

MAHINDRA & MAHINDRA

INR 537

**On track****BUY**

June 24, 2008

We met Mahindra & Mahindra's (M&M) management recently. The following are the key highlights:

Surprise jump in tractor sales in May

Domestic tractor sales were up 19% in May. The company feels that it could be due to advancement of purchases in anticipation of a price hike in June. Customers are expecting tractor prices to increase due to a steep rise in raw material prices. However, the company expects better tractor sales in FY09 compared to FY08 when domestic sales declined 5%. We are factoring in 8% domestic sales growth in both FY09E and FY10E.

To overcome tight credit conditions through Mahindra Finance

In view of the tightness in credit availability, the company intends to use the reach, financial strength, and customer knowledge of its subsidiary Mahindra Finance to boost sales. Mahindra Finance has a market share of 30-35% in M&M's tractor and UV sales. We believe it is a source of competitive advantage for M&M as none of its competitors in the tractor business have a strong financing arm to compensate for the decline in credit availability from banks.

Slew of new product launches in the pipeline

The *Ingenio* is likely to be launched in Q3/Q4FY09. A new SUV platform for the western markets (starting with the US) will be launched in CY2010. A successor for the *Scorpio* will also be launched in CY2010. However, depending on future *Scorpio* volumes and positioning, it may continue to run parallel with the new model for some time. CY2010 will also see the launch of a light cargo vehicle platform. We believe, the company's product launches are bunched up in 2010 and is linked to the commissioning of the Chakan plant. Taking cognizance of the risk of delays, we are not factoring in any new products launches, beyond the *Ingenio*, in our estimates.

Outlook and valuations: Revising earnings estimates; maintain 'BUY'

Our estimates for M&M's earnings have undergone a revision. We estimate core earnings per share (excluding financial income) of INR 31.7 for FY09E and INR 37.1 for FY10E, down 7.7% and 4.7%, respectively from our earlier estimates. This is primarily on account of reduced estimates for UV sales due to later-than-expected launch of the *Ingenio*. We estimate M&M's subsidiary and investment value at INR 338/share (at 40% holding discount). The implied market discount appears to be ~55-60%. We maintain our 'BUY' recommendation on the stock.

Financials

Year ended 31st March	FY07	FY08E	FY09E	FY10E
Revenues (INR mn)	98,585	113,194	134,681	155,692
Rev. growth (%)	21.5	14.8	19.0	15.6
EBITDA (INR mn)	10,689	11,603	13,701	15,661
Net profit (INR mn)	8,952	8,742	10,120	11,771
Share outstanding (mn)	255	255	265	265
Diluted EPS (INR)	35.1	34.2	38.2	44.5
EPS growth (%)	30.8	(2.5)	11.6	16.3
Diluted P/E (x)	15.3	15.7	14.1	12.1
EV/EBITDA (x)	10.5	9.2	7.9	6.6
RoAE (%)	27.9	22.2	21.7	19.0

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Bloomberg : MM IN

Market Data

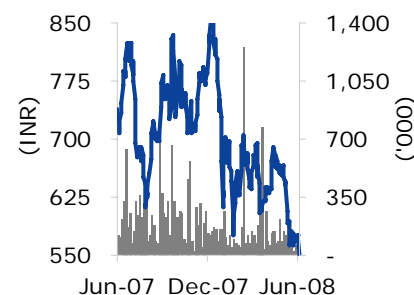
52-week range (INR) : 872 / 543
Share in issue (mn) : 245.7
M cap (INR bn/USD mn) : 131.9 / 3,068.3
Avg. Daily Vol. BSE/NSE ('000) : 849.5

Share Holding Pattern (%)

Promoters : 22.6
MFs, FIs & Banks : 26.5
FIIs : 25.5
Others : 25.4

Relative Performance (%)

	Sensex	Stock	Stock over Sensex
1 month	(14.2)	(0.2)	14.0
3 months	(6.5)	(0.2)	6.3
12 months	(1.2)	(3.0)	(1.8)



To launch CNG variant of *Logan* in current fiscal

M&M sold ~26,000 *Logans* in FY08. The company plans to launch a CNG variant of in FY09. Subsequently, it plans to extend its vehicle offering on the *Logan* platform by launching variants in the next few years.

Update on Chakan plant

- The plant is likely to be commissioned in FY10E. The total investment proposed is INR 40 bn.
- Total installed capacity will be 2,50,000 vehicles p.a. of which 50,000 units will be for the commercial vehicle joint venture with International Truck & Engine Corporation (ITEC), which will manufacture M&HCVs (trucks and buses).
- The balance capacity will be for M&M. The company plans to roll out the following products from its new plant:
 - Light cargo vehicle: Likely to compete with Tata Motors' *Ace* mini truck.
 - New SUV: *Scorpio*'s successor; will be predominantly for the domestic market.
 - *Scorpio*'s global model: Will be on a completely new platform and launched in developed markets like the US and Europe.
 - Variants of MUV *Ingenio*.

Mahindra Holidays IPO: Still some time to go

The proposed Mahindra Holidays (MHR) IPO is unlikely to come to the market for at least another three-four months, given the weak capital market conditions. Pre-IPO placement valued MHR at ~INR 40 bn, with 3% equity placed with SBI and New York Life. Based on the pre-IPO placement, we place a value of ~INR 142 per M&M share on MHR. The IPO and listing of MHR is likely to provide a medium-term trigger for M&M's stock.

Valuation of M&M's subsidiaries

	M&M holding # of shares	M&M holding (%)	Basis of valuation	Parameter (CMP/PAT)	Value/Mcap (INR mn)	Value/share (INR)
Tech Mahindra	53,776,252	46.4	CMP (INR)	762.1	40,983	167.0
Mahindra and Mahindra Financial Ser.	58,241,532	67.7	CMP (INR)	260.0	15,143	61.7
Mahindra Lifespace Developers	20,846,126	55.0	CMP (INR)	491.7	10,249	41.8
Mahindra Holidays and Resorts	71,737,167	87.0	Pre-IPO price	485.1	34,800	141.8
Mahindra Ugine and steel	16,466,789	50.7	CMP (INR)	55.4	911	3.7
Mahindra Holding and Finance			BV excl listed group cos.		1,703	6.9
Mahindra Forgings	41,200,000	60.6	CMP (INR)	127.1	5,237	21.3
Mahindra BT inv. co. (Mauritius)	9,931,638	57.0		152.2	862	3.5
Mahindra Inter-Trade			10x FY09E (INR mn)	294.3	2,943	12.0
Mahindra Engg. Design and Devpt. Co			20x FY09E (INR mn)	385.1	7,701	31.4
Sub-total						491.2
					With a discount of 40%	294.7
Other investments			Book value		10,700	43.6
Total						338.3

Source: Edelweiss research

Company Description

M&M is the flagship company of the Mahindra Group, which has a significant presence in several high-growth sectors. The company has two main divisions—automotive and farm equipment. It is a dominant player in the utility vehicle segment with its *Scorpio* and *Bolero* models—main constituents of sales in the automotive division. M&M is also engaged in the manufacture of three-wheelers and light commercial vehicles (LCVs). It has tied up with Renault to make the *Logan* in India. The company has also invested significantly in developing its auto-components business. M&M is the leader in the Indian tractor market and with the acquisition of Punjab Tractors controls ~40% of the domestic tractor market.

Investment Theme

Both the operating divisions of M&M are expected to perform well over the medium term, in terms of growth and profitability. We expect significant expansion in M&M's addressable market through its entry into the passenger car and M&HCV sector in JVs with Renault and ITEC, respectively, and into the auto-component business through an aggressive global acquisition strategy. The company has significant value embedded in its investments, covering information technology (Tech Mahindra), real estate & infrastructure (Mahindra Gesco), hospitality (Mahindra Holidays), financial services (Mahindra & Mahindra Financial Services), and auto-component (Mahindra Ugine Steel and Mahindra Forgings) sectors.

Key Risks

Tractor sales are dependent on the monsoons and may suffer a downturn on account of successive failure of monsoons. Rising raw material and other input costs could continue to keep margins under pressure. Also, M&M faces stiff competition from several domestic and MNC players in all its business segments. The new business segments (passenger cars and CVs) will require significant capex and will face competition from existing as well as new players.

Financial Statements

Income statement					(INR mn)
Year to March	FY06	FY07	FY08E	FY09E	FY10E
Total volume (nos)	234,446	272,029	294,089	338,397	379,604
Income from operations	81,161	98,585	113,194	134,681	155,692
Materials costs	57,138	68,519	77,259	92,960	107,950
Manufacturing expenses	5,176	6,835	8,400	9,653	11,178
Staff costs	5,518	6,662	8,525	9,803	11,078
S G & A expenses	4,864	6,351	7,925	9,124	10,412
Less: Expenses capitalised	265	471	518	559	587
Total operating expenses	72,431	87,895	101,591	120,980	140,030
EBITDA	8,730	10,689	11,603	13,701	15,661
Depreciation and amortisation	2,000	2,096	2,387	2,733	3,237
Provisions	8	0	82	0	0
EBIT	6,722	8,593	9,135	10,968	12,425
Interest	270	198	876	1,614	1,383
Non-Operational income	2,237	3,630	3,227	3,789	4,147
Profit before tax	8,690	12,025	11,486	13,143	15,188
Provision for tax	2,098	3,073	2,744	3,023	3,417
Current taxes	2,528	3,229	2,744	3,023	3,417
Deferred taxes	(430)	(156)	0	0	0
Core profit	6,592	8,952	8,742	10,120	11,771
Extraordinary income/ (loss)	1,979	1,732	2,291	0	0
Profit after tax	8,571	10,684	11,033	10,120	11,771
Profit after minority interest	8,571	10,684	11,033	10,120	11,771
Shares outstanding	241	245	246	246	265
Earnings per share (EPS)	27	36	36	41	44
Diluted shares outstanding	246	255	255	265	265
Diluted EPS	26.8	35.1	34.2	38.2	44.5
Diluted core business EPS	23.3	28.8	28.9	31.6	37.1
Cash EPS	33.9	44.4	45.3	52.3	56.7
Dividend per share	11.5	13.2	11.5	12.1	12.8
Dividend payout (%)	32.5	30.4	30.0	34.5	33.8

Common size metrics- as % of net revenues

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Operating expenses	89.2	89.2	89.7	89.8	89.9
Materials costs	70.4	69.5	68.3	69.0	69.3
Staff costs	6.8	6.8	7.5	7.3	7.1
S G & A expenses	6.0	6.4	7.0	6.8	6.7
Depreciation	2.5	2.1	2.1	2.0	2.1
Interest expenditure	0.3	0.2	0.8	1.2	0.9
EBITDA margins	10.8	10.8	10.3	10.2	10.1
Net profit margins	8.1	9.1	7.7	7.5	7.6

Growth metrics (%)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Revenues	23.1	21.5	14.8	19.0	15.6
EBITDA	20.4	22.4	8.6	18.1	14.3
PBT	26.5	38.4	(4.5)	14.4	15.6
Net profit	35.7	35.8	(2.3)	15.8	16.3
EPS	35.7	30.8	(2.5)	11.6	16.3

Balance sheet		(INR mn)				
As on 31st March	FY06	FY07	FY08E	FY09E	FY10E	
Equity capital	2,409	2,454	2,457	2,457	2,648	
Reserves & surplus	26,680	33,075	41,042	47,706	71,192	
Shareholders funds	29,089	35,529	43,500	50,163	73,840	
Secured loans	2,167	1,067	10,577	10,527	10,527	
Unsecured loans	6,667	15,294	15,294	22,294	6,956	
Borrowings	8,834	16,360	25,870	32,820	17,483	
Deferred tax (Net)	1,468	198	570	570	570	
Deferred tax liability	1,468	198	570	570	570	
Sources of funds	39,390	52,087	69,940	83,554	91,892	
Gross block	28,855	32,297	38,297	45,797	53,797	
Depreciation	15,103	16,391	18,778	21,511	24,748	
Net block	13,753	15,906	19,519	24,286	29,049	
Capital work in progress	1,792	2,806	4,091	6,591	10,591	
Investments	16,691	22,375	42,150	50,348	50,348	
Inventories	8,419	8,785	10,544	12,915	14,929	
Sundry debtors	6,380	7,009	7,753	9,225	10,664	
Cash and bank balance	7,303	13,261	8,610	6,734	6,228	
Loans and advances	5,112	8,394	8,471	8,471	8,471	
Other current assets	400	33	33	33	33	
Total current assets	27,614	37,482	35,411	37,378	40,325	
Sundry creditors	15,032	19,355	21,708	25,091	27,726	
Others current liabilities	176	147	147	147	147	
Provisions	5,431	7,154	9,515	9,951	10,688	
Total current liab. & provisions	20,640	26,656	31,371	35,189	38,561	
Net current assets	6,974	10,825	4,040	2,188	1,764	
Misc expenditure	181	176	140	140	140	
Uses of funds	39,390	52,087	69,940	83,554	91,892	
Book value per share (BV) (INR)	120	144	176	204	278	

Free cash flow

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Net profit	8,571	10,684	11,033	10,120	11,771
Depreciation	2,000	2,096	2,387	2,733	3,237
Deferred tax	(430)	(156)	0	0	0
Others	430	156	0	0	0
Gross cash flow	10,571	12,780	13,420	12,853	15,008
Less: Changes in WC	449	(2,112)	(2,170)	24	82
Operating cash flow	10,122	14,891	15,590	12,829	14,926
Less: Capex	2,796	5,263	7,285	10,000	12,000
Free cash flow	7,326	9,628	8,305	2,829	2,926

Cash flow metrics

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Operating cash flow	10,122	14,891	15,590	12,829	14,926
Financing cash flow	(1,470)	2,013	6,820	3,493	(3,432)
Investing cash flow	(7,589)	(10,947)	(27,060)	(18,198)	(12,000)
Net cash flow	1,063	5,958	(4,651)	(1,876)	(506)
Capex	(2,796)	(5,263)	(7,285)	(10,000)	(12,000)
Dividend paid	(2,782)	(3,247)	(3,306)	(3,491)	(3,979)
Share issuance/(buyback)	1,212	62	10	35	190

Profitability & liquidity ratios

Year to March	FY06	FY07	FY08E	FY09E	FY10E
ROAE (%)	27.2	27.9	22.2	21.7	19.0
ROACE (%)	31.2	32.8	31.8	36.0	33.2
Inventory days	46	42	41	42	43
Debtors days	26	25	24	23	23
Payable days	80	83	87	83	81
Cash conversion cycle (days)	(9)	(17)	(23)	(19)	(15)
Current ratio	1.3	1.4	1.1	1.1	1.0
Debt/EBITDA	1.0	1.5	2.2	2.4	1.1
Fixed asset turnover (x)	5.9	6.6	6.4	6.1	5.8
Debt/Equity	0.3	0.5	0.6	0.7	0.2
Adjusted debt/equity	0.3	0.5	0.6	0.7	0.2

Operating ratios

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Total asset turnover	2.3	2.2	1.9	1.8	1.8
Fixed asset turnover	5.9	6.6	6.4	6.1	5.8
Equity turnover	3.3	3.1	2.9	2.9	2.5

Du pont analysis

Year to March	FY06	FY07	FY08E	FY09E	FY10E
NP margin %	8.1	9.1	7.7	7.5	7.6
Total assets turnover	2.3	2.2	1.9	1.8	1.8
Leverage multiplier	1.5	1.4	1.6	1.6	1.4
ROAE %	27.2	27.9	22.2	21.7	19.0

Valuations parameters

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Diluted EPS (INR)	26.8	35.1	34.2	38.2	44.5
Y-o-Y growth (%)	35.7	30.8	(2.5)	11.6	16.3
CEPS (INR)	32.1	43.8	45.3	52.3	56.7
Diluted P/E (x)	20.0	15.3	15.7	14.1	12.1
Price/BV (x)	4.5	3.7	3.0	2.6	1.9
EV/Sales (x)	1.4	1.1	0.9	0.8	0.7
EV/EBITDA (x)	13.1	10.5	9.2	7.9	6.6
Dividend yield %	2.1	2.5	2.1	2.3	2.4

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Coverage group(s) of stocks by primary analyst(s): Auto/Auto Components:

Auto: Ashok Leyland, Tata Motors, Bajaj Auto Ltd, Maruti Udyog, Mahindra & Mahindra, Hero Honda Motors, TVS Motor
Auto Components: Amtek Auto, Amtek India, Bharat Forge, and Sono Koyo Steering Systems.

Mahindra & Mahindra



Recent Research

Date	Company	Title	Price (INR)	Recos
12-Jun-08	Auto Sales	Monthly Update		
9-Jun-08	Tata Motors	JLR - value accretive; Event Update	517	Buy
29-May-08	Tata Motors	Wait and watch; Result Update	582	Buy
29-May-08	Mahindra & Mahindra	On track; Result Update	606	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	104	60	15	2	193

* 11 stocks under review / 1 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	85	73	35

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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