

Buy

## Mahindra &amp; Mahindra

Industry: Auto and Auto Components



## Results below than expectations, FES may drive numbers on improved monsoon

## Weak Auto margins leads to subdued profitability

M&M has posted subdued performance in Q1 FY20 on weak and challenging market environment and heightened competition. M&M's standalone Q1FY20 revenues fell by 4.4% yoy and 7.7% qoq at ₹129 bn. Automotive volumes in the quarter dropped by 6% yoy better than the industry decline while falling by 24.6% qoq. Launches done in Q3 and Q4 of last year led to some market share gains in the quarter. FES volumes de-grew by 14.3% yoy better than industry, (which declined 15.6%) while growing 41.6% sequentially. While the auto revenues moved down by just 1.1% yoy, the sequential dip was 22.4%. FES revenues were down by 12.5% yoy, they were up by 36.7% qoq. On profitability front, EBITDA margins went down to 12.6% from 13.8% yoy and were up from 11.7% qoq. Auto EBIT margins were sluggish at 4.7% due to negative operating leverage led by deceleration of demand. FES margins zoomed up at 19.3% qoq, while dropped 160 bps yoy from 20.9%. Higher other income (by 20% yoy) was offset by higher depreciation related with 3 new launches. This led to adjusted net profits to fall by 20.7%, however, reported net profits (including a one off item worth ₹13.7 bn on gain on sales of long term investment in Tech Mahindra) grew by 173% to ₹23.2 bn.

## Auto business outlook stays uncertain

On the back of challenging market environment, M&M has also faced the pressure like other auto manufacturers. SUV, 3W as well as CV segments have reported drop in sales, though they have managed to increase market share in SUV segment on recent launches and the drop in its fall is lesser than the industry. Going forward, the management is getting ready for the BS VI transition and EV wave. We believe with increasing rural thrust from the government the sales may move up in H2 over Q1 and on low base of H2 last year. We believe the newly launched XUV 300 will gain success and contribute to the volume growth hereon. Any tax incentive or reduction in registration costs and insurance costs of vehicles may provide some stimulus for the demand hereon. However, with uncertainty still around, the management has not given any sales outlook for the Auto business. We believe this business to de-grow by 6% in FY 20E v/s YTD July growth of -8.3% and at grow at 7% in FY 21E.

## Reduction in monsoon deficit may lead to recovery in tractor sales

Domestic FES segment of the company has posted 14.2% YTD July de-growth in volume on delayed monsoon and overall weakness in rural income. With current monsoon deficit down at 7% from the highs of June end, further consistency and widespread, proper distribution of rainfall, we expect recovery in tractors sales to follow. Management believes that the worst for this segment is behind and a positive growth in rest of the year may result in a flattish growth in FY 20E. Non agri usage of tractors is also quite strong as construction and infrastructure industries are also expected to gain momentum in H2. The segment reported 19.3% margins in Q1, which going forward in FY20E, we expect the segment to continue to improve on benign RM costs and anticipated growth in volumes. We expect -2%/7% growth in FES business in FY20E/21E.

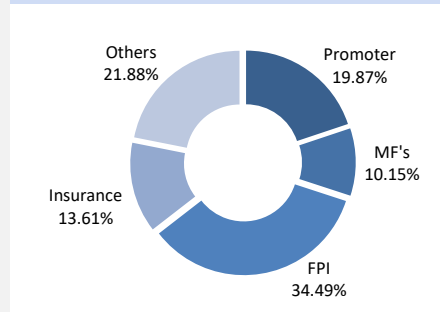
## Margins to get impacted by BS VI costs, auto slowdown and competition

In Q1 FY20, the company posted subdued margins at 12.6% as the Auto segment (~60% of volumes) posted weak margins at ~4%. This was due to higher inventory costs resulting from slowdown across segments, higher marketing expenses in line with promotion of three newly launched products amidst competition and BS VI related expenses. Going forward, in rest of FY 20E too we see these headwinds to have an impact on margins. Softening RM costs, improvement in FES business and price hikes may provide tailwinds for the margins. We expect FY 20E margins to be lower than Q1 levels at 11.7%, while expect them to grow to 12.6% in FY 21E.

Stock Data	
Current Market Price (₹)	520
12M Price Target (₹)	600
Potential upside (%)	15
BSE / NSE Symbol	500520 / M&M
Reuters / Bloomberg	MAHM / MM IN
FV (₹)	5
Market Cap Full (₹ bn)	64,696
52-Week Range (₹)	992 / 515

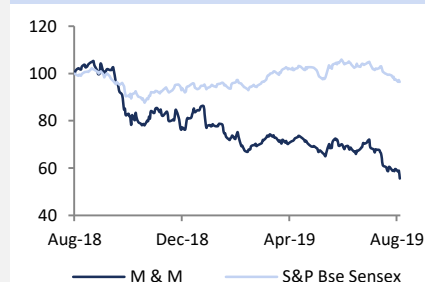
What's Changed	
12 M Price Target (₹)	From 790 to 600
FY2020E EPS (₹)	From 48 to 35
FY2021E EPS (₹)	From 52 to 39

## Shareholding Pattern (June 2019)



YE Mar	FY18	FY19	FY20E	FY21E
Total sales(₹ bn)	487	536	521	575
EBITDA margins (%)	12.8	12.4	12.3	12.6
PAT margins (%)	8.1	9.0	8.0	8.0
EPS (₹)	33.0	40.6	35.1	38.9
P/E (x)	15.8	12.8	14.8	13.4
P/BV (x)	2.0	1.8	1.6	1.5
EV/EBITDA (x)	7.2	6.2	6.2	5.1
ROE (%)	12.9	14.1	11.1	11.2
Dividend yield (%)	0.9	1.9	1.6	1.7

## Relative Price Performance



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LKP Research

**Financial Highlights**

(₹) mn	Q1 FY20	Q4 FY19	% qoq	Q1 FY19	% yoy
Net sales	1,29,277	1,40,352	-7.9%	1,35,199	-4.4%
Raw material costs	91,591	1,00,369	-8.7%	95,566	-4.2%
Employee costs	7,841	7,094	10.5%	7,516	4.3%
Other expenses	13,568	16,432	-17.4%	13,401	1.2%
EBITDA	16,277	16,457	-1.1%	18,716	-13.0%
EBITDA margins %	12.6%	11.7%	90 bps	13.8%	(120 bps)
Other income	3,191	2,368	34.8%	2650	20.4%
Depreciation	5,454	5,325	2.4%	3930	38.8%
Interest expenses	271	281	-3.5%	327	-17.1%
PBT	13,744	13,219	4.0%	17109	-19.7%
Tax	4,226	3,684	14.7%	5108	-17.3%
Reported PAT	23,188	8,488	173.2%	12209	89.9%
Exceptional items	13,670	(1,047)	N/A	209	6450.1%
Adjusted PAT	9,518	9,535	-0.2%	12001	-20.7%
Adj EPS	8.04	8.05	-0.2%	10.1	-20.7%

**Outlook and valuation**

Going ahead, we expect M&M's volume to clock a tepid CAGR of 1% over FY19-FY21E due to ongoing slowdown, down-cycle for the automobile industry and BS-VI-led disruptions, in view of which, we lower our volume estimate for M&M. Expecting improvement in rural demand due to declining monsoon deficit, new products and attractive valuation post sharp correction, we reiterate our BUY recommendation on the stock with a revised SOTP-based Target Price of Rs600 (from ₹790 earlier), valuing M&M @9x P/E FY 21E earnings at ₹350 and subsidiary at Rs249 post 30% discount to Market cap.

## Financials

## Income statement

YE Mar (₹ mn)	FY 18	FY 19	FY 20E	FY 21E
<b>Total Revenues</b>	<b>4,86,855</b>	<b>5,36,140</b>	<b>5,21,344</b>	<b>5,75,254</b>
Raw Material Cost	3,41,347	3,82,565	3,69,112	4,06,130
Employee Cost	28,409	29,802	28,153	29,913
Other Exp	54,860	57,377	59,955	66,730
<b>EBITDA</b>	<b>62,240</b>	<b>66,396</b>	<b>64,125</b>	<b>72,482</b>
EBITDA Margin (%)	12.8	12.4	12.3	12.6
Other Income	10,363	16,890	18,000	19,000
Depreciation	14,794	18,604	21,356	24,275
Interest	1122	1134	1070	1100
<b>PBT</b>	<b>56,687</b>	<b>63,548</b>	<b>59,699</b>	<b>66,107</b>
PBT Margin (%)	11.6	11.9	11.5	11.5
Tax	17,464	15,290	17,910	19,832
<b>Adj PAT</b>	<b>39,223</b>	<b>48,258</b>	<b>41,789</b>	<b>46,275</b>
Adj PAT Margins (%)	8.1	9.0	8.0	8.0
Exceptional items	4336	-297	0	0
<b>Reported PAT</b>	<b>43,559</b>	<b>47,961</b>	<b>41,789</b>	<b>46,275</b>
Rep. PAT Margins (%)	8.9	8.9	8.0	8.0

## Key Ratios

YE Mar	FY 18	FY 19	FY 20E	FY 20E
<b>Per Share Data (₹)</b>				
Adj. EPS	33.0	40.6	35.1	38.9
CEPS	49.0	55.9	53.1	59.3
BVPS	254.6	287.5	317.5	347.4
DPS	4.8	10.0	8.1	8.9
<b>Growth Ratios (%)</b>				
Total revenues	10.5	10.1	-2.8	10.3
EBITDA	37.3	6.7	-3.4	13.0
PAT	25.9	23.0	-13.4	10.7
EPS Growth	25.9	23.0	-13.4	10.7
<b>Valuation Ratios (X)</b>				
PE	15.8	12.8	14.8	13.4
P/CEPS	10.6	9.3	9.8	8.8
P/BV	2.0	1.8	1.6	1.5
EV/Sales	0.9	0.8	0.8	0.6
EV/EBITDA	7.2	6.2	6.2	5.1
<b>Operating Ratios (Days)</b>				
Inventory days	28.9	36.6	35.0	34.0
Receivable Days	22.9	24.0	27.0	28.0
Payables day	82.8	87.2	92.0	94.0
Net Debt/Equity (x)	0.07	0.06	0.06	0.06
<b>Profitability Ratios (%)</b>				
ROE	12.9	14.1	11.1	11.2
Dividend payout	14.4	24.6	23.0	23.0
Dividend yield	0.9	1.9	1.6	1.7

Source: Company, LKP Research

## Balance sheet

YE Mar (₹ mn)	FY 18	FY 19	FY 20E	FY 21E
<b>Equity and Liabilities</b>				
Equity Share Capital	5,950	5,958	5,958	5,958
Reserves & Surplus	2,96,991	3,36,134	3,71,821	4,07,453
Total Networkth	3,02,940	3,42,092	3,77,779	4,13,411
Total debt	35,464	35,196	37,196	39,196
Deferred tax liabilities	2,772	6,341	6,341	6,341
<b>Current liabilities &amp; Provisions</b>	<b>1,33,290</b>	<b>1,43,341</b>	<b>1,41,396</b>	<b>1,54,752</b>
<b>Total Liabilities</b>	<b>4,74,467</b>	<b>5,26,971</b>	<b>5,62,713</b>	<b>6,13,701</b>
<b>Assets</b>				
Fixed assets	1,09,880	1,25,015	1,42,659	1,55,385
Non current Investments	1,66,455	1,90,321	2,05,321	2,20,321
Other non current assets	33,328	30,924	30,924	30,924
<b>Current Assets</b>	<b>1,64,803</b>	<b>1,80,711</b>	<b>1,83,809</b>	<b>2,07,072</b>
Cash and Bank & other cash equivalents	28,937	37,317	40,704	50,952
Inventories	27,017	38,393	35,394	37,831
Sundry Debtors	31,730	39,463	38,565	44,129
Loan, Advances & others	9,752	6,734	8,342	10,355
Other current assets	67,367	58,804	60,804	63,804
<b>Total Assets</b>	<b>4,74,467</b>	<b>5,26,971</b>	<b>5,62,713</b>	<b>6,13,701</b>

## Cash Flow

YE Mar (₹ mn)	FY 18	FY 19	FY 20E	FY 21E
PBT	56,688	63,548	59,699	66,107
Depreciation	14,794	18,604	21,356	24,275
Interest	1,122	1,134	1,070	1,100
Chng in working capital	17,803	-5,060	-1,656	342
Tax paid	-12,887	-14,341	-17,910	-19,832
Other operating activities	-7,250	-14,645	6,385	-12,064
<b>Cash flow from operations (a)</b>	<b>70,270</b>	<b>49,240</b>	<b>68,944</b>	<b>59,928</b>
Capital expenditure	-26,688	-30,316	-39,000	-37,000
Chng in investments	-27,056	-17,945	-15,000	-15,000
Other investing activities	2,640	22,774	12,064	12,064
<b>Cash flow from investing (b)</b>	<b>-51,104</b>	<b>-25,487</b>	<b>-41,936</b>	<b>-39,936</b>
<b>Free cash flow (a+b)</b>	<b>19,166</b>	<b>23,753</b>	<b>27,008</b>	<b>19,992</b>
Equity raised/(repaid)	0	0	0	0
Inc/dec in borrowings	592	-3,725	2,000	2,000
Dividend paid (incl. tax)	-9,230	-10,117	-9,612	-10,643
Other financing activities	-456	-456	-456	-455
<b>Cash flow from financing (c)</b>	<b>-9,094</b>	<b>-14,299</b>	<b>-8,068</b>	<b>-9,098</b>
<b>Net chng in cash (a+b+c)</b>	<b>10,072</b>	<b>9,454</b>	<b>18,941</b>	<b>10,894</b>
<b>Closing cash &amp; cash equivalents</b>	<b>14,179</b>	<b>22,377</b>	<b>40,704</b>	<b>50,952</b>

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