

Date: 31 March, 2007

Every week, the ICICIdirect research team selects a stock based on fundamental and/or technical parameters, which is likely to give a return of 20% or more over a 3-6 month perspective.

Mahindra & Mahindra Ltd. (MAHMAH)

Current Price: Rs 777

Target Price: Rs 990

Potential upside: 27%

Time Frame: 3-6 mths

With new launches, rapidly growing core business, acquisition synergies and boost from its holdings in subsidiaries, the prospects for M&M look bright.

Background

Mahindra & Mahindra (M&M) is the flagship of the Mahindra Group. It has two main operating divisions. The auto division manufactures utility vehicles (UVs), light commercial vehicles (LCVs) and three-wheelers. The tractor division makes agricultural tractors and related implements. Other entities, spun-off into separate business groups, include hospitality, trade and financial services, auto components, IT, telecom and infrastructure development.

Investment Rationale

Growth momentum in core business to continue

M&M's core business is growing at rapid pace. The company regained its market share with the launch of Maxx pick-up variant. Till February 2007, the company reported overall 18% volume growth, with strong support from LCV sales (up 24%), 3-wheeler sales (up 52%), and Scorpio sales (up 16%). Its new launches with Renault and Ingenio are expected to drive future volume growth.

Tractor business growing at rapid pace

Tractor volumes grew 23% till February 2007 and are likely to cross the 1 million mark for FY07. Good GDP growth of over 8%, coupled with easy finance arrangements for farmers and good monsoons should keep the momentum going. Demand for tractors is expected to grow at a steady rate of 18-20% annually over a period of next 2-3 years (Crisil-Infac estimates). Further, the creation of additional irrigational potential of 2,400,000 hectares under the Bharat Nirman and Flagship Programme (BNFP) is expected to boost tractor demand. The intensifying demand for tractors would be met by increasing production from its own plants as well as from Punjab Tractors' plant.

Acquisitions to support top line growth

Acquisition of 67.9% stake in Jeco Holdings of Germany

M&M recently acquired a 67.9% stake in German forging company Jeco Holdings, which has production capacity of 100,000 tonnes of forged components across its 3 plants. It manufactures forgings for gear boxes, engines, axle parts, hubs, gears and piston heads catering to truck, bus and trailer market with leading original equipment manufacturers (OEMs) like Daimler Chrysler, ZF Group, MAN Nutzfahrzeuge, Volvo, Linde and Renault under customer portfolio. The acquisition would help M&M expand its auto component business in overseas market as well as selling its own products to these OEMs.

Stake acquisition in Punjab Tractors to boost top line

M&M recently acquired a 43.3% stake in Punjab Tractors (PTL). PTL also owns a 14% stake in Swaraj Mazda and 33% stake in Swaraj Engines. By acquiring 43.3% stake in PTL, the company brought the 'Swaraj' brand under its portfolio. The brand is very strong in northern India where M&M has minimal presence. Furthermore, PTL has strong models in 50 horsepower (HP) category, which are high-value, high-margin tractors. PTL's current capacity utilization is just 50% and higher utilization would add to revenues. M&M is likely to use the idle capacity to manufacture Mahindra tractors also. Apart from an established dealership network, PTL also has foundry with total capacity of 20,000 tpa, which would benefit M&M.

PTL's engine capacity of 30,000 engines per annum is also utilized only to the extent of 50%, which would be used by M&M's growing engine and genset business. PTL's strong vendor base would also help M&M control rising costs.

Subsidiaries growing at faster pace

M&M holds a 67.8% stake in Mahindra Finance, 43.3% in Tech Mahindra and 33.9% stake in Mahindra Gesco. These are leading players in fast-growing sectors like finance, technology and real estate development. We value its holdings in subsidiaries at Rs 438 per share.

Financials

The company reported a 23.1% growth in net sales to Rs 7,302.8 crore with robust net profit expansion of 55% to Rs 832.3 crore in 9MFY07 on the back of surging volumes from both auto and tractor segments. We expect it to report net sales of over Rs 9,500 crore and net profit of Rs 1,000 crore in FY07, translating into an EPS of Rs 42 per share.

Key Financial Ratios					
	2006/03	2005/03	2004/03	2003/03	2002/03
EPS	36.72	45.92	30.04	12.55	10.34
CEPS	45.3	62.42	45.32	27.23	23.28
Book Value	124.06	178.95	151.73	133.98	128.26
Dividend/Share	10	13	9	5.5	5
OPM	10.71	10.9	10.47	8.21	8.29
RONW	20.77	24.79	17.53	5.82	7.81
Debt/Equity	0.3	0.52	0.41	0.73	0.92
Ratio	1.24	1.19	0.99	1.26	1.46
Interest Cover	39.6	29.94	8.46	3.68	3.12

Valuation

The potential growth in the automobile industry would give the necessary fillip to the company. The better-than-expected performance in the tractor segment is expected to further improve the performance of the company. The company is well positioned to grab a higher market share in various segments. At the current price of Rs 777, the stock is attractively valued at 18.5x FY07E and 16.9x FY08E EPS. With the new launches, rapidly growing core business, acquisition synergies and boost from its holdings in Mahindra Finance and Tech Mahindra, its prospects of the company look promising. We expect the stock to touch around Rs 990, with its holdings in subsidiary companies valued at around Rs 438 per share.



Technical Outlook

The stock has formed a long-term support at the Rs 720 levels. Its correction from the Rs 1,000 levels to Rs 720 has retraced 50% of the rally from Rs 458 to Rs 1,000. The stock is now consolidating in a triangular pattern and a breakout is shortly awaited. The RSI and MACD indicators remain in oversold zones, making it attractive to accumulate with low risk. The short-term resistance is at Rs 810 and a breakout should take it above the Rs 900 levels.

ICICIdirect Research Desk

ICICI Brokerage Services Limited,
 2nd Floor, Stanrose House,
 Appasaheb Marathe Road,
 Prabhadevi, Mumbai - 400 025
research@icicidirect.com

DISCLAIMER: The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Brokerage Services Limited. "The author of the report does not hold any investment/open position in any of the companies mentioned in this report. ICICI Brokerage Services Limited (IBSL) may be holding a small number of shares/ an open position in the above referred companies as on the date of release of this report." This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and may not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgement by any recipient. The recipient should independently evaluate the investment risks. IBSL and affiliates accept no liabilities for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Actual results may differ materially from those set forth in projections. IBSL may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject IBSL and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.