

Buy

Mahindra & Mahindra

Industry: Auto and Auto Components

Industry View: Positive

LKP
Since 1948

Result Update

FES segment and new SUV product pipeline to drive the performance

Stellar Q2 on the back of improvement in automotive profitability

M&M's standalone Q2FY18 revenues came in above street's expectations at Rs 122 bn, growing at 17% yoy and 5.2% sequentially. Automotive volumes in the quarter grew by 17.6% qoq and 9% yoy rising from the weakness of last quarter. While the auto revenues moved up by 1% yoy and 2.7% qoq, FES revenues zoomed up more than 12% yoy and fell by 8.4% qoq on seasonality. FES volumes moved up by 31% yoy, moving de-growing a bit by 4% qoq. On profitability front, EBITDA margins went up to 14.2% from 11.6% yoy and 10.9% qoq. Auto margins improvement was the highlight of the quarter, at 8.6% due to better product mix and tight cost control at other expenses & employee cost levels. Even FES margins zoomed up at 21.3% due to sharp surge in tractor margins along with the volumes offering operating leverage. While other income grew upwards qoq, tax rate moved up to 30%. PAT went up by 14.5% yoy and 73% qoq at Rs 13.3 bn on operating outperformance.

New launches and ambitious EV plans to lift up SUV business performance

The future of UV business of M&M is now pinned upon new launches only as competition is intensifying. Segment. The company will launch a new MPV (code named U321) and another new product based on SsangYong's Tivoli platform in FY2019E. Additionally, the company will launch refresh of existing models such as KUV100, Scorpio and XUV500 in FY2018E. The company will launch a new range of gasoline and CNG engines over the next two years, which will increase addressable market segment of the company. The company was quite upbeat about the volumes of new KUV100, which was recently launched and expects its volume to triple from Q2FY18 run-rate. The company is quite positive on electric vehicles and is looking to expand its manufacturing capacity to ~5,000 units/month by FY2019E from ~400 units/month currently. Sales volume of electric vehicles was ~1,000 units in FY2017. The company will target fleet segment (already tied up with Ola for electric car fleet in Ola) and will also launch premium electric vehicles over the next three years. For fleet segment, the vehicles are affordable (just about breakeven for the company) given the government's subsidies and lower excise duty under GST (compared to other vehicles). The company is targeting further 20% cost reduction over the next 2-3 years. The company has also bid for government orders for electric vehicles. In Phase 1, M&M will supply 150 electric vehicles out of total order of 500 vehicles by the government as it emerged as L2 bidder. In Phase 2, M&M plans to fulfill demand for 4,750 electric vehicles out of total order of 9,500 units. The company is planning to make battery assembly, rotor, transmission and electronics manufacturing in-house for electric vehicles.

MHCV business to improve on expansion of product portfolio

In MHCV segment, the company mentioned that its Blazo series models (higher tonnage segment) are much superior to peers in terms of fuel efficiency. The company has expanded its service network (14 touch points in Delhi-Mumbai route) and parts availability through its parts plazas. The company is now targeting ICV segment and will launch models in 7.5-16 ton segment over the next two years.

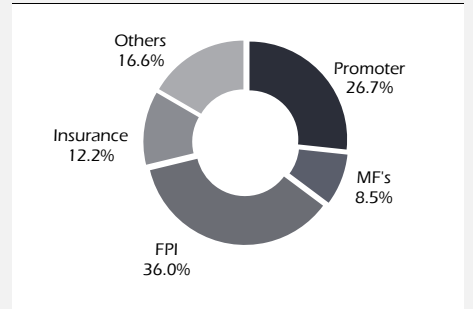
Stock Data

Current Market Price (₹)	1,410
Target Price (₹)	1,678
Potential upside (%)	19
Reuters	MAHM.BO
Bloomberg	MM IN
FV (₹)	5
Market Cap (₹ bn)	881
52-Week Range (₹)	1,460 / 1,142

What's Changed

12 month Price Target (₹)	From 1,454 to 1,678
FY 2018E EPS (₹)	From 62 to 65
FY 2019E EPS (₹)	From 74 to 78

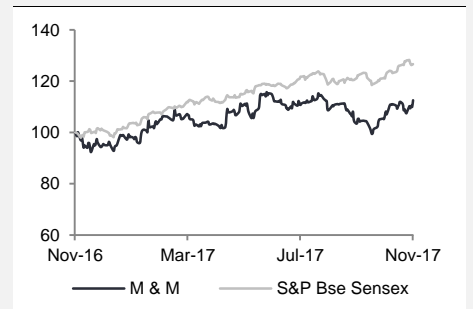
Shareholding Pattern



Fiscal YE

YE Mar	FY 16	FY 17	FY 18E	FY 19E
Total sales (₹ bn)	409	438	506	579
EBITDA margins (%)	11.3	10.9	11.6	12.1
PAT margins (%)	7.7	7.8	7.9	8.4
EPS (₹)	50.5	54.9	64.7	78.2
P/E (x)	27.9	25.7	21.8	18.0
P/BV (x)	3.9	3.4	3.0	2.6
EV/EBITDA (x)	15.5	14.7	11.9	9.6
ROE (%)	14.0	13.3	13.8	14.5
Dividend yield (%)	0.9	0.9	0.6	0.6

Relative Price Performance



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FES segment on a fast track

FES segment of the company has posted a strong 31% yoy volume growth in Q2 led by a strong performance of the southwest monsoons. The company has revised its FES segment growth rate for the industry at 12-14% for FY18E from its earlier guidance of 10-12%. The company had launched a new 24 HP tractor Jivo in April 2017, which is designed particularly for horticulture applications, and will launch a completely new platform under Swaraj brand in FY2018E. Assuming a normal monsoon, we expect tractor volumes for the company to grow at 14.5% yoy in FY2018E, which is based on 12% yoy industry growth and around 110 bps market share gain. The company expects tractor industry to grow in FY2019 as well even if monsoons are below normal due to expectations of increased spending by the government in rural areas.

Improved product mix to result into margins moving upwards

In Q2 FY18, the company posted robust margins at 14.2% as the FES segment (37% of volumes) posted strong margins at ~21%, while Auto business too posted a significant improvement in margins at ~9%. As FES sales move up hereon we expect even better margin performance reducing the impact of rising RM costs to a great extent. Lower discounts as compared to the festive season will be another factor leading to a better margin performance. Furthermore, price increases to be taken on both the segments to offset the RM prices hikes would further assist margins. New launches at SUVs as well as FES segments would provide better product mix. Reduction in losses at subsidiary level (especially 2W) will augur well at the consolidated level.

Financial Highlights

YE Mar (₹.mn)	Q2 FY18	Q1 FY18	% qoq	Q2FY17	% yoy
Net sales	121,821	115,757	5.2%	104,117	17.0%
Other operating income	-	-	0.0%	1,974	NA
Total income	121,821	115,757	5.2%	106,091	14.8%
Raw material costs	84,087	84,203	-0.1%	75,981	10.7%
Employee costs	7,052	6,938	1.6%	6,577	7.2%
Other expenses	13,389	11,950	12.0%	11,201	19.5%
EBITDA	17,293	12,666	36.5%	12,332	40.2%
EBITDA margins %	14.2%	10.9%	340 bps	11.6%	260 bps
Other income	5,620	2,046	174.6%	7075	-20.6%
Depreciation	3,633	3,439	5.6%	3340	8.8%
Interest expenses	229	308	-25.7%	257	-11.2%
Tax	5,736	3,306	73.5%	4176	37.3%
Adjusted PAT	13,316	7,660	73.8%	11634	14.5%
Adj EPS	22.49	12.94	73.8%	19.7	14.5%

Outlook and valuation

M&M's volume growth has picked up well in Q2 FY18. Going forward, new launches SUV segment will help the company to gain market share, which has been moving down the spiral since last several quarters. Better product mix in the form of new model launches will enable M&M to post elevated margins as it did in Q2 on the Auto business front. In line with the company's thrust efforts on the EV business which is the future of the auto industry, we believe the company to fetch first mover advantage. With new model Jivo in the FES business and upcoming model pipeline, the FES business is poised to report even better performance hereon. Additionally, on good monsoon this year, management has revised the tractor industry growth upwards for FY18E. Also with GOI's added emphasis on the rural markets, we expect FY19E too to be a good year for the tractor industry. Margin performance to improve hereon as the company is bringing tighter control on other expenses and employee costs. Price hike would somewhat negate the impact of RM costs moving up. Lower losses at 2W subsidiary would aid the consolidated profitability. In view of this improved performance, we raise our target price to ₹ 1,678 which includes ₹ 505 of the subsidiary valuation. Maintain **BUY**.

Financials
Income statement

YE Mar (₹.mn)	FY16	FY17	FY18E	FY19E
Total Revenues	408,751	437,853	506,372	578,809
Raw Material Cost	295,161	318,027	368,639	416,743
Employee Cost	23,487	25,954	29,370	32,992
Other Exp	43,902	46,180	49,624	59,039
EBITDA	46,201	47,692	58,739	70,036
EBITDA Margin(%)	11.3	10.9	11.6	12.1
Other Income	8,499	13,425	16,000	19,000
Depreciation	10,681	13,272	16,320	18,695
Interest	1861	1456	1013	1010
PBT	42,158	46,390	57,407	69,331
PBT Margin(%)	10.3	10.6	11.3	12.0
Tax	10,799	12,319	17,222	20,799
Adj PAT	31,359	34,071	40,185	48,532
Adj PAT Margins (%)	7.7	7.8	7.9	8.4
Minority interest	0	0	0	0
Exceptional items	687	5485	0	0
Reported PAT	32,047	39,556	40,185	48,532
Rep. PAT Margins (%)	7.8	9.0	7.9	8.4

Key Ratios

YE Mar	FY16	FY17	FY18E	FY19E
Per Share Data (₹)				
Adj. EPS	50.5	54.9	64.7	78.2
CEPS	68.8	85.1	91.0	108.3
BVPS	361.1	413.4	469.0	537.7
DPS	12.0	12.0	8.1	8.4
Growth Ratios(%)				
Total revenues	6.3	7.1	15.6	14.3
EBITDA	10.7	3.2	23.2	19.2
PAT	5.0	8.6	17.9	20.8
EPS Growth	5.0	8.6	17.9	20.8
Valuation Ratios (X)				
PE	27.9	25.7	21.8	18.0
P/CEPS	20.5	16.6	15.5	13.0
P/BV	3.9	3.4	3.0	2.6
EV/Sales	1.8	1.6	1.4	1.2
EV/EBITDA	15.5	14.7	11.9	9.6
Operating Ratios (Days)				
Inventory days	33.2	31.2	30.0	32.0
Receivable Days	22.9	23.4	23.0	24.0
Payables day	74.4	79.4	80.0	81.0
Net Debt/Equity (x)	0.07	0.09	0.09	0.09
Profitability Ratios (%)				
ROE	14.0	13.3	13.8	14.5
Dividend payout	23.8	21.9	12.4	10.7
Dividend yield	0.9	0.9	0.6	0.6

Source: Company, LKP Research

Balance sheet

YE Mar (₹. mn)	FY16	FY17	FY18E	FY19E
Equity and Liabilities				
Equity Share Capital	2,963	2,968	2,968	2,968
Reserves & Surplus	221,269	253,728	288,257	330,913
Total Networth	224,232	256,696	291,225	333,881
Total debt	27,720	35,149	40,549	43,949
Deferred tax liabilities	4,601	6,949	6,949	6,949
Current liabilities & Provisions	98,443	94,589	106,324	120,209
Total Liabilities	354,995	393,382	445,047	504,988
Assets				
Fixed assets	91,581	96,726	122,652	135,957
Non current Investments	111,614	142,955	155,955	170,955
Other non current assets	35,443	29,143	33,143	37,143
Current Assets	116,357	124,559	133,298	160,933
Cash and Bank	22,870	16,870	12,018	23,124
Inventories	26,879	27,156	30,299	36,536
Sundry Debtors	25,116	29,185	31,908	38,059
Loan, Advances & others	4,868	5,059	6,583	7,525
Other current assets	36,624	46,290	52,490	55,690
Total Assets	354,996	393,382	445,047	504,988

Cash Flow

YE Mar (₹ mn)	FY16	FY17	FY18E	FY19E
PBT	42,158	46,390	57,407	69,331
Depreciation	10,681	13,272	16,320	18,695
Interest	1,553	1,456	1,013	1,010
Chng in working capital	14,393	(313)	(1,855)	(2,644)
Tax paid	(9,279)	(9,924)	(17,222)	(20,799)
Other operating activities	(4,579)	(11,168)	(9,250)	(9,001)
Cash flow from operations (a)	54,927	39,712	46,412	56,591
Capital expenditure	(21,597)	(20,605)	(30,500)	(32,000)
Chng in investments	(39,233)	(48,065)	(13,000)	(15,000)
Other investing activities	25,368	36,682	9,001	9,001
Cash flow from investing (b)	(35,461)	(31,988)	(34,499)	(37,999)
Free cash flow (a+b)	19,466	7,725	11,913	18,592
Equity raised/(repaid)	6	0	0	0
Inc/dec in borrowings	(9,500)	(827)	5,000	3,000
Dividend paid (incl. tax)	(8,461)	(8,391)	(5,655)	(5,876)
Other financing activities	(456)	(456)	(456)	(456)
Cash flow from financing (c)	(18,411)	(9,675)	(1,111)	(3,332)
Net chng in cash (a+b+c)	1,055	(1,950)	10,802	15,260
Closing cash & cash equivalents	8,573	5,373	12,018	23,124

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