

Buy

Mahindra & Mahindra

Industry: Auto and Auto Components



Results below expectations, new launches to drive UV volumes

Weak Auto margins lead to subdued profitability

M&M's standalone Q2FY19 revenues came in line with the street's expectations at ₹130 bn, growing at 6.6% yoy and falling by 3.9% sequentially. Automotive volumes in the quarter grew by 9.5% yoy and 7.5% qoq on Marazzo launch. FES volumes de-grew by 3.5% yoy and 22.6% sequentially as a moderation was expected on high base and a deficient monsoon. While the auto revenues moved up by 9.5% yoy and 5.5% qoq, FES revenues were up by 1.8% yoy and down by 19.5% qoq. On profitability front, EBITDA margins went down to 12.4% from 14.2% yoy and 13.8% qoq. Auto EBIT margins were sluggish at 5.3% due to higher RM costs and launch costs associated with Marazzo. FES margins zoomed up at 20.1% which was a surprise to us despite higher RM costs. Higher other income (up by 50% yoy) and lower tax rate at 23% (due to deferred tax asset of ₹1.34 bn) led to net profits to be higher at 23.9%, however, adjusted net profits grew by 14% to ₹15.2 bn.

New launches 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. The company in Q2 launched a new SUV named Marazzo, the order bookings of which have now crossed 13,500 units and has a waiting period of 6-8 weeks. Two more new products will be launched shortly named Y400 (Alturas G4 on 24th November) and one based on SsangYong's Tivoli platform named S201 in Q4 to take on the likes of Brezza and Creta. M&M will launch a new range of gasoline, diesel as well as CNG engines over the next two years, which will increase addressable market segment of the company. Also the rural sales have crossed the urban sales at 51% v/s 49% respectively. With these new launches, we expect M&M to regain its lost market share and post an 8%/9% growth in FY19E/20E respectively. Management expects PV industry to grow at 7-8% in FY 19.

FES volumes weaken, but margins remain strong, concerns surround FY 20 growth

FES segment of the company has posted 3.5% yoy and 22.6% qoq de-growth in volume in Q2 on higher base and weak monsoon. Despite 9% deficient monsoons, management stated that precipitation was better which has led to a robust festive demand and expects industry growth at 12-14% in FY 19E. This is still not as bad as the industry has already reported strong growth since last three years when tractor life cycle is itself of 2-3 years. Non agri usage of tractors is also quite strong as construction and infrastructure industries are also on a rampage now. The company reported healthy 20.1% margins in Q2, which going forward in FY19, we expect the company to continue to do so in line with robust volume growth. However, concerns remain over FY20 as FY19 will provide a high base and an uncertainty surrounds tractor cycle. On the positive side, FY20 is an election year and if GOI tries to push infra development then tractor sales may find the current traction to continue.

Margins to get impacted by launch expenses and RM costs

In Q2 FY19, the company posted subdued margins at 12.4% as the Auto segment (~60% of volumes) posted weak margins at ~6%. This was due to input costs hike and launch costs associated with Marazzo launch. Going forward, in Q3 and Q4 too we see these headwinds to have an impact on margins as two more launches will happen in the H2 of FY19. In FY 20E, we may see some improvement in margins as launch costs may taper off. Hence we have reduced our margin estimates from previous levels to 12.6%/13% in FY19E/20E respectively.

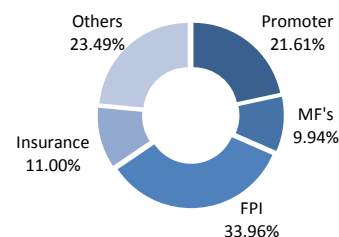
Stock Data

Current Market Price (₹)	766
12M Price Target (₹)	950
Potential upside (%)	24
BSE / NSE Symbol	500520 / M&M
Reuters / Bloomberg	MAHM / MM IN
FV (₹)	5
Market Cap Full (₹ bn)	954
52-Week Range (₹)	683 / 992

What's Changed

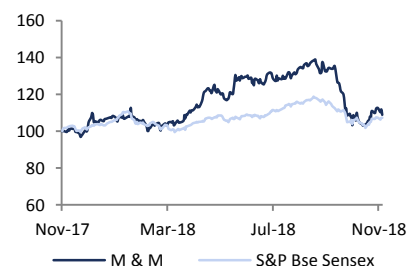
12 M Price Target (₹)	From 1,095 to 950
FY2019E EPS (₹)	From 44 to 43
FY2020E EPS (₹)	From 53 to 51

Shareholding Pattern



YE Mar	FY17	FY18	FY19E	FY20E
Total sales (₹ bn)	441	487	596	683
EBITDA margins (%)	10.3	12.8	12.6	13.0
PAT margins (%)	7.1	8.1	8.5	8.8
EPS (₹)	26.2	33.0	42.8	50.7
P/E (x)	29.3	23.2	17.9	15.1
P/BV (x)	3.4	3.0	2.6	2.3
EV/EBITDA (x)	7.0	11.9	9.6	8.0
ROE (%)	11.6	12.9	14.6	15.0
Dividend yield (%)	0.8	0.5	0.6	0.6

Relative Price Performance



Financial Highlights

(₹) mn	Q2 FY19	Q1 FY19	% qoq	Q2 FY18	% yoy
Net sales	1,29,886	1,35,199	-3.9%	1,21,821	6.6%
Raw material costs	92,556	95,566	-3.1%	84,087	10.1%
Employee costs	7,418	7,516	-1.3%	7,052	5.2%
Other expenses	13,857	13,401	3.4%	13,389	3.5%
EBITDA	16,054	18,716	-14.2%	17,293	-7.2%
EBITDA margins %	12.4%	13.8%	(140 bps)	14.2%	(180 bps)
Other income	8,463	2,650	219.4%	5620	50.6%
Depreciation	4,614	3,930	17.4%	3633	27.0%
Interest expenses	277	327	-15.5%	229	21.1%
PBT	19,627	17,109	14.7%	19051	3.0%
Tax	4,469	5,108	-12.5%	5736	-22.1%
Reported PAT	16,500	12,209	35.1%	13316	23.9%
Exceptional items	1,341	209	542.7%	0	N/A
Adjusted PAT	15,158	12,001	26.3%	13316	13.8%
Adj EPS (₹)	12.80	10.14	26.3%	11.2	13.8%

Outlook and valuation

Except for M&M's FES volume growth, all other segments reported good growth, particularly the Vans & pickups, CVs and 3Ws. UVs grew at a decent higher single digit on the back of Marazzo launch. Going forward, new SUV, FES and CV launches will help the company to gain market share across the board. Better product mix in the form of new model launches will enable M&M to post better margins particularly in FY 20E. In line with the company's thrust efforts on the petrol business and EV front (which is at a low pace now), we believe the company to give a better competition to its rivals. Apart from the new launches, GOI's added emphasis on the rural markets, we expect rest of the FY19E to be a good year for the tractor industry wherein we expect about 12% growth for M&M's FES business. However, some concerns remain on FY 20E growth on tractor cycle extension. CV business will continue to get boost from the infra development in the country. Margin performance may remain subdued in H2 on further launch costs, while it may improve in FY20E as the company is bringing tighter control and launch costs will taper off. Price hike would somewhat negate the impact of higher RM costs and launch costs. In view of this, we have reduced our target to ₹ 950, which includes ₹291 of subsidiary valuation. Maintain **BUY**.

Financials

Income statement

YE Mar (₹ mn)	FY 17	FY 18	FY 19E	FY 20E
Total Revenues	4,40,731	4,86,855	5,95,618	6,82,574
Raw Material Cost	3,20,812	3,41,347	4,21,697	4,84,627
Employee Cost	27,144	28,409	33,355	36,859
Other Exp	47,433	54,860	65,518	72,353
EBITDA	45,342	62,240	75,048	88,735
EBITDA Margin (%)	10.3	12.8	12.6	13.0
Other Income	13,455	10,363	13,000	15,000
Depreciation	15,264	14,794	14,308	16,563
Interest	1,596	1,122	1,010	1,070
PBT	41,937	56,687	72,730	86,102
PBT Margin (%)	9.5	11.6	12.2	12.6
Tax	10,792	17,464	21,819	25,831
Adj PAT	31,145	39,223	50,911	60,271
Adj PAT Margins (%)	7.1	8.1	8.5	8.8
Exceptional items	5,485	4,336	0	0
Reported PAT	36,630	43,559	50,911	60,271
Rep. PAT Margins (%)	8.3	8.9	8.5	8.8

Key Ratios

YE Mar	FY 17	FY 18	FY 19E	FY 20E
Per Share Data (₹)				
Adj. EPS	26.2	33.0	42.8	50.7
CEPS	43.6	49.0	54.8	64.6
BVPS	225.1	254.6	292.4	338.0
DPS	6.3	4.2	4.4	4.5
Growth Ratios (%)				
Total revenues	7.8	10.5	22.3	14.6
EBITDA	-1.9	37.3	20.6	18.2
PAT	-0.7	25.9	29.8	18.4
EPS Growth	-48.2	25.9	29.8	18.4
Valuation Ratios (X)				
PE	29.4	23.4	18.0	15.2
P/CEPS	17.7	15.7	14.0	11.9
P/BV	3.4	3.0	2.6	2.3
EV/Sales	0.7	1.5	1.2	1.0
EV/EBITDA	7.0	11.9	9.6	8.0
Operating Ratios (Days)				
Inventory days	31.4	28.9	29.0	29.0
Receivable Days	22.6	22.9	24.0	27.0
Payables day	77.1	82.8	86.0	83.0
Net Debt/Equity (x)	0.08	0.07	0.07	0.06
Profitability Ratios (%)				
ROE	11.6	12.9	14.6	15.0
Dividend payout	23.9	12.7	10.2	9.0
Dividend yield	0.8	0.5	0.6	0.6

Source: Company, LKP Research

Balance sheet

YE Mar (₹ mn)	FY 17	FY 18	FY 19E	FY 20E
Equity and Liabilities				
Equity Share Capital	2,968	5,950	5,950	5,950
Reserves & Surplus	2,64,888	2,96,991	3,42,026	3,96,195
Total Networth	2,67,856	3,02,940	3,47,975	4,02,145
Total debt	35,487	35,223	37,423	40,823
Deferred tax liabilities	0	2,772	5,272	6,272
Current liabilities & Provisions	96,340	1,33,232	1,47,757	1,60,401
Total Liabilities	3,99,682	4,74,168	5,38,427	6,09,641
Assets				
Fixed assets	98,114	1,09,881	1,28,573	1,54,010
Non current Investments	1,43,017	1,66,455	1,81,455	1,96,455
Other non current assets	32,471	33,086	37,086	41,086
Current Assets	1,26,095	1,64,745	1,91,314	2,18,090
Cash and Bank & other cash equivalents	16,870	28,937	33,842	30,907
Inventories	27,580	27,017	33,505	38,505
Sundry Debtors	29,388	31,730	39,164	50,492
Loan, Advances & others	5,065	9,752	14,295	20,477
Other current assets	47,192	67,309	70,509	77,709
Total Assets	3,99,682	4,74,168	5,38,427	6,09,641

Cash Flow

YE Mar (₹ mn)	FY 17	FY 18	FY 19E	FY 20E
PBT	41,742	56,688	72,730	86,102
Depreciation	15,264	14,794	14,308	16,563
Interest	1,596	1,122	1,010	1,070
Chng in working capital	-508	17,803	-7,140	-17,066
Tax paid	-9,929	-12,887	-21,819	-25,831
Other operating activities	-11,064	-7,250	0	0
Cash flow from operations (a)	37,101	70,271	59,089	60,838
Capital expenditure	-20,742	-26,688	-33,000	-42,000
Chng in investments	-44,344	-27,056	-15,000	-15,000
Other investing activities	37,267	2,646	14,760	-1
Cash flow from investing (b)	-27,819	-51,098	-33,240	-57,001
Free cash flow (a+b)	9,282	19,173	25,849	3,837
Equity raised/(repaid)	0	0	0	0
Inc/dec in borrowings	-1,742	592	1,000	2,000
Dividend paid (incl. tax)	-8,391	-9,230	-5,876	-6,102
Other financing activities	-456	-456	-456	-456
Cash flow from financing (c)	-10,589	-9,094	-5,332	-4,558
Net chng in cash (a+b+c)	-1,307	10,079	20,517	-721
Closing cash & cash equivalents	5,339	14,179	33,842	30,907

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