

All-wheel drive



Our detailed report on Mahindra & Mahindra titled *All-wheel drive* will reach your desks shortly. M&M is our preferred proxy to play the resurgence in India's rural economy. Even as a confluence of macro factors is driving a structural upswing in the tractor cycle, a less-known fact is the positive rub-off on M&M's medium-term growth trajectory from the 5x jump in its R&D expense. A slew of product launches will enable M&M to not only gain share, but also penetrate into new segments, making it among the fastest-growing players

in the Indian auto industry. We value M&M's subsidiaries at Rs230/share; netting this out, the stock is trading at 9.4x FY13ii EPS. Our SOTP-based target price of Rs910 offers 26% upside.

Volume growth to be amongst the fastest in the industry: M&M has quintupled its R&D spend in the last five years, and the results are clearly visible. M&M's auto unit sales grew 27% in FY11, compared to the UV industry's growth of 18%, thanks to new launches in the goods vehicles segment. M&M plans to launch more new models in FY12, largely passenger vehicles, and this will enable it to continue to grow 6pps faster than the industry.

Ssangyong, a value-accretive acquisition: M&M is well-positioned to reap big gains from its recent acquisition of Ssangyong. Synergies relate to building cross-selling abilities, competitive sourcing, knowledge-sharing, and product development. M&M is committed to re-building the brand in Korea (its R&D expense is set to rise 70% in 2011) and thereby reversing the declining trend in volumes. Ssangyong will likely generate EBITDA of over US\$300m in FY13, thus contributing over 20% of M&M's FY13ii EPS.

Tractor cycle on a structural upswing: After decades of anaemic growth, the tractor industry has structurally entered into a high-growth phase. Labour shortages on account of NREGA have led to increased mechanisation. Easy availability of finance and rising economic surpluses on account of higher soft-commodity prices have accelerated growth in tractor demand. Replacement cycle for tractors has shrunk as idle days have declined to 90 days from 180 days on increased non-agri usage.

Company update

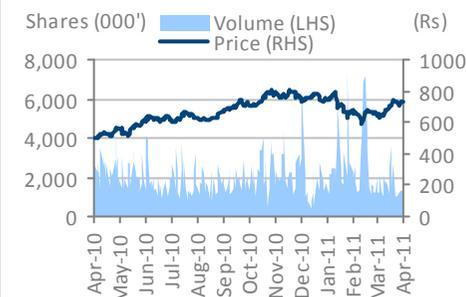
CMP	Rs724
12-mth TP (Rs)	910 (26%)
Market cap (US\$ m)	10,024
Bloomberg	MM IN
Sector	Autos

Price performance (%)	Price performance (%)		
	1M	3M	1Y
Mah. & Mah	12.4	-2.0	42.0
Rel. to Sensex	7.3	-4.8	33.2
Tata Motors	8.2	4.5	59.4
Maruti Suzuki	3.5	-1.0	-7.2
Ashok Leyland	4.6	-6.8	0.1

Shareholding pattern (%)

Mahindras	24.8
FIIIs	22.9
DIIIs	23.7
GDRs	5.9
52Wk High/Low (Rs)	827/490
Shares o/s (m)	614
Daily volume (US\$ m)	35
Dividend yield FY11ii (%)	1.9
Free float (%)	75.2

Stock performance



Financial summary (Rs m)

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Revenues (Rs m)	130,937	186,021	234,290	276,207	314,644
EBITDA Margins (%)	8.3	15.9	15.1	14.6	14.9
Pre-Exceptional PAT (Rs m)	8,368	20,878	25,944	29,322	34,065
Reported PAT (Rs m)	8,368	20,878	25,944	29,322	34,065
EPS (Rs)	15.0	35.9	42.3	47.8	55.5
Growth (%)	-27.8	139.4	17.8	13.0	16.2
PER (x)	48.3	20.2	17.1	15.2	13.1
Adjusted PER*(x)	45.2	15.3	12.9	10.9	9.4
ROE (%)	17.4	31.9	29.2	26.6	25.5
Debt/Equity (x)	0.8	0.4	0.2	0.1	0.1
EV/EBITDA (x)	39.0	14.5	13.0	11.1	9.2
Price/Book (x)	7.7	5.4	4.5	3.7	3.0

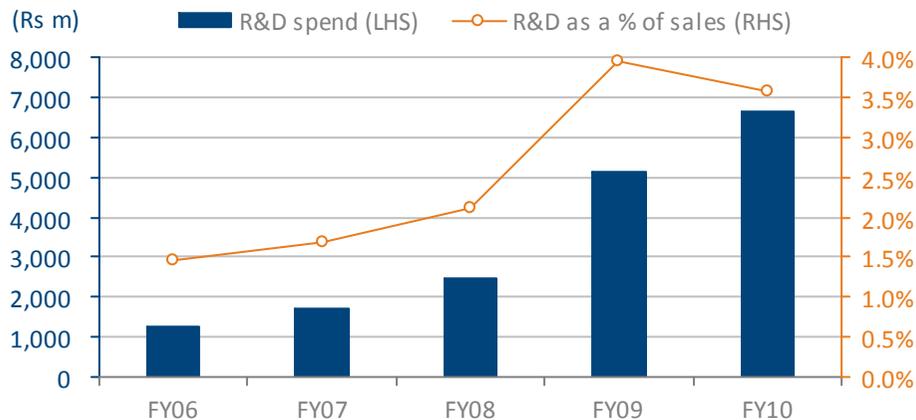
Source: Company, IIFL Research. Priced as on 15 April 2011

*Adjusted for subsidiary value of Rs230/share calculated on a 30% holding-company discount

Autos – driving with a new zeal

M&M has quintupled its R&D investments in the last five years and the results are clearly visible. A slew of new launches in FY11 drove M&M's volume growth in autos at 32% in the year, compared to the UV industry's growth of 18%. These new launches have expanded M&M's presence in the CV segment. In FY12, it plans to launch a number of new models, mainly passenger vehicles, which we reckon would drive M&M's volume growth at 20%, compared to the industry, whose growth we estimate at 14%. With the new launches coming in new segments, cannibalisation will be minimal, in our view. Over the medium term, M&M's two-wheeler company and CV ventures, which are being seeded at present, have the potential to grow into billion-dollar enterprises in their own right.

Figure 1: R&D spend has quintupled in the last five years...



Source: Company, IIFL Research

M&M's focus on product development and confidence in its own product development abilities have increased significantly in the last few years. Its product development spend has more than quintupled, from Rs1.2bn (1.4% of net sales) in FY06 to Rs6.6bn (3.6% of net sales) in FY10. It has developed three completely new

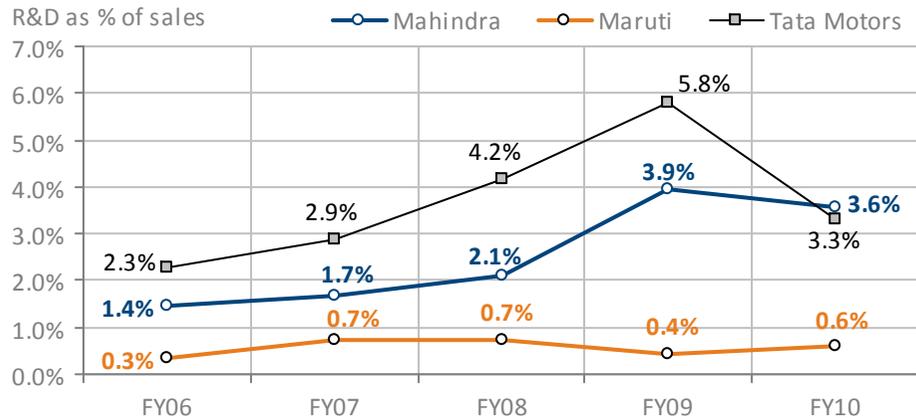
platforms in this period—Ingenio (on which Xylo and Genio are based), one-tonne platform (on which Maxximo is based) and half-tonne platform (on which Gio is based). The company has also developed its first monocoque platform (W201); a new luxury SUV on this platform will be launched in FY12.

Figure 2: We expect M&M's volumes to grow 6pps faster than the industry's

Unit sales	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Bolero	55,924	73,824	83,130	90,951	100,046
% growth	9.6	32.0	12.6	10.0	10.0
Marshall	12,390	16,643	10,582	4,578	5,036
% growth	(4.6)	34.3	(36.4)	(50.4)	10.0
Scorpio	29,995	36,973	43,439	47,788	52,566
% growth	(24.9)	23.3	17.5	10.0	10.0
W201				1,800	6,000
% growth					233.3
Xylo	7,246	28,907	32,057	33,388	35,057
% growth		298.9	10.9	5.0	5.0
Smaller Xylo				15,000	24,000
% growth					60.0
Pick-ups	48,100	57,781	65,870	72,457	79,703
% growth	7.3	20.1	14.0	10.0	10.0
Gio			8,000	15,000	15,000
% growth				87.5	-
Maxximo			26,047	55,000	70,000
% growth				111.1	27.3
Three-wheelers	44,803	57,424	72,529	76,155	79,963
% growth	31.5	28.2	26.3	5.0	5.0
Auto exports	8,500	10,567	17,138	22,279	28,963
% Growth	(31.1)	24.3	62.1	30.0	30.0
Total Auto sales	198,458	271,552	358,792	434,397	496,335
% growth	8.5	36.8	32.1	21.0	14.2

Source: Company, IIFL Research

Figure 3: ... and is now amongst the highest in the Indian auto industry



Source: Companies, IIFL Research

Figure 4: R&D efforts, which started with Scorpio, are now going full-speed ahead



Source: IIFL Research

Figure 5: M&M will launch more new models in FY12 than it has ever done in its history

Model	Type	Planned launch yr	Comments
W201	New SUV	2011	New flagship vehicle, Mahindra's first monocoque model, expected to be priced at ~Rs1.5m
Genio (U202)	Pickup	2011	Recently launched pick-up on the Xylo platform, launches in both single and double-cab variants
U203	Compact SUV	2011	Sub-4m version of the Xylo with a 1.5-litre engine to take advantage of excise benefits
U205	MPV	2012	Xylo with mHawk engine currently being used in the Scorpio
U206	MPV	2011	Restyled Xylo
S101	Ultra compact SUV	2012	'Nano of SUVs': Mahindra is targeting an aggressive price tag of Rs0.3m for this vehicle
New Bolero	SUV	2011	Bolero is going from strength to strength even in its 10th year; engine change likely
New Scorpio	SUV	2012	No major changes expected
Korando	SUV	2011	Ssangyong's flagship model will be the first one to come to India
Rexton	SUV	2011	Another SUV from the Ssangyong stable based on the Mercedes Benz M-class platform
Logan	Car	2011	Shorter version of the Logan to comply with the 4m rule and lower the price point

Source: Company, IIFL Research

New launches in FY12 will be in passenger vehicles

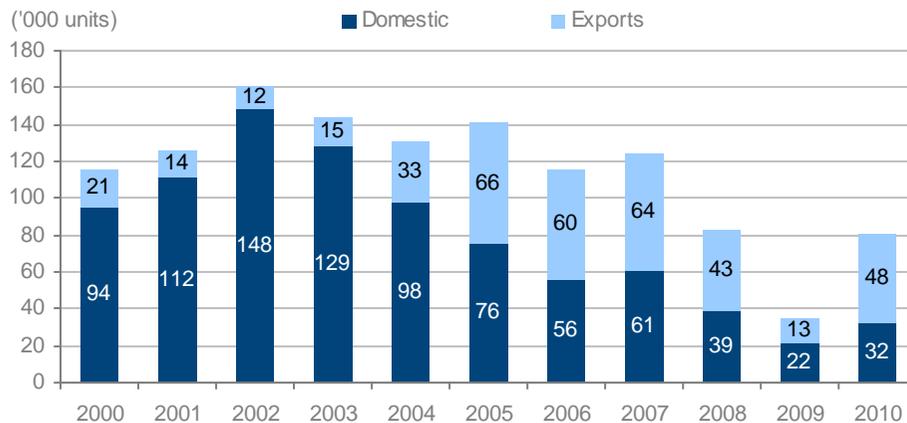
Most of M&M's new launches in FY11 were goods vehicles (Maxximo and Gio, for instance). In FY12, we believe the company will launch passenger variants of these, in addition to a smaller version of the Xylo. Mahindra will launch more models in FY12 than it has launched in any single year so far. The Scorpio will be replaced as the company's flagship by a new vehicle currently being developed, codenamed W201. The new model will be positioned one rung above the Scorpio. The company also plans to revamp almost all the models in its existing portfolio, including a long-overdue revamp of the Bolero and a refresh of the Scorpio.

Ssangyong, a value-accretive acquisition

The 70% stake that M&M has acquired in Ssangyong could soon double in value from US\$378m to US\$750m in a couple of years, in our view. Ssangyong's volumes in Korea declined from 130,000 units in 2003 to 30,000 units in 2010 after the company was taken over by SAIC (China) in 2004. We reckon M&M is well-placed to improve Ssangyong's brand image in the domestic market. Whereas paucity of funds under SAIC had stalled R&D, M&M has pledged KRW200bn (nearly US\$175m) for R&D in 2011, a 70% increase over R&D investment in 2010. Synergies between the two—not just in product development, but also through cross-selling and knowledge-sharing—can be substantial, in our view.

We reckon Ssangyong could add Rs15, or over 20%, to M&M's FY13ii EPS. We estimate Ssangyong will report an EBITDA of over US\$300m in FY13ii. Our assessment of M&M's SOTP includes Rs41/share for Ssangyong.

Figure 6: Ssangyong enjoyed its best period just before SAIC's takeover



Source: Company, IIFL Research

Figure 7: Our volume assumptions for Ssangyong

Model	CY07	CY08	CY09	CY10	CY11ii	CY12ii
Actyon	45,087	34,885	16,928	32,711	36,000	37,800
Korando				4,582	40,000	60,000
Kyron	36,356	19,663	5,762	19,309	20,800	21,800
Rexton	23,991	10,630	4,091	10,849	11,700	12,300
Rodius	9,439	4,290	2,655	4,458	4,800	5,000
Chairman H	9,744	6,245	2,683	3,589	3,900	4,100
Chairman W		6,692	2,817	4,717	5,100	5,400
Total Volumes	124,617	82,405	34,936	80,215	122,300	146,400

Source: Company, IIFL Research

Figure 8: We reckon Ssangyong can post >US\$300m EBITDA in 2012

US\$ m	CY08	CY09	CY10	CY11ii	CY12ii
Unit sales (nos)	82,405	34,936	80,215	122,300	146,400
Growth		-57.60%	129.61%	52.47%	19.71%
Average realisation (US\$)	23,805	23,657	22,186	21,210	21,568
Revenues	1,984.27	840.44	1,791.72	2,606.69	3,170.84
Growth		-57.64%	113.19%	45.49%	21.64%
Cost of goods sold	1,739.00	790.23	1,473.83	2,085.35	2,473.25
Gross profit	245.27	50.21	317.89	521.34	697.58
Gross profit margin	12.36%	5.97%	17.74%	20.00%	22.00%
Staff cost	57.65	84.00	31.70	32.76	34.08
Other costs	257.16	126.38	229.33	309.77	363.21
EBITDA	(69.54)	(160.17)	56.87	178.81	300.29
EBITDA margins	-3.50%	-19.06%	3.17%	6.86%	9.47%
Total dep and amortisation	(111.29)	(70.99)	(104.49)	(98.75)	(104.59)
Net interest costs	(28.62)	(82.96)	(38.54)	(8.26)	(12.40)
Sales guarantee	5.96	6.13	4.34	4.35	4.37
Exceptional items	(360.87)	35.20	88.84	197.14	-
PBT	(564.36)	(272.79)	7.02	273.29	187.67
PAT	(564.36)	(272.79)	7.02	273.29	187.67
Pre-exceptional PAT	(203.49)	(307.99)	(81.82)	76.15	187.67

Source: Company, IIFL Research

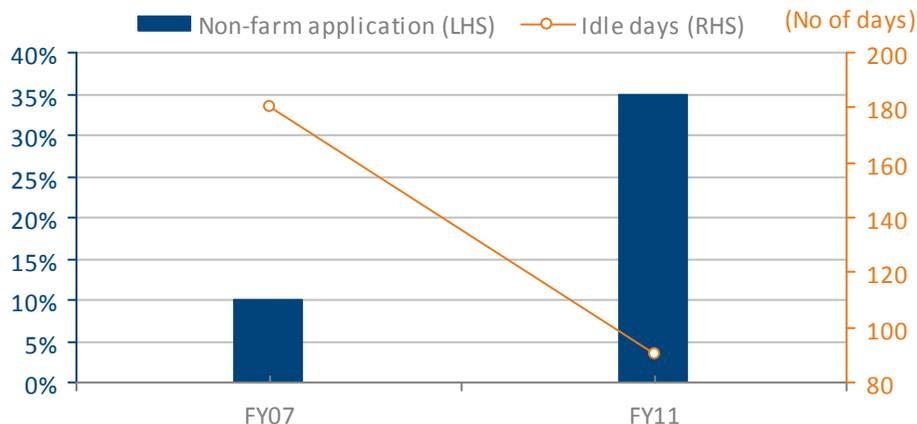
Tractors and beyond

We believe the tractor industry has entered a structural phase of high growth, as urbanisation and the government’s flagship employment guarantee scheme (NREGA) have made farm labour expensive and scarce, leading to an increased need for mechanisation. As such, volume sales of tractors should continue to beat estimates. With the increasing usage of tractors in non-agri applications, replacement cycles for tractors too have shortened. The robust volume momentum will ensure that pricing power remains intact.

Structural drivers for the tractor industry

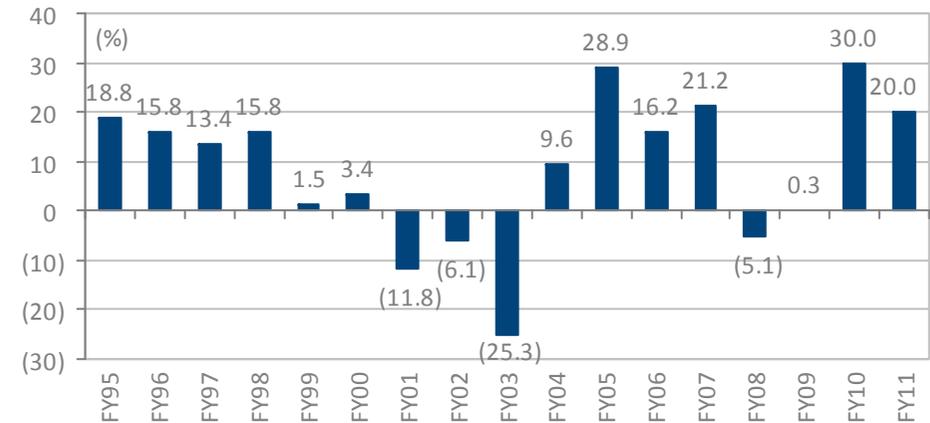
- Urbanisation is leading to labour shortages
- A problem accentuated by NREGA
- Farm incomes have improved on higher crop prices
- Multiple crops, especially cash crops
- Rural road construction is driving increased tractor usage
- Improved availability of finance
- Reduced dependence on monsoon rainfall

Figure 9: Increase in non-agri usage has led to an increase in tractor usage



Source: CRISIL, IIFL Research

Figure 10: Tractor sales usually have long business cycles



Source: Tractor Manufacturers’ Association, IIFL Research

Yuvraj could drive volume surprises

M&M’s low-cost tractor for small farms, *Yuvraj*, priced at Rs175,000, has been very well-received in the two states in which it has been launched so far (Gujarat and Maharashtra). The model is made by Deepak Diesels Pvt Ltd (DDPL), Rajkot, under an exclusive contract from M&M.

Normally, tractors make economic sense only for farms with area of more than 5 acres. M&M designed this tractor specifically for farms covering less than 5 acres, as such farms form over 82% of the country’s farmland. The Yuvraj is ideal for farm sizes between 2 and 5 acres, and hence is capable of addressing a further 19% of the market. That still leaves 63% of the market with farm-holding sizes less than 1 acre; these will come into the fold only if land consolidation gains momentum.

Moving beyond tractors in agriculture

We reckon the company’s strategy of going beyond tractors in farm mechanisation will pay rich dividends in the medium term. It has started selling rice transplanters, combined harvesters and rotovators, and recently acquired a small micro-irrigation company, EPC.

Valuation – India’s cheapest auto stock

We reckon M&M’s volume growth over the next 2-3 years would be higher than that of any of the other listed large-cap auto stock. In spite of that, at 9.2x FY13ii EPS, it remains one of the cheapest stocks in our coverage universe.

One reason for M&M’s low multiple has been its conglomerate structure. But as the table below shows, M&M has more often than not created value from its investments, be it in the autos space or in other segments.

Figure 11: M&M has created value in other sectors too

(Rs m)	Investment till date	Stake	Mkt cap	Value of M&M’s stake	Returns on M&M’s investment (x)
M&M Fin. Services	1,600	56.0%	79,152	44,325	27.7
Mah Lifespace	2,769	50.0%	16,283	8,142	2.9
Tech Mahindra	1,918	44.4%	85,433	37,932	19.8
Mah Holiday Resorts	303	83.1%	32,934	27,368	90.3
Mah Forgings	7,952	50.7%	6,418	3,252	0.4
Mah UGINE Steel	492	55.5%	1,918	1,064	2.2

Source: Company, IIFL Research

Furthermore, other subsidiaries still contribute only ~20% of the value in M&M; the core auto business accounts for the lion’s share of the group’s value. We reckon Ssangyong’s contribution will increase in a couple of years, and hence the share of the auto business is likely to increase further.

Moreover, the company is making significant investments in the two-wheelers and CV businesses. Although the market is not attributing any value to these investments, we reckon the option value from these investments will provide further upsides.

Figure 12: Our SOTP-based target price of Rs910 implies a >25% upside

	Valuation at	Equity value (Rs m)	M&M’s stake	M&M’s share (Rs m)	Value per share (Rs)
Tech Mahindra	CMP	85,433	44.40%	37,932	67
M&M Financial Services	CMP	79,152	56.00%	52,087	79
Mahindra Lifespace Developers	CMP	16,283	50.00%	8,142	14
Mahindra Holiday Resorts	CMP	32,934	83.10%	25,186	49
Ssangyong	4x EV/EBITDA	47,135	70.00%	32,995	59
Other subsidiaries	Book value				60
Subsidiary value					328
Subsidiary value post 30% holding co. discount					230
Core auto business	8.5x EV/EBITDA				680
Target price					910

Source: Company, IIFL Research

Assumptions

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Passenger UVs	105,560	156,350	169,210	194,790	224,100
Four-wheeler pickups	48,100	57,780	99,920	142,460	164,700
Auto exports	8,500	10,570	17,140	22,280	28,960
Three-wheelers	44,800	57,420	72,530	76,160	79,960
Tractors (including exports)	119,710	174,630	213,650	239,290	263,220

Source: Company data, IIFL Research

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Revenue	130,937	186,021	234,290	276,207	314,644
EBITDA	10,927	29,553	35,492	40,340	46,781
EBIT	8,012	25,845	31,608	35,822	41,883
Interest income	889	1,290	1,179	990	930
Interest expense	-1,341	-1,569	-811	-800	-800
Others items	2,806	2,901	2,898	2,371	2,591
Profit before tax	10,365	28,468	34,874	38,382	44,604
Tax expense	-1,997	-7,590	-8,930	-9,061	-10,539
Net Profit	8,368	20,878	25,944	29,322	34,065

Cash flow summary (Rs m)

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
EBIT	8,012	25,845	31,608	35,822	41,883
Depreciation & Amortization	2,915	3,708	3,884	4,518	4,898
Tax paid	-1,550	-6,671	-8,912	-9,043	-10,521
Working capital change	8,168	-8,154	1,238	1,459	1,311
Other operating items	-171	300	0	0	0
Operating Cash-flow	17,373	15,027	27,817	32,756	37,571
Capital expenditure	-11,449	-8,592	-12,808	-5,750	-5,750
Free cash flow	5,923	6,436	15,009	27,006	31,821
Equity raised	8,310	12,646	3,723	0	0
Investments	-12,481	-4,439	-25,000	-8,000	-8,000
Debt financing/disposal	14,657	-11,726	-11,025	0	0
Dividends paid	-7,648	-4,760	-6,238	-8,310	-8,310
Other items	-750	2,586	0	0	0
Net change in Cash & cash equivalents	10,365	3,366	-20,264	13,256	18,232

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Cash & cash equivalents	24,435	27,801	7,535	20,792	39,023
Sundry debtors	10,437	12,581	16,047	18,918	21,551
Trade Inventories	10,607	11,888	19,257	22,702	25,861
Other current assets	13,842	18,523	18,781	19,044	19,313
Fixed assets	32,144	37,028	45,952	47,184	48,037
Other assets	49,480	53,619	78,619	86,619	94,619
Total assets	140,944	161,439	186,191	215,259	248,404
Sundry creditors	33,368	32,601	44,932	52,971	60,343
Other current liabilities	14,610	19,365	21,454	21,472	21,490
Long-term debt/Convertibles	40,528	28,802	17,777	17,777	17,777
Other long-term liabilities	-183	2,403	2,403	2,403	2,403
Networth	52,621	78,268	99,625	120,636	146,391
Total liabilities & equity	140,944	161,439	186,191	215,259	248,404

Ratio analysis

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Sales growth (%)	13.2	42.1	25.9	17.9	13.9
Core EBITDA growth (%)	-21.7	170.5	20.1	13.7	16.0
Core EBIT growth (%)	-30.7	222.6	22.3	13.3	16.9
Core EBITDA margin (%)	8.3	15.9	15.1	14.6	14.9
Core EBIT margin (%)	6.1	13.9	13.5	13.0	13.3
Net profit margin (%)	6.4	11.2	11.1	10.6	10.8
Dividend payout ratio (%)	90.3	37.7	32.0	28.3	24.4
Tax rate (%)	19.3	26.7	25.6	23.6	23.6
Net Debt/Equity (%)	123.5	72.3	25.4	32.0	38.8
Return on Equity (%)	17.4	31.9	29.2	26.6	25.5
Return on Assets (%)	6.9	13.8	14.9	14.6	14.7

Source: Company data, IIFL Research

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.

SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.

Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.

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