

## Equities

8 August 2011 | 15 pages

# Mahindra & Mahindra (MAHM.BO)

## 1QFY12 Results Beat Estimates

- Company Update
- Target Price Change
- Estimate Change

■ **1QFY12 PAT at ~Rs 6.05bn was ~8% above our estimates** — the first beat after 2 consecutive Qs of misses. The beat was driven at the EBITDA level - ~8% ahead of estimates, as EBITDA margins of 13.3% exceeded estimates by ~80bps and rose 60bps Q/Q. Interestingly, material costs rose ~115bps Q/Q to 71.8% of net revenues - almost 60bps ahead of estimates. Lower SG&A expenses contributed to the positive variance. Mgmt noted in the conference call that if one were to look at M&M + MVML in aggregate, the margins are 14.2% - down ~100bps Y/Y - of which 60bps is attributed to the change in the ruling on VAT on vehicles manufactured at MVML.

■ **Segmentally, both tractors and UVs showed slight contraction in margins** — tractor/UV margins were 16%/10.7% respectively – down ~100bps/flattish Q/Q respectively. Mgmt attributed the slippage in tractors to rising input costs (especially steel, castings and rubber). Encouragingly, outlook for input costs is stable, and with ~1.5-2% price hikes undertaken, we expect commodity cost pressures to reverse from 2HFY12. Within tractors, mgmt explained capital employed rose on account of rising inventories to meet demand post monsoons – we note the Q/Q increase of 25% deviates from trends witnessed the last 3 years, and believe this number will require monitoring, especially in the context of a slightly weaker macro environment.

■ **Other conference call takeaways** — i) **Capex:** mgmt maintained broad capex guidance of Rs50bn over the next 3 years, ii) **Key new model initiatives** this fiscal: a new SUV, & 2 new variants of the Verito, iii) **balance sheet** is healthy; debt equity is ~0.2x.

■ **Volume outlook maintained, for now**— volume guidance for tractors remains at ~11-13%. For UVs, guidance is ~10% – no meaningful change vs. 4Q11, and fairly healthy in the context of a challenging macro outlook. Competitive intensity remains high in UVs, but less so in tractors – though John Deere has gained market share (~10% in 1Q12 vs. 8.8% in 1Q11, aided by launch of Krish series in the 30-40hp space).

■ **Maintain Buy; Revise TP to Rs767** — Key risk to our thesis is decelerating volumes, given decelerating economic growth in India.

<b>Buy/Low Risk</b>	<b>1L</b>
Price (08 Aug 11)	Rs666.00
Target price	Rs767.00
	<i>from Rs757.00</i>
Expected share price return	15.2%
Expected dividend yield	1.8%
<b>Expected total return</b>	<b>17.0%</b>
Market Cap	Rs408,907M
	US\$9,144M

### Price Performance (RIC: MAHM.BO, BB: MM IN)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2010A	19,970	34.00	122.3	19.6	4.8	30.5	1.4
2011A	24,961	42.50	25.0	15.7	3.8	27.5	1.8
2012E	26,606	43.33	2.0	15.4	3.1	23.3	1.8
2013E	31,787	51.77	19.5	12.9	2.7	23.3	2.2
2014E	37,026	60.31	16.5	11.0	2.3	23.2	2.5

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
<b>Valuation Ratios</b>					
P/E adjusted (x)	19.6	15.7	15.4	12.9	11.0
EV/EBITDA adjusted (x)	12.9	10.5	9.1	7.3	6.2
P/BV (x)	4.8	3.8	3.1	2.7	2.3
Dividend yield (%)	1.4	1.8	1.8	2.2	2.5
<b>Per Share Data (Rs)</b>					
EPS adjusted	34.00	42.50	43.33	51.77	60.31
EPS reported	35.55	45.33	43.33	51.77	60.31
BVPS	138.31	175.61	213.69	250.53	293.46
DPS	9.36	12.02	12.13	14.50	16.89
<b>Profit &amp; Loss (RsM)</b>					
Net sales	185,888	234,944	282,526	332,413	384,591
Operating expenses	-160,044	-204,521	-249,925	-293,602	-339,519
<b>EBIT</b>	<b>25,845</b>	<b>30,423</b>	<b>32,601</b>	<b>38,811</b>	<b>45,072</b>
Net interest expense	-1,569	-709	-1,022	-736	-263
Non-operating/exceptionals	4,191	5,482	3,895	4,307	4,559
<b>Pre-tax profit</b>	<b>28,468</b>	<b>35,196</b>	<b>35,474</b>	<b>42,382</b>	<b>49,368</b>
Tax	-7,590	-8,575	-8,869	-10,596	-12,342
Extraord./Min.Int./Pref.div.	0	0	0	0	0
<b>Reported net income</b>	<b>20,878</b>	<b>26,621</b>	<b>26,606</b>	<b>31,787</b>	<b>37,026</b>
Adjusted earnings	19,970	24,961	26,606	31,787	37,026
Adjusted EBITDA	29,552	34,562	37,486	44,746	52,056
<b>Growth Rates (%)</b>					
Sales	41.6	26.4	20.3	17.7	15.7
EBIT adjusted	222.6	17.7	7.2	19.0	16.1
EBITDA adjusted	170.5	17.0	8.5	19.4	16.3
EPS adjusted	122.3	25.0	2.0	19.5	16.5
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>20,467</b>	<b>34,173</b>	<b>38,041</b>	<b>43,387</b>	<b>49,265</b>
Depreciation/amortization	3,708	4,139	4,884	5,934	6,984
Net working capital	-4,119	3,413	6,551	5,666	5,254
<b>Investing cash flow</b>	<b>-14,708</b>	<b>-40,103</b>	<b>-24,971</b>	<b>-20,934</b>	<b>-21,984</b>
Capital expenditure	-8,592	-10,830	-12,174	-20,934	-21,984
Acquisitions/disposals	0	0	0	0	0
<b>Financing cash flow</b>	<b>-6,957</b>	<b>-6,503</b>	<b>-6,941</b>	<b>-20,146</b>	<b>-22,868</b>
Borrowings	-11,726	-4,749	-2,695	-10,000	-11,050
Dividends paid	-6,238	-8,026	-8,493	-10,146	-11,819
<b>Change in cash</b>	<b>-1,198</b>	<b>-12,433</b>	<b>6,129</b>	<b>2,306</b>	<b>4,412</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>161,438</b>	<b>198,406</b>	<b>235,165</b>	<b>258,673</b>	<b>289,952</b>
Cash & cash equivalent	17,432	6,146	12,275	14,581	18,993
Accounts receivable	12,581	13,547	19,539	18,429	21,373
Net fixed assets	37,027	43,719	51,008	66,008	81,008
<b>Total liabilities</b>	<b>83,170</b>	<b>95,272</b>	<b>109,672</b>	<b>111,539</b>	<b>117,611</b>
Accounts payable	32,601	45,940	63,778	66,991	77,440
Total Debt	28,802	24,053	21,358	11,358	309
<b>Shareholders' funds</b>	<b>78,268</b>	<b>103,134</b>	<b>125,493</b>	<b>147,134</b>	<b>172,341</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	15.9	14.7	13.3	13.5	13.5
ROE adjusted	30.5	27.5	23.3	23.3	23.2
ROIC adjusted	46.7	44.9	46.3	47.2	42.9
Net debt to equity	14.5	17.4	7.2	-2.2	-10.8
Total debt to capital	26.9	18.9	14.5	7.2	0.2

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## Healthy 1QFY12 Results: Maintain Buy; Revise TP to Rs767

M&M's 1QFY12 PAT exceeded our estimates by ~8%. EBITDA beat of ~8%, was driven primarily by lower SG&A expenses – compensating for ~115bps QoQ increase in input costs. Higher inventory levels in the tractors segment resulted in lower RoCE, while cost pressures (especially steel, castings and rubber) resulted in subdued EBIT margin.

Figure 1. Mahindra & Mahindra -- Volumes/Earnings Revisions

	Old		New			Deviation	
	FY2012E	FY2013E	FY2012E	FY2013E	FY14E	FY2012E	FY2013E
UV Volumes	284,332	327,897	268,420	314,947	357,027	-5.6%	-3.9%
LCVs	50,000	60,000	50,000	60,000	75,000	0.0%	0.0%
Tractors	241,630	266,377	246,474	271,800	299,761	2.0%	2.0%
3 Wheelers	78,456	87,871	84,280	96,079	109,531	7.4%	9.3%
<b>Total Volumes</b>	<b>654,418</b>	<b>742,145</b>	<b>649,173</b>	<b>742,826</b>	<b>841,319</b>	<b>-0.8%</b>	<b>0.1%</b>
<b>Net Revenues</b>	<b>278,795</b>	<b>323,427</b>	<b>282,526</b>	<b>332,413</b>	<b>384,591</b>	<b>1.3%</b>	<b>2.8%</b>
<b>EBITDA</b>	<b>38,093</b>	<b>44,459</b>	<b>37,486</b>	<b>44,746</b>	<b>52,056</b>	<b>-1.6%</b>	<b>0.6%</b>
EBITDA Margin (%)	13.7%	13.7%	13.3%	13.5%	13.5%		
PBT	35,727	41,818	35,474	42,382	49,368	-0.7%	1.4%
Tax (Rs)	8,574	10,036	8,869	10,596	12,342	3.4%	5.6%
<b>PAT</b>	<b>27,153</b>	<b>31,781</b>	<b>26,606</b>	<b>31,787</b>	<b>37,026</b>	<b>-2.0%</b>	<b>0.0%</b>
PAT Margin (%)	9.7%	9.8%	9.4%	9.6%	9.6%		
<b>Fully Diluted EPS (ex dividends from subsidiaries)</b>	<b>44.0</b>	<b>51.9</b>	<b>41.2</b>	<b>49.7</b>	<b>58.2</b>	<b>-6.4%</b>	<b>-4.3%</b>

Source: Citi Investment Research and Analysis estimates

We revise our target price for M&M to Rs767 from Rs757. We value M&M's core business at Rs623 based on 10.5x March 13E CEPS (roll forward from 10.5x Sept 12e CEPS). We assign a value of Rs144 to M&M's listed subsidiaries, based on 25% holding company discount to market price.

Figure 2. Mahindra & Mahindra: Sum-of-the-Parts Valuation

<b>Core Business at 10.5x March 13E CEPS</b>	<b>Rs 623</b>
<b>Listed Subsidiaries at 25% discount to market price</b>	
Tech Mahindra	Rs 53
M&M Financial Services	Rs 48
Mahindra Forge	Rs 4
Mahindra Life space	Rs 9
Mahindra Holidays	Rs 31
<b>Total Subsidiaries</b>	<b>Rs 144</b>
<b>SOTP Valuation for Mahindra and Mahindra</b>	<b>Rs 767</b>

Source: Citi Investment Research and Analysis

Figure 3. Mahindra and Mahindra: Volume Trends

	1QFY11	4QFY11	1QFY12	% Chg YoY	% Chg QoQ
Passenger UVs	38,862	46,678	44,407	14.3%	-4.9%
4 Wheel pick-ups (incl Gio +Maxximo)	22,994	31,616	31,056	35.1%	-1.8%
3-wheelers	12,168	17,671	14,058	15.5%	-20.4%
LCVs	2,978	2,802	2,952	-0.9%	5.4%
Exports (Auto sector)	3,125	5,158	5,717	82.9%	10.8%
Logan	1,966	3,693	3,807	93.6%	3.1%
<b>Auto division</b>	<b>82,093</b>	<b>107,618</b>	<b>101,997</b>	<b>24.2%</b>	<b>-5.2%</b>
Tractors (Dom + Exp)	50,148	59,388	60,152	19.9%	1.3%
<b>Total</b>	<b>132,241</b>	<b>167,006</b>	<b>162,149</b>	<b>22.6%</b>	<b>-2.9%</b>

Source: Company

Figure 4. Mahindra and Mahindra: 1QFY12 Results (Rs mn)

	1QFY11	4QFY11	1QFY12	% Chg YoY	% Chg QoQ	CIRA Comments
Gross Sales	56,430	73,438	72,694	28.8%	-1.0%	
Less: Excise duty	4,829	5,657	5,359	11.0%	-5.3%	
<b>Net sales</b>	<b>51,601</b>	<b>67,782</b>	<b>67,335</b>	<b>30.5%</b>	<b>-0.7%</b>	<b>~1% above estimates. Reflects price hike undertaken by the company on both tractors and UVs in 1Q</b>
Decrease/(Increase) in Stocks 694	(633)	(2,583)				
Raw Materials	35,211	48,515	50,919	34.6%	0.9%	~2% above estimates
Staff costs	3,137	4,261	4,034	28.6%	-5.3%	~6% below estimates. Includes Rs 265mn additional charge on account of amortization of ESOPs
Other Expenses	4,803	7,020	5,992	24.7%	-14.6%	~8% below estimates
<b>Total Expenditure</b>	<b>43,845</b>	<b>59,163</b>	<b>58,362</b>	<b>33.1%</b>	<b>-1.4%</b>	
<b>EBITDA</b>	<b>7,756</b>	<b>8,619</b>	<b>8,973</b>	<b>15.7%</b>	<b>4.1%</b>	<b>~8% above estimates. Reflects lower than expected employee costs and SG&amp;A expense</b>
Interest	(227)	(158)	(20)			
Other income	205	474	249	21.4%	-47.5%	
EBDT	8,188	9,251	9,242	12.9%	-0.1%	
Depreciation	976	1,171	1,099	12.6%	-6.1%	~8% below estimates
PBT	7,211	8,080	8,143	12.9%	0.8%	
Exceptionals						
Tax	1,588	2,015	2,095	31.9%	3.9%	
<b>PAT</b>	<b>5,624</b>	<b>6,065</b>	<b>6,049</b>	<b>7.6%</b>	<b>-0.3%</b>	<b>~8% above estimates</b>
<b>Profit Margins</b>						
EBITDA Margin (%)	15.0	12.7	13.3			
Pre tax margins (%)	12.8	11.0	11.2			
Tax / PBT (%)	22.0	24.9	25.7			
Net profit margins (%)	10.9	8.9	9.0			
<b>Cost ratios (Net sales)</b>						
Raw materials / sales	69.6	70.6	71.8			
Staff costs / sales	6.1	6.3	6.0			
Other expenses / sales	9.3	10.4	8.9			

Source: Company, Citi Investment Research and Analysis

## Conference call takeaways

**Industry growth expected to be sluggish**—Mgmt expects the domestic UV industry to grow at a modest 10% in FY12, reflecting impact of higher interest rates and fuel price hikes on demand growth. Volume growth guidance for the tractor industry is slightly higher at 11-13%. Mgmt expects M&M volumes to grow in line or slightly higher than overall industry volumes. In terms of competition, mgmt conceded that competition in the UV segment is increasing. Within the tractor segment, there is no significant

product from incumbents or newcomers which could impact M&M's market share - the last significant launch was the Krish tractor series from John Deere in 2QFY11. Mgmt also expects commodity cost pressure to turn more benign, which should help margins going forward – especially in the tractors segment where raw material cost/sales are higher (lower extent of value addition).

**Demand scenario appears favorable** — with waitlist for the Bolero, Scorpio and pickups (Maxximo+Gio). Notably, the sales from MVML increased from 5,700 in 1QFY11 to 17,700 in 1QFY12, buoyed by high demand for the different variants of Maxximo and Gio. The new models launched in 1QFY12 viz. Genio DC, Scorpio EX, Maxximo Cab and Verito had received positive customer feedback, per mgmt. In the farm equipment segment, Arjun is in high demand while demand for the Yuvraj has also increased post its launch in Tamil Nadu, Andhra Pradesh and Karnataka (capacity will increase from the current 1,000/ month to 1,500 / month Fy12 end). However, demand for MHCVs from the Mahindra-Navistar JV remains lackluster with monthly sales of ~200 MHCVs/ month. Mgmt noted that new product acceptability in the truck market was slower and expected demand to pick up once potential customers get favorable feedback from owners.

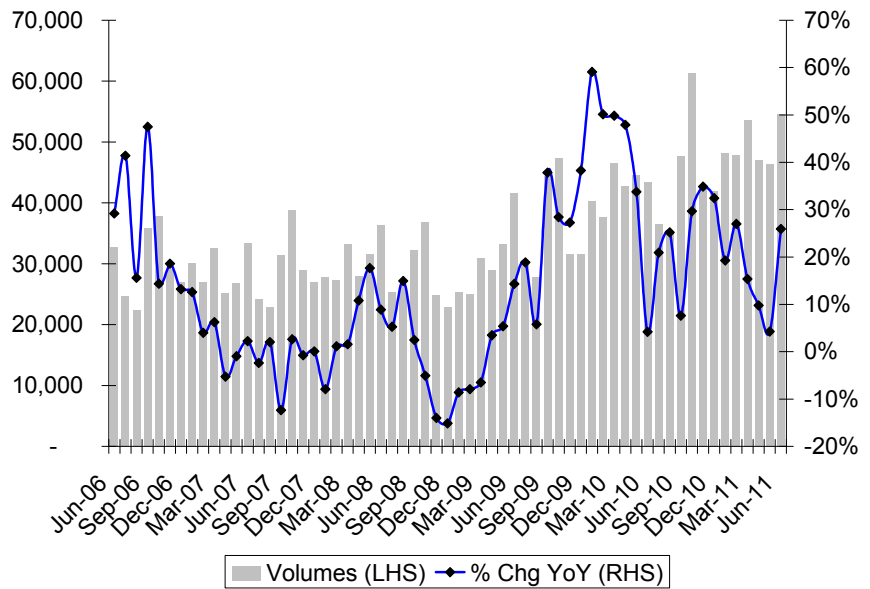
**Pricing environment is positive** — M&M undertook price hikes of 1.5-2% on UVs and tractors in 1Q and followed it by similar hike on Swaraj tractors in July. Per mgmt, while this was more aggressive than its peers, it was necessitated by mounting raw material cost pressures. Mgmt also said that despite passing on the entire cost increase to the customers through price hikes, margins were impacted as the company did not make any profit on the additional revenue (due to price hikes).

**Change Tax Incentive structure at Chakan to impact MVML** — The change in the tax incentive to M&M's Chakan operations is expected to impact M&M as well as MVML profits. Per mgmt, EBITDA margins would be impacted by 60-80bps due to the new incentive structure. However, mgmt appeared optimistic over the possibility of a favorable solution to the dispute.

**AP plant to resolve capacity constraints in tractor segment** — Mgmt said that currently, M&M has ~100% capacity utilization in the tractors segment, while noting that higher inventory build up was to cater to peak demand in Sept –Oct (higher inventory resulted in subdued RoCE for the farm equipment segment). The new plant in Telangana, Andhra Pradesh, is expected to start production in 12 months, and will ease supply constraints (and reduce capacity utilization levels).

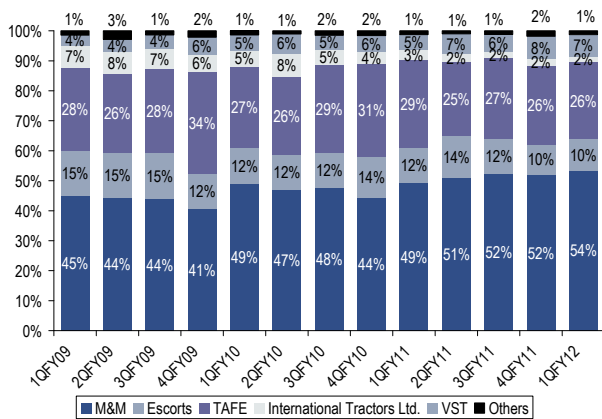
**Mgmt positive on new model launches and Ssangyong**—Mgmt expressed optimism on new model launches planned in FY12 and 1QFY13- **1)** New SUV (W201), **2)** 2 new versions of Verito (old Logan) by end FY12, **3)** New model from Ssangyong portfolio in 1QFY13, and **4)** Electric vehicle from the Reva series in 1QFY13

Figure 5. Indian Tractor Industry: Volume Trends



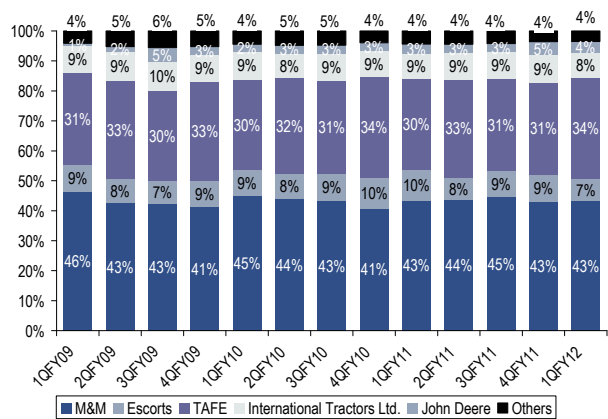
Source: CMIE IAS, Citi Investment Research and Analysis

Figure 6. Tractor OEMs Market Share: up to 30HP



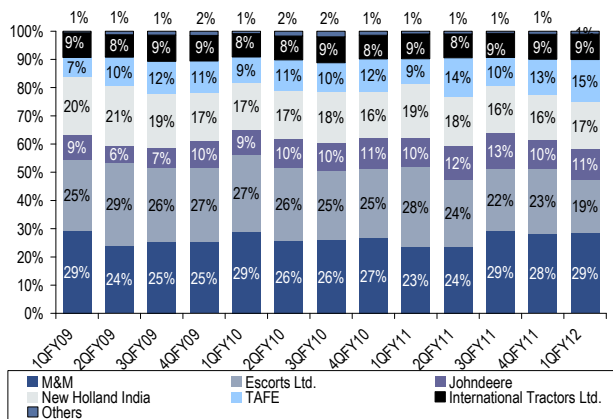
Source: CMIE IAS, Citi Investment Research and Analysis

Figure 7. Tractor OEMs Market Share: 31-40HP



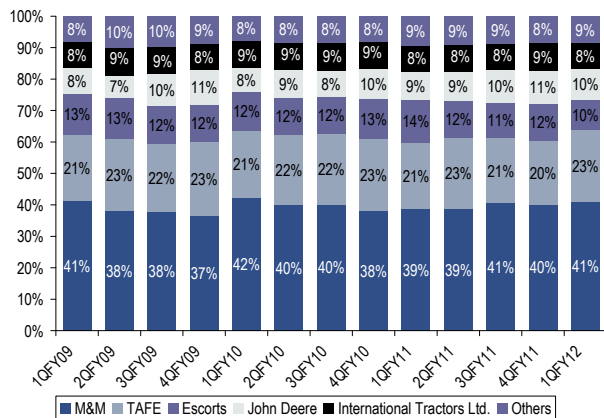
Source: CMIE IAS, Citi Investment Research and Analysis

Figure 8. Tractor OEMs Market Share: 41-50HP



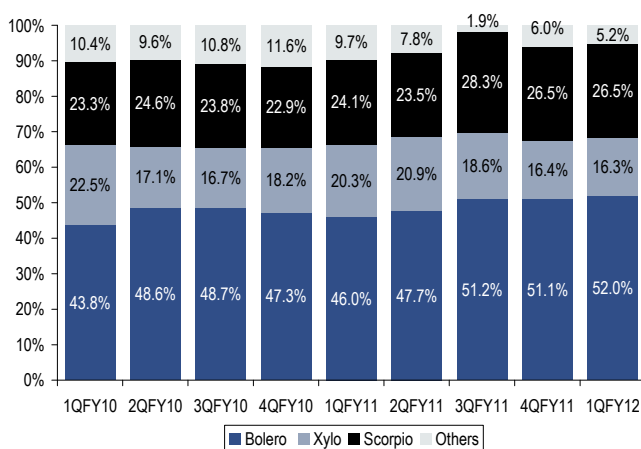
Source: CMIE IAS, Citi Investment Research and Analysis

Figure 10. Tractor OEMs Market Share: Overall



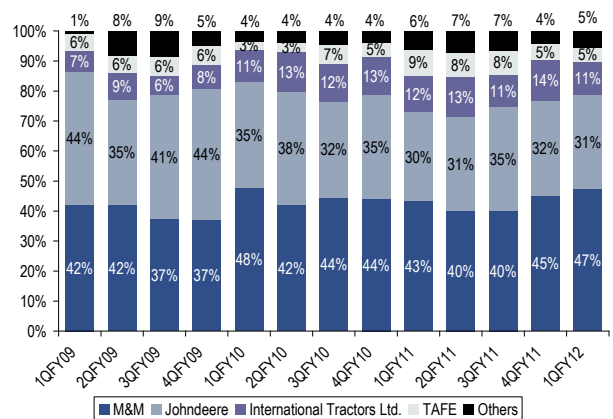
Source: CMIE IAS, Citi Investment Research and Analysis

Figure 12. Mahindra and Mahindra: Model-mix in Domestic UV Sales



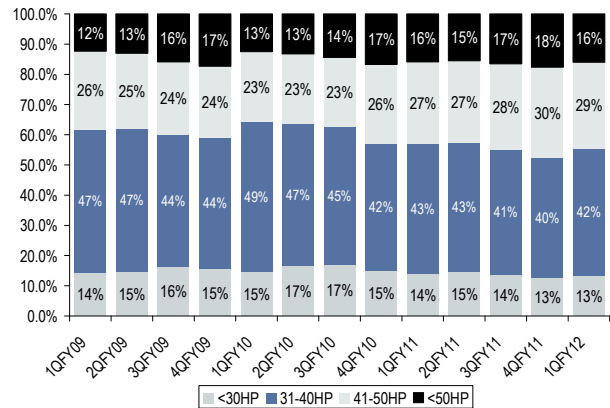
Source: CRISIL, Citi Investment Research and Analysis

Figure 9. Tractor OEMs Market Share: above 50HP



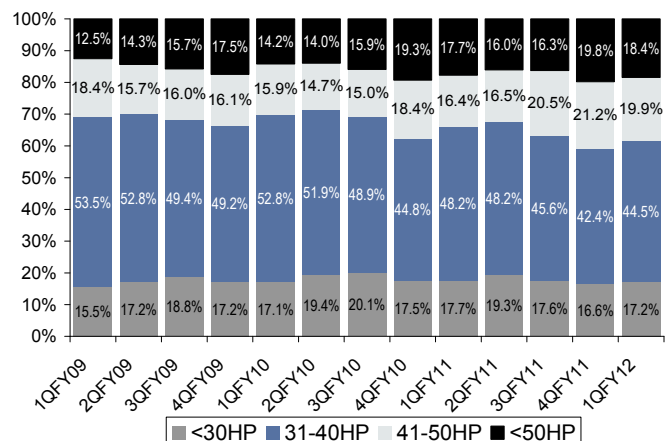
Source: CMIE IAS, Citi Investment Research and Analysis

Figure 11. Indian Tractor Industry: Product Mix



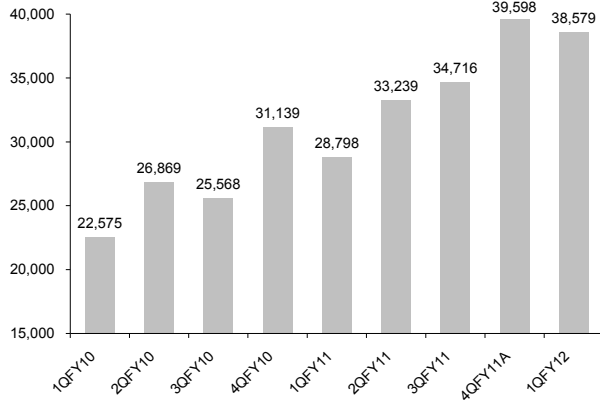
Source: CMIE IAS, Citi Investment Research and Analysis

Figure 13. Mahindra and Mahindra Tractors : Product Mix



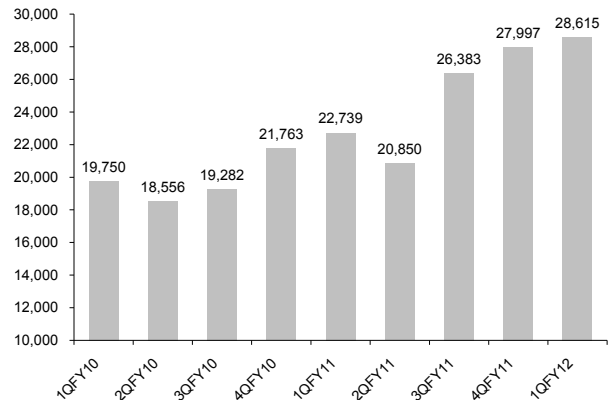
Source: CMIE IAS, Citi Investment Research and Analysis

Figure 14. M&M : Automotive Segment Revenue (Rs m)



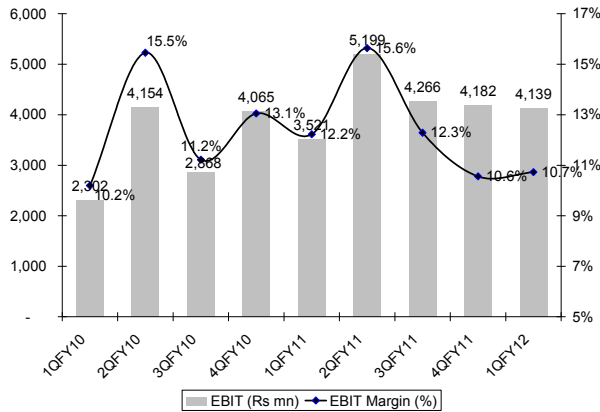
Source: Company, Citi Investment Research and Analysis

Figure 15. M&M : Farm Equipment Segment Revenue (Rs m)



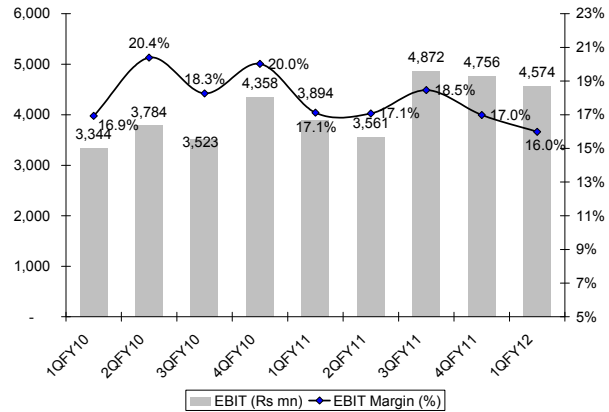
Source: Company, Citi Investment Research and Analysis

Figure 16. M&M : Automotive Segment EBIT Trend



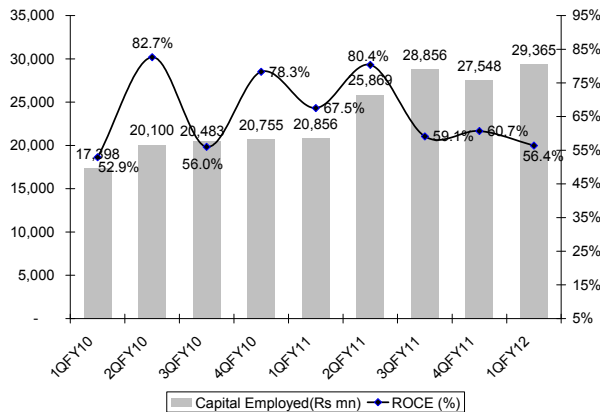
Source: Company, Citi Investment Research and Analysis

Figure 17. M&M : Farm Equipment Segment EBIT Trend



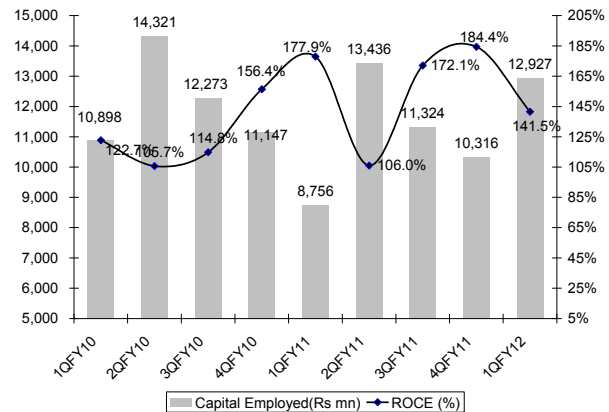
Source: Company, Citi Investment Research and Analysis

Figure 18. M&M : Automotive Segment ROCE Trend



Source: Company, Citi Investment Research and Analysis

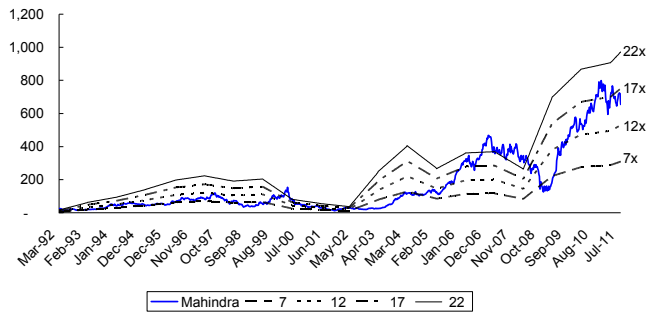
Figure 19. M&M : Farm Equipment Segment ROCE Trend



Source: Company, Citi Investment Research and Analysis

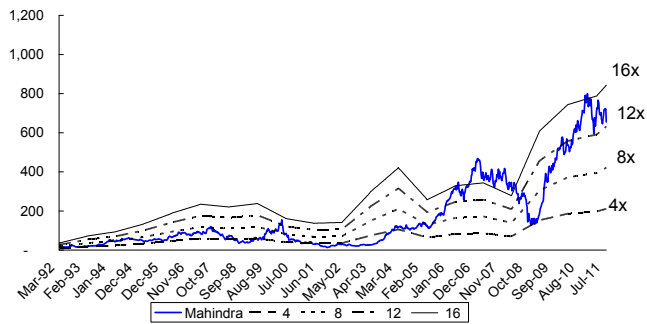


Figure 20. M&M: 1 yr fwd P/ EPS (x)



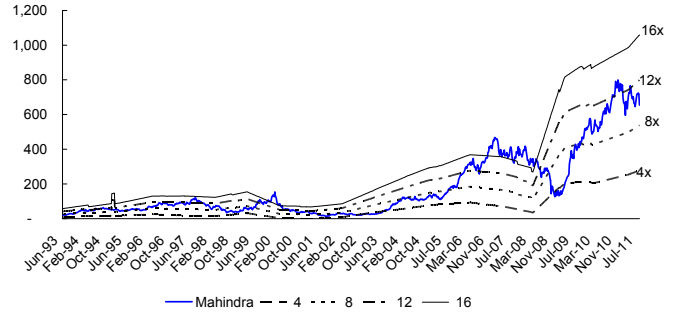
Source: Company, Citi Investment Research and Analysis

Figure 22. M&M: 1 yr fwd P / CEPS (x)



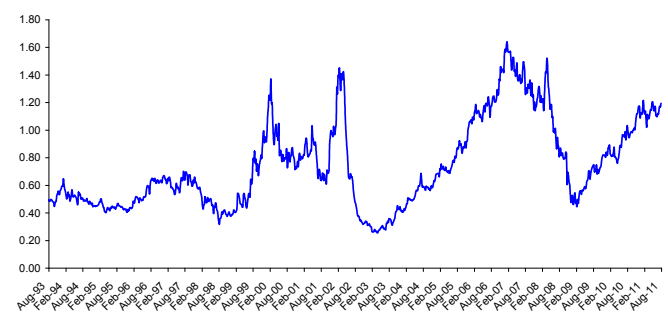
Source: Company, Citi Investment Research and Analysis

Figure 21. M&M: 1 yr fwd EV / EBITDA (x)



Source: Company, Citi Investment Research and Analysis

Figure 23. M&M: PE Relative to BSE Sensex



Source: Company, Citi Investment Research and Analysis

## Mahindra & Mahindra

### Company description

Mahindra and Mahindra manufactures utility vehicles, light commercial vehicles and tractors. It has also made a foray into the MHCV segment. M&M is the market leader in both the utility vehicle and tractor segments.

### Investment strategy

We rate M&M shares as Buy / Low Risk (1L), with a target price of Rs767. M&M's utility-vehicle business is benefiting from new product launches and strong product positioning for all its brands viz. Bolero, Scorpio and Xylo. We expect M&M's utility-vehicle business to maintain its market share over the next 12 months due to a stronger product profile. The LCVs launched by the company, particularly the Maxximo, has garnered favorable response from customers. Over the longer term, we remain positive on the tractor business due to relatively low penetration levels in India and government incentives offered to the agricultural sector. We also remain positive on management's efforts to de-risk from the local market by pursuing sales in select international markets. In addition to the UV models / variants planned to be launched, we are also optimistic on the new LCV and MHCV models launched by the company.

### Valuation

Our target price of Rs767 is based on a sum-of-parts methodology. We value M&M's core business at Rs623/share (10.5x March2013E core CEPS, at a slight premium to its 10-year average multiple). We also incorporate value for M&M's listed subsidiaries at Rs144/share. Our subsidiary valuations are based on a 25% discount to market prices of the listed subsidiaries. We have chosen P/CEPS to value the core business to facilitate comparison with historical trading bands; the company is undertaking a significant product development and capital expenditure program, and also undertook a restructuring of the balance sheet in FY02. We believe valuations will also be supported by M&M's listed subsidiaries.

### Risks

We rate M&M shares Low Risk, in line with our quantitative risk rating system which tracks 260-day historical share price volatility, and also reflecting a decline in capex intensity, and improved business fundamentals have reduced earnings volatility. Key risk factors to our investment thesis which could prevent the shares from reaching our target price include: a) Any substantial rise in interest rates that could curb demand for farm equipment and utility vehicles, b) Increase in raw material costs, especially Steel and Rubber may put downward pressure on margins. c) Given M&M's strong dependence on the rural economy (a substantial part of the demand for their products emanates herein), any weak trend in the prices of agricultural commodities could also impact demand and sales, d) Escalating competition within the UV segment, which might lead to an increase in discounts and result in margin pressure.

## Appendix A-1

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#### Mahindra & Mahindra (MAHM.BO)

##### Ratings and Target Price History Fundamental Research

Analyst: Jamshed Dadabhoj



Chart current as of 6 August 2011

	Date	Rating	Target Price	Closing Price
1	30-Oct-08	*1M	*223.50	151.25
2	3-Jun-09	*1L	*422.00	348.75
3	29-Oct-09	1L	*543.50	463.88

	Date	Rating	Target Price	Closing Price
4	26-Jan-10	1L	*619.00	536.18
5	31-May-10	1L	*676.00	572.45
6	29-Jul-10	1L	*753.00	644.10

	Date	Rating	Target Price	Closing Price
7	31-Oct-10	1L	*842.00	731.85
8	9-Feb-11	1L	*771.00	654.20
9	30-May-11	1L	*757.00	664.60

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

#### Mahindra & Mahindra (MAHM.BO)

##### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Jamshed Dadabhoj

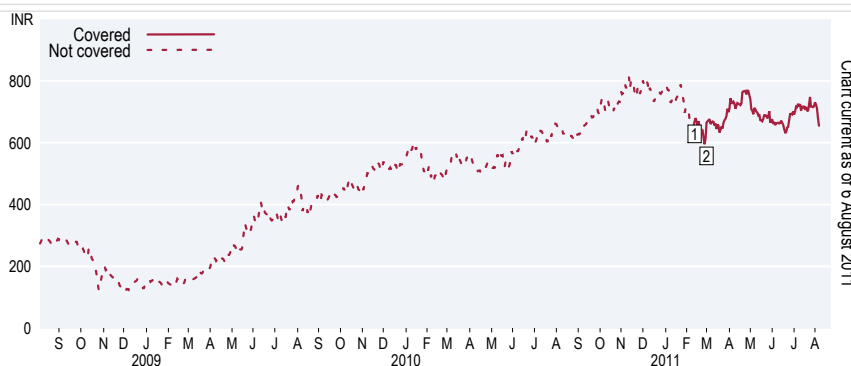


Chart current as of 6 August 2011

	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD MP	-	668.40

	Date	Rating	Target Price	Closing Price
2	1-Mar-11	*REM MP	-	665.45

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Citi Investment Research & Analysis Global Fundamental Coverage	54%	36%	11%	10%	81%	10%
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