

## Sector: Automobiles

## Result Update

	Change
Reco: <b>Buy</b>	↔
CMP: <b>Rs. 601</b>	
Price Target: <b>Rs. 750</b>	↔

↑ Upgrade ↔ No change ↓ Downgrade

## Company details

Market cap:	Rs. 74,666 cr
52-week high/low:	Rs. 625/246
NSE volume: (No of shares)	56.2 lakh
BSE code:	500520
NSE code:	M&M
Sharekhan code:	M&M
Free float: (No of shares)	100.8 cr

## Shareholding (%)

Promoters	19.9
FII	34.2
DII	24.6
Others	21.3

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	22.3	78.3	7.4	12.2
Relative to Sensex	12.2	60.6	14.0	10.0

Sharekhan Research, Bloomberg

Mahindra & Mahindra (MM+MVML) results were below our as well as street estimates due to lower than anticipated margin performance in automotive segment. Impacted by steep fall in volumes due to lockdown on account of COVID-19, the automotive segment reported loss at EBIT level dragging the overall performance. The tractor segment's margins improved y-o-y despite double-digit fall in volumes and were better than estimates, driven by better pricing power and cost control. Due to strong farm sentiments, M&M expects tractor demand to remain robust and expects the industry to report growth in FY2021. Also, M&M is likely to gain market share in tractors due to better outlook in regions where it has higher market share. M&M's automotive segment is also witnessing recovery due to robust rural sentiments and increased preference for personal transport. The company expects m-o-m improvement to continue till the festive season in October-November 2020. Tighter capital allocation strategy of no fund infusion in businesses with an unclear path to profitability will continue and M&M is evaluating the performance of its other international subsidiaries (recently M&M has decided against additional fund infusion in Ssangyong and Genze). This would significantly improve the overall performance and act as a key re-rating trigger. Hence, we retain our Buy rating on the stock. M&M continues to remain our preferred pick in the automotive space.

## Key positives

- The tractor segment's EBIT margin surprised positively, improving by 110 bps y-o-y despite double-digit drop in volumes. Better pricing power and cost-control measures led to higher-than-anticipated margins.
- Tractor demand is buoyant due to strong farm sentiments. The company expects the tractor industry to grow in FY2021.
- The automotive segment's volumes are recovering and are expected to continue improving on m-o-m basis till the festive season in October-November.
- Inventory levels in both tractors and automotive are below the normalised levels. Inventories are the lowest in past three years.

## Key negatives

- The automotive segment reported loss at EBIT level in Q1FY2021, impacted by steep fall in volumes. The automotive segment's performance was lower than expectations.
- In Q1FY2021, other income at Rs. 130 crore dropped by 30% y-o-y and was lower than estimates.

## Our Call

**Valuations: Fine-tuned estimates; Retain Buy with an unchanged PT of Rs. 750:** M&M's tractor division is witnessing strong demand pull, while automotive volumes are picking up, driven by strong rural sentiments. We have fine-tuned our earnings estimates for FY2021 and FY2022. At the CMP, the stock is trading at 12x its FY2022 core earnings, which is lower than its long-term historical average of 15x. With good outlook for core business along with prudent capital allocation policy, M&M multiples are likely to get re-rated considering companies with lower market share such as Escorts are trading at higher multiples than M&M. Hence, we retain our Buy rating on the stock with an unchanged PT of Rs. 750. M&M remains our preferred pick in the space.

## Key Risks

Prolonged COVID-19 infection could dampen consumer sentiments and impact demand. Further, increased competitive intensity in the utility vehicles segment could affect market share.

## Valuation (MM+MVML)

	Rs cr				
Particulars	FY18	FY19	FY20	FY21E	FY22E
Total Income	47,577.4	52,848.2	44,865.5	43,728.2	53,982.5
Growth (%)	15.0%	11.1%	-15.1%	-2.5%	23.5%
EBITDA	7,043.4	7,530.1	6,350.6	6,034.8	7,851.7
EBITDA margin (%)	14.8%	14.2%	14.2%	13.8%	14.5%
PAT	4,189.6	5,423.9	3,550.9	3,475.6	4,688.5
Growth (%)	24.1%	29.5%	-34.5%	-2.1%	34.9%
FD EPS (Rs.)	33.7	43.6	28.6	28.0	37.7
P/E (x)	17.8	13.8	21.0	21.5	15.9
P/B (x)	2.4	2.1	2.0	1.9	1.8
EV/EBITDA (x)	9.7	9.0	10.9	11.5	8.8
ROE (%)	13.7%	15.5%	9.5%	8.8%	11.0%
ROCE (%)	18.0%	18.2%	13.3%	11.1%	13.7%

Source: Company; Sharekhan estimates

**Lower-than-expected results dragged by the auto segment; tractor performance better than estimates with y-o-y margin improvement:** Mahindra & Mahindra's (MM+MVML) Q1FY2021 results were lower than our as well as street expectations. Revenue declined by 56% y-o-y (in line with estimates) mainly driven by drop in volumes due to the lockdown on account of COVID-19. Automotive volumes dropped by 77% y-o-y, while the tractor segment was relatively better with volume falling by 24%. Operating profit margin (OPM) dropped by 370 bps y-o-y to 10.3% and were lower than estimates of 12.3%. The automotive segment posted loss at EBIT level with margins of -2.9%, impacted by negative operating leverage due to steep volume fall. The tractor segment's margins surprised positively, improving by 110 bps y-o-y to 20.4% despite 24% fall in volumes. Better pricing power and cost-control measures led to better-than-expected margins in the tractor segment. Other income at Rs. 134 crore dropped by 30% y-o-y and was lower than estimates. During the quarter, M&M realised exceptional gain of Rs. 29 crore on account of gain on certain long-term investments. Adjusted PAT at Rs. 39 crore was lower than estimates of Rs. 201 crore.

**Tractor segment likely to grow in FY2021:** M&M stated that farm sentiments have been strong. Favourable factors such as expectations of normal monsoon (monsoon has been 1% above normal so far), higher kharif sowing (sowing has increased by 19% y-o-y so far), and increased government spending on agriculture and rural development would boost farm incomes, thus benefiting the tractor industry. M&M expects the tractor industry to register growth in FY2021 (tractor would be the only industry to register growth in a challenging demand environment due to COVID-19). M&M, deriving about 35% of its revenue from tractors, would benefit from growth in the tractor segment. Also, M&M is likely to gain market share in tractors due to better outlook in regions where it has higher market share.

**Automotive segment recovering:** M&M's automotive portfolio (50% of automotive volumes are derived from rural) has been witnessing recovery, driven by strong rural sentiments. Sales of rural-centric brands such as Scorpio and Bolero are witnessing recovery. Moreover, the pick-up segment (light commercial vehicle) majorly used in rural and FMCG sectors for last-mile connectivity are witnessing strong recovery. M&M's automotive sales have already reached 65% of normal in July 2020 and the company expects m-o-m improvement till the festive season in October to November 2020.

#### Conference call highlights:

**Tractor segment update:** Management indicated that tractor demand is strong on account of robust farm sentiments due to higher kharif sowing, expectations of normal monsoon, and increased government spending on infrastructure. Management expects the tractor industry to grow in FY2021.

**Automotive segment update:** M&M stated that automotive demand is recovering. Pent-up demand coupled with increased preference for personal transportation is driving the automotive demand. The company expects automotive demand to continue improving m-o-m till the festive season in October-November 2020. Management has refrained from providing FY2021 outlook for automotive demand.

**Production update:** The tractor segment has reached 90% of capacity utilisation, while the automotive segment has reached more than 50% utilisation. Supply chain issues on account of localised lockdown have impacted production in the automotive segment. Management is ramping up capacity and expects to reach full capacity in the next two to three months.

**New launches in the automotive space:** M&M has planned three new launches in the utility vehicle segment. The company would commercially launch Thar off-roader in October 2020; W601 SUV (B segment UV) in Q1FY2022; and Z101 (C segment UV) in Q3FY2022.

**Cost-control initiatives:** Management stated it would focus on reducing costs in the post-COVID-19 era. Expense heads such as travel, advertising, and promotion as well as fixed costs would also be reduced.

**Ford JV:** Joint venture with Ford is on track, with the teams working on finalising business plans and product development. There were some regulatory delays at state level for obtaining the registration and the same is expected to be completed by October 2020.

**Inventory levels:** M&M stated that inventory levels in both automotive and tractors are below the normalised levels. Inventory levels are the lowest in past three years.

**Capital allocation strategy and enhancing ROE:** M&M stated that after Ssangyong Motors and Genze, it is looking at more international subsidiaries; and if it finds that there is no clear path to profitability and no strategic fit, it would exit the business. Similarly, keeping in mind the goal of 18% ROE target for the business, subsidiary Mahindra Automotive North America did not bid for government vehicle postal order, as it would not give the desired ROE.

## Results (MM+MVML)

Particulars	Q1FY21	Q1FY20	%YoY	Q4FY20	%QoQ
Revenue	5,589.4	12,805.5	-56.4	9,004.7	-37.9
Total Expenses	5,016.3	11,011.9	-54.4	7,777.3	-35.5
EBITDA	573.2	1,793.6	-68.0	1,227.5	-53.3
Other income	133.8	191.9	-30.3	315.5	-57.6
Depreciation	581.3	583.9	-0.4	617.2	-5.8
Interest	76.8	30.2	154.6	35.9	114.2
PBT	48.8	1,371.4	-96.4	889.9	-94.5
Tax	9.9	478.7	-97.9	567.3	-98.3
Adjusted PAT	38.9	892.7	-95.6	322.6	-87.9
Reported PAT	67.8	2,259.7	-97.0	(3,255.0)	-102.1
EPS (Rs.)	0.3	7.2	-95.6	2.6	-87.9
EBITDA margin (%)	10.3	14.0	(370 bps)	13.6	(330 bps)

Source: Company; Sharekhan Research

## Segmental

Particulars	Q1FY21	Q1FY20	% YoY	Q4FY20	% QoQ
<b>Automotive division</b>					
Volumes (units)	29,651	1,31,689	-77.5	92,423	-67.9
Revenue	2,039.5	7,985.8	-74.5	5,505.8	-63.0
PBIT	-58.7	518.0	NA	225.3	NA
PBIT Margins (%)	-2.9	6.5	(940 bps)	4.1	(700 bps)
<b>Farm Equipment division</b>					
Volumes (units)	65,657	86,350	-24.0	59,290	10.7
Revenues	3,340.8	4,382.2	-23.8	3,111.0	7.4
PBIT	682.3	844.7	-19.2	548.8	24.3
PBIT Margins (%)	20.4	19.3	110 bps	17.6	280 bps
<b>Others</b>					
Revenue	220.5	522.9	-57.8	451.8	-51.2
PBIT	-5.4	28.5	NA	8.9	NA
PBIT Margins (%)	-2.4	5.5	(790 bps)	2.0	(440 bps)

Source: Company; Sharekhan Research

## SOTP

Particulars	per share (Rs.)	Remarks
<b>Core business (MM+MVML)</b>	<b>560</b>	<b>At 16x its FY2022 earnings</b>
<b>Key Subsidiaries</b>		
Tech Mahindra	152	Bloomberg consensus estimates
Mahindra & Mahindra Financial Services Ltd.	68	FY2022 Book Value
Mahindra Lifespace	4	Market cap
Mahindra Holiday Resort	12	Market cap
Mahindra CIE	4	Market cap
Ssangyong	21	Market cap
Mahindra Logistics	6	Market cap
Swaraj Engines	5	Market cap
Value of subsidiaries before discount	272	
<b>After holdings 30% discount</b>	<b>190</b>	
<b>Target Price</b>	<b>750</b>	

Source: Company; Sharekhan Research

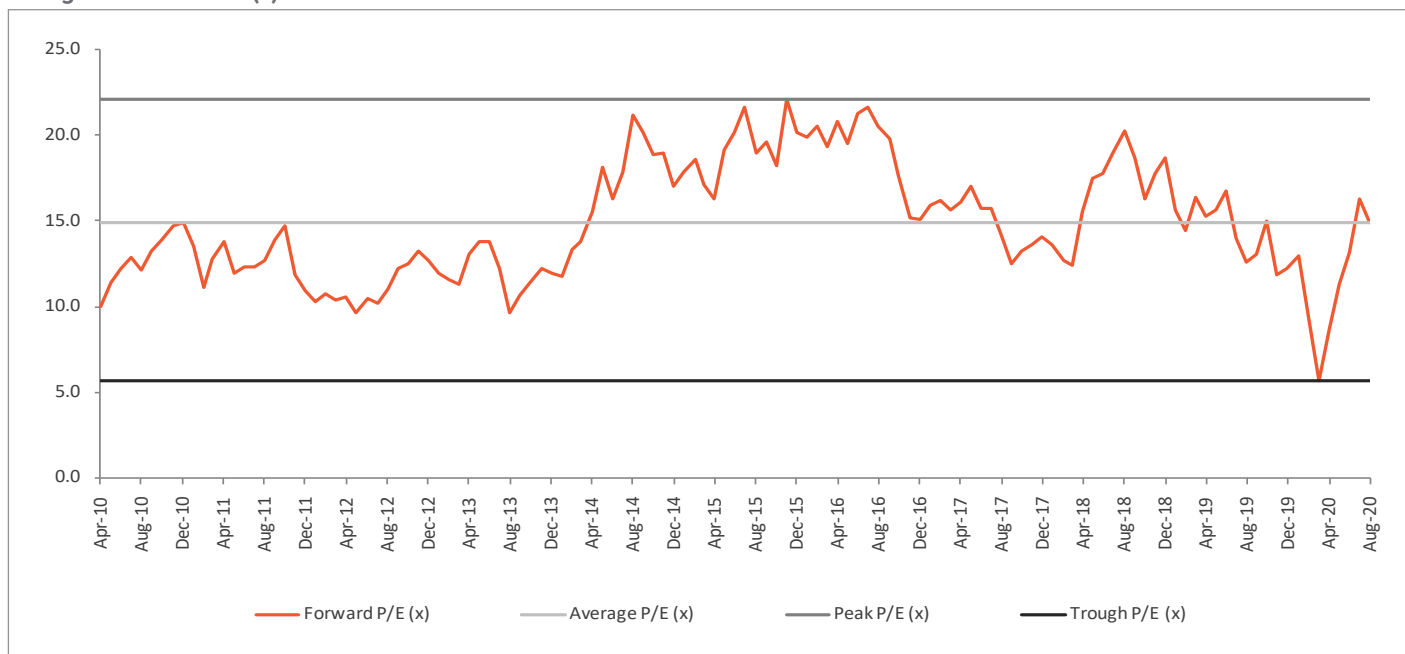
## Outlook

**Tractor volumes to grow; automotive volumes recovering:** With strong farm sentiments on account of normal monsoon expectations, higher kharif sowing, and government reform measures, tractor demand pull is strong and the company expects the tractor industry to register growth in FY2021. With strong rural sentiments and increased preference for personal transport, automotive volumes are also picking up, and the company has already reached 65% of normal sales in July 2020. Management expects automotive volumes to continue improving m-o-m till the festive season.

## Valuation

**Fine-tuned estimates; Retain Buy with an unchanged PT of Rs. 750:** M&M's tractor division is witnessing strong demand pull, while automotive volumes are picking up, driven by strong rural sentiments. We have fine-tuned our earnings estimates for FY2021 and FY2022. At the CMP, the stock is trading at 12x its FY2022 core earnings, which is lower than its long-term historical average of 15x. With good outlook for core business along with prudent capital allocation policy, M&M multiples are likely to get re-rated considering companies with lower market share such as Escorts are trading at higher multiples than M&M. Hence, we retain Buy rating on the stock with an unchanged PT of Rs. 750. M&M remains our preferred pick in the space.

One year forward P/E (x) band



Source: Sharekhan Research

## About company

M&M is the flagship company of the Mahindra group. M&M core business houses the automotive and the tractor segment. M&M is the only automotive company which is virtually present across all the segments. It is market leader in light commercial vehicles, leading Utility vehicle and 3W player. M&M also manufactures MHCV and is present in 2W space through its investment in Jawa. Apart from a strong player in automotive space, M&M is the market leader in the tractor segment having market share of about 40%. Apart from the core business, M&M is also the promoter/holds controlling interest in companies which are engaged in diverse business under the Mahindra brand (IT services, NBFC, logistics, hospitality, real estate and auto ancillary business).

## Investment theme

M&M is present across the automotive segments ranging from 2W to trucks and is a leading player in both the LCV and Utility vehicles. M&M is market leader in tractors with share of ~ 40%. M&M expects tractor demand to remain robust and expects the industry to report growth in FY2021. M&M's automotive segment is also witnessing recovery due to robust rural sentiments and increased preference for personal transport. The company expects m-o-m improvement to continue till the festive season in October-November 2020. Further, with clear capital allocation strategy of exiting business which have unclear path of profitability would reduce losses in subsidiaries and significantly improve the performance. Hence, we retain Buy rating on the stock; M&M continues to remain our preferred pick in the automotive space. M&M core business P/E multiple of ~12x is discount to its long-term average

## Key Risks

Prolonged COVID-19 infection could dampen the consumer sentiments and impact the demand. Further, increased competitive intensity in utility vehicles segment could affect market share.

## Additional Data

### Key management personnel

Anand Mahindra	Executive Chairman
Pawan Goenka	Managing Director
Anish Shah	Deputy Managing Director & Group CFO
Rajesh Jejurikar	Executive Director

Source: Company Website

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	PRUDENTIAL MGMT & SERVICES	11.38
2	M & M BENEFIT TRUST	6.79
3	First State Investments	4.56
4	MAHINDRA & MAHIN EMP STK OP TRST	4.06
5	SBI Funds Management Pvt Ltd	2.61
6	BlackRock Inc	2.09
7	Vanguard Group Inc	1.71
8	ICICI Prudential Asset Management	1.6
9	Republic of Singapore	1.4
10	Franklin Resources Inc	1.2

Source: Bloomberg

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by BNP PARIBAS

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