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Mahindra & Mahindra

New Year; New Beginnings

Automobiles	Sharekhan code: M&M	Company Update

Stock Update

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		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 732**	
Price Target: **Rs. 872**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

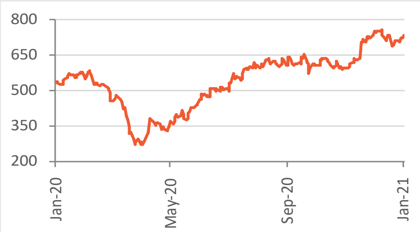
Company details

Market cap:	Rs. 91,113 cr
52-week high/low:	Rs. 764 / 246
NSE volume: (No of shares)	62.1 lakh
BSE code:	500520
NSE 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	-0.3	20.6	43.5	36.6
Relative to Sensex	-7.5	-5.1	6.4	20.7

Sharekhan Research, Bloomberg

Summary

- We maintain a Buy rating on M&M with unchanged price target of Rs. 872 considering key business decisions announced on January 1
- We believe these decisions are in line M&M's commitment to achieve an 18% RoE by exiting loss-making subsidiaries and focusing on core businesses.
- We expect M&M to benefit from its leadership status in tractor space, strengthened position in LCV segment and steady market share gains in UV segment.
- Stock is attractively valued with a P/E multiple of 17.2x and EV/EBITDA multiple of 9x its FY2023E estimates; it trades at a discount to long-term average multiples.

Mahindra and Mahindra (M&M) held an investor meet to discuss on the possible stake sales of Ssangyong Motor Company (SMC) to a potential investor, termination of JV with Ford Motor Company (FMC) and the company's future narrative for the automotive business. The company is in advanced discussions with a potential investor for sale of its majority stake in Ssangyong Motor Company (SMC). We believe that the decision to exit SMC is logical and in line with its overall objective to achieve an 18% RoE. Moreover, the joint venture between M&M and Ford Motor Company (FMC) was terminated owing to the fundamental changes in global economic and business conditions caused partly by the global COVID-19 pandemic over the past 15 months. The decision to terminate was amicable and thus, would not impact M&M's other engagements with FMC. The termination of the JV also does not have any major financial implication other than minor legal and miscellaneous expenses. M&M continues to focus on expanding its utility vehicle (UV) business, leverage brand recall and improve returns on capital investment. The company reinforced its capex plans of Rs 9,000 crore in the next three years, as announced earlier. In terms of its UV business, M&M's next-gen XUV500 is slated to hit the roads by March 2021, while the next-gen Scorpio is likely to be launched in the second quarter of 2021 with both petrol and diesel engine options. M&M is planning to accelerate investments in electric vehicles as well and create a global brand in this space. Structural growth drivers remain intact. We expect M&M to benefit from its leadership status in the tractor space (40% share), strengthening position in LCV segment and a steady market share in UV segment. For tractors, the farm sector is expected to remain buoyant, driven by good monsoon and higher crop output. The tractor business has high ROCEs that will help M&M improve overall return ratios. M&M also leads in the LCV space with an over 45% market share and a greater than 65% share in the 2-3.5T LCV category. We expect M&M to further consolidate market share in the overall LCV segment. Demand for LCVs is likely to be driven by higher demand for short distance movement of goods. In the UV market, we expect M&M's growth to be driven by new launches in a highly competitive markets. Concrete steps to achieve an 18% RoE by exiting loss-making subsidiaries and focusing on core businesses will improve overall performance. We expect standalone earnings to grow by 28.8% y-o-y in FY22E and 15.4% y-o-y in FY23E, driven by 15.5% CAGR during FY2021-FY2023E in revenues and 60 bps increase in operating profit margin. We remain positive on M&M's fundamental growth prospects and hence, maintain a Buy rating on the stock.

Our Call

Valuation - Maintain Buy with unchanged PT of Rs. 872: We expect M&M to benefit from its leadership status in the tractor segment, strengthening position in the LCV segment and defending its market share in the highly competitive UV segment. Going ahead, M&M's strategy revolves around tighter capital allocation, exit from loss-making subsidiaries and focusing on core UV business and emerging EV businesses. The company has started to take concrete steps to achieve an 18% RoE from all its businesses makes a strong case for re-rating of the stock. Our SOTP-based valuation provides a price target of Rs. 872. The stock is attractively valued with P/E multiple of 17.2x and EV/EBITDA multiple of 9x its FY2023E estimates, and is at a discount to its long-term average multiples. We recommend a Buy on the stock.

Key Risks

M&M is facing supply issues due to supply shortage of micro-processors (semiconductors) used in Electronic Control Unit (ECUs). If the situation persists for longer period can impact the automotive business. Also, the company can be impacted by second wave of COVID.

Valuation (M&M+MVML) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue (Rs cr)	52,848	44,866	43,312	51,957	57,840
Growth (%)	11.1	(15.1)	(3.5)	20.0	11.3
EBITDA (Rs cr)	7,530	6,351	6,298	7,796	8,711
EBITDA margin (%)	14.2	14.2	14.5	15.0	15.1
PAT (Rs cr)	5,424	3,551	3,553	4,577	5,283
Growth (%)	29.5	(34.5)	0.1	28.8	15.4
FD EPS (Rs)	43.6	28.6	28.6	36.8	42.5
P/E (x)	16.8	25.6	25.6	19.9	17.2
P/B (x)	2.6	2.6	2.5	2.3	2.1
EV/EBITDA (x)	11.2	13.5	13.6	10.6	9.0
ROE (%)	15.5	10.2	9.6	11.4	12.2
ROCE (%)	18.1	14.0	11.9	13.8	14.7

Source: Company; Sharekhan estimates

Mahindra and Mahindra (M&M) held an investor meet to discuss on the possible stake sales of Ssangyong Motor Company (SMC) to a potential investor, termination of JV with Ford Motor Company (FMC) and the company's future narrative for the automotive business. The key highlights of the conference are as below:

Ssangyong stake sale: Mahindra and Mahindra (M&M) is in advanced discussions with a potential investor to sale its stake in Ssangyong Motor Company (SMC). M&M currently holds 74.7% stake in SMC and plans to reduce its stake below 30% post the deal. M&M expects to conclude the deal probably in a week or two.

SMC defaulted on a loan repayment of Rs. 408 crore, which was due and payable on December 14, 2020. The outstanding loan amount aggregates to Rs. 680 crore, where M&M has extended guarantee to bankers to the extent that the amount is not recovered by SMC. SMC has applied for rehabilitation procedure with Seoul Bankruptcy Court. SMC has also requested for Autonomous Restructuring Support (ARS) scheme under which the Court has given a timeframe of up to February 28, 2021, whereby SMC's Board and management have to provide a restructuring plan.

M&M's liability is limited to the amount of equity and debt that it has invested in the SMC so far. M&M has made equity investment of Rs. 980 crore in SMC for which it has already impaired its investments. M&M's commitment of Rs 680 crore to SMC's bankers will be made from SMC or any new investor. M&M liability will be reduced to the amount not recovered. Also, in a scenario if M&M is not able to find investor, then SMC would go through a pre-packaged rehabilitation programme and there could be other options for that as well. However, in either scenario, M&M would cease to be a majority shareholder by the end of FY21.

We believe M&M's decision to do away with the majority shareholder of SMC is a logical approach and is in line with its overall objective to move towards an 18% ROE. SMC has made a loss of Rs 3,029 crore in FY2020 and Rs. 315 crore in FY2019. SMC's losses every quarter is ~Rs. 600 crore, which M&M believes to save after its majority stake sale in SMC.

Termination of JV between M&M and Ford Motor Corporation: The joint venture between M&M and Ford Motor Company (FMC) got terminated on January 1, 2021. M&M & FMC had executed a business transfer agreement and share subscription agreement in October 2019 to form a JV. The decision to terminate was done on an amicable note and thus, would not impact M&M's other engagements with FMC. The outcome was driven by fundamental changes in global economic and business conditions caused, in part, by the global pandemic over the past 15 months. M&M has planned to commit an investment of Rs. 1,400 crore at the time of initial agreement. Due to pandemic, the investment amount increased substantially and the expected return on capital employed was no more attractive, paving a way for termination. These changes influenced separate decisions by FMC and M&M to reassess their respective capital allocation priorities. The termination of JV do not have any major financial implication other than minor legal and miscellaneous expenses.

However, both the companies are in dialogue for other works except the JV. FMC and M&M had inked a pact to explore a strategic alliance covering areas like product development, electric vehicles and distribution in India and emerging markets in September 2017. In 2018, the two partners have agreed to develop new SUVs, a small electric vehicles and connected car solutions besides supply of M&M's powertrains to extend Ford's product range as part of several initiatives.

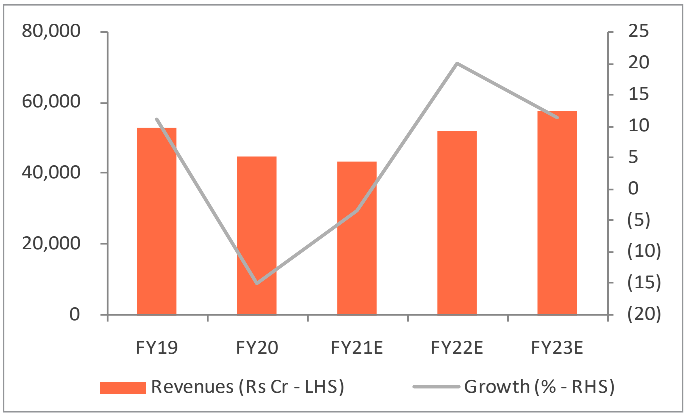
Future narrative of automotive business: M&M continues to focus on expanding its utility vehicle (UV) business, leverage brand recall and improve returns on capital investment. The company reinforced its capex plans of Rs 9,000 crore in the next three years. In terms of its UV business, M&M's next-gen XUV500 is slated to hit the roads by March 2021, while the next-gen Scorpio is likely to be launched in the second quarter of 2021 with both petrol and diesel engine options. M&M is planning to accelerate investments in electric vehicles as well and create a global brand in this space. M&M is planning to have electric options for all its vehicles in the medium term and the investments for same will be used from the savings of the FMC-M&M JV that got terminated.

New launches in automotive segment to defend its market in highly competitive markets: In the automotive segment, M&M launched 'Thar' SUV in October. The company stated that it has received encouraging response, having garnered 30,000 bookings. Thar has attracted a whole new set of buyers with about 55% of bookings from first-time buyers. Moreover, about 50% of bookings were for the automatic variant. The company has lined up model upgrades and new launches over the next 18 months. We could expect upgrades in Thar, XUV500, Scorpio and e-XUV 300. This will help M&M to defend its market share, given the intense competition in the segment.

Strong broad-based recovery; expect double-digit growth in FY22: We expect M&M's standalone earnings to grow at 28.8% y-o-y in FY22E and 15.4% y-o-y in FY23E, driven by 15.5% CAGR during FY2021-FY2023E in revenues and a 60 bps increase in operating profit margin.

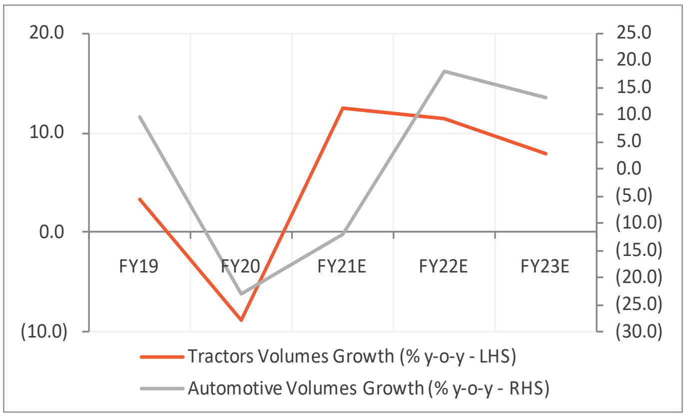
Financials in charts

Revenue and growth trend



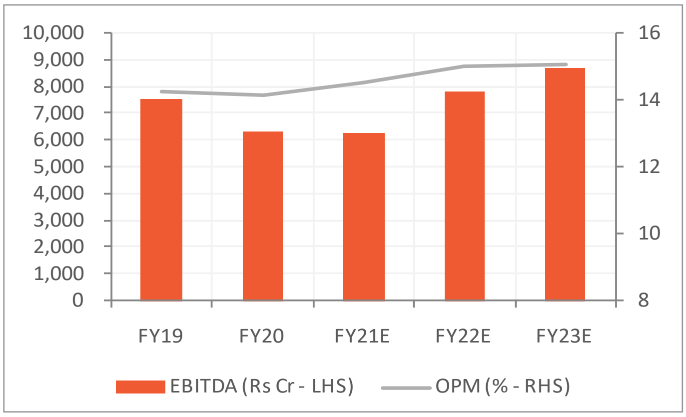
Source: Company, Sharekhan Research

Volume growth trend – Tractors & Automotive segment



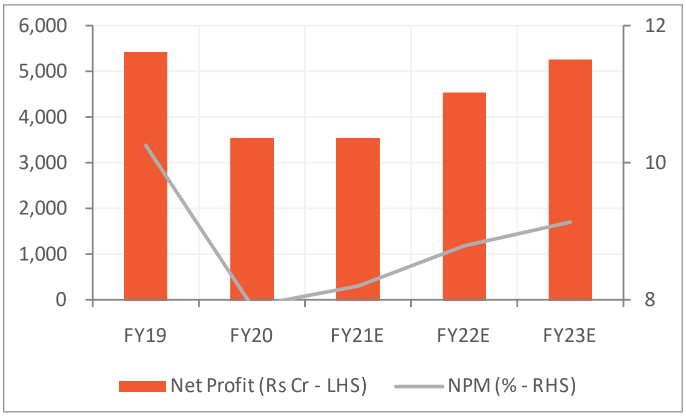
Source: Company, Sharekhan Research

EBITDA and OPM trend



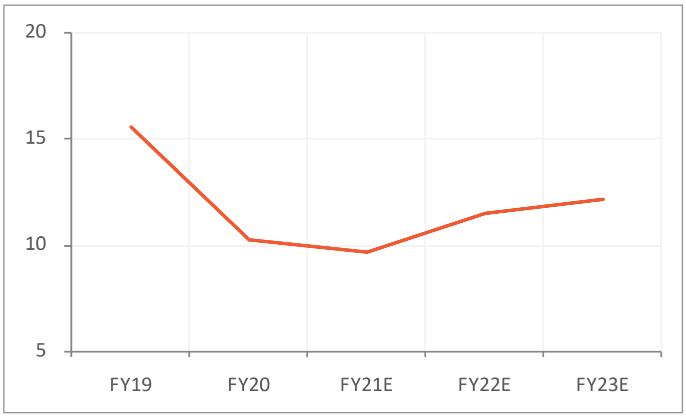
Source: Company, Sharekhan Research

Net profit and growth trend



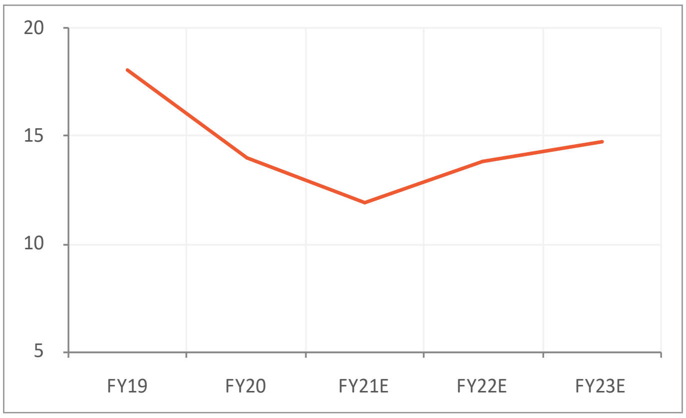
Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

RoCE trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Demand picking up in automotive and industrial sector

The domestic tractor industry is the only segment reporting growth on a y-o-y basis in H1FY2021 as the agricultural sector has been relatively less impacted by COVID-19. Good monsoons and higher kharif sowing have boosted farm sentiments, with the tractor industry growing in double digits since June 2020 that is expected to sustain for the whole fiscal as well. The PV and LCV industry have reported positive growth from August onwards. We expect a strong recovery for PV and LCV from FY2022, driven by normalisation of economic activity and pent-up demand.

■ Company outlook - Strong earnings growth

M&M is the market leader in the tractors segment, commanding 40% market share. The company is working on lightweight compact global tractor project (named K2), which would see the launch of four new platforms. K2 would witness launch of 38 models and would further strengthen the company's position in the tractor space. M&M has one of the highest exposures to the rural markets (~65% of volumes), which are expected to be less impacted by the on-going impact of COVID-19. M&M is committed to improve its capital allocations and achieve an 18% ROE. The company is taking serious steps towards exiting the loss making subsidiaries and investing in core businesses that secure decent returns on investment.

■ Valuation - Maintain Buy with a PT of Rs. 872, providing an upside room of 19%

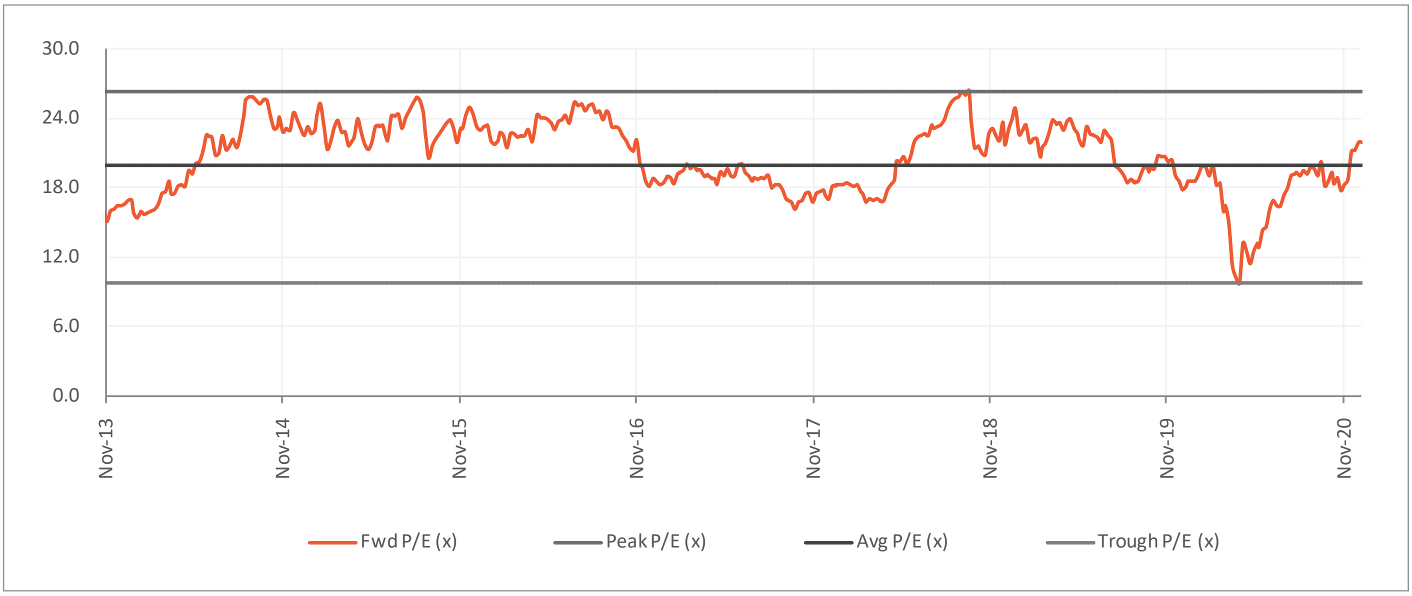
We expect M&M to benefit from its leadership status in the tractor segment, strengthening position in the LCV segment and defending its market share in the highly competitive UV segment. Going ahead, M&M's strategy revolves around tighter capital allocation, exit from loss-making subsidiaries and focusing on core UV business and emerging EV businesses. The company has started to take concrete steps to achieve an 18% RoE from all its businesses makes a strong case for re-rating of the stock. Our SOTP-based valuation provides a price target of Rs. 872. The stock is attractively valued with P/E multiple of 17.2x and EV/EBITDA multiple of 9x its FY2023E estimates, and is at a discount to its long-term average multiples. We recommend a Buy on the stock.

M&M's Sum-of-Part-Valuation provide PT of Rs. 872

Business	Valuation rationale	M&M's stake (%)	Value of M&M's stake (Rs crore)	Value per share (Rs)
Core (MM+MMVL) business excl. dividend earnings from subsidiaries & associates	16x FY23E EPS	100.0	79,079	636
Value of listed subsidiaries & associates				
Tech Mahindra	Market Capitalisation	26.0	23,467	189
M&M Financial Services	Market Capitalisation	51.2	11,090	89
Mahindra Lifespaces	Market Capitalisation	51.5	892	7
Mahindra Holiday and Resorts	Market Capitalisation	67.3	1,877	15
SYMC	Market Capitalisation	74.7	2,846	23
Mahindra Logistics	Market Capitalisation	58.5	1,656	13
Swaraj Engines	Market Capitalisation	34.8	595	5
Mahindra CIE	Market Capitalisation	11.4	691	6
Value of listed subsidiaries & associates			41,829	336
Fair value of subsidiary cos @30% discount	Holding co. discount		29,280	236
Fair Value of M&M entity			**1,08,359**	**872**
CMP				731.8
Potential Upside/(downside)				19.1

Source: Company Data; Sharekhan Research

One-year forward P/E (x) band



Source: Sharekhan Research

About company

M&M is the flagship company of Mahindra Group. M&M's core business houses the automotive and tractor segment. M&M is the only automotive company that is virtually present across all segments. The company is the market leader in light commercial vehicles and is a leading utility vehicle, and 3W player. M&M also manufactures MHCV and is present in the 2W space through its investment in Jawa. Apart from being a strong player in the 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 that are engaged in diverse businesses under the Mahindra brand (IT services, NBFC, logistics, hospitality, real estate, and auto ancillary business).

Investment theme

With strong farm sentiments on account of higher rainfall, expected increase in kharif output, and increased government spending, M&M has raised FY2021 tractor industry's growth forecast from mid-single digit growth earlier to 12%. Higher ground water reservoir levels coupled with robust farmer cash flows would mean tractor demand would remain buoyant in FY2022 as well. Automotive volumes are also improving with the decline narrowing to 14% y-o-y in October 2020 as compared to 78% in Q1FY2021. With the success of new launches (Thar with strong bookings) and inventory filling (automotive inventory is lower than normal), automotive demand is expected to improve further. Going ahead, M&M's strategy revolves around tighter capital allocation, exit from loss-making subsidiaries and focusing on core UV business and emerging EV businesses. The company has started to take concrete steps to achieve an 18% RoE from all its businesses makes a strong case for re-rating of the stock. This would further substantially reduce losses in overseas subsidiaries and act as key re-rating trigger for M&M. Our SOTP-based valuation provides a price target of Rs. 872, providing a 19% upside. Hence, we maintain our Buy call on the stock.

Key Risks

- M&M is facing supply issues due to supply shortage of micro-processors (semiconductors) used in Electronic Control Unit (ECUs). If the situation persists for longer period can impact the automotivAlso, the company can be impacted by second wave of COVID.
- The second wave of COVID-19 can lead to slow down in the economic activities and thus can impact earnings of the company.

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

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

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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