

Company

1 September 2009 | 8 pages

Mahindra & Mahindra (MAHM.BO)

Equity

Aug Sales Mixed: UV Volumes Accelerate, Tractors Hit a Bump

- **Aug09 was a mixed month** — With UV sales rising a very robust 42% Y/Y, continuing the trend exhibited over June/July. Tractor unit growth softened meaningfully, growth was c2% for the month – management attributes this to a combination of base effects and seasonality.
- **Xylo performance stabilises, overall UVs ahead of forecasts** — Xylo volumes have stabilised at a monthly run rate of ~2-2,500 units; lower than the initial spurt, which had volume growth of 4000 units/month. Annual sales should be slightly ahead of our forecast of 36k units for FY10E (assuming that the current run rate continues). Overall UV sales are buoyed by the Bolero (semi urban/rural demand continue to be strong) as well as the refreshed Scorpio. Ex-Xylo, volume growth for the month was c20%.
- **Tractors: It's not the monsoon** — Management noted that the sedate tractor sales are a function of seasonality and deferment of purchases prior to the festive season rather than monsoon-related concerns. Volume guidance remains at 6-8%. Management stated that the NREGS programme if continued will result in a structural deficiency in farm labor, resulting in increased mechanization. Monsoon impact, if any, will be exhibited over FY11 rather than FY10E.
- **Logan volumes disappoint** — due to strong competition in the A3 segment. 3-wheeler sales also slumped – down 15%Y/Y; we suspect M&M lost market share and await Bajaj Auto's results tomorrow. Exports declined – expected – given challenging conditions in key markets like S Africa and Sri Lanka.

Buy/Low Risk	1L
Price (01 Sep 09)	Rs847.30
Target price	Rs844.00
Expected share price return	-0.4%
Expected dividend yield	1.2%
Expected total return	0.8%
Market Cap	Rs236,245M
	US\$4,852M

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



Figure 1. M&M: Aug09 Sales

	Aug-09 Nos	% change yoy	% change over July	FY10 YTD Nos	% chg yoy
UVs	16,631	41.8	(0.3)	82,039	36.0
LCVs	658	(19.0)	(35.4)	4,171	(15.1)
3-wheelers	3,652	(15.4)	(4.0)	16,490	(16.7)
Exports (Auto sector)	653	(26.6)	29.1	2,304	(55.5)
Logan	469	(68.0)	5.6	2,391	(68.0)
Auto division	22,063	14.8	(1.8)	107,395	10.0
Tractors (Dom + Exp)	10,594	1.6	17.4	66,496	38.5
Total	32,657	10.2	3.7	173,891	19.4

Source: Company

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See Appendix A-1 for Analyst Certification and important disclosures.

Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	21.9	23.1	25.4	19.7	16.2
EV/EBITDA adjusted (x)	26.8	34.5	52.2	17.1	13.4
P/BV (x)	6.1	5.0	4.3	3.5	3.1
Dividend yield (%)	1.3	1.3	1.2	1.2	1.2
Per Share Data (Rs)					
EPS adjusted	38.64	36.72	33.34	43.04	52.41
EPS reported	41.82	43.18	31.11	43.04	52.41
BVPS	139.06	170.26	196.17	239.87	274.97
DPS	11.05	11.06	10.00	10.00	10.00
Profit & Loss (RsM)					
Net sales	96,298	107,865	124,674	139,010	159,759
Operating expenses	-89,991	-103,795	-123,400	-129,932	-147,861
EBIT	6,307	4,070	1,273	9,078	11,898
Net interest expense	-198	-876	-1,341	-1,438	-1,841
Non-operating/exceptionals	6,991	9,304	9,201	7,416	8,181
Pre-tax profit	13,101	12,497	9,133	15,055	18,238
Tax	-3,501	-3,034	-1,997	-2,649	-3,132
Extraord./Min.Int./Pref.div.	1,084	1,570	1,539	0	0
Reported net income	10,684	11,034	8,675	12,406	15,105
Adjusted earnings	9,872	9,382	9,297	12,406	15,105
Adjusted EBITDA	8,403	6,456	4,188	12,444	15,599
Growth Rates (%)					
Sales	20.7	12.0	15.6	11.5	14.9
EBIT adjusted	18.1	-35.5	-68.7	613.0	31.1
EBITDA adjusted	14.5	-23.2	-35.1	197.1	25.4
EPS adjusted	47.6	-5.0	-9.2	29.1	21.8
Cash Flow (RsM)					
Operating cash flow	14,886	15,554	14,932	13,600	17,016
Depreciation/amortization	2,096	2,387	2,915	3,366	3,701
Net working capital	2,107	2,133	3,342	-2,172	-1,790
Investing cash flow	-10,947	-27,060	-24,882	-20,000	-20,000
Capital expenditure	-5,263	-7,284	-11,312	-10,000	-10,000
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	3,283	6,367	18,135	1,952	10,042
Borrowings	7,526	9,511	14,657	-1,643	13,443
Dividends paid	-3,247	-3,211	-3,290	-3,401	-3,401
Change in cash	7,222	-5,140	8,185	-4,448	7,058
Balance Sheet (RsM)					
Total assets	78,743	102,449	133,071	145,119	170,229
Cash & cash equivalent	13,261	8,612	15,744	9,628	14,990
Accounts receivable	7,009	10,049	10,767	11,213	12,979
Net fixed assets	18,712	23,609	32,106	38,844	45,254
Total liabilities	43,214	58,948	78,372	75,982	90,974
Accounts payable	18,136	21,613	24,686	24,328	25,877
Total Debt	16,360	25,871	40,528	38,885	52,328
Shareholders' funds	35,529	43,501	54,700	69,138	79,255
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	8.7	6.0	3.4	9.0	9.8
ROE adjusted	30.6	23.7	18.9	20.0	20.4
ROIC adjusted	12.6	4.0	-2.3	16.3	18.4
Net debt to equity	8.7	39.7	45.3	42.3	47.1
Total debt to capital	31.5	37.3	42.6	36.0	39.8

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Mahindra & Mahindra

Company description

Mahindra and Mahindra manufactures utility vehicles, light commercial vehicles and tractors. It recently entered the three-wheeler segment. M&M is the market leader in both the utility vehicle and tractor segments.

Investment strategy

We rate M&M shares Buy/Low Risk, with a target price of Rs844. M&M's utility-vehicle business is benefiting from new product launches and strong product positioning for both Bolero and Scorpio brands. We expect M&M's utility-vehicle business to maintain its market share over the next 12 months due to a stronger product profile. On the tractor business, we remain concerned about the outlook for FY10 as increasing NPA levels of banks may lead to further curtailment of credit to the sector. Over the longer term we remain positive on the tractor business due to relatively low penetration levels in India. We also remain positive on management's efforts to de-risk from the local market by pursuing sales in select international markets. The target is to raise international sales from around 10% at present to 20% over the next three years. The substantial value of the company's real estate and investment holdings (particularly in the information technology business through Tech Mahindra and in the financial-services business through M&M Financial Services) should provide downside support (especially with increasing dividends from key subsidiaries). The rise in capital costs due to aggressive capacity expansion plans would lead to slower earnings growth for M&M over the next 2-3 years, on our estimates.

Valuation

Our target price of Rs844 is based on a sum-of-parts methodology. We value M&M's core business including Punjab Tractors at Rs680/share (12x Sep10E core CEPS, a slight premium to longer term average of 11x). We also incorporate value for M&M's listed subsidiaries (Rs131/share) and M&M's investment in other subsidiaries (including Mahindra Holidays at Rs33/share). At our core fair value (of Rs680) the stock would trade at around 12x Sep10E CEPS (excluding dividends from subsidiaries). Our subsidiary valuations are based on a 25% discount to market prices of the listed subsidiaries, while for Mahindra Holidays our multiple of 12x is in line with the average valuation for the listed Indian hotel stocks. 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: a) management's continued efforts to unleash value from investments in group concerns (we believe that the listing of the group's hotel / resorts venture is next on the anvil); and b) new initiatives announced in the auto component segment, which should fructify over the next 2-3 years.

Risks

We rate M&M shares Low Risk, overriding our quantitative model rating of High Risk (which tracks 260-day historical share price volatility) due to 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) 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, c) 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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Fundamental Research

Analyst: Jamshed Dadabhoy

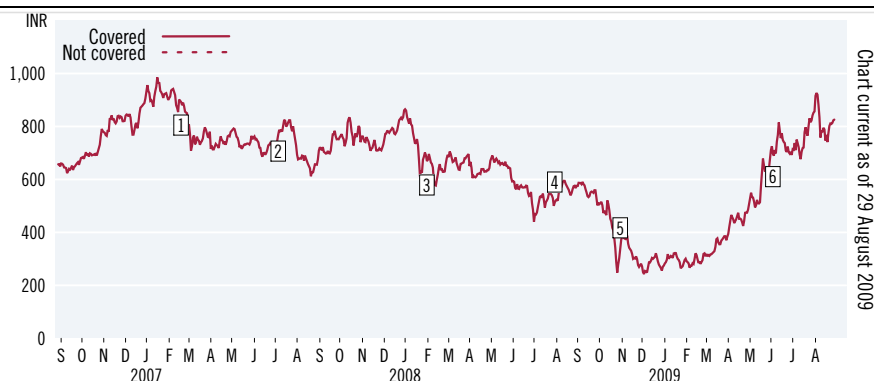


Chart current as of 29 August 2009

	Date	Rating	Target Price	Closing Price
1	18-Feb-07	1L	*1,032.00	901.60
2	5-Jul-07	1L	*945.00	769.20

* Indicates change

	Date	Rating	Target Price	Closing Price
3	31-Jan-08	1L	*865.00	669.35
4	30-Jul-08	1L	*643.00	513.50

	Date	Rating	Target Price	Closing Price
5	30-Oct-08	*1M	*447.00	302.50
6	3-Jun-09	*1L	*844.00	697.50

Rating/target price changes above reflect Eastern Standard Time

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