industry decline will slow down in 2HFY20 to -5% (UVs will grow by 10% whereas PC will decline by 12-13% in H2). HCVs will continue to decline in 2HFY20. Tractor – 2QFY20 witnessed 10% decline in volume instead of 5% decline expected earlier. Above average monsoon, moist soil, good reservoir level and increase in yields will be beneficial for the tractor industry. Management estimates that the tractor industry will see an overall decline of 7-8% for the full year.

Festive demand: October witnessed bunching up of festivals (Dusherra & Diwali) along with heavy discounting which led to highest ever monthly retail for M&M in both UVs and LCVs. UV business witnessed retail growth of 23% YoY (industry retail growth was 14-15% YoY as per M&M's estimates). Tractor business witnessed retail decline of 4% YoY. Management believes that higher retail sales also had some pre-buying effect.

BS-VI: M&M expects 1.2L diesel engines to become unviable post BS-VI and hence it will discontinue the same. 1.5L engines will have a diesel/petrol mix, which it expects to be 50:50 post BS-VI implementation. It expects 2L engine to largely remain diesel as the effect of price increase will not be very high for such vehicles. Management also indicated that BS-VI diesel fuel will be available from April 2020 onwards and industry needs the fuel at least 6-8 weeks before the March-end deadline and SIAM is in discussion with Petroleum Ministry for early retailing of BS-VI fuel.

Market share: In 2QFY20, overall domestic automotive segment volume declined by 21.5%. PV/CV volume declined by 26.6%/20.8%, respectively. M&M's market share however increased in both PVs and CVs as it had lower than industry decline in volume. M&M has lost market share in UV to existing and new entrants in the industry. Company, however, believes that since overall share of UVs has been increasing in PV industry and the fact that most of the new launches are also in UV segment, it makes better sense to track PV market share than UV market share. CV – M&M's market share crossed 50% in sub-3.5 tonne segment. Its LCV market share increased 200bps YoY to 9.5%. Domestic tractors volume declined by 6.5% as against industry volume decline of 9.8%, which led to increase in market share by 1.5% to 41.3% for M&M.

Discounts: Discounts during the festivities increased by Rs3,400 per vehicle QoQ and Rs1,000 YoY for M&M. Higher discounts have been withdrawn in November. December, however, will again see year end consumer schemes.

Margin: Benign commodity, astute cost management and margin focus led to improvement in gross margin during the quarter. EBITDA margin declined by 40bps YoY due to negative operating leverage. Margins of Automotive segment benefited by 1% decline in commodity price, price hikes and favourable product mix (1% impact). Margin of Farm Equipment segment benefited from lower commodity price and price hike. Other operating costs reduced YoY in absolute terms due to tighter cost controls.

Ssangyong: Over the last 2 quarters, the Korean market has slowed down which affected volume. Also, Ssangyong's export markets are facing macro-economic challenges. This has affected its topline. Exchange rate fluctuation also had some impact on topline. Also, Korean auto industry is witnessing sudden shift to gasoline (SsangYong has been strong in diesel), which further affected volume in domestic market (though M&M has started supplying gasoline engine). Negative leverage on account of lower volume played out on the bottomline. The company is working on material cost reduction, exploring newer export markets to turn around volume and has lined up new launches to grow its market share. Ssangyong needs annual volume of 155,000 to turn PBT positive.

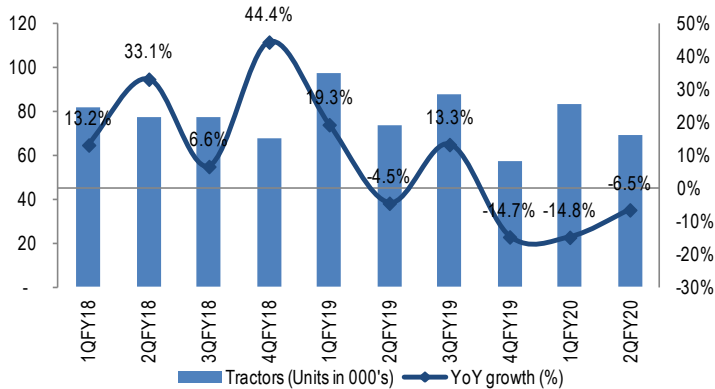
Mahindra USA – Company's efforts in the last 12 months has paid off with US business witnessing increase in retail volume, increase in billing, increased market share and reduced channel inventory. It is focusing on cost reduction measures and expects to break even by FY2021.

Dealer inventory: Auto inventory is lowest ever at dealer and plant level and company is short of 5,000-6,000 vehicles than ideal channel inventory. Tractor industry is under control..

EVs: M&M retailed 2,000 EVs in October, of which 1,800 was in 3W segment (increase in 3W EV demand in Delhi, Lucknow, Kolkata and Patna). Government's focus on EV will be beneficial for M&M as management believes that the company is well ahead of the industry. M&M is currently testing various EVs and has 5,000 EVs running on road, which has completed about 135mn kms. The company expects EVs to make its way in the 3W segment. In 4Ws, the company expects shared mobility to drive EV demand.

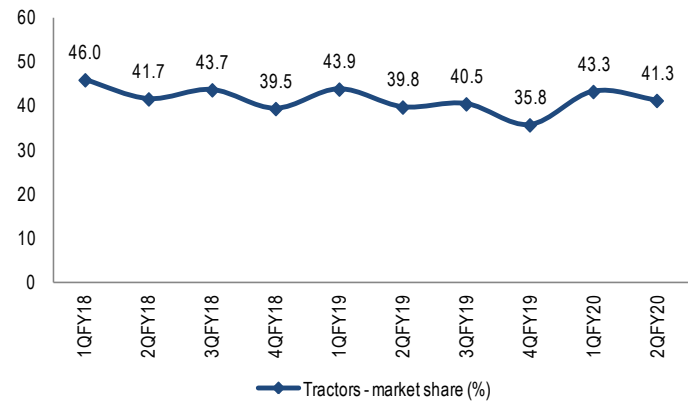
Story in Charts

Exhibit 6: Tractors - Domestic volume & YoY growth (%)



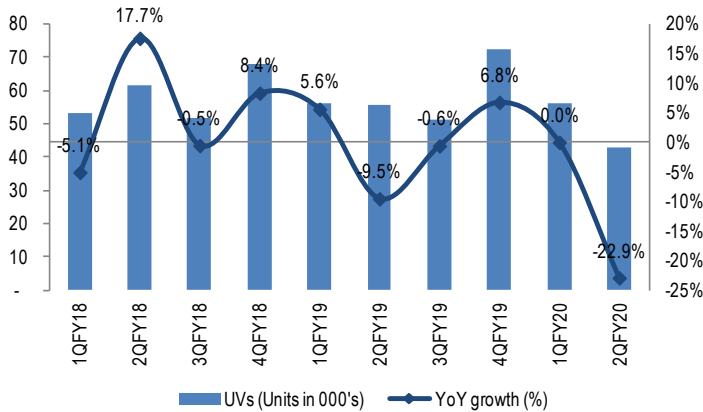
Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 7: Tractors – Domestic market share (%)



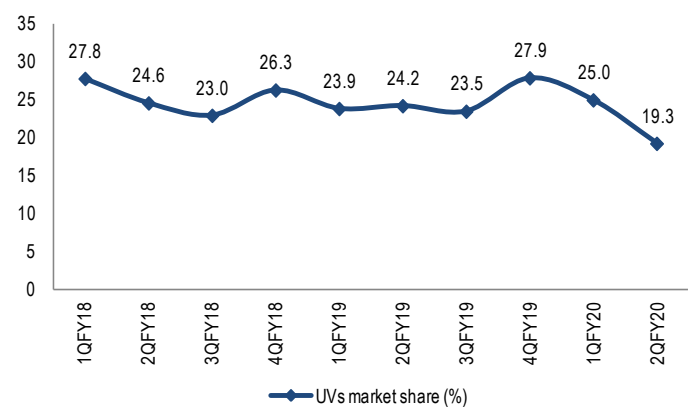
Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 8: UVs - Domestic volume & YoY growth (%)



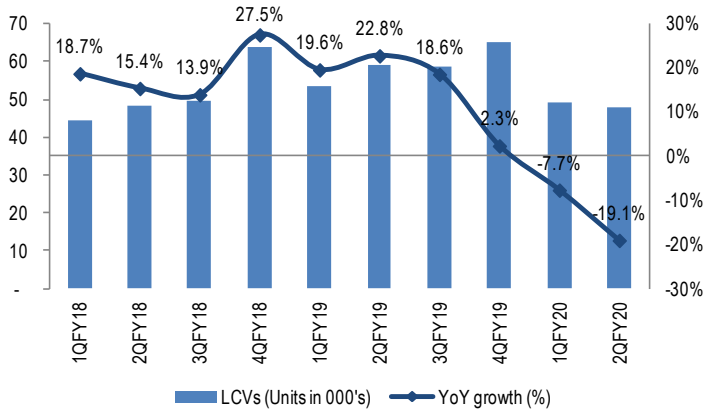
Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 9: UVs – Domestic market share (%)



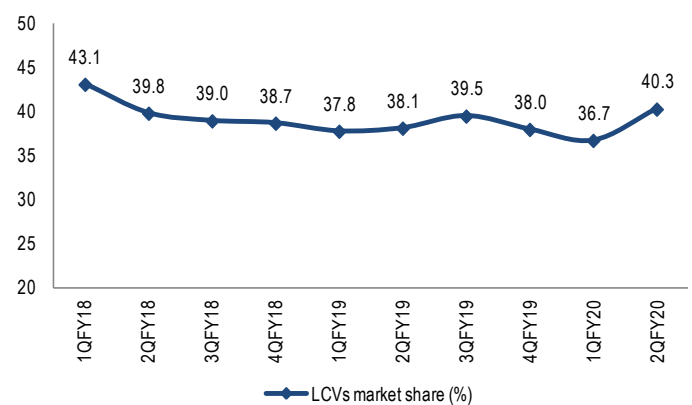
Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 10: LCVs - Domestic volume & YoY growth (%)



Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 11: LCVs – Domestic market share (%)



Source: SIAM, Nirmal Bang Institutional Equities Research

Financials (MM+MVML)

Exhibit 12: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net Sales	475,774	528,482	503,621	522,117	576,561
% Growth	13.3	11.1	(4.7)	3.7	10.4
Raw material	316,280	359,977	339,944	350,862	387,449
Staff costs	31,773	32,830	33,743	34,982	38,053
Other expenses	57,286	60,375	57,534	59,648	65,867
Total expenses	405,339	453,182	431,221	445,492	491,369
EBITDA	70,434	75,301	72,400	76,625	85,192
% Growth	20.9	6.9	(3.9)	5.8	11.2
EBITDA margin (%)	14.8	14.2	14.4	14.7	14.8
Other income	9,517	16,303	17,933	20,623	23,716
Interest costs	1,882	1,467	1,290	1,190	1,090
Depreciation	16,254	20,030	23,778	26,736	30,336
Profit before tax (before exceptional items)	61,816	70,106	65,264	69,322	77,482
Exceptional items	4,336.1	0.0	0.0	0.0	0.0
Tax	19,920	15,867	16,427	17,448	19,502
Profit after tax	46,232	54,239	48,837	51,874	57,980
Adj. Profit after tax	43,414	54,239	48,837	51,874	57,980
% Growth	14.0	24.9	(10.0)	6.2	11.8
Adj PAT margin (%)	9.1	10.3	9.7	9.9	10.1
EPS (Rs)	36.3	45.4	40.9	43.4	48.5
% Growth	14.0	24.9	(10.0)	6.2	11.8
DPS (Rs)	7.5	8.5	10.5	11.5	11.5
Payout (incl. div. tax) (%)	24.3	21.3	29.2	30.1	26.9

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Balance sheet

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Share capital	5,950	5,958	5,958	5,958	5,958
Reserves	298,924	343,979	378,575	414,851	457,233
Net worth	304,874	349,937	384,533	420,809	463,191
Total debt	32,142	26,803	24,803	22,803	20,803
Deferred tax liability	4,557	7,896	7,896	7,896	7,896
Capital employed	341,574	384,636	417,232	451,508	491,890
Net block	96,826	118,532	138,532	158,532	178,532
Capital work-in-progress	33,244	26,437	26,437	26,437	26,437
Investments	193,999	206,262	231,262	256,262	281,262
Inventories	33,271	47,631	45,391	47,058	51,965
Debtors	30,984	38,119	36,326	37,660	41,587
Cash	29,242	38,321	23,338	10,910	7,465
Loans & advances	10,182	8,612	8,612	10,334	10,334
Other current assets	65,545	65,257	73,088	80,396	88,436
Total current assets	169,224	197,940	186,754	186,358	199,786
Creditors	93,737	103,607	98,733	102,359	113,032
Other current liabilities & provisions	57,984	60,928	67,021	73,723	81,095
Total current liabilities	151,720	164,535	165,753	176,082	194,127
Net current assets	17,504	33,405	21,001	10,277	5,659
Application of funds	341,573	384,636	417,232	451,508	491,890

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Cash flow

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
OP/(loss) before tax	54,181	55,271	48,621	49,889	54,856
Depreciation & amortization	16,254	20,030	23,778	26,736	30,336
Other income	9,517	16,303	17,933	20,623	23,716
(Inc.)/dec. in working capital	16,800	(6,822)	(2,578)	(1,704)	1,172
Direct taxes paid	(23,943)	(12,528)	(16,427)	(17,448)	(19,502)
Cash flow from operations before EO	72,808	72,253	71,328	78,095	90,578
Extraordinary (EO) items	4,336	-	-	-	-
Cash flow from operations after EO	77,144	72,253	71,328	78,095	90,578
Capital expenditure (-)	(32,874)	(34,930)	(43,778)	(46,736)	(50,336)
Net cash after capex	44,270	37,324	27,549	31,360	40,242
Other investing activities	(18,510)	(12,263)	(25,000)	(25,000)	(25,000)
Dividends paid (-)	(8,962)	(10,157)	(12,547)	(13,742)	(13,742)
Inc./(dec.) in total borrowings	(8,387)	(6,807)	(3,290)	(3,190)	(3,090)
Others	3,504	981	(1,694)	(1,855)	(1,855)
Cash from financial activities	(13,846)	(15,983)	(17,531)	(18,788)	(18,688)
Opening cash balance	17,328	29,242	38,321	23,338	10,910
Closing cash balance	29,242	38,320	23,338	10,910	7,465
Change in cash balance	11,914	9,079	(14,982)	(12,428)	(3,446)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Key ratios

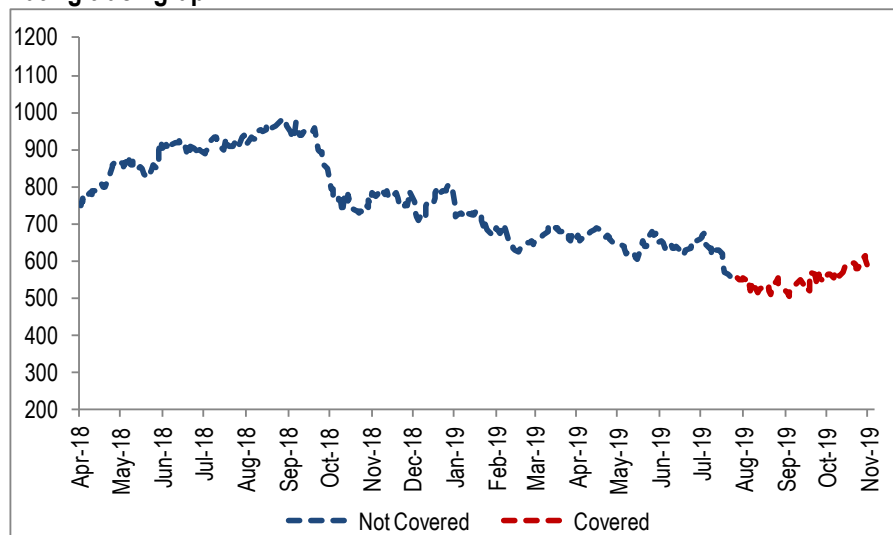
Y/E March	FY18	FY19	FY20E	FY21E	FY22E
Per share (Rs)					
EPS	36.3	45.4	40.9	43.4	48.5
EPS Growth (%)	14.0	24.9	(10.0)	6.2	11.8
Cash EPS	49.9	62.2	60.8	65.8	73.9
Book value per share	256.2	293.7	322.7	353.1	388.7
DPS	7.5	8.5	10.5	11.5	11.5
Payout (incl. div. tax) %	24.3	21.3	29.2	30.1	26.9
Valuation (x)					
P/E	16.1	12.9	14.3	13.5	12.1
Cash P/E	11.7	9.4	9.6	8.9	7.9
EV/Sales	1.1	0.9	0.9	0.9	0.7
EV/EBITDA	7.2	6.4	6.5	5.9	5.0
P/BV	2.3	2.0	1.8	1.7	1.5
Dividend yield (%)	1.3	1.5	1.8	2.0	2.0
Return ratios (%)					
RoCE	18.6	18.6	16.0	15.6	16.0
RoE	14.2	15.5	12.7	12.3	12.5
Profitability ratios (%)					
EBITDA margin	14.8	14.2	14.4	14.7	14.8
PAT margin	9.7	10.3	9.7	9.9	10.1
Turnover ratios					
Debtors (days)	24	26	26	26	26
Inventory (days)	26	33	33	33	33
Creditors (days)	72	72	72	72	72
Working capital (days)	(23)	(12)	(12)	(12)	(12)
Asset turnover (x)	1.4	1.4	1.2	1.2	1.2
Leverage Ratio					
Debt/equity (x)	0.1	0.1	0.1	0.1	0.0

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
29 July 2019	Buy	565	800
08 August 2019	Buy	517	782
23 September 2019	Buy	565	711
11 November 2019	Buy	582	686

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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