Mahindra CIE Automotive (MAHCIE)

ICICI direct Research

CMP: ₹ 137 | Target: ₹ 170 (24%) | Target Period: 12 months | BUY

October 22, 2020

Worst behind, attractive risk reward opportunity…

Mahindra CIE Automotive (MCI) reported a muted operational performance in Q3CY20. Standalone numbers were steady but consolidated performance was impacted by weakness in Europe. Standalone sales were down 5.4% YoY to ₹ 621 crore with consolidated sales down 9.3%, dragged by 12.3% drop in Europe. Standalone margins rose 44 bps YoY to 11.2% tracking gross margin improvement. Europe EBIT margins fell 225 bps YoY to 5.4% with India margins stable at 7.8%. Consolidated margins were down 230 bps YoY to 8.9%, which includes one-time restructuring costs at MCI Europe. Consolidated PAT for the quarter was at ₹ 61 crore supported by higher other income with standalone PAT at ₹ 29 crore.

Expected to outperform industry in CY19-22E

For MCI, India, Europe formed ~45%, ~55% of consolidated operations, respectively, as of CY19. In terms of technological profile, ~62% of consolidated sales were derived from forging segment while aluminium, stampings, gears/machining formed 10% each. MCI does not expect automotive industry to touch CY18 volume highs before CY23E. However, MCI's own prospects are brighter, with management guiding for regaining past performance highs latest by early CY22E on the back of (i) increasing wallet share with existing clients, (ii) new client additions and (iii) focus on exports. New orders are expected to form >15% of sales each year. Domestically, 2-W, tractors and PV segments have bounced back healthily in recent months but a return to last year's levels (ex-tractors) remains some way away. In Europe, the German CV forgings business is seen continuing to lag overall business recovery. We build healthy 19.3% revenue CAGR over CY20E-22E, factoring in positive guidance and MCI's demonstrated capability of outpacing base user industries over the years.

Cost initiatives to help bottomline recover faster than topline

Amid general sluggishness on topline front, MCI's ongoing efforts towards reducing breakeven levels through cost controls, efficiency improvements would hold key to protecting profitability. MCI is aiming at a return to pre-Covid margin profile by the beginning of CY21E. It had previously communicated that Europe restructuring efforts in Metalcastello, Mahindra Forgings Europe would lead to staff cost savings worth ~€4 million per annum, while it has achieved ~10% reduction in fixed costs. We build improvement in margin profile to 12.6% by CY22E (8.0% in CY20E) on the back of continued cost focus along with gradual uptick in utilisation levels.

Valuation & Outlook

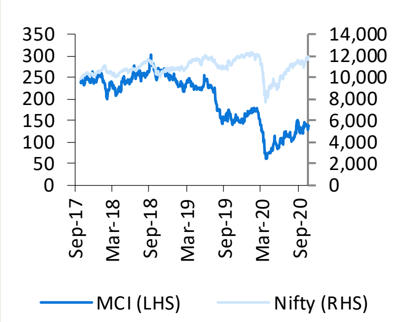
Post the blip in CY20E, financial performance is stated to improve meaningfully over CY20-22E. It will be a function of revenue growth and margin expansion with consequent decline in B/S leverage and improvement in return ratios matrix. We value MCI at ₹ 170 (i.e. 6.5x CY22E EV/EBITDA) and upgrade the stock to **BUY**. The company's strong parentage and excellent cash generation track record remain long term positive drivers. With limited capex spend, going forward, its present CFO, FCF yield is at ~8%, 5%, respectively, offering high margin of safety.

Mahindra CIE

Particulars

Particular	₹ crore
Market Capitalization	5,186.1
Total Debt (CY19)	1,469
Cash & Investments (CY19)	237.5
EV	6,417.7
52 week H/L (₹)	179 / 59
Equity capital	₹ 379 Crore
Face value	₹ 10

Price chart



Key Highlights

- Standalone sales fell 5.4% YoY in Q3CY20 while weakness in Europe (down 12.3% YoY) led to higher 9.3% decline in consolidated performance
- On revenue, MCI confident of outperforming industry in CY20-22E on improving wallet share with existing clients, new client addition, incremental focus on exports
- Margin improvement is seen tracking cost saving initiatives, better utilization levels
- Upgrade from HOLD to BUY with revised target price of ₹ 170

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Company Update

ICICI Securities – Retail Equity Research

Key Financial Summary

Key Financials	CY18	CY19	CY20E	CY21E	CY22E	CAGR (CY20E-22E)
Net Sales	8,031.5	7,907.8	5,949.5	7,455.0	8,467.8	19.3%
EBITDA	1,051.1	967.7	440.3	835.0	1,066.9	55.7%
EBITDA Margins (%)	13.1	12.2	7.4	11.2	12.6	
Net Profit	498.1	353.8	67.8	358.1	528.9	179.3%
EPS (₹)	13.2	9.3	1.8	9.5	14.0	
P/E	10.4	14.7	76.5	14.5	9.8	
RoNW (%)	12.4	7.7	1.4	7.1	9.5	
RoCE (%)	12.6	10.2	2.0	7.5	10.4	

Source: ICICI Direct Research, Company

Q3CY20 Earnings conference call highlights

Management outlook/guidance and demand

- **MCI does not expect industry volumes to reach peak CY18 volumes before CY23E. However, the company is working towards regaining past peak performance well ahead of the industry i.e. by early CY22E if not in CY21E itself. Increased share of exports from India (from ~13% at present to >20% in the future; benefits to flow from H2CY21E) along with focus on increasing share of business with existing clients (M&M, Bajaj, MSIL), new client additions and supplies to Tier I customers would be drivers for this outperformance. New orders are expected to form >15% of MCI sales in any year**
- Outlook for the German CV forgings business remains subdued; however, PV forgings business (Spain and Lithuania) and gears (Italy) are expected to do well in the next quarter
- Domestic outlook is reasonably positive next few months (especially in 2-W and tractors) due to tailwinds like shift to personal mobility and healthy rural demand etc
- **The company informed that Q3CY20 performance was better than it initially anticipated, and Q4CY20 could be on similar lines. The key markets for the company are presently performing well**
- During Q3CY20, German CV industry was down by 23% and this impacted CV forgings business (Mahindra Forgings Europe i.e. MFE)
- Metalcastello (Italy gears business) performance was impacted by construction equipment industry being near the bottom of its cycle (Caterpillar is the main client) as well as reduced spending in the US amid ongoing elections
- **MCI does not expect battery EV sales in PV segment in Europe to take off in a big way over the next 3-5 years, with hybrid powertrains seen gaining greater traction instead. ~25% of its overall revenues are at risk in the case of 100% switchover to EVs (~20% in India; ~30% in Europe). This is the portion of present business related to PV crankshaft operations. MCI is winning orders for hybrid vehicles**
- **The company has won orders worth ~₹ 2-5 crore per month in India gears and magnetics verticals in respect of import substitution away from China. Chief technologies like forgings and stampings do not present similar opportunities courtesy strong domestic presence. In its overseas forging business, management opines that the import substitution opportunities are limited**
- **Present capacity utilisation levels in India stand at ~90%, while those in European CV and PV businesses are at ~65-70% and ~80% respectively**
- Company sees no adverse impact of Brexit on its operations

Revenues, costs and margins

- **Europe breakeven levels are at ₹ 550 crore per quarter (with scope to lower it further to ₹ 530 crore). Close to completing in Germany. India breakeven levels are at ₹ 350 crore per quarter**
- Some restructuring costs for MFE would continue in Q4CY20. The company does not believe ~15% margin profile in MFE is possible in the next two to three years

Others

- **Total India capex for CY20E is seen at ~₹ 250 crore (₹ 200 crore spent in 9MCY20), with CY21E capex expected to be at similar**
- Net financial debt as of Q3CY20 stood at ~₹ 1,600 crore, up ₹ 120 crore vs. CY19 end
- Total Maharashtra government grant in the case of Aurangabad Electrical receivable as on date is ~₹ 190 crores. It would get recognised in the books over the next ~5 years

Salient points from MCIE CY19 Annual Report

Performance update and outlook

- **In Europe, production of M&HCV (> 6T) fell 7.2% YoY during CY19, with Germany's decline far sharper at 18.9% YoY. Steep decline in Germany M&HCV production during H2CY19 affected MCIE Europe revenues as large part of MCIE Europe CV forgings business comes from supply to German OEMs**
- **In India, MCIE expects to see some stability in industry demand only from H2CY20 onwards.** The outlook, however, can be adversely affected by Covid-19 outbreak. Over the longer term, the company remains confident of PV demand in India amid low present penetration levels
- In India, the focus remains on upgrading facilities to improve margins and plant efficiencies by adding new capabilities. During CY19, productivity and capacity utilisation improvement through reduced outsourcing and higher automation were also pursued. Facility upgradation included (1) modernisation of Rajkot Gears plant, (2) new plants for composites and stampings (3) investment in new moulding line for foundry and (4) investment in magnetics

Strategy going forward

- **The company is of the view that structural changes (tighter emission norms, move away from ICE towards electric/hybrid powertrains and changing consumer preferences) will continue to confront the automotive industry over medium to long term**
- Electrification impacts a small part of MCIE revenue. The technology shift will favour stamped, plastic, and aluminium parts as against forged, cast or machined parts. MCIE's presence across these processes prepares it well for the change
- **MCIE's focus would be attuned towards cost optimisation, higher operational efficiencies, and diversifying product as well as customer base**
- **Germany truck forgings business would witness product portfolio rationalisation to achieve higher margins.** Car forgings business in Spain and Lithuania are at par on profitability front with CIE group worldwide. Here, the company would aim to maintain profitability levels while matching market growth. Italian operations are also challenged with focus here also being on maintaining profitability levels
- **In India, MCIE is gearing up towards increasing plant efficiencies to preserve margins through incremental automation, manpower optimisation and upgradation of facilities. It is also working towards further diversifying customer base in India and has in CY19 witnessed traction for BS-VI and EV products.** AEL acquisition would help MCIE supply aluminium components to 2-W space which is expected to be the first to witness electrification in India. AEL would increase exports focus going forward

Aurangabad Electricals (AEL) integration

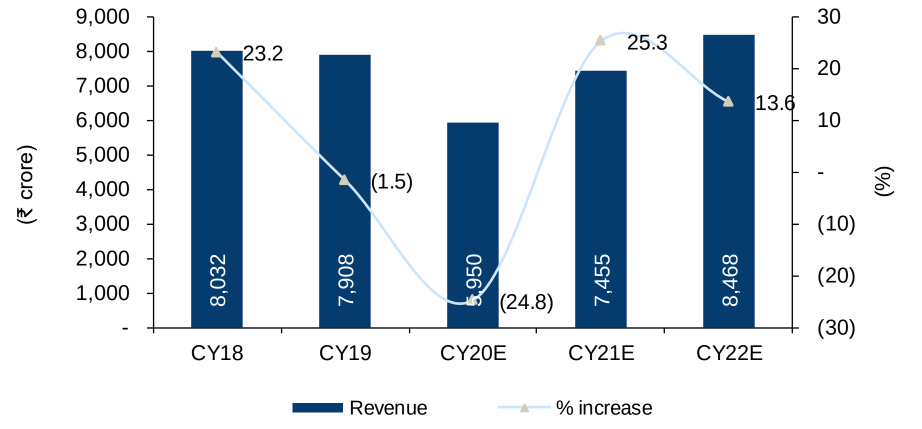
- MCIE results for CY19 include 9 months of AEL financials from April 2019. AEL supplies small but highly critical tolerance parts for pumps, alternators, starters, cylinder heads, etc to 2-W and PV OEMs as well as Tier I suppliers using aluminium die casting process (high pressure die casting i.e. HPDC as well as gravity die casting i.e. GDC).
- **AEL acquisition helped MCIE fill product white space i.e. aluminium die casting products and now its product profile mirrors that of parent CIE Group. The technology provides capabilities on light weighting and electrification side along with customer diversification by adding Bajaj Auto (AEL anchor client)**

Others

- MCIE has 31 plants including 8 in Europe and 1 in Mexico
- The company merged Bill Forge into itself during CY19 and stopped production at Stokes UK. Complete liquidation process of Stokes is expected to be completed during CY20

Financial story in charts

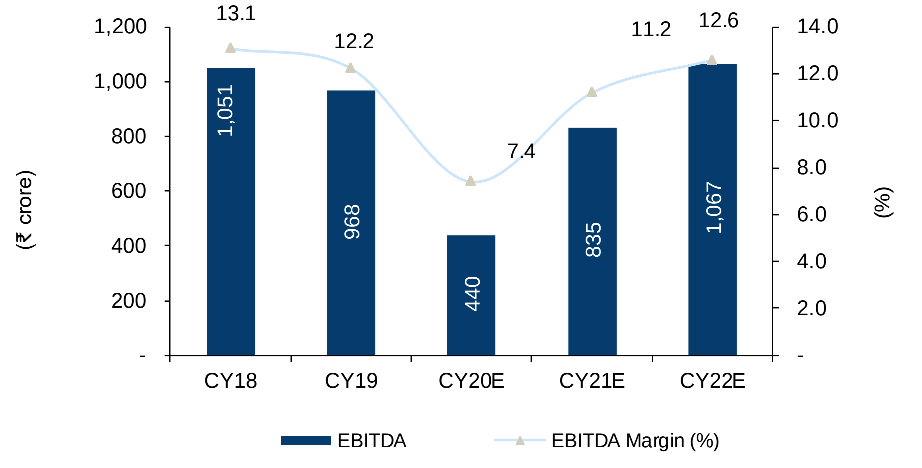
Exhibit 1: Trend in topline



Source: Company, ICICI Direct Research

We expect revenues to be grow at 19.3% CAGR over CY20E-22E

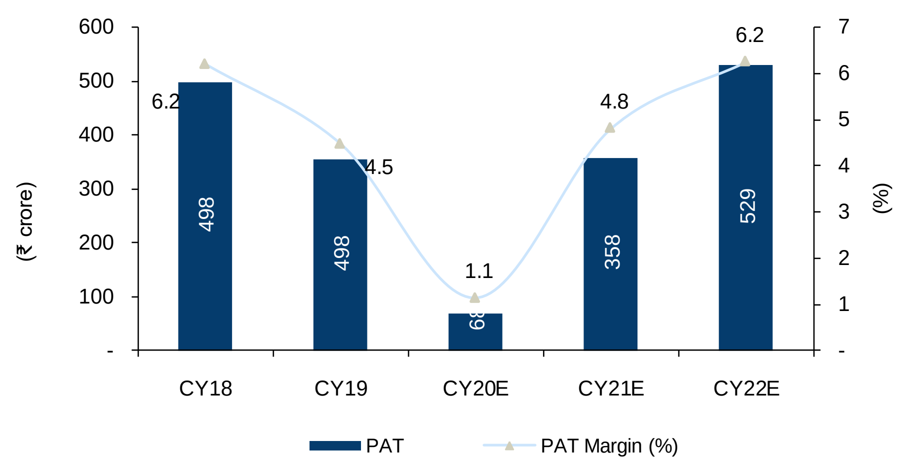
Exhibit 2: EBITDA and EBITDA margins trend



Source: Company, ICICI Direct Research

MCI's margins are seen rising to 11.2% in CY21E and later on to 12.6% by CY22E amid ongoing efforts to reduce breakeven levels and fixed costs

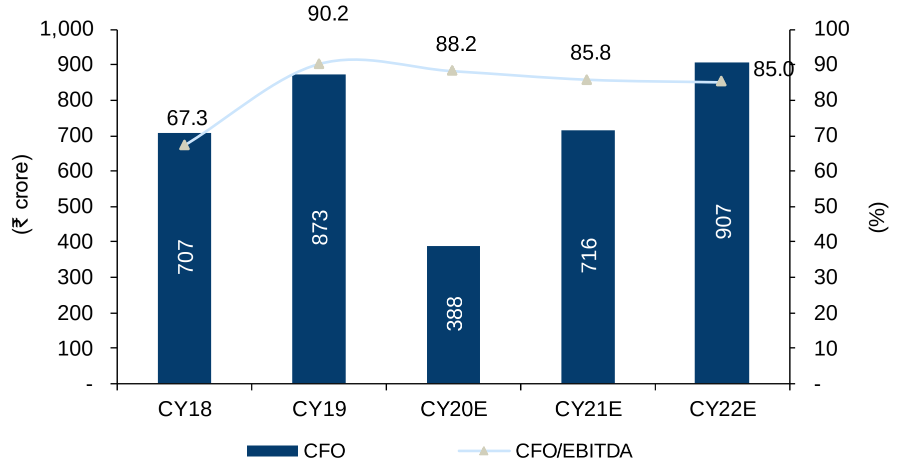
Exhibit 3: Trend in profitability



Source: Company, ICICI Direct Research

PAT is expected to grow to | 529 crore by CY22E

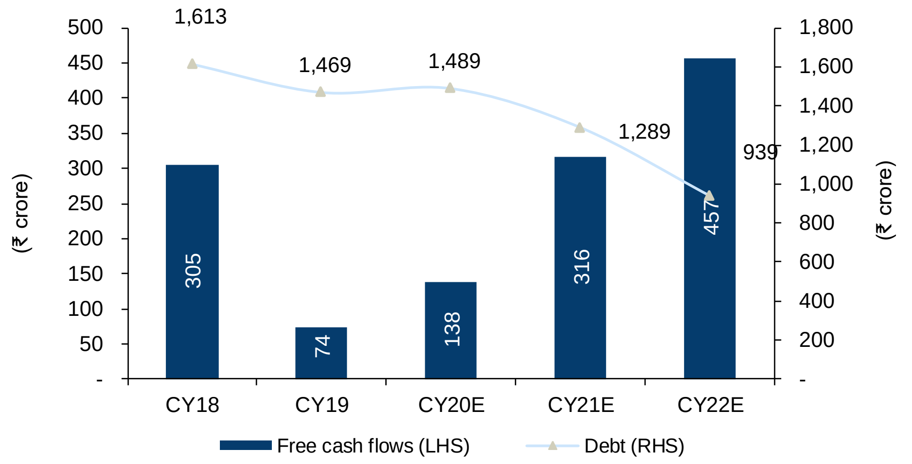
Exhibit 4: Trend in CFO generation



Source: Company, ICICI Direct Research

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

Exhibit 5: Trend in FCF generation and debt



Source: Company, ICICI Direct Research

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

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/Machning (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	Growth	EPS	Growth	PE	EV/EBITDA	RoNW	RoCE
	(₹ cr)	(%)	(₹)	(%)	(x)	(x)	(%)	(%)
CY18	8,032	23.2	13.2	35.0	10.4	5.7	12.4	12.6
CY19	7,908	(1.5)	9.3	(29.0)	14.7	6.6	7.7	10.2
CY20E	5,950	(24.8)	1.8	(80.8)	76.5	14.5	1.4	2.0
CY21E	7,455	25.3	9.5	428.1	14.5	7.4	7.1	7.5
CY22E	8,468	13.6	14.0	47.7	9.8	5.4	9.5	10.4

Source: Company, ICICI Direct Research

Exhibit 8: Target price calculation

Particulars	
CY22E EBITDA (₹ crore)	1067
Target EV/EBITDA (x)	6.5
EV (₹ crore)	6935
CY22E Net Debt (₹ crore)	564
Mcap (₹ crore)	6371
No. of shares (crore)	37.9
Target Price (₹ per share)	170

Source: ICICI Direct Research

Exhibit 9: Shareholding pattern

(in %)	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
Promoter	67.7	67.7	67.7	69.5	71.6
FII	10.5	14.0	14.9	14.6	14.5
DII	7.1	6.6	6.7	5.3	3.4
Others	14.7	11.7	10.7	10.6	10.6

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 10: Profit and loss statement ₹ crore

(Year-end March)	CY19	CY20E	CY21E	CY22E
Total operating Income	**7,907.8**	**5,949.5**	**7,455.0**	**8,467.8**
Growth (%)	-1.5	-24.8	25.3	13.6
Raw Material Expenses	3,748.7	2,766.5	3,466.6	3,937.5
Employee Expenses	1,308.0	1,160.2	1,304.6	1,439.5
Other Expenses	1,883.4	1,582.6	1,848.8	2,023.8
Total Operating Expenditure	6,940.1	5,509.3	6,620.0	7,400.8
EBITDA	**967.7**	**440.3**	**835.0**	**1066.9**
Growth (%)	-7.9	-54.5	89.6	27.8
Other Income	33.1	29.7	37.3	42.3
Interest	52.3	67.0	58.0	42.3
Depreciation	316.1	312.4	335.5	359.9
PBT	**627.8**	**90.7**	**478.7**	**707.1**
Total Tax	274.1	22.8	120.6	178.2
PAT before Minority Interest	353.8	67.8	358.1	528.9
Minority Interest	0.0	0.0	0.0	0.0
PAT after Minority Interest	**353.8**	**67.8**	**358.1**	**528.9**
EPS (₹)	**9.3**	**1.8**	**9.5**	**14.0**

Source: Company, ICICI Direct Research

Exhibit 11: Cash flow statement ₹ crore

(Year-end March)	CY19	CY20E	CY21E	CY22E
Profit after Tax	**353.8**	**67.8**	**358.1**	**528.9**
Add: Depreciation	316.1	312.4	335.5	359.9
(Inc)/dec in Current Assets	324.9	372.0	-406.3	-273.3
Inc/(dec) in CL and Provisions	-174.0	-430.9	370.9	249.5
CF from operating activities	**873.0**	**388.2**	**716.2**	**907.3**
(Inc)/dec in Investments	131.3	9.1	-37.4	-25.1
(Inc)/dec in Fixed Assets	-798.6	-250.0	-400.0	-450.0
Others	36.9	-89.1	1.0	-5.9
CF from investing activities	**-630.4**	**-330.0**	**-436.4**	**-481.0**
Interest Paid	-52.3	-67.0	-58.0	-42.3
Inc/(dec) in loan funds	-144.2	20.0	-200.0	-350.0
Dividend paid & dividend tax	0.0	0.0	0.0	0.0
Others	-9.1	1.0	1.0	1.0
CF from financing activities	**-205.6**	**-46.0**	**-257.0**	**-391.3**
Net Cash flow	37.0	12.2	22.8	35.0
Opening Cash	113.0	150.0	162.2	185.0
Closing Cash	**150.0**	**162.2**	**185.0**	**220.0**

Source: Company, ICICI Direct Research

Exhibit 12: Balance Sheet ₹ crore

(Year-end March)	CY19	CY20E	CY21E	CY22E
Liabilities				
Equity Capital	379.0	379.0	379.0	379.0
Reserve and Surplus	4,254.8	4,323.6	4,682.7	5,212.6
Total Shareholders funds	**4633.8**	**4702.6**	**5061.7**	**5591.6**
Total Debt	1,469.1	1,489.1	1,289.1	939.1
Minority Interest	0.0	0.0	0.0	0.0
Total Liabilities	**6746.5**	**6803.6**	**7046.1**	**7282.1**
Assets				
Gross Block	7,379.6	7,633.8	8,033.8	8,483.8
Less: Acc Depreciation	4,861.2	5,173.5	5,509.0	5,868.9
Net Block	**2518.4**	**2460.3**	**2524.8**	**2614.9**
Capital WIP	54.2	50.0	50.0	50.0
Total Fixed Assets	2,572.6	2,510.3	2,574.8	2,664.9
Investments	95.5	115.5	135.5	155.5
Goodwill	3,526	3,526	3,526	3,526
Inventory	1,056.6	896.5	1,123.4	1,276.0
Debtors	736.8	570.5	714.9	812.0
Other current assets	127.3	95.8	120.0	136.3
Cash	**150.0**	**162.2**	**185.0**	**220.0**
Total Current Assets	2,070.7	1,725.0	2,143.2	2,444.2
Creditors	1,477.1	1,141.0	1,429.7	1,624.0
Provisions	56.2	51.3	64.3	73.0
Other Current Liabilities	363.4	273.4	342.5	389.1
Total Current Liabilities	1,896.6	1,465.7	1,836.5	2,086.0
Net Current Assets	**174.1**	**259.3**	**306.7**	**358.2**
Application of Funds	**6746.5**	**6803.6**	**7046.1**	**7282.1**

Source: Company, ICICI Direct Research

Exhibit 13: Key ratios

(Year-end March)	CY19	CY20E	CY21E	CY22E
Per share data (₹)				
EPS	**9.3**	**1.8**	**9.5**	**14.0**
Cash EPS	17.7	10.0	18.3	23.5
BV	122.4	124.2	133.7	147.7
DPS	0.0	0.0	0.0	0.0
Cash Per Share	4.0	4.3	4.9	5.8
Operating Ratios (%)				
EBITDA Margin	12.2	7.4	11.2	12.6
PAT Margin	4.5	1.1	4.8	6.2
Inventory days	48.8	55.0	55.0	55.0
Debtor days	34.0	35.0	35.0	35.0
Creditor days	68.2	70.0	70.0	70.0
Return Ratios (%)				
RoE	7.7	1.4	7.1	9.5
RoCE	10.2	2.0	7.5	10.4
RoIC	10.5	2.0	7.8	10.8
Valuation Ratios (x)				
P/E	14.7	76.5	14.5	9.8
EV / EBITDA	6.6	14.5	7.4	5.4
EV / Net Sales	0.8	1.1	0.8	0.7
Market Cap / Sales	0.7	0.9	0.7	0.6
Price to Book Value	1.1	1.1	1.0	0.9
Solvency Ratios				
Debt/Equity	0.3	0.3	0.3	0.2
Current Ratio	1.0	1.1	1.1	1.1
Quick Ratio	0.5	0.5	0.5	0.5

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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