Sharekhan
by BNP PARIBAS

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Mahindra Logistics Limited

Steadily improving performance riding on non-M&M business

Logistics	Sharekhan code: MAHLOG	Result Update

Stock Update

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

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 365**	
Price Target: **Rs. 432**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

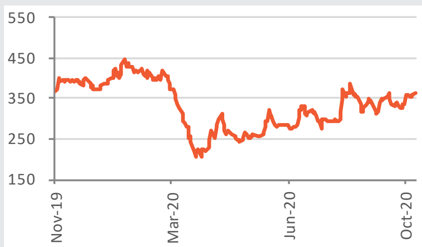
Company details

Market cap:	Rs. 2,611 cr
52-week high/low:	Rs. 458 / 199
NSE volume: (No of shares)	0.7 lakh
BSE code:	540768
NSE code:	MAHLOG
Free float: (No of shares)	3.0 cr

Shareholding (%)

Promoters	58.4
FII	20.4
DII	10.0
Others	11.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.5	21.4	41.0	-1.4
Relative to Sensex	1.5	13.8	15.6	0.0

Sharekhan Research, Bloomberg

Summary

- We recommend Buy on Mahindra Logistics Limited (MLL) with a price target of Rs. 432 considering its attractive valuation and strong net earnings growth trajectory over FY2021E-FY2023E.
- MLL posted better-than-expected performance for Q2FY2021 led by rebound in its SCM business revenue growth at almost pre-COVID level. E-commerce and consumer drive non-M&M segment revenues.
- The company added 0.8msf warehousing space and introduced Flexi Warehousing solutions of ~1msf which would help in addressing seasonality, network expansion and demand uncertainty.
- MLL generated strong operating cash flows during H1FY2021. Improving auto demand along with sustained high growth in E-commerce, consumer and freight forwarding to drive earnings.

Mahindra Logistics Limited (MLL) reported better-than-expected performance for Q2FY2021 led by a rebound in its SCM business revenue growth at almost pre-COVID level. The company's consolidated net revenues declined by 2.3% y-o-y to Rs. 832.5 crore as its SCM business (97% revenue share) grew 6.4% y-o-y to Rs. 804 crore. Within SCM, non-M&M revenue grew 16.1% y-o-y (led by strong growth driven by E-commerce, Pharma and FMCG verticals) while M&M revenue declined by 1.2% y-o-y (supported by the farm segment). The OPM remained steady at 4.5% y-o-y (up 5bps y-o-y). Further, higher other income and lower effective tax rate led to adjusted net profit growth of 33.8% to Rs. 15 crore (higher than our estimate). During the quarter, the company added 0.8msf warehousing space and introduced flexi warehousing solutions (adding ~1msf). The Flexi warehousing solutions is expected to aid in catering to seasonality, network expansion and demand uncertainty. The company also added few large clients from the consumer durable sector. Going ahead, the company expects demand momentum in E-commerce and consumer space to continue while the auto segment is expected to have a much better H2 than H1. The demand environment from tier II and III cities is expected to remain strong in H2. During H1FY2021, MLL generated strong cash flow from operations of Rs. 141 crore versus Rs. 85 crore in FY2020. In the post COVID era, the 3PL industry is expected to benefit with customers assessing their supply chain management with want of smarter solutions along with formalization of the logistics sector. The auto sector is also expected to recover gradually with strong growth expectations during FY2022 which is expected to benefit MLL having higher exposure towards auto sector. We believe MLL is on the right path of improving its earnings growth trajectory going ahead while it is currently trading at a P/E of 29.6x its FY2023E earnings which is below its historical average. Hence, we recommend Buy on the stock with a price target of Rs. 432.

Key positives

- Strong beat on revenues lead by growth in its non-Mahindra SCM business.
- Net operating cash flow generation of Rs. 141.2 crore in H1FY2021 versus Rs. 85.4 crore in FY2020.

Key negatives

- Enterprise Mobility division reported 70% y-o-y dip in revenues and is expected to remain weak in near term.
- Gross margins affected by one-time costs, new projects, higher freight costs, lower gross margins in EM

Our Call

Valuation – Recommend Buy with price target of Rs. 432: MLL continues to see improving performance led by strong growth in non-M&M business (driven by E-commerce and consumer segments) and improving M&M business. The company has been continuously adding warehousing capacities and has now introduced Flexi warehousing which would further aid in maintaining asset light balance sheet, higher margins and better RoCEs. The company has seen strong rise in operating cash flows during H1FY2020. With improving auto demand along with growth in its E-commerce, Consumer and Freight Forwarding business, the company is expected to improve its earnings growth trajectory. However, it is currently trading at a P/E of 29.6x its FY2023E earnings which is below its historical average. Hence, we recommend Buy on the stock with a price target of Rs. 432.

Key Risks

Sustained weakness in the auto industry outlook is a key downside risk to our call.

Valuations (Consolidated) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	3,471.1	3,176.5	3,635.5	4,180.8
OPM (%)	4.6	4.3	5.0	5.2
Adjusted PAT	55.1	39.5	63.5	88.1
% YoY growth	*(35.6)*	*(28.4)*	*60.9*	*38.7*
Adjusted EPS (Rs.)	7.7	5.5	8.9	12.3
P/E (x)	47.3	66.0	41.0	29.6
P/B (x)	4.2	4.0	3.6	3.2
EV/EBITDA (x)	15.9	18.5	14.0	11.7
RoNW (%)	10.6	7.0	10.3	12.7
RoCE (%)	12.2	8.6	11.7	13.9

Source: Company; Sharekhan estimate
Note: We now convert Mahindra Logistics into a Stock Update; It was earlier a 'Viewpoint' under our coverage

Strong traction in non-M&M business leads to higher than expected net earnings

MLL reported a consolidated net revenue decline of2.3% y-o-y to Rs. 832.5 crore which was higher than our estimate. Its Supply Chain Management (SCM) revenue (97% revenue share) grew by 6% y-o-y to Rs. 804 crore while Enterprise Mobility (EM) revenue declined 70% y-o-y to Rs. 29 crore. The company continued to witness strong growth in fulfillment logistics solutions and services driven by E-commerce, Pharma and FMCG verticals. Consequently, the revenue from non-Mahindra group SCM grew by 16.1% y-o-y to Rs. 387 crore while Mahindra group SCM revenue declined 1.2% y-o-y to Rs. 417 crore. The operating margins remained stable at 4.5% (up 5 bps y-o-y). Operating profit declined by 1.2% y-o-y to Rs. 37.3 crore. Further, higher other income (up 4.5x y-o-y) and lower effective tax rate (26.6% Vs 36.4% in Q2FY2020) led to adjusted net profit growth of 33.8% y-o-y to Rs. 15 crore.

Increase in warehousing and addition of new customers

The company commenced ~1 msf Flex fulfillment centres during the quarter at 12 locations which are short term in nature. Flex warehousing solutions handle seasonality, network expansion and demand uncertainty. Flex would yield higher margins and better RoCEs for the company. During the quarter, the company also launched two new built-to-suit warehousesaggregating 0.8 million square feet and continued to see strong demand for value-addedservices & solutions.The company also won a large end-to-end contract for a large consumer durable company which would require ~1msf warehousing services across pan-India. The project is a long gestation project. The company won a large contract with glass company, consumer durable company (western part). It commissioned distribution solutions in Kolkata for capital goods company. It will be going live for power tools company in Chennai before Diwali. With improving auto demand, combinedwith growth in its E-commerce, Consumer and Freight Forwarding business, MLL remains positive that the execution of its strategy will continue to provide strong momentum.

Key result highlights from Concall

- **Recovery:** The company has seen recovery across its end user markets. Pharma continued to do show strength and expect the same in short term. In auto, there has been m-o-m improvement barring medium & heavy CVs. Auto is expected to further improve with festive season. Expect H2 to be much better for two-wheelers, PVs. The manufacturing &engineering sector witnessed improvement while capital goods remained muted. E-commerce saw a sharp growth in volume where leading market places growing at 40%+. Post the pandemic, demand for essential goods expected to remain strong. Demand from tier II & III cities has been strong in H1 and is expected to continue.
- **Flex warehousing solution:** The company commenced ~1 msf Flex fulfillment centres during the quarter at 12 locations which are short term. Flex solutions are constructed to handle seasonality, network expansion and demand uncertainty. Flex would yield higher margins and better RoCEs.
- **Recent Trends:** The company is seeing growth in fulfillment logistics & warehousing services in an increased adoption of multi-modal transportation services, increase in omni channel distribution especially for e-commerce and consumer, higher demand for integrated solutions and adoption of digital technologies.
- **New contracts:** The company won a large end-to-end contract for a large consumer durable company which would require ~1msf warehousing services across pan-India. The project is a long gestation project. The company also won large contract with a glass company, consumer durable company in western part. It commissioned distribution solutions in Kolkata for capital goods company. It will be going live for power tools company in Chennai before diwali.
- **Non-Mahindra pick up:** About 50% of the non-Mahindra SCM revenues came from e-com and consumer business. The company is seeing acceleration in non-mahindra SCM business which rose to Rs. 387 crore from Rs. 334 crore in Q2FY2020. The warehousing business grew 18% y-o-y to Rs. 134 crore. The company is in talks with pharma companies for last mile delivery for COVID vaccines.
- **Drop in gross margins:** The company's gross margins dipped 28 bps y-o-y to 9.9% on account of one-time costs related to streamlining of operations, new large projects getting started, higher freight costs, lower gross margins in mobility business and impact of freight forwarding business.

- **Transporation:** The line-haul and long haul continue to see improvement. However, there are fuel price challenges and working capital for transporters. There is strong growth in last mile express distribution. Freight forwarding continue to grow although affected on gross margins due to tight carrier availability.
- **Warehousing:** The warehousing business is pretty back to pre-COVIDlevel barring auto. It added 0.8 BTS multi-user capacity during Q2.
- **Mobility business:** Its mobility business (~3% revenue share in Q2FY2021) has not seen any recovery. It has been able to reach only upto 25% pre-COVIDtrip levels. The business is expected to take 2-3 quarters before it normalizes.

Financials (Consolidated) Rs cr

Particulars	Q2FY2021	Q2FY2020	y-o-y%	Q1FY2021	q-o-q%
Net sales	**832.5**	**852.4**	**-2.3%**	**410.5**	**102.8%**
other income	8.3	1.9	345.9%	2.8	193.6%
Total income	840.8	854.3	-1.6%	413.3	103.4%
Total expenses	803.4	814.6	-1.4%	412.7	94.7%
Operating profit	**37.3**	**37.8**	**-1.2%**	**-2.2**	**-**
Depreciation	20.9	17.7	17.7%	18.4	13.2%
Interest	4.5	4.2	8.0%	4.6	-1.5%
Exceptional items					
Profit Before Tax	20.2	17.8	13.9%	-22.4	-
Taxes	5.4	6.5	-16.7%	-5.9	-
PAT	14.9	11.3	31.4%	-16.5	-
Minority Interest	-0.1	0.1	-230.0%	-0.7	-
Adjusted PAT	**15.0**	**11.2**	**33.8%**	**-15.8**	**-**
EPS (Rs.)	2.1	1.6	33.8%	-2.2	-
			BPS		**BPS**
OPM (%)	4.5%	4.4%	5	-0.5%	502
NPM (%)	1.8%	1.3%	49	-3.9%	565
Tax rate (%)	26.6%	36.4%	-978	26.4%	27

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector view - Pace of recovery to be gradual; although 3PL companies better placed**

The Logistics industry had been severely hit by the pandemic impacting the overall trade environment both domestically as well as globally. Though, the domestic indicators like e-way bill generations, FASTag collections among others highlight toward improvement m-o-m, the international EXIM environment is yet to show clear signs of revival. The EXIM volumes continue to remain weak with frequent imbalance in trade. The competitive intensity remain high as many companies are going after weak volumes in the industry putting pressure on profitability. Hence, we expect the pace of recovery in the logistics industry especially in the EXIM business to be gradual. However, 3PL industry has seen faster improvement in operations led by segments like E-commerce, Pharma and FMCG. Hence, within Logistics industry, 3PL companies are better placed.

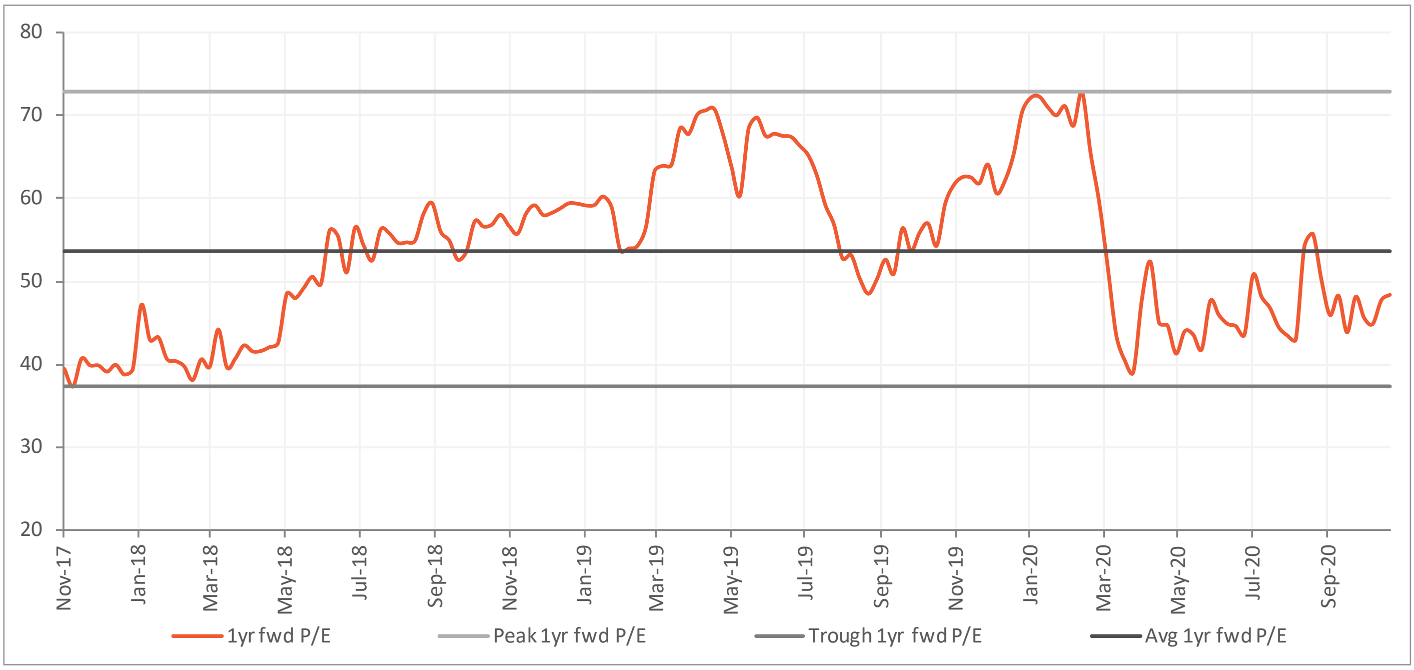
■ **Company outlook - On a faster recovery path**

MLL witnessed strong m-o-m improvement in revenues run-rate from May 2020 with gradual unlocking of the economy. Meanwhile it has been able to add key clients and have gone live with few clients. In the post COVID era, the company expects to benefit from increasing reliance of clients on providers of smart supply chain management solutions like itself. The strong revival of the auto sector expected in FY2022 is further expected to lead to strong revenue growth for MLL. Overall, with improving auto demand along with growth in its E-commerce, Consumer and Freight Forwarding business, the company is expected to improve its earnings growth trajectory.

■ **Valuation - Recommend Buy with price target of Rs. 432**

MLL continues to see improving performance led by strong growth in non-M&M business (driven by E-commerce and consumer segments) and improving M&M business. The company has been continuously adding warehousing capacities and has now introduced Flexi warehousing which would further aid in maintaining asset light balance sheet, higher margins and better RoCEs. The company has seen strong rise in operating cash flows during H1FY2020. With improving auto demand along with growth in its E-commerce, Consumer and Freight Forwarding business, the company is expected to improve its earnings growth trajectory. However, it is currently trading at a P/E of 29.6x its FY2023E earnings which is below its historical average. Hence, we recommend Buy on the stock with a price target of Rs. 432.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Mahindra Logistics	41.0	29.6	14.0	11.7	3.6	3.2	10.3	12.7
TCI Express	27.1	22.6	19.4	16.1	5.9	4.9	24.4	24.0
Gateway Distriparks	18.6	13.7	6.2	5.4	0.8	0.8	4.3	5.9

Source: Sharekhan Research

About company

Mahindra Logistics Ltd (MLL) is a portfolio companyof Mahindra Partners, the $1 billion private equitydivision of the $19-billion Mahindra Group. MLL isan integrated third-party logistics (3PL) serviceprovider, specializing in supply chain managementand people transport solutions. Founded morethan a decade ago, MLL serves over 300 corporatecustomers across various industries like automobiles,engineering, consumer goods and e-commerce. Thecompany pursues an asset-light business modelunder which assets necessary for its operationssuch as vehicles and warehouses are owned orprovided by a large network of business partners onlease rentals, while MLL largely invests in logisticstechnology. The company provides customized and technology-enabled solutions that span across thesupply chain and people transport operations.

Investment theme

India's logistics sector is expectedto remain under pressure in the near term as the automotive sector is the largest user and contributor to itsrevenue. The COVID-19 had added challenges in the near term. The other verticals like consumer, pharma and e-commerce are expected to fare well but do not contribute materially to positively drive overall logistics sector. However, third-party logistics is expected to benefit structurally from favourablepolicies implemented by the government such as GST, e-way bill and infrastructure status over the long run.

Key Risks

- Slowdown in automotive industry can affectfinancials 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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