Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Mahindra Logistics Ltd

Valuation factors transition; Upgrade to Buy

Logistics	Sharekhan code: MAHLOG	
Reco/View: Buy ↑	CMP: **Rs. 379**	Price Target: **Rs. 502** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↑	

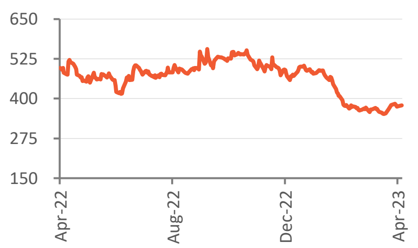
Company details

Market cap:	Rs. 2,728 cr
52-week high/low:	Rs. 567 / 350
NSE volume: (No of shares)	1.4 lakh
BSE code:	540768
NSE code:	MAHLOG
Free float: (No of shares)	3.0 cr

Shareholding (%)

Promoters	58.1
FII	15.6
DII	15.5
Others	10.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.3	-21.6	-27.9	-23.7
Relative to Sensex	0.0	-20.4	-30.5	-28.5

Sharekhan Research, Bloomberg

Summary

- We upgrade Mahindra Logistics Limited (MLL) to Buy with an unchanged PT of Rs. 502, considering the recent correction led by its transition phase providing buying opportunity.
- Our interaction with the management underscores its upbeat outlook on end-user demand in the medium-term barring e-commerce. Focus stays on margin expansion.
- 3PL business is expected to grow at 15-16% CAGR with focus on almost doubling share of high margin integrated 3PL revenues over the next five years.
- Key account downsizing in SCM has led to key learnings in terms of processes and capabilities. Express business consolidation to provide synergistic benefits.

We recently interacted with Mahindra Logistics Limited (MLL) management, which remained upbeat on end-user demand in the medium term barring e-commerce. The 3PL business (83% of SCM revenues and 79% of consolidated revenues in 9MFY2023) is expected to grow at 15-16% CAGR, focusing on increasing share of high-margin integrated 3PL revenues (target 40% of 3PL revenues over five years from current 20%+). The company is currently downsizing Bajaj Electricals account by 80% on mutually agreed terms where it has derived key takeaways in the form of learnings, processes and capabilities. It has also recently consolidated its express business in MSEPL (houses Rivigo's acquired B2B business), enabling benefits in terms of synergies, resource optimisation and enhanced customer services. MLL has corrected by 17% since we downgraded the stock to Hold in our report dated February 2, 2023. We believe the current valuation aptly factors in transitioning uncertainties providing opportunity to Buy. Hence, we upgrade to Buy with an unchanged PT of Rs. 502.

- **Target 15-16% CAGR in 3PL with a focus on solutions:** MLL would leverage its all India reach, integrated transport & warehousing offerings and technology platform to grow its 3PL business at 15-16% CAGR. Within 3PL, it would focus on solutions (integrated 3PL) and targets to increase share of solutions to 40% of the total 3PL revenues over the next five years from the current 20%+. The rise in share of integrated 3PL offerings along with cost optimisation is expected to improve gross margins of the overall 3PL business.
- **Lessons learned from Bajaj Electricals account:** MLL is downsizing the Bajaj Electricals SCM account (3-4% of consolidated revenues and 6-7% of non-M&M 3PL revenues) by ~80% on mutually agreed terms as the base design of SCM was no longer valid. It has already transitioned 60% of the networks, and the balance is expected to be completed by May 2023. The investments made in technology would be utilised for other clients. The company had achieved breakeven in its second year of operations. The key takeaways from the account were processes, learnings and capabilities.
- **Express business consolidation and Pune warehouse launch:** The company recently transferred its express business to MSEPL for lumpsum consideration of Rs. 20.8 crores (to be received as equity shares of MSEPL). MSEPL, which houses Rivigo's acquired B2B express business, would enable synergies, optimisation of resources and enhanced customer services. MLL and Ascendas-Firstspace are setting up of a new 1 msf of multi-client warehouse park in Talegaon, Pune. The entire development will be spread over three phases with the first phase of 0.5 msf to be operational by the end of FY2024.

Our Call

Valuation – Upgrade to Buy with an unchanged PT of Rs. 502: MLL remains focused on the turnaround of B2B express business of Rivigo consolidating its express business under MSEPL. Further, it targets to increase the share of solutions business in 3PL vertical, which would provide better margins. It remains upbeat on end-user demand on medium-term barring e-commerce with focus on expanding margins. It remains committed on adding 2-3msf warehousing capacities per annum. The stock has seen a correction of 17% since we downgraded the stock to Hold in our report dated February 2, 2023. We believe the current valuation at a P/E of 58x/34x its FY2024E/FY2025E earnings aptly factors its transitioning-related uncertainties providing an opportunity to Buy. Hence, we upgrade the stock to Buy with an unchanged PT of Rs. 502.

Key Risks

Weakness in the automobile industry's outlook is a critical downside risk to our call.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	4,140.8	5,260.2	6,521.8	7,500.1
OPM (%)	4.5	5.0	5.2	5.4
Adjusted PAT	17.6	30.8	46.7	80.2
% YoY growth	*(46.4)*	*75.1*	*51.8*	*71.9*
Adjusted EPS (Rs.)	2.4	4.3	6.5	11.2
P/E (x)	155.1	88.6	58.3	33.9
P/B (x)	4.1	3.9	3.7	3.3
EV/EBITDA (x)	13.6	9.4	7.4	6.1
RoNW (%)	3.0	5.1	7.2	11.3
RoCE (%)	4.8	8.8	10.6	13.8

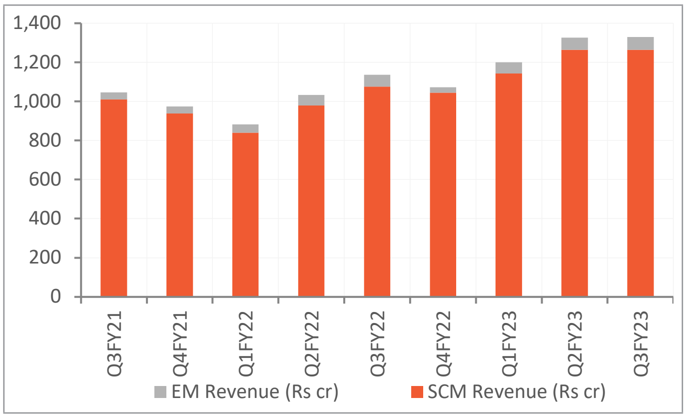
Source: Company; Sharekhan estimates

Key conference call takeaways

- **Outlook:** company remains upbeat on demand on medium-term barring e-commerce, which has seen contraction. It continues to work on margin expansion. The warehouse addition of 2-3msf p.a. remains intact.
- **Bajaj Electricals account:** The company is restructuring the contract with Bajaj Electricals by downsizing it by ~80% as the base design SCM was invalid. The transitioning would be done from February 2023 to May 2023 while it has already transitioned ~60% of the networks. The transition-related costs would be there. The account comprised 3-4% of the consolidated revenues and 6-7% of non-M&M 3PL revenues. The investment done in technology will be used for the long term for other clients. The key takeaways from the account were processes, learnings and capabilities.
- **Transfer of express business to MESPL:** The company on March 30, 2023, entered into a Business Transfer Agreement with MLL Express Services (MESPL), a wholly-owned subsidiary of the company, for transfer of the express network business of the company to MESPL, effective April 1, 2023, for a lump sum consideration of Rs. 20.8 crores to be discharged by MESPL through the issue of equity shares to the company. It expects the closure of the transfer by July 2023. The valuation related to the transfer of express business arrived considering DCF over five years, customer concentration, costs in building scale, and pin-code reach, among other things.
- **Pune warehouse launch:** The company and Ascendas-Firstspace (an industrial real estate developer) are setting up a new 1 million square feet of multi-client warehouse park in Talegaon, Pune. The entire development will be spread over three phases, with the first phase of 0.5 million sq. ft. to be operational by the end of FY2024. The company expects volumes to contribute at half the capacity from Q3FY2024. At peak capacity, it expects Rs. 75-80 crores revenues p.a. from the facility.
- **3PL outlook:** The 3PL segment is expected to grow at 15-16% CAGR. It would like to target solutions (integrated 3PL) to comprise 40% (currently 20% plus) over the next five years. Warehousing is less than 15% in M&M business and 30-35% in non-M&M business.
- **Network services outlook:** It targets Rs. 2500-3000 crore revenues.
- **Express business outlook:** The company anticipates EBITDA break-even by the end of H2FY2024 and be the positive zone by the FY2024 end.
- **Rivgo:** The integration of Rivigo's B2B express business is going quite well and is expected to be completed by H1FY2024.
- **Freight Forwarding outlook:** The freight forwarding business had been growing at 25-26% CAGR till FY2019. The segment contributes Rs. 1000 crore revenues and operates on 250 plus lanes. The freight forwarding revenues are expected to be lower compared to FY2022. The prices are expected to be bottoming out on some lanes. It would be focusing on volumes and charter services.

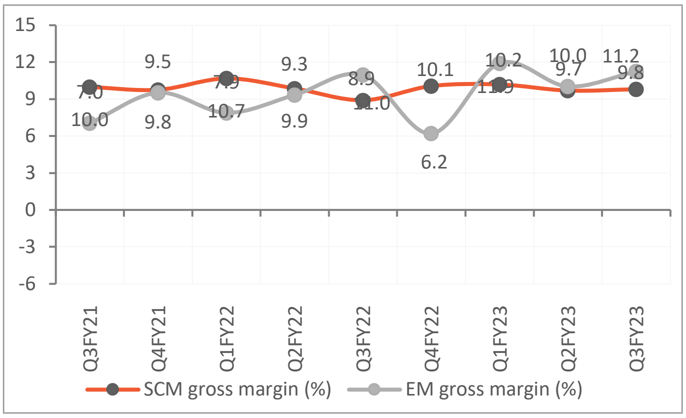
Financials in charts

Revenue Mix trend



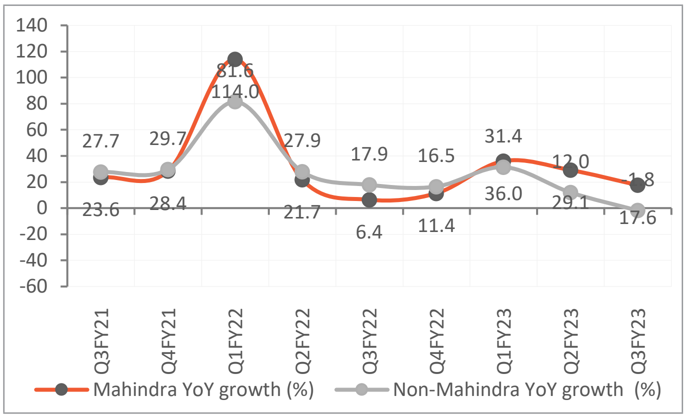
Source: Company, Sharekhan Research

SCM/EM gross margin trend



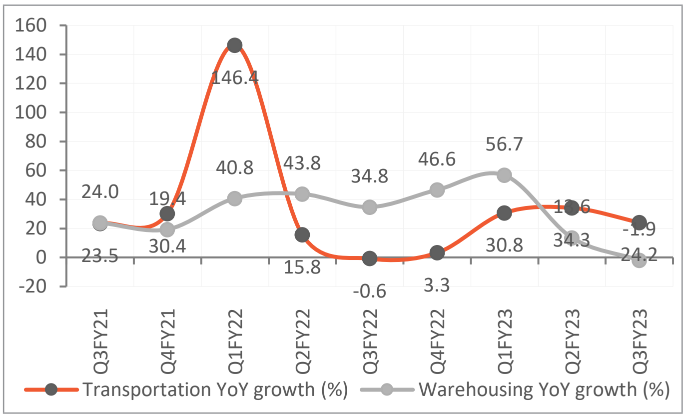
Source: Company, Sharekhan Research

M&M/Non-M&M growth trend



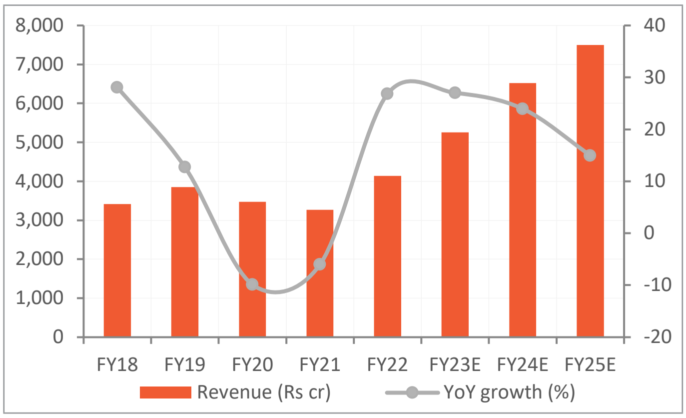
Source: Company, Sharekhan Research

Transportation/Warehousing growth trend



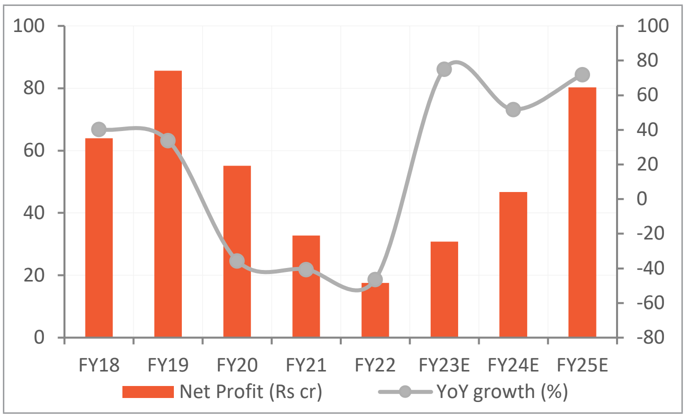
Source: Company, Sharekhan Research

Revenue trend



Source: Company, Sharekhan Research

Net Profit trend



Source: Company, Sharekhan Research

Outlook and Valuation

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

The logistics industry had been one of the key sectors which showed a strong revival post-COVID-19 pandemic that affected the overall trade environment 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 improved their business, led by user industries' preferences towards credible supply chain management in the wake of the impact of COVID-19 on supply chain operations. Further, the 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 of the sector.

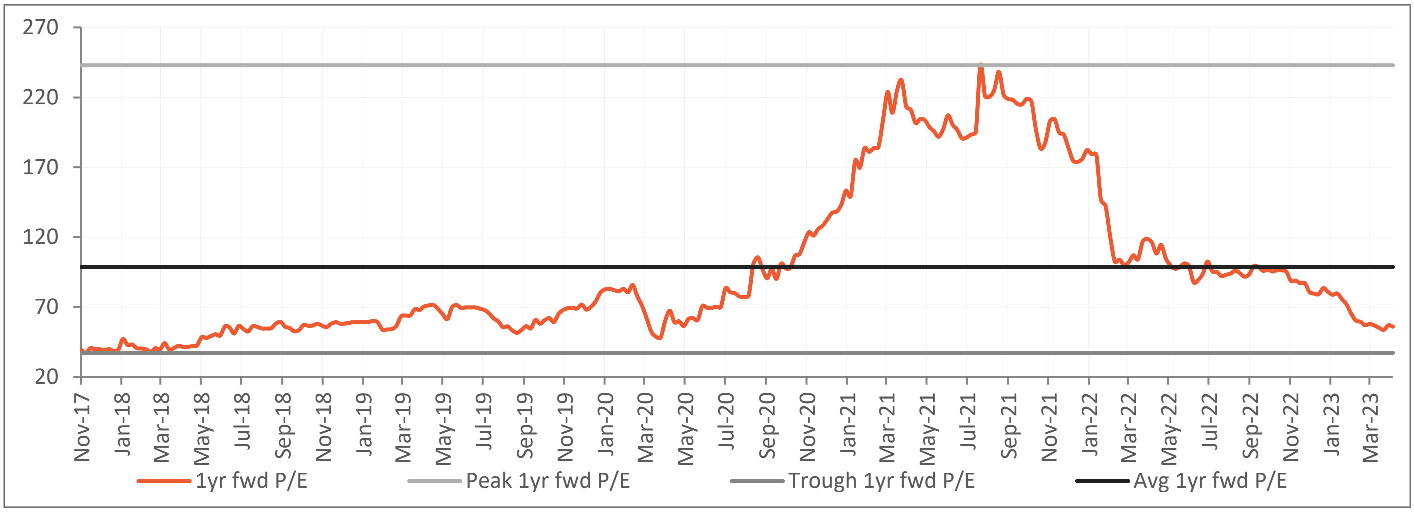
■ Company Outlook – Rivigo to delay growth acceleration

MLL had been on a strong earnings growth trajectory pre-acquisition of the B2B express business of Rivigo. The low margin profile of Rivigo, along with increased leverage to fund acquisition, has led to a downward revision in net earnings CAGR over the next two years than earlier envisaged. Further, its freight forwarding business is expected to recover over the next six months due to weak demand-supply dynamics in global economies. Its non-M&M SCM business is witnessing lower growth than earlier envisaged. Overall, we expect FY2024 to be a year of a turnaround for its newly acquired business, while growth acceleration is expected from FY2025 onwards.

■ Valuation – Upgrade to Buy with an unchanged price target of Rs. 502

MLL remains focused on the turnaround of B2B express business of Rivigo, consolidating its express business under MSEPL. Further, it targets to increase share of solutions business in 3PL vertical, which would provide better margins. It remains upbeat on end-user demand on medium-term barring e-commerce, with focus on expanding margins. It remains committed on adding 2-3msf warehousing capacities per annum. The stock has seen a correction of 17% since we downgraded the stock to Hold in our report dated February 2, 2023. The current valuation at a P/E of 58x/34x its FY2024E/FY2025E earnings aptly factors its transitioning-related uncertainties providing an opportunity to Buy. Hence, we upgrade the stock to Buy with an unchanged PT of Rs. 502.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Mahindra Logistics	58.3	33.9	7.4	6.1	3.7	3.3	7.2	11.3
TCI Express	33.1	27.5	23.4	19.4	7.9	6.3	27.0	25.8

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 over 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 an extensive network of business partners on lease rentals. At the same time, MLL largely invests in logistics technology. The company provides customised and technology-enabled solutions across the supply chain, and people transport operations.

Investment theme

MLL has gathered pace in both of its key verticals, viz. M&M SCM and non-M&M SCM businesses 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 the 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 the 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

Anish Shah	Chairman
Rampraveen Swaminathan	Chief Executive Officer & MD
Ruchie Khanna	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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