26 December 2022
Sector: Automobiles

Mahindra CIE

BSE SENSEX	S&P CNX
60,567	18,015

Bloomberg	MACA IN
Equity Shares (m)	379
M.Cap.(INRb)/(USDb	118.7 / 1.4
52-Week Range	345 / 164
1, 6, 12 Rel. Per (%)	10/27/34
12M Avg Val (INR M)	193
Free float (%)	25.0

Financials & Valuations (INR b)

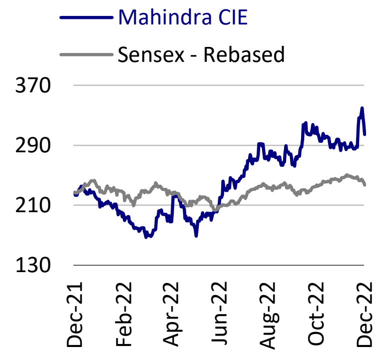
Y/E MARCH	CY22E	CY23E	CY24E
Sales	107.3	120.2	130.9
EBITDA (%)	11.5	13.1	14.0
Adj. PAT	7.0	8.7	10.5
Adj EPS (INR)	18.5	23.1	27.7
EPS Gr (%)	33.3	25.3	20.0
BV/Sh (INR)	152	171	193
Ratios			
RoE (%)	12.7	14.3	15.3
RoCE (%)	10.4	11.8	12.8
Payout (%)	17.0	16.7	16.7
Valuations			
P/E (x)	17.0	13.6	11.3
P/BV (x)	2.1	1.8	1.6
Div. Yield (%)	1.0	1.2	1.5
FCF Yield (%)	0.6	4.1	7.6

Shareholding pattern (%)

As On	Sep-22	Jun-22	Sep-21
Promoter	75.0	74.9	72.2
DII	7.7	8.1	7.8
FII	7.3	6.9	10.5
Others	10.1	10.2	9.5

FII Includes depository receipts

Stock Performance (1-year)



CMP: INR313 TP: INR360 (+15%) Buy

Focus on profitability, capital allocation

Strong traction in India business | EV order wins gaining momentum

We met the management of Mahindra CIE (MACA) to learn more about 1) its decision to sell German CV forging operations and its implications on operational/financials, 2) the company's key focus areas in terms of geography and product, 3) factors leading to margin expansion in the near to medium term, and 4) focus areas in EVs and details of order wins. We believe the proposed sale of its German CV forging operations is a positive development for MACA as it will result in a better financial performance (profitability improvement and debt reduction) and free up managements bandwidth. Moreover, management's focus on profitability has intensified further, as it has become selective in terms of order acceptance (to only consider orders with RoI >20%) and investments in high value-added products. We believe MACA's growth story is on track, led by its organic initiatives (new products/customers) and M&A focus (adding new technologies). Under CIE's parentage, MACA has been able to improve its efficiencies, cut costs, and improve profitability. The stock trades at 13.6x/11.3x CY23E/CY24E consolidated EPS. We maintain our Buy rating with a TP of INR360 (~13x Dec'24E consolidated EPS).

- **Sale of MFE Germany—A step in right direction:** MACA's board has approved to sell its German Forging operation (Mahindra Forgings Europe AG- MFE), which supplies forging parts to the European trucking industry. However, the company will continue to focus on the other part of the business, which supplies forging parts to the light vehicle industry from its own plant and subsidiaries in EU. We believe this sale should help the company improve its consolidated financials (MFE had been consistently incurring loss at PAT level; EUR22.6m cumulative loss over CY18-21) and strengthen its focus on the light vehicle industry, which is going through a rapid transition to EVs. MFE contributed ~20% of consolidated revenue in CY21 and reported an average EBITDA margin of ~3% over CY17-21 (vs ~12%/11% for India/EU operations). Assuming this transaction goes through, our CY23E/CY24E consol revenue/EBITDA /PAT will see downgrade of 16%/7%/3%, whereas EBITDA margins will be higher by 160bp to 14.7% in CY23E. The sale will reduce net debt by ~EUR50m (INR4.4b) vs net debt of INR6.8b in CY21. Hence, we believe the transaction is crucial for the improvement of the company's overall performance. Also, consol RoE will see substantial improvement, though benefit will depend on sale consideration.
- **Focus on profitable growth over sales:** Management reiterated its focus on profitable growth with an aim to achieve EBITDA margin of over ~15% in the near term (vs ~12% in CY21). To achieve this margin, the company will solely accept orders with the threshold margin level and is willing to let go of not so profitable opportunities. Moreover, the company expects EBITDA margin in the domestic market to expand to 17-18% (without assuming RM decline) over the next 2-3 years vs ~13% in CY21, driven by increase in value add and operating leverage. This would be supported by new orders coming at higher margins/RoI.

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- **Well placed to outperform domestic market led by healthy order book:** Led by good order book and strong traction in new order wins, MACA is confident to outperform the domestic auto industry by ~10%. Considering strong demand in India, it is prioritizing domestic demand over exports. Consequently, export mix may not increase to targeted 20% from 12-13% currently. The demand situation in Europe is still uncertain; however, despite macro headwinds, order schedules remain strong. Moreover, in the long run, the company should continue to accrue benefits of being a low-cost supplier and factors like the 'China-plus-one strategy', especially in segments like gears and magnetics.
- **Focus on reducing investments with large part of capex to be allocated to the Indian business:** The company reiterated its capex guidance of 5% of consolidated revenue, wherein a large part of it would be allocated to the Indian business. As part of the capex plan for the domestic market, the company is adding capacity/ramping up its operations across its business divisions: 1) Gears - added new capacity in Rajkot in CY21 and now the transition is undergoing from its Pune plant, 2) Forging – ramp-up in warm forging in Chakan, 3) Bill Forge – ramp-up in CIE Hosur plant, 4) Castings - adding new casting lines, and 5) Magnetics - doubling capacity over 1-2 years. In Europe the company will only incur maintenance capex (1.5-2% of revenue). For its Metalcastello business, the company looks forward to debottlenecking, which should generate 15-20% of additional capacity. While multiple OEMs are approaching MACA for capacity expansion, the company will only commit capex after ramp-up in the existing capacities for these OEMs.
- **New order wins in domestic EV industry:** As the transition happens from ICE to EV, 65% of the parts would remain fuel agnostic. The remaining 35% of the components include parts such as battery housing, battery tray and battery panels, etc. The company has already won new orders in certain EV specific components. It is receiving strong demand for its gear and stamping division. The company expects to gain higher content/vehicle in EVs vs ICE initially due to limited vendor optionality.

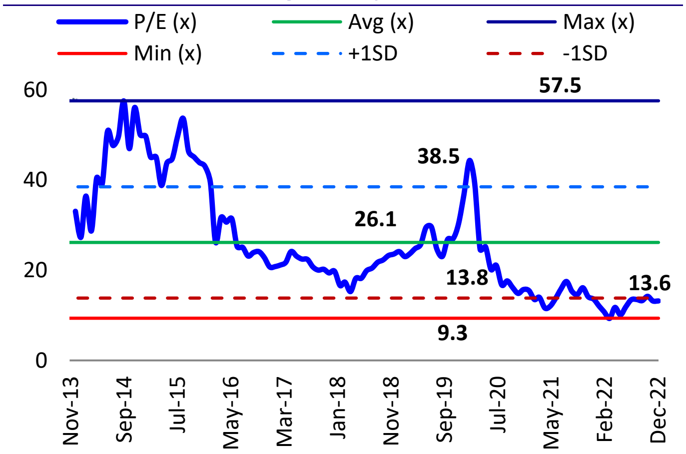
Other takeaways:

- M&M's stake in MACA has come down to 9.3% (vs 11.4% earlier), while CIE's stake has gone up to 65.7% (vs 63.4%). This has resulted in declassification of M&M as a promoter of MACA.
- The board has approved to change the name of Mahindra CIE to CIE Automotive India. Certain OEMs weren't comfortable working with OEM owned supplier. Consequently, it was facing multiple challenges during the process of getting orders from these clients. The change in name will help to get foothold with such OEMs. One of the reason behind naming the Hosur plant as 'CIE Hosur' is to underscore its different identity.
- For energy cost hyperinflation in the EU, MACA has passed on average 60-70% of the cost inflation with special focus on cost pass through in Germany. Hence, we believe margin in Germany is largely stable. However, CY23 is expected to be challenging from the margin front as it will face rising employee inflation.
- Magnetics division - EV is an opportunity for most of the segments for MACA, except for 2W magnetics division wherein the company could face risk of product disruption as the usage of rare earth magnets will emerge. However,

within magnetics, 4Ws will see increase in magnets made by MACA and hence focus is on getting 4W orders.

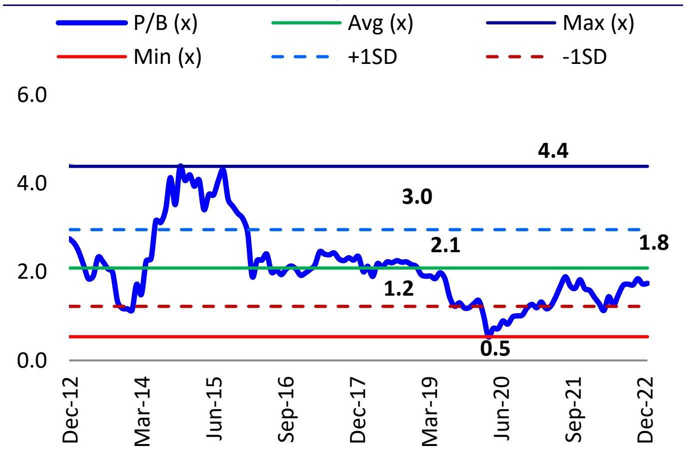
- **Valuation and view:** MACA's has increased its focus on investing in profitable orders with margins of >15% and on the domestic market. India is expected to be the key growth driver, led by: 1) value-added products (machined castings, higher grade magnets, complex gears, etc.); 2) exports; and 3) new products and customers. EBITDA margin expansion is likely to be driven by: 1) higher value-added products, 2) optimization of product process, and 3) operating leverage. While demand is expected to remain uncertain in Europe, the order schedules have remained intact so far. On the other hand, MACA's board has approved to sell part of its German Forging operation (Mahindra Forgings Europe AG- MFE). We believe the sale is a step in the right direction as it should help the company improve its consolidated financials (MFE had incurred cumulative loss of EUR22.6m over CY18-21) and strengthen its focus on growth in the light EV market. We believe MACA's growth story is on track, led by its organic initiatives (new products/customers) and M&A focus. Under CIE's parentage, MACA has been able to improve its efficiencies, cut costs, and improve profitability. The stock trades at 13.6x/11.3x CY23E/CY24E consolidated EPS. We maintain our Buy rating with a TP of INR360 (~13x Dec'24E consolidated EPS).

Exhibit 1: Price-to-earnings (one-year forward)



Source: MOFSL, Company

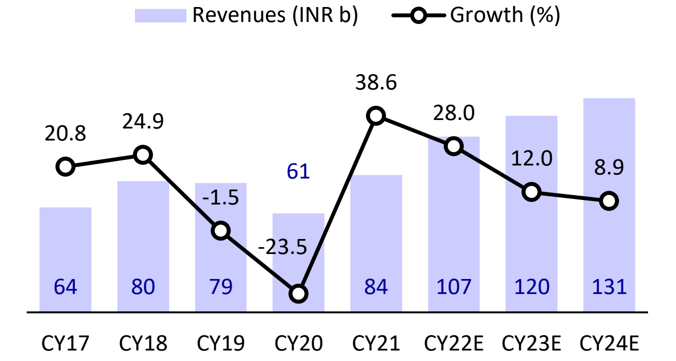
Exhibit 2: Price-to-book (one-year forward)



Source: MOFSL, Company

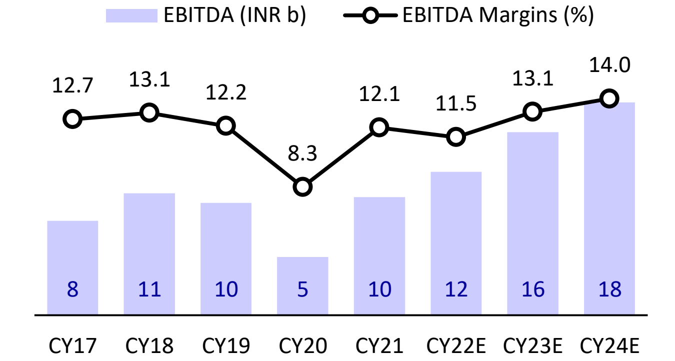
Story in charts

Exhibit 3: Consolidated revenue to recover



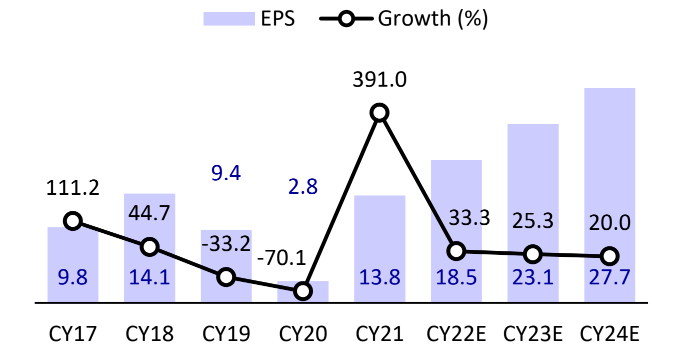
Source: MOFSL, Company

Exhibit 4: EBITDA margin to expand 190bp over CY21-24E



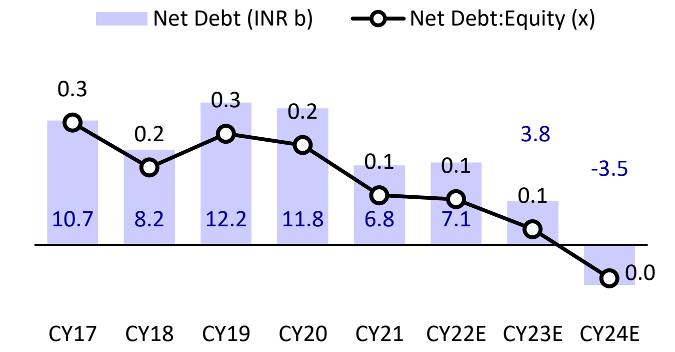
Source: MOFSL, Company

Exhibit 5: EPS to see ~26% CAGR over CY21-24E



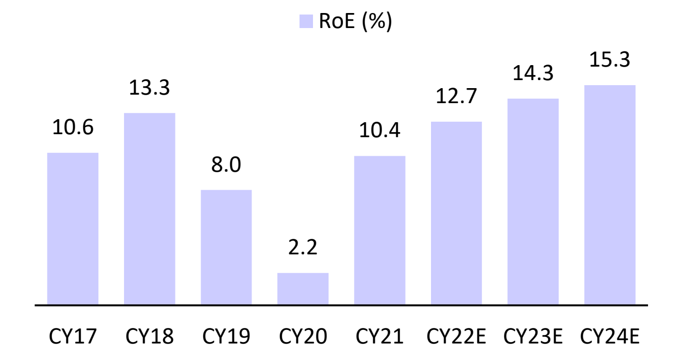
Source: MOFSL, Company

Exhibit 6: Expect net debt to fall substantially by CY23



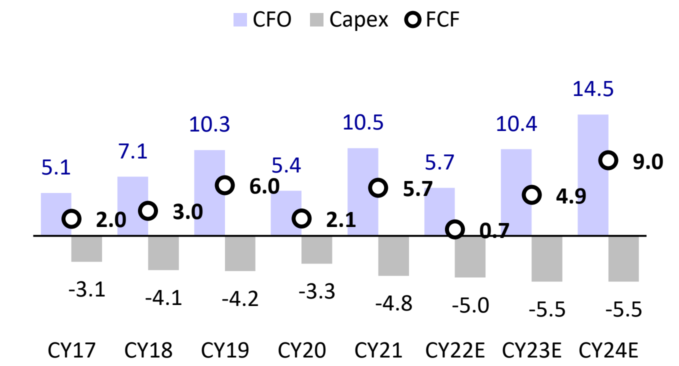
Source: MOFSL, Company

Exhibit 7: Expect consistent expansion in ROE over CY22-24



Source: Company, MOFSL

Exhibit 8: FCF positive throughout, except CY19, due to the AEL acquisition



Source: Company, MOFSL

Financials and valuations

Consolidated - Income Statement							(INR M)
Y/E December	**CY18**	**CY19**	**CY20**	**CY21**	**CY22E**	**CY23E**	**CY24E**
Total Income from Operations	**80,315**	**79,078**	**60,501**	**83,867**	**1,07,336**	**1,20,170**	**1,30,881**
Change (%)	24.9	-1.5	-23.5	38.6	28.0	12.0	8.9
Total Expenditure	**69,805**	**69,401**	**55,485**	**73,694**	**94,978**	**1,04,377**	**1,12,542**
% of Sales	86.9	87.8	91.7	87.9	88.5	86.9	86.0
EBITDA	**10,511**	**9,677**	**5,016**	**10,173**	**12,359**	**15,794**	**18,339**
Margin (%)	13.1	12.2	8.3	12.1	11.5	13.1	14.0
Depreciation	2,867	3,161	3,064	3,431	3,537	4,095	4,457
EBIT	**7,643**	**6,516**	**1,952**	**6,743**	**8,822**	**11,699**	**13,882**
Int. and Finance Charges	502	523	548	533	406	438	426
Other Income	387	331	549	556	875	640	724
PBT bef. EO Exp.	**7,529**	**6,324**	**1,953**	**6,766**	**9,291**	**11,901**	**14,180**
EO Items	-504	-46	0	-1,260	0	0	0
PBT after EO Exp.	**7,025**	**6,279**	**1,953**	**5,505**	**9,291**	**11,901**	**14,180**
Total Tax	2,043	2,741	886	1,589	2,340	3,186	3,720
Tax Rate (%)	29.1	43.7	45.4	28.9	25.2	26.8	26.2
Share of profit from associate	0	0	0	12	25	25	25
Reported PAT	**4,981**	**3,538**	**1,066**	**3,928**	**6,977**	**8,740**	**10,485**
Adj. PAT	**5,339**	**3,564**	**1,066**	**5,236**	**6,977**	**8,740**	**10,485**
Change (%)	44.7	-33.2	-70.1	391.0	33.3	25.3	20.0
Margin (%)	6.6	4.5	1.8	6.2	6.5	7.3	8.0

Consolidated - Balance Sheet							(INR M)
Y/E December	**CY18**	**CY19**	**CY20**	**CY21**	**CY22E**	**CY23E**	**CY24E**
Equity Share Capital	3,788	3,790	3,790	3,790	3,790	3,790	3,790
Total Reserves	39,103	42,548	45,290	48,176	53,722	60,714	69,102
Net Worth	**42,891**	**46,338**	**49,080**	**51,966**	**57,512**	**64,504**	**72,892**
Minority Interest	0	0	0	0	0	0	0
Total Loans	16,134	14,691	16,476	12,816	12,817	12,818	12,819
Deferred Tax Liabilities	-1,565	912	1,236	2,459	2,459	2,459	2,459
Capital Employed	**57,460**	**61,941**	**66,792**	**67,241**	**72,789**	**79,782**	**88,171**
Gross Block	32,235	42,936	53,135	57,335	61,484	66,984	72,484
Less: Accum. Deprn.	12,294	17,619	23,204	26,635	30,172	34,266	38,723
Net Fixed Assets	**19,941**	**25,316**	**29,931**	**30,700**	**31,312**	**32,717**	**33,760**
Goodwill on Consolidation	29,111	35,260	37,554	36,265	36,265	36,265	36,265
Capital WIP	960	542	123	150	1,001	1,001	1,001
Total Investments	**6,808**	**955**	**2,340**	**4,380**	**4,380**	**4,380**	**4,380**
Curr. Assets, Loans&Adv.	**26,455**	**23,553**	**23,686**	**26,712**	**35,853**	**42,691**	**53,106**
Inventory	12,286	10,566	10,062	13,486	15,613	16,872	18,192
Account Receivables	7,414	7,368	7,054	6,687	10,293	11,523	12,550
Cash and Bank Balance	1,127	1,499	2,380	1,595	1,361	4,683	11,894
Loans and Advances	5,628	4,120	4,190	4,943	8,587	9,614	10,470
Curr. Liability & Prov.	**25,815**	**23,686**	**26,843**	**30,965**	**36,021**	**37,272**	**40,341**
Account Payables	16,838	14,771	14,590	19,385	23,419	23,163	24,975
Other Current Liabilities	5,038	4,745	7,909	7,605	7,514	8,412	9,162
Provisions	3,939	4,170	4,344	3,976	5,088	5,697	6,205
Net Current Assets	**640**	**-133**	**-3,157**	**-4,253**	**-168**	**5,419**	**12,765**
Appl. of Funds	**57,460**	**61,941**	**66,792**	**67,241**	**72,789**	**79,782**	**88,171**

Financials and valuations

Ratios

Y/E December	CY18	CY19	CY20	CY21	CY22E	CY23E	CY24E
Basic (INR)							
EPS	**14.1**	**9.4**	**2.8**	**13.8**	**18.5**	**23.1**	**27.7**
Cash EPS	21.7	17.8	10.9	22.9	27.8	33.9	39.5
BV/Share	113.4	122.6	129.8	137.4	152.1	170.6	192.8
DPS	0.0	0.0	0.0	2.5	3.1	3.8	4.6
Payout (%)	0.0	0.0	0.0	24.1	17.0	16.7	16.7
Valuation (x)							
P/E	22.2	33.3	111.3	22.7	17.0	13.6	11.3
Cash P/E	14.5	17.7	28.7	13.7	11.3	9.2	7.9
P/BV	2.8	2.6	2.4	2.3	2.1	1.8	1.6
EV/Sales	1.7	1.7	2.2	1.6	1.2	1.1	0.9
EV/EBITDA	12.7	13.7	26.5	12.8	10.6	8.1	6.5
Dividend Yield (%)	0.0	0.0	0.0	0.8	1.0	1.2	1.5
FCF per share	7.9	15.9	5.4	15.1	1.9	12.8	23.8
Return Ratios (%)							
RoE	13.3	8.0	2.2	10.4	12.7	14.3	15.3
RoCE (Post-tax)	10.9	6.5	2.1	7.7	10.4	11.8	12.8
RoIC	11.5	6.8	1.8	7.8	10.4	12.6	14.6
Working Capital Ratios							
Fixed Asset Turnover (x)	2.5	1.8	1.1	1.5	1.7	1.8	1.8
Asset Turnover (x)	1.4	1.3	0.9	1.2	1.5	1.5	1.5
Inventory (Days)	56	49	61	59	53	51	51
Debtor (Days)	34	34	43	29	35	35	35
Creditor (Days)	77	68	88	84	80	70	70
Leverage Ratio (x)							
Net Debt/Equity	0.2	0.3	0.2	0.1	0.1	0.1	0.0

Consolidated - Cash Flow Statement **(INR M)**

Y/E December	CY18	CY19	CY20	CY21	CY22E	CY23E	CY24E
OP/(Loss) before Tax	7,025	6,279	1,953	6,778	9,316	11,926	14,205
Depreciation	2,898	3,168	3,064	3,431	3,537	4,095	4,457
Interest & Finance Charges	525	525	548	533	-469	-202	-298
Direct Taxes Paid	-1,444	-1,161	-503	-1,053	-2,340	-3,186	-3,720
(Inc)/Dec in WC	-1,769	1,556	761	1,364	-4,320	-2,266	-134
CF from Operations	**7,235**	**10,367**	**5,823**	**11,052**	**5,724**	**10,367**	**14,510**
Others	-155	-94	-430	-541	0	0	0
CF from Operating incl EO	**7,080**	**10,273**	**5,393**	**10,511**	**5,724**	**10,367**	**14,510**
(Inc)/Dec in FA	-4,101	-4,238	-3,343	-4,778	-5,000	-5,500	-5,500
Free Cash Flow	**2,979**	**6,035**	**2,050**	**5,733**	**724**	**4,867**	**9,010**
(Pur)/Sale of Investments	-6,201	-1,871	-1,376	-1,880	0	0	0
Others	129	219	502	-967	875	640	724
CF from Investments	**-10,173**	**-5,890**	**-4,217**	**-7,625**	**-4,125**	**-4,860**	**-4,776**
Issue of Shares	57	30	0	10	0	0	0
Inc/(Dec) in Debt	4,089	-3,545	506	-2,787	1	1	1
Interest Paid	-525	-525	-477	-318	-406	-438	-426
Dividend Paid	0	0	0	0	-1,187	-1,457	-1,747
Others	0	0	-409	-532	0	0	0
CF from Fin. Activity	**3,621**	**-4,040**	**-380**	**-3,627**	**-1,592**	**-1,894**	**-2,172**
Inc/Dec of Cash	**528**	**343**	**796**	**-740**	**8**	**3,613**	**7,561**
Opening Balance	719	1,247	1,590	2,386	1,646	1,654	5,267
Closing Balance	**1,247**	**1,590**	**2,386**	**1,646**	**1,654**	**5,267**	**12,828**

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall be within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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