Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

# Mahindra Logistics Ltd

## Near-term headwinds; Long-term outlook positive

| Logistics | Sharekhan code: MAHLOG | | |
|---|---|---|---|
| Reco/View: Buy ↔ | CMP: Rs. 428 | Price Target: Rs. 580 ↓ | |

↑ Upgrade ↔ Maintain ↓ Downgrade


**Summary**

- Our interaction with the management of Mahindra Logistics Limited (MLL) indicates its focus on scaling both 3PL and network services businesses along with presence of levers for margin expansion.
- Management reiterated Rs. 10,000 crore revenue target by FY2026 with 200 bps expansion in net profit margin from FY2021 level.
- The staggered acquisition of Whizzard is expected to strengthen its last mile service capabilities through access to tier 2 and 3 cities, quick commerce capabilities, and technology.
- We retain Buy with a revised PT of Rs. 580, lowering valuation multiple to factor in near-term headwinds, while its long-term growth outlook remains intact.


| 3R MATRIX | + | = | - |
|---|---|---|---|
| Right Sector (RS) | ✓ | | |
| Right Quality (RQ) | ✓ | | |
| Right Valuation (RV) | ✓ | | |

\+ Positive = Neutral – Negative

**What has changed in 3R MATRIX**

| | Old | | New |
|---|---|---|---|
| RS | | ↔ | |
| RQ | | ↔ | |
| RV | | ↔ | |

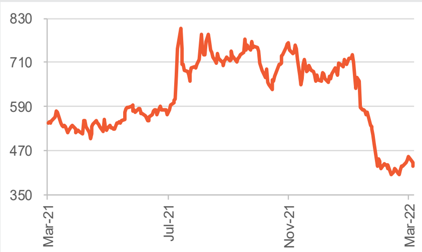
**Company details**

| | |
|---|---|
| Market cap: | Rs. 3,077 cr |
| 52-week high/low: | Rs. 819 / 396 |
| NSE volume: (No of shares) | 1.4 lakh |
| BSE code: | 540768 |
| NSE code: | MAHLOG |
| Free float: (No of shares) | 3.0 cr |

**Shareholding (%)**

| | |
|---|---|
| Promoters | 58.2 |
| FII | 21.7 |
| DII | 11.1 |
| Others | 9.1 |

**Price chart**




**Price performance**

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | -0.6 | -37.0 | -41.1 | -21.4 |
| Relative to Sensex | -1.9 | -38.2 | -37.9 | -37.2 |

*Sharekhan Research, Bloomberg*

**We interacted with the management of Mahindra Logistics Limited (MLL), which reiterated its revenue target of Rs. 10,000 crore in FY2026 along with 200 bps expansion in net margin from 1% in FY2021. The company's core 3PL business is expected to double from Rs. 3,000 crore in FY2020, network services business (20% of revenue) is expected to grow 3x, freight forwarding is likely to post 25-30% CAGR, while new businesses (eDEL, Whizzard) are expected to achieve scale. Margin expansion would be led by higher warehousing revenue mix in 3PL, higher margins in network services by scaling up, and overall higher revenue leading to better absorption of fixed costs. The company is focusing on both 3PL and network services, a combination seen in large global players. The company expects to be in the top 10 players, which would have 28-30% share of the logistics market from 17% currently over the longer term. However, rise in diesel prices, supply chain shortages continuing to impact electronics and appliances segments, and weak farm and agri demand are key near-term headwinds, which are expected to affect financials in the near term. The secular auto sector's recovery and easing of chip shortages are expected from H2FY2023.**

- **FY2026 guidance remains intact:** Management remained confident of achieving its revenue target of Rs. 10,000 crore by FY2026, which comprises doubling of core 3PL revenue over the five-year period, growing network services business by 3x, and revival in the enterprise mobility business. Net profit margin is targeted at 3% in FY2026 from 1% in FY2021, which would be achieved through levers such as higher warehousing revenue mix in overall 3PL revenue, margin expansion in network services as it achieves scale, and better overhead absorption with rise in overall revenue.
- **Whizzard acquisition to strengthen last mile services:** MLL entered into a 60% stake purchase agreement with ZipZap Logistics (Whizzard) in tranches (by FY2024 end) at a cost of Rs. 72 crore. Whizzard would provide MLL access to tier 2 and 3 cities (MLL has urban-centric last mile capability), quick commerce capabilities, and technology. Whizzard is present in 14 states and 325 cities (tier 1, 2, and 3) and has grown 10x in three years, crossing Rs. 100 crore revenue mark with profitability. MLL has had strength in first and mid-mile logistics historically, which now through eDel and Whizzard would strengthen its last mile logistics services, especially in smaller packages.
- **Near-term headwinds expected till H2FY2023:** The company expects secular auto sector recovery from 2HFY2023 especially farm and agri segment (which comprises 20% of total revenue). The resolution of chip shortages affecting the electronics and appliances segment and revival in the enterprise mobility business is also expected over the next two to three quarters. Further, the recent surge in crude prices, led by Russia-Ukraine crisis, has started to increase diesel prices, which is passed on to customers with a lag and is expected to put pressure on margins in the near term. Overall, we believe the above near-term headwinds can put pressure on MLL's financials in the near term.

**Our Call**

**Valuation – Retain Buy with a revised PT of Rs. 580:** MLL's operational performance is likely to be affected in the near term on account of weakness in the farm and agri sector, chip shortages affecting electronics and appliances sectors, startup costs related to Bajaj Electrical account, and rising diesel prices. However, the company continues to focus on addition of warehousing capacities, scaling up network services business, and eyeing capabilities-based acquisitions in the logistics space. The company's five-year revenue target of Rs. 10,000 crore remains intact along with net profit margin expansion. We remain optimistic on the long-term growth potential for MLL although near-term headwinds are likely to affect its operational profitability. Hence, we lower our valuation multiple, leading to a revised price target (PT) of Rs. 580. We retain our Buy recommendation on the stock.

**Key Risks**

Weakness in the auto industry's outlook is a key downside risk to our call.

**Valuation (Consolidated)** Rs cr

| Particulars | FY21 | FY22E | FY23E | FY24E |
|---|---|---|---|---|
| Revenue | 3,263.7 | 4,085.6 | 4,887.0 | 5,732.1 |
| OPM (%) | 4.1 | 4.6 | 5.3 | 5.6 |
| Adjusted PAT | 32.7 | 28.7 | 67.5 | 98.9 |
| *% YoY growth* | *(40.6)* | *(12.4)* | *135.3* | *46.5* |
| Adjusted EPS (Rs.) | 4.6 | 4.0 | 9.4 | 13.8 |
| P/E (x) | 93.7 | 106.9 | 45.5 | 31.0 |
| P/B (x) | 4.8 | 4.6 | 4.2 | 3.7 |
| EV/EBITDA (x) | 22.1 | 16.0 | 11.6 | 9.3 |
| RoNW (%) | 5.9 | 4.9 | 10.7 | 13.9 |
| RoCE (%) | 8.0 | 8.1 | 13.4 | 16.1 |

*Source: Company; Sharekhan estimates*

## Key Management Interaction takeaways -

- **FY2026 target intact:** The company is confident of achieving Rs. 10,000 crore revenue in FY2026. The company's core 3PL business, which contributed Rs. 3,000 crore in FY2020, can be doubled over a five-year period. The network services business, which is now 20% of overall revenue (5-6% in FY2019), can grow 3x by FY2026. Freight forwarding (Lords freight) can post a 25-30% CAGR without any acquisitions. B2B express remains a concern, which needs to be scaled up. Overall net profit margin is expected to be 3% by FY2026, leading to RoE expansion.
- **Current sector-wise demand environment:** The auto segment is slightly better on the original equipment manufacturers (OEM) and components front. Although the farm segment (longer line haul business) is down, which is not expected to recover till 2HFY2023. FMCG, durables, and pharma are witnessing good growth. The retail segment post the third wave of COVID-19 is seeing good increase. Traditional e-commerce business remains soft, although value growth is still there. Electronics and appliances continue to be affected by chip shortages. Demand from tier 2 and 3 cities is relatively robust but for low category products. Overall, revenue is still holding up but not at the pace that the company has envisaged.
- **Sector-wise outlook:** Farm and agri comprise over 20% of overall revenue. For FY2023, farm and agro would be flat. The company expects secular recovery in auto from 2HFY2023.
- **Whizzard outlook:** The company would be acquiring 60% of Whizzard in a staggered manner (35% by FY2023 end and 60% by FY2024 end) at a cost of Rs. 72 crore. Whizzard is present in 14 states and 325 cities (tier 1, 2, and 3). Whizzard is profitable and has grown 10x in three years with revenue crossing Rs. 100 crore mark. The company would stand to benefit from Whizzard's strong presence in tier 2 and 3 cities, quick commerce capabilities, and technology.
- **Margin expansion levers:** Margin expansion would be driven by higher warehousing revenue share in integrated logistics services, scaling up of its network services business and higher overhead cost absorption with rise in overall revenue. The network services business is expected to grow at a faster rate than core 3PL business. Currently, integrated logistics services comprise 70%, network services comprise 20%, and mobility comprises 5%.
- **Bajaj Electricals business:** The business has low-teen gross margin, which is higher than the overall company's margin.
- **Global versus domestic:** Large global logistics companies have balanced portfolio of 3PL and network services. The Indian addressable logistics market is estimated at Rs. 1,50,000 crore with the top 10 players accounting for 17% market share. Globally, the top 10 players account for 28-30% market share. The company expects the Indian logistics market is expected to consolidate with the top 10 players accounting for 30% over a period of time.
- **Warehouse addition:** The company targets to add 2-2.5 msf warehousing space each year, taking its total warehousing space to 18 msf in FY2024 end from 14.5 msf currently.
- **Yield improvement:** The company has seen 7-8% psf yield improvement excluding stockyards and flex business, although capital density has also increased. The yield for groceries is Rs. 120 psf; the top 10 pharma accounts generate Rs. 150-160 psf yield, while bulky products such as ACs generate only Rs. 25-27 psf yield.

## Outlook and Valuation

### ■ Sector view – Strong growth outlook led by changing consumer preferences and macro pick-up

The logistics industry had been one of the key sectors, which showed strong revival post COVID-19 pandemic, which affected the overall trade environment both domestically and globally. Domestic indicators such as e-way bill generations, FASTag collections, Indian rail volumes, domestic port volumes, and foreign trade are showing clear signs of revival. Further, organised domestic logistics players have been able to improve their business, led by user-industries' preference towards credible supply chain management in the wake of the impact of COVID-19 on supply chain operations. Further, third-party logistics (3PL) industry has seen faster improvement in operations, led by segments such as e-commerce, pharma, and FMCG. Hence, we have a positive view on the sector.

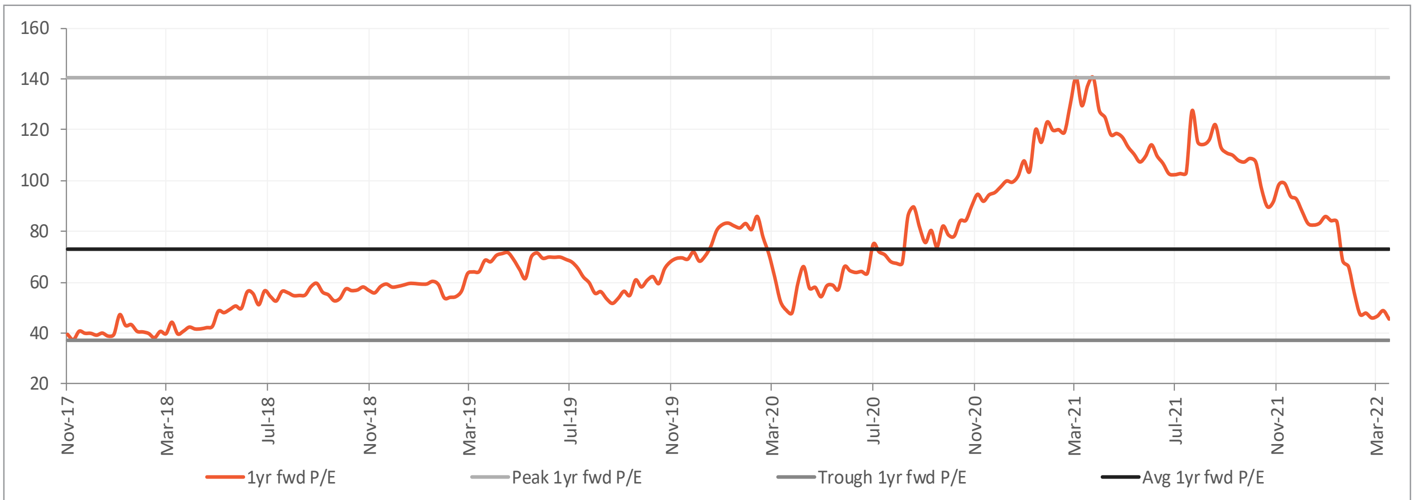
### ■ Company outlook – On a growth path

MLL is on an improving growth trajectory, which is expected to gather pace with the unlocking of the economy as the impact of COVID-led second wave recedes. Meanwhile, MLL has been able to add key clients and has gone live with few clients. In the post COVID era, the company expects to benefit from the increasing reliance of clients on smart supply chain management solution providers such as itself. A strong revival in the auto sector and growth momentum in the consumer space are expected to lead to strong revenue growth for MLL going ahead. The company continues to focus on providing integrated logistics solution, adding new warehousing capacities, and new clients.

### ■ Valuation – Retain Buy with a revised price target of Rs. 580

MLL's operational performance is likely to be affected in the near term on account of weakness in the farm and agri sector, chip shortages affecting electronics and appliances sectors, startup costs related to Bajaj Electrical account, and rising diesel prices. However, the company continues to focus on addition of warehousing capacities, scaling up network services business, and eyeing capabilities-based acquisitions in the logistics space. The company's five-year revenue target of Rs. 10,000 crore remains intact along with net profit margin expansion. We remain optimistic on the long-term growth potential for MLL although near-term headwinds are likely to affect its operational profitability. Hence, we lower our valuation multiple, leading to a revised price target (PT) of Rs. 580. We retain our Buy recommendation on the stock.

**One-year forward P/E (x) band**




*Source: Sharekhan Research*

**Peer Comparison**

| Particulars | P/E (x) | | EV/EBITDA (x) | | P/BV (x) | | RoE (%) | |
|---|---|---|---|---|---|---|---|---|
| | FY23E | FY24E | FY23E | FY24E | FY23E | FY24E | FY23E | FY24E |
| Mahindra Logistics | 45.5 | 31.0 | 11.6 | 9.3 | 4.2 | 3.7 | 10.7 | 13.9 |
| TCI Express | 40.4 | 33.2 | 29.0 | 23.7 | 9.6 | 7.6 | 26.8 | 25.9 |
| Transport Corporation of India | 17.1 | 15.5 | 11.2 | 10.0 | 2.6 | 2.3 | 16.7 | 15.9 |

*Source: Sharekhan Research*

## About company

MLL is a portfolio company of Mahindra Partners, the $1 billion private equity division of the $19-billion Mahindra Group. MLL is an integrated third party logistics (3PL) service provider, specialising in supply chain management and people transport solutions. Founded more than a decade ago, MLL serves over 300 corporate customers across various industries such as automobiles, engineering, consumer goods, and e-commerce. The company pursues an asset-light business model under which assets necessary for its operations such as vehicles and warehouses are owned or provided by a large network of business partners on lease rentals, while MLL largely invests in logistics technology. The company provides customised and technology-enabled solutions that span across the supply chain and people transport operations.

## Investment theme

MLL has gathered pace in both its key verticals viz. M&M SCM and non-M&M SCM businesses, which are expected to sustain going forward. The company continues to focus on providing integrated logistics solutions and has been able to add new clients and warehousing capacities each quarter. Further, MLL's venture into last-mile small package deliveries through EV would capture strong growth in the express delivery segment. The company continues to generate strong cash flows following its asset-light model.

## Key Risks

- Slowdown in the automotive industry can affect financials due to its high dependency.
- Changes in supply chain strategy of Mahindra Group can negatively affect its financials due to its high dependency.
- The industry is highly competitive and fragmented with low entry barriers.

## Additional Data

**Key management personnel**

| | |
|---|---|
| Zhooben Bhiwandiwala | Chairman, Non-Executive Director |
| Rampraveen Swaminathan | Chief Executive Officer |
| Yogesh Patel | Chief Financial Officer |
| Brijbala Batwal | Company Secretary & Compliance Officer |

*Source: Company Website*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | Mahindra & Mahindra Ltd | 58.40 |
| 2 | Reliance Capital Trustee Co Ltd | 4.66 |
| 3 | First State Investments ICVC | 3.86 |
| 4 | Goldman Sachs Group Inc/The | 2.48 |
| 5 | Invesco Trustee Private | 1.86 |
| 6 | BHANSHALI AKASH | 1.85 |
| 7 | MOTILAL OSWAL FOC EMERG FD | 1.26 |
| 8 | Federated Hermes | 0.97 |
| 9 | Motilal Oswal Asset Management | 0.88 |
| 10 | Frostrow Capital LLP | 0.86 |

*Source: Bloomberg*

## Understanding the Sharekhan 3R Matrix

| | |
|---|---|
| **Right Sector** | |
| Positive | Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies |
| Neutral | Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies |
| Negative | Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability. |
| **Right Quality** | |
| Positive | Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance. |
| Neutral | Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable |
| Negative | Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet |
| **Right Valuation** | |
| Positive | Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment. |
| Neutral | Trading at par to historical valuations and having limited scope of expansion in valuation multiples. |
| Negative | Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple. |

*Source: Sharekhan Research*

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