

## Monthly Manager Views

# FSSA Regional India Strategy

### Mahindra CIE Automotive: A transformation in progress

As with global automotive manufacturers, several Indian automotive original equipment manufacturers (OEMs) including Maruti Suzuki, Mahindra & Mahindra (M&M), Tata Motors and Eicher Motors have recently announced that the shortage of semiconductor supply has impacted their production schedules. This has added to the persistent challenges faced by the industry over the last few years. The introduction of new safety and emission regulations, higher insurance costs and an increase in road taxes in several states have raised vehicle ownership costs substantially over the last three years. A funding crisis among non-bank finance companies reduced financing available to buyers. The disruption from Covid-19 exacerbated the impact on industry sales. In fiscal year (FY) 2021, passenger vehicle sales in India were only 8% higher than a decade ago, while commercial vehicle sales have declined by 16% over a decade<sup>1</sup>.

We have found investing in high-quality suppliers to automakers, including bearing manufacturers, automotive paint companies and critical component suppliers, to be more attractive than investing in OEMs. One such component supplier which is a large holding in our portfolio is Mahindra CIE Automotive. We have followed the company for almost two decades, since the Mahindra Group acquired Amforge, a forgings manufacturer in which we were invested. Following this, the Mahindra Group acquired various other component suppliers in India as well as Europe and consolidated these businesses into Mahindra Systech. Many of its acquired entities had high cost structures and the company struggled with poor profitability. CIE Automotive of Spain acquired a controlling stake in Mahindra Systech in 2013 and merged its highly profitable European business with the company. The Mahindra Group's shareholding fell to 20% and the

### RISK FACTORS

This is a financial promotion for The FSSA India Strategy. This information is for professional clients only in the EEA and elsewhere where lawful. Investing involves certain risks including:

- **The value of investments and any income from them may go down as well as up and are not guaranteed. Investors may get back significantly less than the original amount invested.**
- **Currency risk:** the Fund invests in assets which are denominated in other currencies; changes in exchange rates will affect the value of the Fund and could create losses. Currency control decisions made by governments could affect the value of the Fund's investments and could cause the Fund to defer or suspend redemptions of its shares.
- **Indian subcontinent risk:** although India has seen rapid economic and structural development, investing there may still involve increased risks of political and governmental intervention, potentially limitations on the allocation of the Fund's capital, and legal, regulatory, economic and other risks including greater liquidity risk, restrictions on investment or transfer of assets, failed/delayed settlement and difficulties valuing securities.
- **Single country / specific region risk:** investing in a single country or specific region may be riskier than investing in a number of different countries or regions. Investing in a larger number of countries or regions helps spread risk.
- **Smaller companies risk:** Investments in smaller companies may be riskier and more difficult to buy and sell than investments in larger companies.

For a full description of the terms of investment and the risks please see the Prospectus and Key Investor Information Document for each Fund.

**If you are in any doubt as to the suitability of our funds for your investment needs, please seek investment advice.**

<sup>1</sup> Source: Society of Indian Automobile Manufacturers (SIAM)

company was renamed Mahindra CIE Automotive. We purchased a holding after this change in ownership.

Since it was founded, CIE Automotive has consolidated several global component suppliers through mergers & acquisitions (M&A). The management teams of the acquired entities are given operational autonomy, while CIE's financial discipline, focused on earning high returns on capital (20% return on net assets), consistent cash flows (60% of EBITDA<sup>2</sup> to be converted into operating cash flow) and low leverage, is imposed on all companies. This has been rewarding for shareholders. An investment in CIE has earned 19% annualised total shareholder returns (in USD terms) since it listed in 1995.

Ander Alvarez, who has led several CIE group companies since 2006, was appointed to lead the turnaround of Mahindra CIE as group CEO. The new management has led several changes to the business.

- As several small component suppliers have struggled amidst the weak industry environment, Mahindra CIE has gained substantial market share. Several large new customers such as Bajaj Auto and Maruti have been acquired. Its share of revenues from M&M and Tata Motors has declined from almost 30% in past years to around 15% now.
- The efficiency of Mahindra's Indian plants have improved significantly. Its plants in Europe which were structurally challenged were shut down. The company's operating margin has more than doubled from 4.6% in 2014 to 10% in 1H 2021 and its profit before tax (PBT) margin has improved from 2.2% to 9.3% over the same period. As automotive volumes normalise in India, there is potential for continued improvement in profitability from operating leverage.
- The company has also acquired high-quality businesses such as Bill Forge, a manufacturer of high-precision automotive components. These acquisitions have helped Mahindra CIE to gain new customers and products. With consistently strong cash flows, its Net Debt / EBITDA has declined from over 2x to below 1x despite the acquisitions.
- The company's return on net assets has increased to 12% from 4% in 2014. The management and its parent's target is to improve this to 20% in the coming years.

During our call with Ander Alvarez recently, we found him to be more confident about the company's prospects than he has ever been in the past. Mahindra CIE is now running its Indian factories at full capacity and expanding most of its businesses, backed by customer orders (as demand revives) and market share gains. Despite inflation in raw material costs, the management expects to continue improving its profitability as it cut costs aggressively over the last year. In this context, its valuation of 13x forward price-to-earnings (P/E) appears compelling to us. Its parent, CIE Automotive, seems to agree, having increased its stake in the company by almost 5% during the past year through market purchases. Its turnaround has taken longer than we expected due to the



challenges faced by the industry. But the company has grown stronger over this period, while its competitive environment has weakened. We believe it is now poised to reap the benefits of its transformation over the medium term.

## Performance commentary

The FSSA Indian Subcontinent strategy rose in August. The key contributors to performance were **Godrej Consumer Products, HDFC Bank** and **ICICI Bank**. Each of these is among the top five holdings of the strategy.

**Godrej Consumer Products Limited** rose after it reported growth of 24% in revenue and 38% in recurring profit in Q1 of FY 2022 compared to the same period last year. Its business in Africa which has struggled in recent periods is witnessing a substantial improvement in growth and profitability.

**HDFC Bank** benefited from the regulator's decision which allowed the lender to issue new credit cards. The regulator had previously directed the bank to stop issuing new credit cards after outages on its internet banking platform. The company's management has been investing aggressively to strengthen its technology infrastructure. This regulatory approval should improve the bank's growth prospects.

**ICICI Bank** rose after it reported strong quarterly results, with loan growth of 17% and lower provision costs which led to net profit growth of 78% in Q1 of FY 2022 compared to the same period last year.

The key detractors were **Mahindra CIE Automotive, Blue Star Limited** and **Bosch Limited**.

**Mahindra CIE Automotive** and **Bosch Limited** declined due to expectations of weaker growth following a shortage in the supply of semiconductors affecting production of major automotive OEMs.

**Blue Star** declined after it reported lower revenue and profit compared to the previous quarter due to the movement restrictions. The company has gained market share and raised prices across its product portfolio. Its growth and profitability should improve in the coming periods.

<sup>2</sup> Earnings before interest, taxation, depreciation and amortisation

**Composite Performance (to 31 August 2021)**

| Discrete 1 Year Returns    | 12mths to<br>31/08/21 | 12mths to<br>31/08/20 | 12mths to<br>31/08/19 | 12mths to<br>31/08/18 | 12mths to<br>31/08/17 |
|----------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| <b>Indian Subcontinent</b> | 51.80%                | 0.66%                 | -9.19%                | 7.99%                 | 21.35%                |
| <b>MSCI IN Gross</b>       | 53.70%                | 3.18%                 | -7.64%                | 7.12%                 | 17.46%                |

**These figures refer to the past. Past performance is not a reliable indicator of future results. For investors based in countries with currencies other than USD, the return may increase or decrease as a result of currency fluctuations.**

The strategy performance figures is the weighted average performance of FSSA IM's funds that contribute to the strategy in question, is based on monthly performances and are net of a default annual management fee of 0.85%. The strategy was launched 7 February 1994.

Source: Lipper IM / First Sentier Investors (UK) Funds Limited.

\* Company data retrieved from company annual reports or other such investor reports. Financial metrics and valuations are from FactSet and Bloomberg. As at 31 August 2021 or otherwise noted.

**Important Information**

This document has been prepared for informational purposes only and is only intended to provide a summary of the subject matter covered. It does not purport to be comprehensive or to give advice. The views expressed are the views of the writer at the time of issue and may change over time. This is not an offer document and does not constitute an offer, invitation or investment recommendation to distribute or purchase securities, shares, units or other interests or to enter into an investment agreement. No person should rely on the content and/or act on the basis of any material contained in this document.

This document is confidential and must not be copied, reproduced, circulated or transmitted, in whole or in part, and in any form or by any means without our prior written consent. The information contained within this document has been obtained from sources that we believe to be reliable and accurate at the time of issue but no representation or warranty, express or implied, is made as to the fairness, accuracy, or completeness of the information. We do not accept any liability whatsoever for any loss arising directly or indirectly from any use of this document.

References to “we” or “us” are references to First Sentier Investors a member of MUFG, a global financial group. First Sentier Investors includes a number of entities in different jurisdictions. MUFG and its subsidiaries do not guarantee the performance of any investment or entity referred to in this document or the repayment of capital. Any investments referred to are not deposits or other liabilities of MUFG or its subsidiaries, and are subject to investment risk including loss of income and capital invested.

If this document relates to an investment strategy which is available for investment via a UK UCITS but not an EU UCITS fund then that strategy will only be available to EU/EEA investors via a segregated mandate account.

In the United Kingdom, issued by First Sentier Investors (UK) Funds Limited which is authorised and regulated in the UK by the Financial Conduct Authority (registration number 143359). Registered office Finsbury Circus House, 15 Finsbury Circus, London, EC2M 7EB number 2294743. In the EEA, issued by First Sentier Investors (Ireland) Limited which is authorised and regulated in Ireland by the Central Bank of Ireland (registered number C182306) in connection with the activity of receiving and transmitting orders. Registered office: 70 Sir John Rogerson’s Quay, Dublin 2, Ireland number 629188. Outside the UK and the EEA, issued by First Sentier Investors International IM Limited which is authorised and regulated in the UK by the Financial Conduct Authority (registered number 122512). Registered office: 23 St. Andrew Square, Edinburgh, EH2 1BB number SCO79063.

Copyright © (2021) First Sentier Investors

All rights reserved.