

Demand worries overshadow margin initiatives

Mahindra CIE (MCI) reported weak Q2CY20 results, with India performance a bigger drag than Europe. Consolidated sales were down 66% YoY to ₹ 736 crore, with India revenues down 71%, Europe revenues down 58%. Consolidated, standalone EBITDA was in the red amid broad-based spike in all cost heads. India, Europe EBIT margins were at -23.1%, -14.5% respectively. Standalone loss at the PAT level was at ₹ 47 crore, with consolidated loss at ₹ 129 crore.

Slow grind to topline revival, cost reduction efforts under way

MCI's Indian, European operations (Germany, Italy, Spain) are seeing challenging prospects on demand front. While India lagged Europe in Q2CY20 on the back of sterner pandemic impact, the situation is expected to reverse, going ahead. Exposure to 2-W segment in India through Hero MotoCorp, Bajaj Auto is seen aiding quicker recovery domestically. Europe, on the other hand, courtesy exposure to CV space in Germany is expected to be slower to catch up. MCI's overall performance, however, could be supported by increased wallet share amid vendor industry consolidation and move towards substitution of Chinese competitors. MCI stays focused on controllables, with substantial cost rationalisation efforts underway across geographies with the aim to lower breakeven levels, achieve previous margin trajectory by beginning of CY21E. We build -4.2% revenue CAGR in CY19-21E followed by return to 11.5% margins by end of the period.

Q2CY20 earnings conference call highlights, key takeaways

The management said (1) June, July recovery is better than expected, with current capacity utilisation at 65-70% across geographies; (2) CY19 Europe volumes at industry level are not expected to be regained by CY21E (~10% shortfall); (3) However, MCI expects to grow faster than industry via consolidation opportunities and move towards import substitution by Indian OEMs (seen adding 5-10% growth in gears, magnetics divisions); (4) MCI would enhance exports focus going forward; (5) Europe restructuring efforts (Metalcastello, Mahindra Forgings Europe) would lead to staff cost savings worth ~€4 million per annum; (6) India operations were EBIT positive & Europe operations were EBITDA positive in June (ex-restructuring costs); (7) breakeven reduction efforts are ongoing, with ~10% reduction achieved so far (current fixed costs down to ₹ 90 crore/month); (8) MCI is targeting return to pre-Covid margin profile by CY21E beginning; (9) EV threat may impact ~5% of business, going forward; (10) H1CY20 capex at ₹ 140 crore.

Valuation & Outlook

We expect sales, PAT to grow at a CAGR of -4.2%, 3%, respectively, in CY19-21E. While demand challenges remain, margin supportive efforts are encouraging. Valuing MCI at ₹ 115 (i.e. 6.25x CY21E EV/EBITDA), we downgrade the stock to **HOLD** after a sharp run up in the stock over the past couple of months. MCI's track record of consistent CFO generation combined with strong MNC parentage remains a comforting factor.

Key Financial Summary

Key Financials	CY17	CY18	CY19	CY20E	CY21E	CAGR (CY19-21E)
Net Sales	6,520.0	8,031.5	7,907.8	5,828.5	7,257.2	-4.2%
EBITDA	814.6	1,051.1	967.7	466.3	834.6	-7.1%
EBITDA Margins (%)	12.5	13.1	12.2	8.0	11.5	
Net Profit	369.0	498.1	353.8	115.4	375.1	3.0%
EPS (₹)	9.7	13.2	9.3	3.0	9.9	
P/E	11.3	8.4	11.8	36.1	11.1	
RoNW (%)	10.1	12.4	7.7	2.4	7.3	
RoCE (%)	11.4	13.2	10.7	3.5	8.5	

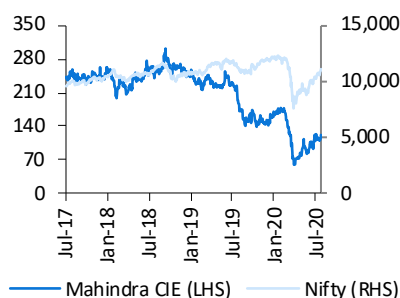
Source: ICICI Direct Research, Company

Mahindra CIE

Particulars

Particular	Amount
Market Capitalization (₹ Crore)	4,164.0
Total Debt (CY 19)	₹ 1469.14 Crore
Cash & Investments (CY 19)	₹ 237.5 Crore
EV	₹ 5395.6 Crore
52 week H/L (₹)	196 / 59
Equity capital	₹ 379 Crore
Face value	₹ 10

Price chart



Key Highlights

- Consolidated revenues decline 66% YoY in Q2CY20 amid 71% fall in India and 58% decline in Europe
- EBITDA and PAT in the red across geographies, Europe business undergoing restructuring.
- Demand challenges remain intact, particularly in Europe. Breakeven reduction efforts via focus on costs and efficiencies (staff costs, VA-VE, insourcing) underway.
- Downgrade from BUY to **HOLD** with revised target price of ₹ 115.

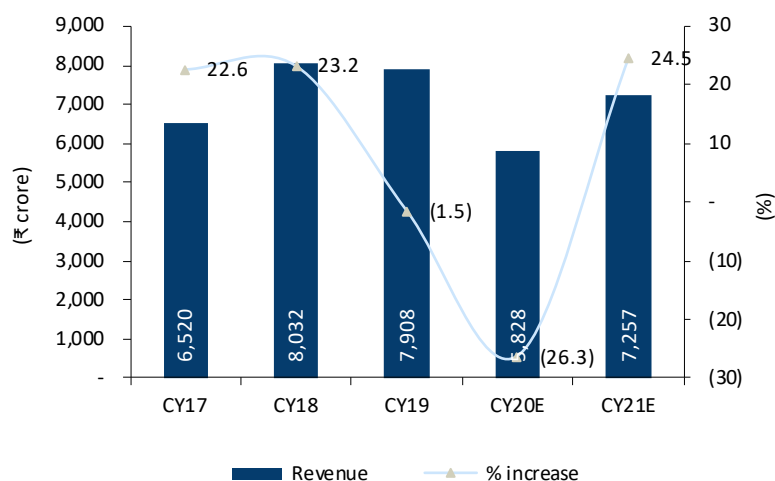
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Financial story in charts

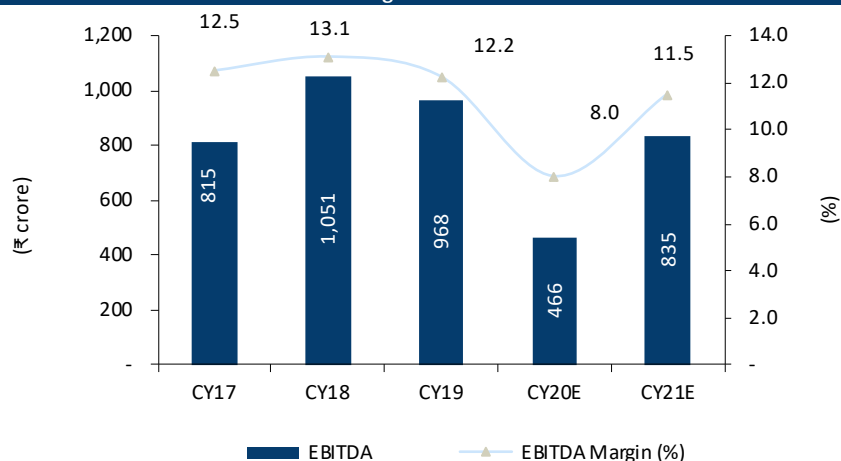
Exhibit 1: Trend in topline



We expect revenues to decline at 4.2% CAGR over CY19-21E amid expected weakness in Europe operations

Source: Company, ICICI Direct Research

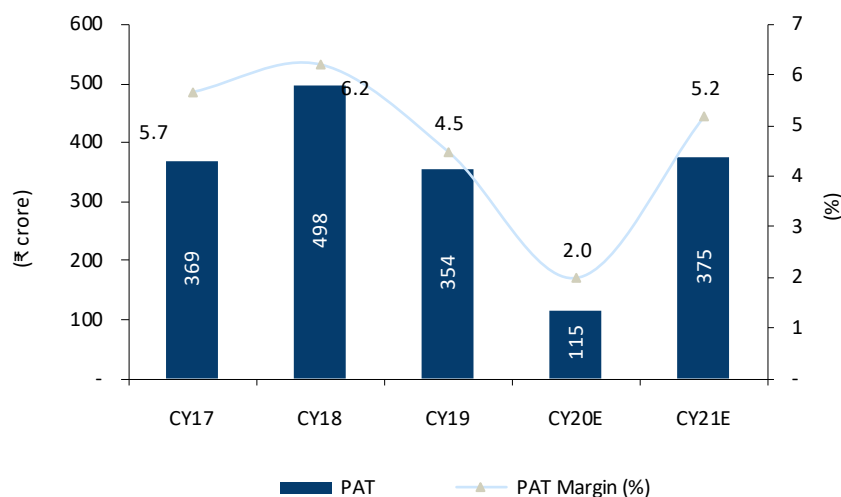
Exhibit 2: EBITDA and EBITDA margins trend



MCI's margins are seen dipping to 8% in CY20E before recovering to 11.5% by CY21E amid ongoing efforts to reduce breakeven levels and fixed costs in areas such as staff costs, VA-VE, insourcing, etc

Source: Company, ICICI Direct Research

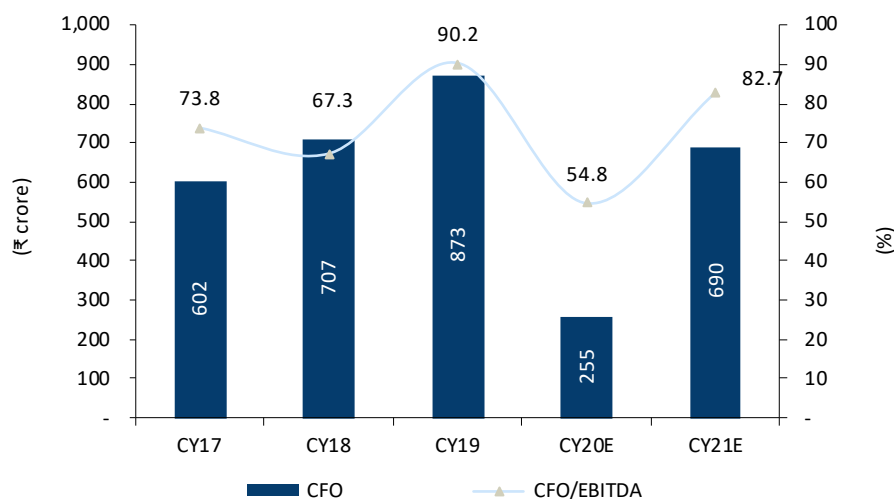
Exhibit 3: Trend in profitability



PAT is expected to grow at 3% CAGR over CY19-21E despite fall in revenues owing to margin accretive efforts

Source: Company, ICICI Direct Research

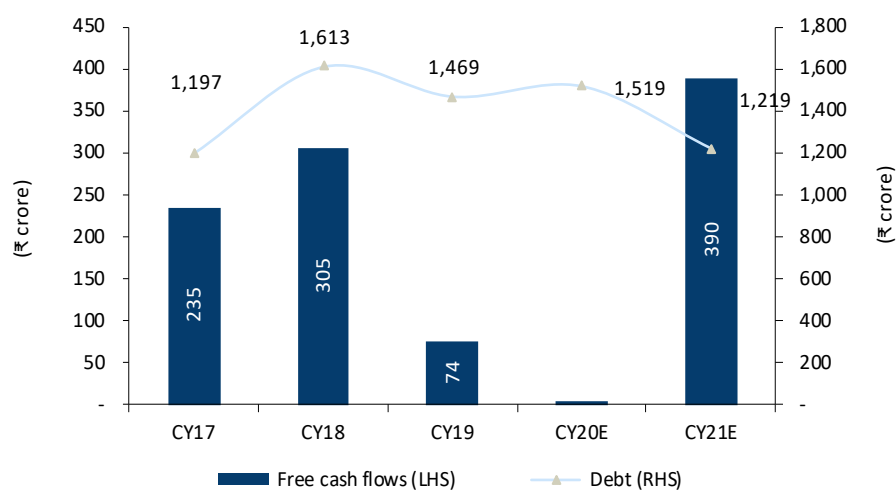
Exhibit 4: Trend in CFO generation



We expect the company to continue to generate positive CFO even during ongoing tough times

Source: Company, ICICI Direct Research

Exhibit 5: Trend in FCF generation and debt



Amid reduced capex requirements, cash on books is expected to be utilised for retiring debt

Source: Company, ICICI Direct Research

Exhibit 6: Technology, client profile at MCI (CY19)

Technology	MCIE Consolidated	MCIE India	MCIE Europe
Forging	62%	34%	87%
Aluminum	10%	22%	0%
Stampings	10%	22%	0%
Gears/Machining	10%	6%	13%
Castings	5%	11%	0%
Magnetics	1%	3%	0%
Composites	1%	3%	0%
User segments			
India - PV, 2-W, LCV, M&HCV, Tractors			
Europe - Car Forgings (Spain, Lithuania); Heavy truck forgings (Germany), Gears/Machining (Italy)			
Top clients			
India - M&M, Bajaj Auto, Maruti Suzuki, Tata Motors, Hero MotoCorp			
Europe -			
Car forgings - Renault, Volkswagen, Ford, JLR, BMW			
Heavy truck forgings - Daimler, MAN, Scania, DAF, Renault			
Gears/Machining - CAT, Eaton, CNH			

Source: Company, ICICI Direct Research

Exhibit 7: Valuation summary

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
CY 17	6,520	22.6	9.7	118.4	11.3	6.4	10.1	11.4
CY 18	8,032	23.2	13.2	35.0	8.4	4.7	12.4	13.2
CY 19	7,908	(1.5)	9.3	(29.0)	11.8	5.6	7.7	10.7
CY 20E	5,828	(26.3)	3.0	(67.4)	36.1	11.6	2.4	3.5
CY 21E	7,257	24.5	9.9	225.1	11.1	6.1	7.3	8.5

Source: Company, ICICI Direct Research

Exhibit 8: Target price calculation

Particulars	
CY 21E EBITDA (₹ crore)	835
Target EV/EBITDA (x)	6.3
EV (₹ crore)	5216
CY 21E Net Debt (₹ crore)	892
Mcap (₹ crore)	4324
No. of shares (crore)	37.9
Target Price (₹ per share)	115

Source: ICICI Direct Research

Exhibit 9: Shareholding pattern

(in %)	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Promoter	67.7	67.7	67.7	67.7	69.5
FII	10.3	10.5	14.0	14.9	14.6
DII	7.1	7.1	6.6	6.7	5.3
Others	14.9	14.7	11.7	10.7	10.6

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 10: Profit and loss statement					₹ crore
(Year-end March)	CY18	CY19	CY20E	CY21E	
Total operating Income	8,031.5	7,907.8	5,828.5	7,257.2	
Growth (%)	23.2	-1.5	-26.3	24.5	
Raw Material Expenses	3,631.5	3,748.7	2,710.2	3,374.6	
Employee Expenses	1,329.7	1,308.0	1,136.6	1,306.3	
Other Expenses	2,019.2	1,883.4	1,515.4	1,741.7	
Total Operating Expenditure	6,980.5	6,940.1	5,362.2	6,422.6	
EBITDA	1051.1	967.7	466.3	834.6	
Growth (%)	29.0	-7.9	-51.8	79.0	
Other Income	38.7	33.1	43.7	54.4	
Interest	50.2	52.3	76.0	61.0	
Depreciation	286.7	316.1	279.8	326.6	
PBT	702.4	627.8	154.3	501.5	
Total Tax	204.3	274.1	38.9	126.4	
PAT before Minority Interest	498.1	353.8	115.4	375.1	
Minority Interest	0.0	0.0	0.0	0.0	
PAT after Minority Interest	498.1	353.8	115.4	375.1	
EPS (₹)	13.2	9.3	3.0	9.9	

Source: Company, ICICI Direct Research

Exhibit 11: Cash flow statement					₹ crore
(Year-end March)	CY18	CY19	CY20E	CY21E	
Profit after Tax	498.1	353.8	115.4	375.1	
Add: Depreciation	286.7	316.1	279.8	326.6	
(Inc)/dec in Current Assets	-73.7	324.9	324.8	-405.1	
Inc/(dec) in CL and Provisions	-54.0	-174.0	-540.6	332.4	
CF from operating activities	707.4	873.0	255.3	689.9	
(Inc)/dec in Investments	-5.6	131.3	41.2	-28.3	
(Inc)/dec in Fixed Assets	-402.7	-798.6	-250.0	-300.0	
Others	-699.6	36.9	16.6	21.3	
CF from investing activities	-1107.9	-630.4	-192.2	-307.0	
Interest Paid	-50.2	-52.3	-76.0	-61.0	
Inc/(dec) in loan funds	416.5	-144.2	50.0	-300.0	
Dividend paid & dividend tax	0.0	0.0	0.0	0.0	
Others	75.4	-9.1	1.0	1.0	
CF from financing activities	441.8	-205.6	-25.0	-360.0	
Net Cash flow	41.3	37.0	38.2	23.0	
Opening Cash	71.7	113.0	150.0	188.2	
Closing Cash	113.0	150.0	188.2	211.2	

Source: Company, ICICI Direct Research

Exhibit 12: Balance Sheet					₹ crore
(Year-end March)	CY18	CY19	CY20E	CY21E	
Liabilities					
Equity Capital	378.8	379.0	379.0	379.0	
Reserve and Surplus	3,910.3	4,254.8	4,371.2	4,747.3	
Total Shareholders funds	4289.1	4633.8	4750.2	5126.3	
Total Debt	1,613.4	1,469.1	1,519.1	1,219.1	
Minority Interest	0.0	0.0	0.0	0.0	
Total Liabilities	6415.9	6746.5	6874.5	7029.8	
Assets					
Gross Block	6,539.2	7,379.6	7,633.8	7,933.8	
Less: Acc Depreciation	4,545.1	4,861.2	5,140.9	5,467.5	
Net Block	1994.1	2518.4	2492.8	2466.3	
Capital WIP	96.0	54.2	50.0	50.0	
Total Fixed Assets	2,090.1	2,572.6	2,542.8	2,516.3	
Investments	680.8	95.5	95.5	115.5	
Goodwill	2,911.1	3,526	3,526	3,526	
Inventory	1,228.6	1,056.6	878.3	1,093.5	
Debtors	741.4	736.8	638.7	795.3	
Other current assets	193.7	127.3	93.8	116.8	
Cash	113.0	150.0	188.2	211.2	
Total Current Assets	2,276.7	2,070.7	1,799.1	2,216.9	
Creditors	1,683.9	1,477.1	1,037.9	1,292.4	
Provisions	44.9	56.2	50.3	62.6	
Other Current Liabilities	265.4	363.4	267.8	333.5	
Total Current Liabilities	1,994.2	1,896.6	1,356.0	1,688.4	
Net Current Assets	282.5	174.1	443.0	528.5	
Application of Funds	6415.9	6746.5	6874.5	7029.8	

Source: Company, ICICI Direct Research

Exhibit 13: Key ratios					
(Year-end March)	CY18	CY19	CY20E	CY21E	
Per share data (₹)					
EPS	13.2	9.3	3.0	9.9	
Cash EPS	20.7	17.7	10.4	18.5	
BV	113.3	122.4	125.5	135.4	
DPS	0.0	0.0	0.0	0.0	
Cash Per Share	3.0	4.0	5.0	5.6	
Operating Ratios (%)					
EBITDA Margin	13.1	12.2	8.0	11.5	
PAT Margin	6.6	4.5	2.0	5.2	
Inventory days	55.8	48.8	55.0	55.0	
Debtor days	33.7	34.0	40.0	40.0	
Creditor days	76.5	68.2	65.0	65.0	
Return Ratios (%)					
RoE	12.4	7.7	2.4	7.3	
RoCE	13.2	10.7	3.5	8.5	
RoIC	13.0	10.5	3.0	8.0	
Valuation Ratios (x)					
P/E	8.4	11.8	36.1	11.1	
EV / EBITDA	4.7	5.6	11.6	6.1	
EV / Net Sales	0.6	0.7	0.9	0.7	
Market Cap / Sales	0.5	0.5	0.7	0.6	
Price to Book Value	1.0	0.9	0.9	0.8	
Solvency Ratios					
Debt/Equity	0.4	0.3	0.3	0.2	
Current Ratio	1.2	1.0	1.2	1.2	
Quick Ratio	0.5	0.5	0.6	0.6	

Source: Company, ICICI Direct Research

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