



Mahindra & Mahindra

STOCK INFO.	BLOOMBERG
BSE Sensex: 19,978	MM IN
	REUTERS CODE
S&P CNX: 5,906	MAHM.BO

29 October 2007

Buy

Previous Recommendation: Buy

Rs796

Diluted Eq. Shares (m)	255.9
52-Week Range	1,002/608
1,6,12 Rel.Perf.(%)	-10/-42/-53
M.Cap. (Rs b)	203.8
M.Cap. (US\$ b)	5.1

YEAR	NET SALES	S/A PAT	ADJ.EPS	CONS.	P/E	CONS.	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	EPS (RS)	(X)	P/E (X)	(%)	(%)	SALES	EBITDA
3/07A	99,874	9,198	35.9	55.1	22.2	14.5	25.9	22.3	1.7	14.2
3/08E	113,496	9,372	36.6	63.7	21.7	12.5	22.0	21.0	1.4	12.3
3/09E	126,287	10,127	39.6	75.5	20.1	10.5	20.6	20.8	1.2	10.6

- ✦ M&M's standalone results for 2QFY08 were below our expectations. Adjusted PAT declined 8.6% YoY to Rs2.3b, while EBITDA margin declined 260bp YoY (up 20bp QoQ) on account of higher staff costs and higher other expenditure.
- ✦ The company has reported overall volume growth of 8.3% YoY (excluding Logan). Net sales (adjusted for octroi refund of Rs9.3b) grew 10.6% YoY to Rs27.1b, boosted by realization growth of 2.1% YoY. (Net sales in 2QFY07 have also been adjusted for an octroi refund of Rs4b).
- ✦ EBITDA margin at 10.8% (-260bp YoY and +20bp QoQ) was lower than our estimate of 11.7%, primarily on account of higher other expenditure and higher staff costs –performance awards and ex-gratia were sanctioned (amount not disclosed), there was recruitment at new locations, and salaries were revised during the quarter.
- ✦ M&M's total consolidated gross revenue (including other income but adjusted for excise refund in standalone entity) grew 40.3% YoY to Rs63.9b, while the adj. PAT declined 10.4% YoY to Rs3.3b (adjusted for octroi refund in 2QFY08, and for Tech Mahindra stake sale gain, Tech Mahindra special dividend, and octroi refund in 2QFY07).
- ✦ We remain positive on the core business of M&M and the accretion to its share value from its subsidiaries. The imminent IPO of Mahindra Holidays will result in further value unlocking for the stock. The stock trades at 12.5x FY08E consolidated EPS of Rs63.7 (-0.9%) and 10.5x FY09E consolidated EPS of Rs75.5 (+0.4%). We maintain **Buy**.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Total Volumes (nos)	62,417	66,649	73,971	77,720	70,915	72,203	81,400	85,738	280,766	310,256
Total Income	22,172	24,501	25,761	27,439	26,128	27,095	29,056	31,217	99,874	113,496
Change (%)	22.4	28.0	17.8	23.2	17.8	10.6	12.8	13.8	22.7	13.6
Total Cost	19,660	21,209	22,664	24,340	23,357	24,170	25,570	27,492	87,874	100,589
EBITDA	2,512	3,292	3,096	3,099	2,771	2,925	3,487	3,725	12,000	12,907
As % of Sales	11.3	13.4	12.0	11.3	10.6	10.8	12.0	11.9	12.0	11.4
Change (%)	30.2	50.9	17.5	46.3	10.3	-11.2	12.6	20.2	35.4	7.6
Non-Operating Income	454	478	412	354	316	692	450	326	1,698	1,784
Extraordinary Income	190	1,393	0	116	0	929	0	0	1,699	929
Extraordinary Expense	15	0	6	192	16	19	0	0	213	35
Interest	-147	-155	-168	-205	-51	82	60	44	-675	135
Gross Profit	3,288	5,318	3,670	3,582	3,122	4,444	3,877	4,008	15,859	15,450
Less: Depreciation	463	501	522	609	571	577	590	595	2,096	2,332
PBT	2,825	4,817	3,148	2,973	2,551	3,867	3,287	3,413	13,763	13,118
Tax	784	952	731	613	640	1,008	756	754	3,079	3,157
Effective Tax Rate (%)	27.7	19.8	23.2	20.6	25.1	26.1	23.0	22.1	22.4	24.1
PAT	2,042	3,865	2,417	2,360	1,912	2,859	2,531	2,659	10,684	9,961
Change (%)	40.6	145.9	3.5	-26.5	-6.4	-26.0	4.7	12.7	24.7	-6.8
Adj PAT	1,867	2,472	2,423	2,436	1,923	2,259	2,531	2,659	9,198	9,372
Change (%)	27.2	55.8	35.3	49.0	3.0	-8.6	4.4	9.2	42.0	1.9

E: MOST Estimates

M&M has reported overall volume growth of 8.3% YoY for 2QFY08 (excluding *Logan*), driven by strong growth in LCVs (+40.2% YoY) and UVs (+18.2% YoY). Three-wheeler sales growth was lower at 2.6% YoY, while tractor sales were down 5.7% YoY on account of stringent financing norms and the high base of the previous year. *Logan* sales in 2QFY08 were 7,326 units, while YTD *Logan* sales are 12,493 units.

Farm equipment segment performance

Tractor sales in 2QFY08 were down 5.7% YoY on account of stringent financing norms and the high base of the previous year. Despite tractor industry sales declining in 1HFY08, M&M's market share has increased from 29.8% to 32% (including Punjab Tractors, its market share has increased from 39% to 39.5%).

TRACTORS: REGION-WISE MARKET SHARE

STATE	% OF INDUSTRY		COMMENT
	SALES	M&M MKT SHARE	
Karnataka	7.0	32.0	Last 2 years have seen volume degrowth
Tamil Nadu	7.0	39.3	-
Uttar Pradesh	16.0	24.2	Part of the sugar belt
Gujarat	9.0	26.2	Banks have stopped funding
Rajasthan	11.0	23.6	-
Andhra Pradesh	11.0	43.0	Part of the paddy belt, which is a growing market

Source: Company

The key reasons for the decline in tractor sales in 1HFY08 are:

- ☞ Increase in NPAs for banks, resulting in lower financing and more stringent financing norms. Also, interest rate has increased from 10% to 14%.
- ☞ Constraints on castings, leading to lower production.
- ☞ Drop in volumes in the sugar belt states of Madhya Pradesh and Karnataka due to the ongoing problems in the sugar industry, followed by a drop in volumes in Uttar Pradesh, Gujarat, Maharashtra, Rajasthan and Tamil Nadu.

However, these problems are getting resolved to some extent, with Mahindra Financial Services offering easy loans to tractor buyers, and foundry expansion at Punjab Tractors being approved. Moreover, on a macro level, the area sown has increased by 4% in FY08, which will drive demand for tractors, as well.

Automotive segment performance

Utility vehicles: UV growth remained robust in 2QFY08, increasing by 18.2% YoY, driven by non-*Scorpio* sales. *Scorpio* sales growth in the quarter was 8.3% YoY. Non-*Scorpio* segments like the re-launched *Bolero* are driving sales.

M&M's UVs are facing competition from GM's *Tavera* and Toyota *Innova*. Nevertheless, M&M continues to be the leader in the segment, with a domestic market share of 43% (+260bp YoY). We expect UV volumes to increase by 12.5% in FY08 and by 11% FY09.

Three-wheelers: M&M has been performing well in the three-wheeler segment; however, after increasing by 11.1% YoY in 1QFY08, growth has slowed down in 2QFY08, increasing by just 2.6% YoY. Growth is being driven by conversion to CNG, leading to higher demand in cities such as Ahmedabad. M&M has increased its domestic three-wheeler market share in 1HFY08 to 22.5% (from 16.9% in 1HFY07) in the goods segment. However, its presence in the passenger segment continues to be marginal.

VOLUME BREAK-UP (UNITS NOS)

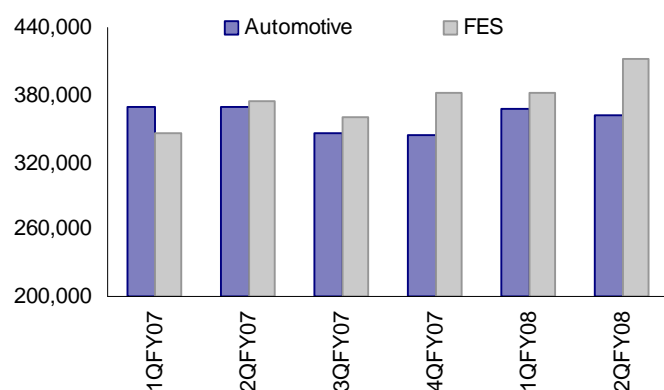
	2QFY08	2QFY07	% CH.	1QFY08	% CH.
Utility Vehicle	38,067	32,207	18.2	33,607	13.3
LCVs	2,792	1,991	40.2	2,681	4.1
Three Wheelers	9,117	8,887	2.6	7,336	24.3
Cars	7,326	0	NA	5,175	NA
Total Automotive	57,302	43,085	33.0	48,799	17.4
Tractors	22,227	23,563	(5.7)	27,291	(18.6)
Total	79,529	66,648	19.3	76,090	4.5

Source: Company/Motilal Oswal Securities

EBITDA margin declines

Net sales (adjusted for octroi refund of Rs9.3b) grew 10.6% YoY to Rs27.1b, boosted by realization growth of 2.1% YoY. (Net sales for 2QFY07 have also been adjusted for an octroi refund of Rs4b).

REALIZATION FOR FARM EQUIPMENT SEGMENT IMPROVES (RS/UNIT)



Source: Company/Motilal Oswal Securities

EBITDA margin at 10.8% (–260bp YoY and +20bp QoQ) was lower than our estimate of 11.7%, primarily on account of higher other expenditure (14.8% v/s 13.7% in 2QFY07 and 1QFY08) and higher staff costs (8.5% v/s 6.7% in 2QFY07 and 7.2% in 1QFY08). However, raw-material costs were lower at 65.9% of net sales (v/s 66.2% in 2QFY07 and 68.4% in 1QFY08) aided by an increase in inventory of Rs1.8b.

SEGMENTAL PERFORMANCE (RS M)

	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08
Revenue from Operations						
Automotive Segment	12,248	15,161	15,103	17,820	15,045	17,090
Farm Equipment Segment	9,463	8,833	10,145	8,964	10,385	9,164
Other Segments	926	1,151	1,215	1,398	1,301	1,650
Total	22,637	25,145	26,463	28,182	26,731	27,904
Profit/Loss Before Interest and Tax						
Automotive Segment	1,040	1,914	1,513	1,727	1,317	1,625
Farm Equipment Segment	1,274	1,255	1,522	1,054	1,390	1,148
Other Segments	35	39	68	122	37	23
Total	2,350	3,208	3,102	2,903	2,744	2,796
EBIT Margins (%)						
Automotive Segment	8.5	12.6	10.0	9.7	8.8	9.5
Farm Equipment Segment	13.5	14.2	15.0	11.8	13.4	12.5

Source: Company/Motilal Oswal Securities

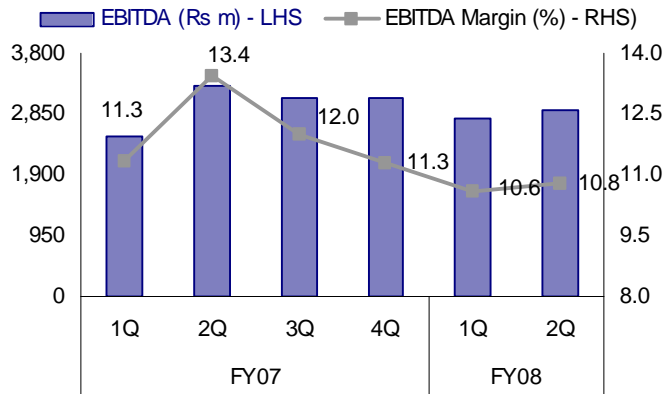
Staff cost was higher on three main counts – performance awards and ex-gratia were sanctioned (amount not disclosed), there was recruitment at new locations, and salaries were revised during the quarter. Performance awards and ex-gratia payment constitute a significant amount, and are unlikely to be repeated in the next two quarters.

Within the business segments, the automotive segment saw an EBIT margin decline of 310bp YoY, although it increased 70bp QoQ. The farm equipment segment saw EBIT margin declining 170bp YoY and 90bp QoQ.

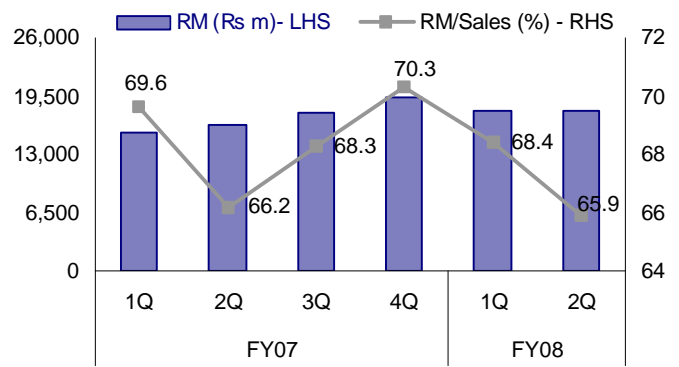
Other income was higher at Rs692m (adjusted for the one-time special dividend received from Tech Mahindra in 2QFY07). There was an interest expense on account of lower free cash flows due to expenditure incurred for capex and acquisitions.

M&M has been jointly sourcing material for both its tractor and automotive divisions for quite some time – synergies in sourcing will help M&M improve margins. Mahindra Systech will act as the sourcing partner. Further synergies in the automotive segment may be derived by joint sourcing by M&M and the M&M-Renault-Nissan JV.

EBITDA MARGIN DECLINES...

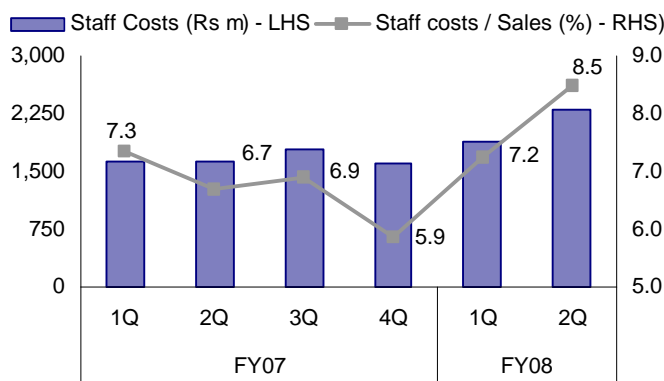


... EVEN AS RAW-MATERIAL COSTS DECLINE

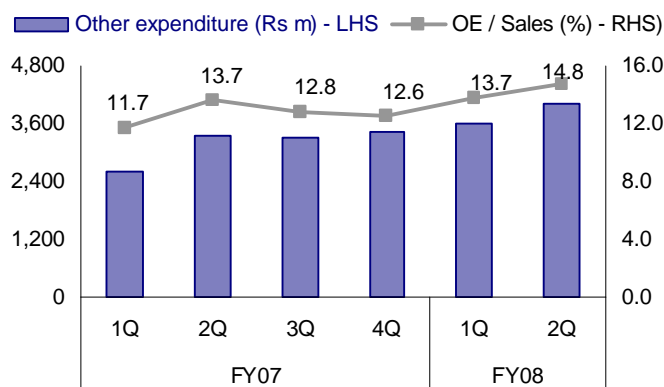


Source: Company/Motilal Oswal Securities

... DUE TO HIGHER STAFF COSTS...



... AND HIGHER OTHER EXPENDITURE...



Source: Company/Motilal Oswal Securities

Consolidated results

M&M's total consolidated gross revenue (including other income but adjusted for excise refund in standalone entity) grew 40.3% YoY to Rs63.9b, while the adj. PAT declined 10.4% YoY to Rs3.3b (adjusted for octroi refund in 2QFY08, and for Tech Mahindra stake sale gain, Tech Mahindra special dividend, and octroi refund in 2QFY07).

Valuation and view

We remain positive on the core business of M&M and the accretion to its share value from its subsidiaries. The imminent IPO of Mahindra Holidays will result in further value unlocking for the stock.

We have upgraded our realization estimate for FY08 to 2.8% (1.7% previously), while lowering our EBITDA margin estimate by 10bp to 11.4%. We expect M&M to report an EBITDA margin of 11.4% in FY09 (previous estimate 11.5%). We have also factored in high other income and interest expense (interest income in previous quarters). Our FY08 standalone EPS estimate stands reduced by 1.7%, while our FY09 estimate has increased by 0.4%. The stock trades at 12.5x FY08E consolidated EPS of Rs63.7 (-0.9%) and 10.5x FY09E consolidated EPS of Rs75.5 (+0.4%). We maintain **Buy**.

Mahindra & Mahindra: an investment profile

Background

Mahindra & Mahindra, the leading UV and Tractor manufacturer in the country, has gone from strength to strength during the quarter. Its market share in overall tractor sales stands at 32%. It is also expected to benefit from the Government's thrust on the development of the rural economy. In the UV segment, it is expected to maintain its market share in even in the face of competition.

Key investment arguments

- ✍ M&M has successfully ventured into various businesses, unrelated to its core business, thereby making it a diversified conglomerate.
- ✍ Most of these ventures have strong growth prospects (like Mahindra Systech), or have already entered into the growth phase (like Tech Mahindra).
- ✍ With several growth drivers for the company over the next 3-4 years, coupled with cheap valuations, M&M remains one of our top bets in auto sector.

Key investments risks

- ✍ Numerous launches in the UV has lead to an increase in the competitive scenario
- ✍ Higher interest rates may be a dampener for the UVs and passenger cars demand.

COMPARATIVE VALUATIONS

		M&M	TATA MOTORS	MARUTI
P/E (x)	FY08E	12.5	15.6	17.4
	FY09E	10.5	13.7	14.9
EPS Gr (%)	FY08E	15.7	-1.9	26.4
	FY09E	18.6	13.6	16.8
RoE (%)	FY08E	22.0	21.4	22.7
	FY09E	20.6	21.0	21.3
EV/EBITDA (x)	FY08E	12.3	10.4	9.9
	FY09E	10.6	9.4	8.3

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	22.7	23.0	23.2
Domestic Inst	25.6	23.2	21.5
Foreign	35.0	37.3	41.9
Others	16.7	16.5	13.4

Recent developments

- ✍ Mahindra – Renault's first product launch – the Logan, has been launched in the fast growing 'C' segment.
- ✍ The JV would start contributing positively to M&M's consolidated earnings post FY08.
- ✍ M&M has acquired Actis and the Burman family's 43.3% stake in Punjab Tractors, and has made an open offer for a further 20% stake.

Valuation and view

- ✍ We remain positive on the growth prospects of M&M's core business. We expect volume growth of 6% in tractors and 12.5% in UVs in FY08, with stable margins at 11.4 in FY08 and FY09.
- ✍ The stock trades at 12.5x FY08E cons. EPS of Rs63.7 (-0.9%) and 10.5x FY09E cons EPS of Rs75.5 (+0.4%). Maintain **Buy**.

Sector view

- ✍ We remain bullish on the macro growth picture for passenger cars in India
- ✍ We also believe that within passenger cars, UVs will increase their market share consistently over the next few years
- ✍ We maintain an overweight stance on the sector.

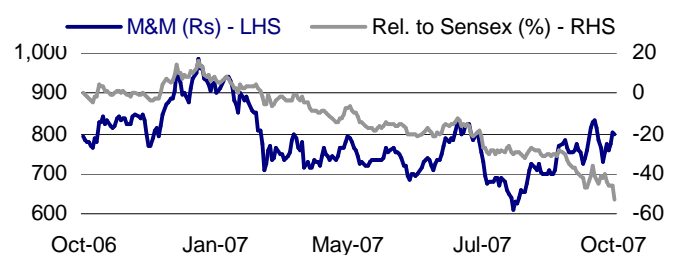
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	63.7	54.9	16.2
FY09	75.5	60.1	25.7

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
796	1,029	29.3	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Total Income	66,606	81,412	99,874	113,496	126,287	
Change (%)	34.8	22.2	22.7	13.6	11.3	
Total Expenditure	58,897	72,546	87,874	100,589	111,901	
EBITDA	7,709	8,865	12,000	12,907	14,386	
Change (%)	50.8	15.0	35.4	7.6	11.5	
% of Net Sales	11.6	10.9	12.0	11.4	11.4	
Depreciation	1,840	2,000	2,096	2,297	2,597	
EBIT	5,869	6,865	9,904	10,610	11,789	
Deferred Revenue Exp.	0	0	0	35	0	
Interest & Finance Charges	-56	-184	-675	135	162	
Other Income	1,084	1,854	1,698	1,784	1,876	
Non-recurring Expense	3	8	213	35	0	
Non-recurring Income	136	2,100	1,699	929	0	
Profit before Tax	7,141	10,995	13,763	13,118	13,503	
Tax	2,015	2,424	3,079	3,157	3,376	
Effective Rate (%)	28.2	22.0	22.4	24.1	25.0	
Profit after Tax	5,126	8,571	10,684	9,961	10,127	
Change (%)	47.1	67.2	24.6	-6.8	17	
Adj. Profit after Tax	5,040	6,479	9,198	9,372	10,127	
Change (%)	52.0	28.6	42.0	19	8.1	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Share Capital	2,320	2,334	2,380	2,380	2,380	
Reserves	18,962	26,755	33,149	40,194	46,698	
Net Worth	21,283	29,089	35,529	42,575	49,078	
Deferred tax	1,898	1,468	198	198	198	
Loans	10,526	8,834	16,360	16,360	16,360	
Capital Employed	33,706	39,390	52,087	59,133	65,636	
Gross Fixed Assets	26,997	28,855	32,297	36,797	41,297	
Less: Depreciation	13,356	15,103	16,391	18,689	21,285	
Net Fixed Assets	13,642	13,753	15,906	18,108	20,012	
Capital WIP	1,107	1,792	2,806	503	503	
Investments	11,898	16,691	22,375	22,375	22,375	
Curr.Assets, L & Adv.	24,334	27,614	37,482	48,648	56,872	
Inventory	7,294	8,419	8,785	12,715	14,145	
Sundry Debtors	5,115	6,380	7,009	8,767	9,761	
Cash & Bank Balances	6,240	7,303	13,261	24,621	30,411	
Loans & Advances	4,197	5,112	8,394	2,502	2,502	
Others	1,488	400	33	43	53	
Current Liab. & Prov.	17,518	20,640	26,656	30,677	34,300	
Sundry Creditors	10,948	13,707	18,136	23,084	25,835	
Other Liabilities	1,572	1,502	1,366	1,416	1,466	
Provisions	4,997	5,431	7,154	6,177	7,000	
Net Current Assets	6,816	6,974	10,825	17,971	22,571	
Misc. Expenditures	244	181	176	176	176	
Application of Funds	33,706	39,390	52,087	59,133	65,636	

E: MOSI Estimates

RATIO						
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Basic (Rs)						
Adjusted EPS	19.7	25.3	35.9	36.6	39.6	
Consolidated EPS	24.2	38.5	55.1	63.7	75.5	
Cash EPS	29.7	36.3	47.4	49.0	53.5	
Book Value per Share	91.7	124.6	149.3	178.9	206.2	
DPS	13.0	10.0	11.5	12.5	15.0	
Payout (Incl. Div. Tax) %	59.6	28.5	25.9	30.2	35.8	
Valuation (x)						
P/E		315	22.2	21.7	20.1	
Consolidated P/E		20.7	14.5	12.5	10.5	
Cash P/E		21.9	16.8	16.2	14.9	
EV/EBITDA		19.3	14.2	12.3	10.6	
EV/Sales		2.1	1.7	1.4	1.2	
Price to Book Value		6.4	5.3	4.5	3.9	
Dividend Yield (%)		13	14	16	19	
Profitability Ratios (%)						
RoE	23.7	22.3	25.9	22.0	20.6	
RoCE	20.6	22.1	22.3	21.0	20.8	
Leverage Ratio						
Debt/Equity (x)	0.5	0.3	0.5	0.4	0.3	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
OP/(Loss) before Tax	5,869	6,865	9,904	10,575	11,789	
Int./Dividends Received	1,084	1,854	1,698	1,784	1,876	
Depreciation & Amort.	1,840	2,000	2,096	2,297	2,597	
Direct Taxes Paid	-2,150	-2,854	-4,349	-3,157	-3,376	
(Inc)/Dec in Wkg. Capital	6	905	2,106	4,214	1,189	
CF from Oper. Activity	6,649	8,770	11,456	15,714	14,075	
Extra-ordinary Items	132	2,092	1,486	894	0	
Other Items	-147	63	5	0	0	
CF after EO Items	6,634	10,926	12,947	16,608	14,075	
(Inc)/Dec in FA+CWIP	-2,471	-2,796	-5,263	-2,197	-4,500	
(Pur)/Sale of Invest.	-786	-4,793	-5,684	0	0	
CF from Inv. Activity	-3,257	-7,589	-10,947	-2,197	-4,500	
Change in Net Worth	300	1,674	-1,472	106	2	
Inc/(Dec) in Debt	3,228	-1,692	7,526	0	0	
Interest Paid	56	184	675	-135	-162	
Dividends Paid	-3,054	-2,440	-2,772	-3,020	-3,624	
CF from Fin. Activity	530	-2,274	3,957	-3,049	-3,784	
Inc/(Dec) in Cash	3,907	1,063	5,957	11,361	5,791	
Add: Beginning Balance	2,333	6,240	7,303	13,261	24,621	
Closing Balance	6,240	7,303	13,261	24,621	30,413	

E: MOSI Estimates

N O T E S



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Disclosure of Interest Statement

Mahindra & Mahindra

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
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