KIM ENG

Mahindra

BUY

Initiating Coverage

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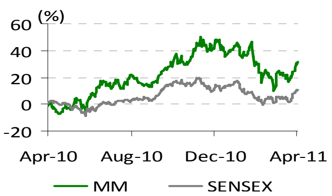
Price	**Rs711**
Target	**Rs845**
BSE Index	**19,421**

Historical Chart



Performance	1m	3m	6m
Absolute (%)	*6.3*	*-8.6*	*-2.3*
Relative (%)	*1.2*	*-3.3*	*2.8*

Stock Information

Ticker code	MM IN
Market cap (US$m)	9701
52-week high (Rs)	826
52-week low (Rs)	475
Shares issued (m)	587
6m avg d.vol (US$m)	35.3
Free float (%)	77.2
Major shareholders (%)	
Mahindra Group	22.8

Statutory Auditor
Deloitte Haskins & Sells

Key Indicators (FY12F)

ROE (%)	27.3
Net gearing (%)	Net Cash
NTA (US$bn)	129
Interest cover (x)	102

INDIA

Mahindra & Mahindra Ltd (MM)

Proxy on growing rural consumption, BUY

MM, is a leading maker of tractors and utility vehicles (UVs). Growing rural income (rising agri price) would support EPS growth of 17–20% over FY11-FY13. MM's sales are far less sensitive to crude prices unlike those of passenger car makers because tractors (38% of MM's revenue) are business equipment for farmers. We derive our 'sum-of-the-parts' valuation of Rs845/sh by valuing the auto business at PER of 12x FY12F (Rs614/sh) and investments at market price (Rs232/sh).

Rural market accounts for 60% of revenue

MM's sales volume is growing 15% pa. We forecast it to remain at this level over the next 2 years. Market share gains through innovative product launches have helped MM to exceed sector growth of 12% (estimated by auto makers). For our FY12 earnings forecast, we factor in market share gains in the UV and CV segments (+150bp in UV and +350bp in CV).

FY12F GM to remain unchanged at 29%; EPS growth of 17%

GM ranged 27–32% and in the past 3 years. Rising prices of steel cut GM to 29% in FY11. We are confident of EPS growth of 21% for FY11F and 17% in FY12F because tractor sales, which form 50% of earnings, are at less risk from rising interest rates and fuel prices.

3-year CAPEX of Rs70bn funded mainly by free CF; net D/E of 0.1x

Capex on product development is Rs14bn for FY11 and Rs18bn pa over the next 2 years. In Jan 2011, MM acquired 70% stake in Ssangyong, the Korean SUV maker, for Rs21bn.

PER based 'sum-of-the-parts' valuation of Rs845/sh

MM's CMP of Rs711 reflects value of only the auto business. Market value of its holdings in financial services, technology is at least Rs232/sh.

Year End March 31	FY09	FY10	FY11F	FY12F	FY13F
Revenue (Rs bn)	130.9	186.0	235.9	277.8	315.9
Recurring Net Profit (Rs bn)	7.7	19.8	25.3	30.0	35.6
Recurring EPS (Rs)	14.2	36.1	43.8	51.1	60.7
EPS growth (%)	-25.1	*154.7*	*21.3*	*16.7*	*18.7*
PER (x)	49.3	19.4	16.0	13.7	11.5
P/BV (x)	7.5	5.1	4.2	3.4	2.8

SEE APPENDIX I FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATIONS

Revenue – Auto maker with rural India focus

One of India's most respected conglomerate

MM's current product range includes utility vehicles, tractors, engines, cars, 2 and 3 wheelers and even small aircraft. Its key focus remains the rural market where it enjoys strong brand loyalty among customers for its products and services. (Details of products in **Annexure 1**, page 15). This note focuses on MM auto business and covers the standalone financials of the company.

Revenue grew by 2.2x in past 5 years

In the last 5 years, MM doubled revenue to Rs186bn by gaining share in the rural market. Its current product range includes:

- Passenger vehicles (63% market share in UV's) - 49% of MM's revenue
- Tractors (41% market share) - 38% of MM's revenue
- Commercial vehicles (17% market share) - 13% of MM revenue

MM: Sales break-up

Segment (Yr to Mar)	FY06	FY07	FY08	FY09	FY10
Passenger vehicles ('000)	86	101	142	127	164
% of revenue	*53*	*53*	*54*	*51*	*49*
Tractors ('000)	85	103	99	120	175
% of revenue	*37*	*37*	*35*	*37*	*38*
Commercial vehicles ('000)	64	77	89	102	133
% of revenue	*10*	*10*	*11*	*12*	*13*
Total volume ('000)	**235**	**281**	**330**	**349**	**472**
Total revenue (Rs bn)	**79.9**	**96.0**	**108.0**	**126.5**	**180.3**

Source: Company data

For FY11, we forecast volume growth of 28% and revenue growth of 27%. Strong demand and market share gains for tractors, utility vehicles and commercial vehicles support this growth.

High base to moderate future growth

We forecast MM's revenue to grow at 10% pa over FY12/13. Growth will be supported by 15% increase in volume thru rising demand from the rural sector and entry into new segments.

Utility Vehicles - New launches to support growth

MM's core strength lies in the UV segment where it is the market leader with 62% share. MM has strengthened its position in the UV market thru:

- Growth in existing brands
- Acquisition of Ssangyong
- Major new product launches in FY12

Top 3 brands are in good demand

The UV segment accounts for 49% of revenue. It has 3 main products:

- *Bolero* - The best selling SUV in India, 45% MM's UV volume
- *Scorpio* - Popular as a value-for-money vehicle - 35% of volume
- *Xylo* - Targeted at the urban user - 20% of volume.

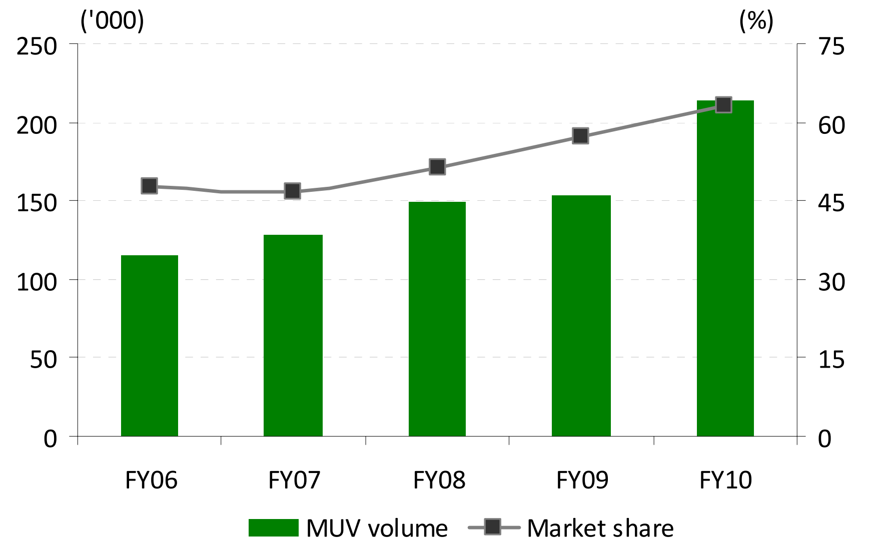
Both *Bolero* and *Scorpio* are mostly sold in the rural market due to their affordability, low maintenance cost, and fuel economy. *Xylo* was launched in Jan 2009, keeping in mind the semi-urban and city user in the price range of Rs600–750k. The cheapest foreign SUV (*Toyota Innova*) is 20–30% costlier than Xylo. MM competes with Tata Motors and Toyota in the mid-priced UV segment.

Thar is a new launch in Q3 FY11, more to follow in FY12

MM's UV volume grew 70% in the past 4 years to 170k. For FY12, we forecast 15% growth in line with sector growth. Our growth forecast is below the high growth of the past because of increasing competition and launch of new models like Thar (Dec '10) that are not in our forecast.

MM is consistently ahead of Tata Motor and Toyota

MM: Market share in UV segment



Source: Company data; Note: MUV includes passenger and commercial vehicles (2-4 ton GVW)

To target urban market in FY12

During FY12, MM will enter the high end SUV market, a segment in which it is not yet present. It will achive this by launching *W201*, a locally developed SUV and thru the acquired Ssangyong's portfolio (launch of *Korando C* and *Rexton* SUVs). Refer to discussion on acquisition of Ssangyong on page 9

Xylo compact and W201 could provide trigger to volume next year

MM considers *W201* as its most significant new launch in the past 8 years after its launch of *Scorpio* in 2003. Details of planned launches are:

MM: New product launches

Product	Segment	Price Range (Rs '000)	Date
Xylo Compact	A2*	450-500	Jun-11
Mahindra 'W201'	Premium SUV	1200-2000	Jun-11
Ssangyong Korando C	Premium SUV	1200-2000	Mar-12
Ssangyong Rexton	Premium SUV	1200-2000	Mar-12

*Source: Company data, SIAM; Note: *length less than 4m*

Farm Equipment/Tractors – Growth thru innovation

Tractors account for 38% of revenue.

Strong brand equity with Indian farmers

MM makes tractors in a wide engine rating of 15–125 HP, catering to a large user segment. Almost all its sales are domestic and it exports only 5%.

MM competes with TAFE, Eicher Motors, Sonalika at home, and John Deere globally.

MM's tractor sales doubled in the past 4 years due to a combination of strategies as outlined below:

- Rural prosperity/increased credit to farm sector
- Acquisition/Innovation
- Exports

Rising rural income, cheap credit support tractor demand

<10% of Indian farmers own tractors

Farming contributes 17% to India's GDP but provides livelihood to 50% of the population. Despite India being one of the world's largest food grain producers, farming in India is manual due to the small size of farms and lack of credit for automation. Until 2006, tractor demand grew at 7% pa.

Gov't thrust on food security and rural prosperity

In the past 4 years demand grew 14% pa following gov't schemes to help farmers fair secure price for crops. The schemes included:

- Cheap credit - farm loans at interest rate of 7% (4% below commercial loans rate)
- Waiver of loans disbursed prior to 2005
- Encouraging fair pricing for crop purchases to remove price cartels
- Specific programs to increase rural employment.

MM capitalized on demand for customized products

Nearly 80% of farms in India are below 5 acres in size and hence face major productivity issues. Keeping in mind these limitations, MM offers many products (*Arjun, Bhoomiputra, Sarpanch, Shaan* and *Yuvraj*) to specifically suit soil types of small farms in different regions. This enabled MM increase tractor market share to 42% from 30% in 3 years.

Minimum support price for crops helped farmers

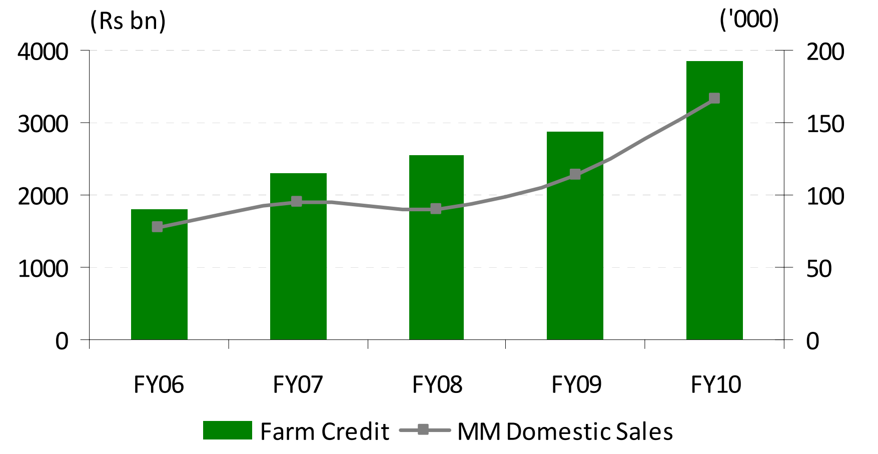
Farmers benefited from market-driven prices of crops and increase in farm land. This new prosperity induced farmers to increase mechanization in farming.

NREGA is a big success

Gov't schemes such as the National Rural Employment Guarantee (NREGA), which has a budget of Rs500bn, are boosting increase in farming activities. The NREGA scheme, which was launched in 2009, has provided direct funds to millions of farmers across the country.

Central bank mandates banks to lend 40% to farm/rural sector

MM: Rising farm credit supports tractor demand



Source: Company data, Reserve Bank of India

MM offers other services to engage farmers

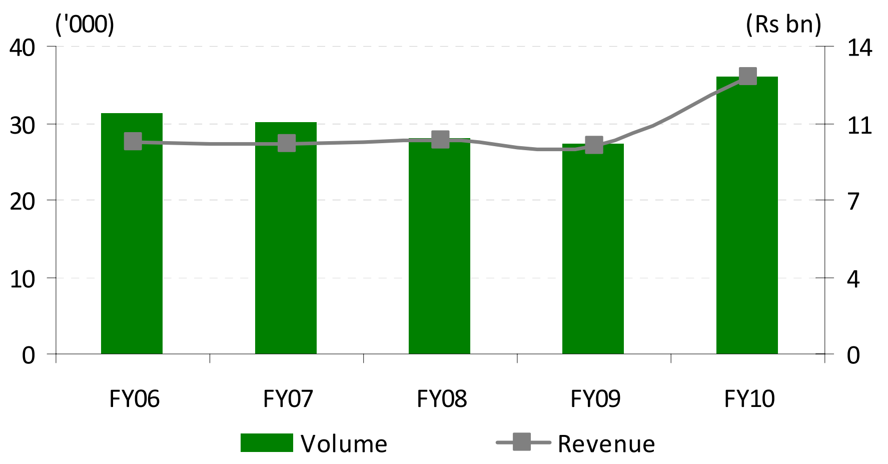
To increase its hold on the farm sector, MM offers supplementary equipment to farmers, financing for tractor purchase, micro irrigation, and crop protection/nutrition support. It runs 75 centers named 'Samruddhi', which provide free assistance to farmers on crop patterns, prices etc.

Acquisition of the *Swaraj* brand

Punjab tractor acquisition gave a strong foothold in North

MM acquired the *Swaraj* brand of tractors through its acquisition of Punjab Tractors (the 3rd largest tractor company in India) in March '08. This increased it market share and added a new territory, the Punjab state, to MM's business.

MM: Swaraj sales and revenue

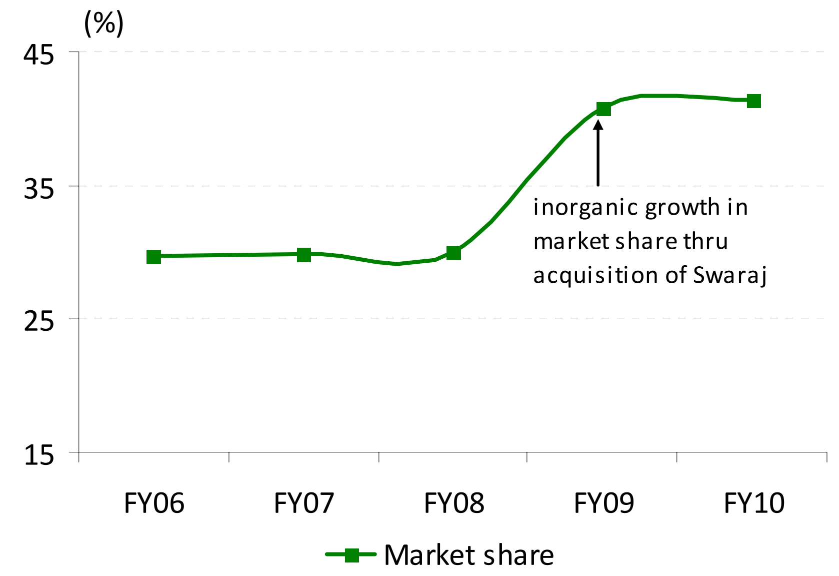


Source: Company data, Punjab Tractors Ltd

Acquisition of Punjab Tractors has increased MM's market share to 40% in FY09 from 30% earlier. Swaraj has market share of 8%.

Next competitor has less than half of MM's market share

MM: Market share in the tractor segment



Source: Company data

After 2 big years tractor volume could rise by 11%

We forecast MM to sell 215k tractors in FY11 and 238k tractors in FY12. Sales growth in FY12 will mainly come from 10% increase in domestic demand.

MM: Sales by brand ('000)

Brand (Yr to Mar)	FY06	FY07	FY08	FY09	FY10
MM	78.0	95.0	90.5	85.9	126.5
Swaraj	-	-	-	27.4	40.0
MM total sales	78.0	95.0	90.5	113.3	166.5
Industry	**262.1**	**317.7**	**302.2**	**303.9**	**400.2**

Source: Company data

Exports/International business – Slow but rising

MM currently exports 9k tractors to the US and Europe mainly due to competitive pricing. Exports grew 27% (+1.9k units, 6.9k units in FY06) in the past 5 years. Due to the global recession, which was more pronounced in the US and Europe, MM's tractor sales decreased to 6.9k units in FY09. We forecast 20% growth in exports in FY11/12.

Entered China thru JV in 2009

To increase its presence in the international market through means other than exports, MM set up JVs to manufacture and distribute tractors in China, the largest tractor market in the world after India. FY11 is the second year of production and MM expects to sell 40k tractors in FY11 in China.

Commercial vehicles - High growth due to low base and aggressive new launches

CVs form 13% of MM's revenue. MM competes in the light commercial vehicle (LCV) segment thru its 4-wheeler pick-ups and 3-wheelers. Growth will come thru:

- Strong demand for small trucks
- Entry into large trucks thru JVs

CV forms 9% of MM's earnings

Over the past 3 years, MM's earnings for the CV segment grew at 22% pa. We forecast CV sales to grow 22% in FY12, supported by the successful launches of new products such as *Gio, Maxximo* and *Genio* in FY11 (combined volume of 42k units). MM competes with Tata Motors, Ashok Leyland, Bajaj Tempo and Eicher in the trucks segment.

Low base and new launches are driving growth

MM is the 2nd largest LCV maker in India with 20% market share. It has products from lower than 1 ton to 7 tons. In the past 2 years, MM focused on the rapidly growing small truck category by launching *Gio* and *Maxximo*. These products were responsible for most of the incremental volume and they increased market share as well. MM is gearing up to launch 2 new products in FY12.

MM: Market share in light commercial vehicle segment

Yr to Mar ('000 units)	FY06	FY07	FY08	FY09	FY10
MM CV's*	64	77	89	100	131
4 Wheelers Industry	143	192	229	232	338
3 Wheelers Industry	360	404	365	350	440
Total LCV Industry	**503**	**596**	**594**	**582**	**778**
MM Market share (%)	13	13	15	17	17

*Source: Company data, SIAM; Note: *includes sales from Mahindra Navistar JV*

JV with Navistar allows MM to create a new segment for growth

In 2007, MM formed a 51-49% JV with Navistar of US to make CV's with gross vehicle weight (GVW) rating of between 3.5 tons and 49 tons. The partnership complements MM's existing portfolio of 3.5-7 tons vehicles and provides entry to the US market (one of the largest markets for pick-up trucks).

Sales of large trucks will double next year

The JV launched its first heavy weight truck (25 ton cargo) in Nov 2010, with reasonable success. The JV has 2 more launches in the pipeline for FY12. These trucks are aimed to compete directly with Tata Motors and Ashok Leyland in the cargo, tipper, and tractor-trailer segment.

In FY11, the JV sold 11k vehicles (including 500 heavy trucks) and for FY12 we expect the number to increase 104% to 23.5k (including 12k heavy trucks).

Diversification into overseas market thru Ssangyong

MM did a geographic diversification by acquiring Ssangyong

MM diversified its investment portfolio by investing in financial services, property, technology, etc. The Main income drivers, however, remain the auto and tractor businesses which form 61% of earnings. To achieve geographic diversity in the auto business, MM acquired a tractor company in Punjab and recently acquired Korean SUV maker Ssangyong. This acquisition is a major step toward reducing dependence on India's automobile industry.

Ssangyong will provide technology and global distribution

MM paid Rs21bn to acquire 70% stake in Ssangyong, Korea. MM funded this acquisition thru internal CF. A large part of these funds were paid to settle Ssangyong's creditors. Ssangyong has no debt on its books now and MM also funds its working capital requirements.

Ssangyong's operating loss narrowed to KRW55bn (Rs2.2bn) in CY10 compared with KRW293bn (Rs12bn) in CY09. These losses were mainly due to high funding cost and dearth of working capital funds for development of new products.

We believe Ssangyong will prove to be a good platform for expanding into the global markets. For FY12, MM management is undertaking the following initiatives to generate a turnaround in Ssangyong's earnings:

- MM targets production at full capacity and sales of 50% more vehicles in FY12. Ssangyong is operating below capacity (capacity of 120k, production of 81k vehicles).
- It intends to spend Rs2.0bn on product development and brand building in FY12
- MM will enhance its SUV portfolio by launching Ssangyong's products *Rexton and Korando-C* in the Indian market in FY12. Ssangyong will add 20% to MM's overall volume in FY12F.
- MM will use Ssangyong's distribution in Western Europe to export its products.

Given MM's past track record of acquisitions, we believe Ssangyong should emerge profitable in FY12. Over the next 3 years, profit from Ssangyong should yield ROI of 13% on MM's investment. In 3 years, it would contribute 30% to MM's earnings and to that extent reduce its dependence on earnings from India.

Other auto businesses – Electric car and 2 wheelers

Electric cars is a product of the future

MM acquired the Reva, the electric car company, in May 2010 from private equity investors AEV LLC and the founders Maini Group. However, it retained the founding team and promoters. MM paid Rs550m to acquire 55% stake in Reva and it plans to invest Rs450m more to increase Reva's capacity to 30k pa from 15k. Established in 1994 in Bangalore, Reva sold 4k cars since its inception.

Reva sales of 4000 have potential to rise 7x

The electric car market is at a nascent stage at present but it promises to emerge big in 5 years. A forecast by MarketResearch.com says that the global electric car market will grow 2x to 1.5m vehicles by 2014**.**

EV technology can enhance current UV/CV portfolio

With recent gov't push to promote environmentally friendly vehicles, electric cars are now Rs100k cheaper than before. This presents a large opportunity for growth for MM. The company plans to use the technology gained from Reva in its current UV and CV product portfolio to develop diesel-electric hybrid variants of its products.

Success of 2 wheeler business is untested

MM entered the 2-wheeler business in June 2008 thru acquisition of 80% stake of Kinetic Motors. MM renamed the company as 'Mahindra Two Wheelers' (MTW). MTW's major brands are *Rodeo* and *Duro* power scooters and *Stallio* motorbike. It has 1.3% market share (9MFY11) in the 2-wheeler sector.

So far, MM invested Rs1.2bn in MTW. It plans to increase market share to 3% over the next few years by leveraging its distribution net work.

Revenue from these two units is Rs6.9bn (3% of MM's total revenue)

Cost – Rising RM cost offset by overall efficiency

MM owns 10 production facilities across India

MM's passenger vehicles plants are located in Nashik and Pune in the state of Maharashtra in west India. In manufactures tractors at numerous plants spread across west India (Mumbai, Nagpur) and north India (Rajasthan, Punjab, Uttarakhand). It makes commercial vehicles in south, west and north India (Zaheerabad, Mumbai, Pune, Haridwar). It would be setting up a tractor plant in south India by end- FY12 at a cost of Rs3bn.

Strong and reliable vendor base

MM manufactures critical parts like engines, engine components and gears in house and outsources other parts. It outsources 70% of parts. To facilitate production and new launches, MM invested Rs25bn in a subsidiary, Mahindra Systech (MSAT), which manufactures critical parts, forgings, alloy steel components, and gears.

Other than RM cost overall volatility is low

For MM, steel, aluminum, rubber and components are major RM. In FY11, rising commodity prices increased RM cost by 300bp to 80% of total cost. We forecast RM cost to be unchanged in FY12.

Despite achieving a rapid rate of new launches in the recent past, MM reduced product development cost by 300bp to 4% in FY11. Due to strong brand acceptance, the company's SG&A expenses (including discounts) are low.

MM: Break up of expenses

Yr to Mar (Rs bn)	FY09	FY10	FY11F	FY12F	FY13F
RM & purchased products	92.4	123.5	164.1	192.2	217.3
(% of expenses)	*75*	*77*	*80*	*80*	*80*
Employees cost	10.2	12.0	14.1	16.3	18.6
(% of expenses)	*8*	*7*	*7*	*7*	*7*
SG&A	4.2	5.9	7.8	9.5	10.8
(% of expenses)	*3*	*4*	*4*	*4*	*4*
Product development	8.2	9.1	8.0	9.5	10.8
(% of expenses)	*7*	*6*	*4*	*4*	*4*
Depreciation	2.9	3.7	4.1	5.4	6.4
Manufacturing	3.9	4.5	4.8	5.4	5.4
Advertising & publicity	1.5	2.2	3.0	3.4	3.9
Expenses capitalized	-0.4	-0.6	-0.8	-0.9	-1.0
Total	**122.9**	**160.2**	**205.2**	**240.8**	**272.2**

Source: Company data, Kim Eng Securities

Earnings – Growth to be in line with volume, strong possibility of earning upgrades

In this note, we discuss only the standalone business (auto business) as information on its investment is often released with a time gap.

Our forecast for FY12 assumes stable GM of 29%

MM's EPS has risen 3x from global crisis level of Rs14.2. We forecast earnings growth of 17-21% for the next 3 years.

MM: Results and forecasts

Yr to Mar (Rsm)	FY09	FY10	FY11F	FY12F	FY13F
Revenue (Rs bn)	130.9	186.0	235.9	277.8	315.9
Recurring Net Profit (Rs bn)	7.7	19.8	25.3	30.0	35.6
Recurring EPS (Rs)	14.2	36.1	43.8	51.1	60.7
EPS Growth (%)	*-25.1*	*154.7*	*21.3*	*16.7*	*18.7*

Source: Company data, Kim Eng Securities

Our base case volume growth leaves scope for upgrades

The possible earnings upside and upgrades stem from 1) turnaround at Ssangyong, 2) above-expectation sales of new products such as *W201*, and 3 new light trucks, and 3) breakeven in *Logan* car when sales go above 1k cars/month (current 700/month).

Tractor earnings are less sensitive to interest rate and fuel price

Tractors forms 47% of earnings and UV 41% (balance from CV etc). For FY12, we forecast earnings growth of 14% from tractors and 20% from UVs.

MM: Segment wise contribution to earnings

	FY10		FY11F		FY12F		FY13F	
Segment	**Revenue (Rs bn)**	**EPS (Rs)**	**Revenue (Rs bn)**	**EPS (Rs)**	**Revenue (Rs bn)**	**EPS (Rs)**	**Revenue (Rs bn)**	**EPS (Rs)**
Passenger vehicles	86	14.1	108	17.5	130	21.0	150	25.5
Chg (%)			*25.0*	*24.5*	*20.7*	*19.6*	*15.2*	*21.6*
Commercial vehicles	21	2.2	30	3.9	37	4.6	44	5.5
Chg (%)			*43.8*	*82.0*	*22.4*	*16.7*	*17.5*	*18.7*
Tractors + FES	67	18.8	86	21.0	97	24.0	107	27.9
Chg (%)			*28.7*	*12.0*	*12.9*	*14.2*	*10.3*	*16.2*
Spare Parts	5	1.1	6	1.3	7	1.5	9	1.8
Chg (%)			*22.3*	*21.3*	*25.0*	*16.7*	*20.0*	*18.7*
Total	**180**	**36.1**	**230**	**43.8**	**272**	**51.1**	**309**	**60.7**
Chg (%)			***27.5***	***21.3***	***18.1***	***16.7***	***13.9***	***18.7***

Source: Company data, Kim Eng Securities

Ssangyong and Logan car are making losses

For MM, the risk to earnings comes from 1) recently acquired Ssangyong, which made loss of Rs2bn in FY11 and 2) the car production business (*Logan*) in a JV with Renault. The Logan JV may make loss of up to Rs1bn in FY11F.

Strategy in place to prevent losses and make profit very soon

MM is quite confident of a profitable year for Ssangyong in FY12 due to expected 50% increase in volume. Ssangyong has no debt and hence its financial position is sound, which will minimize scope for big losses.

In case of Logan, although the company has not confirmed this, we expect it to achieve breakeven on sales exceeding 1k cars/month. Currently, it is selling 700 cars a month.

Consolidated earnings are big enough to offset minor losses in startup businesses

MM's consolidated earnings are 20% more than its standalone earnings. The main contributors to consolidated earnings, apart from the auto business, are software and financial services. These businesses are growing strongly and would be able to offset small losses incurred by the newly acquired businesses.

Sensitivity – earnings are sensitive to change in GM

Margin pressure is a bigger risk to earnings than volume

MM's earnings would be affected by sharp increase in prices of steel or other RM in the short term. Usually, competition prevents an immediate increase in prices. Our sensitivity analysis shows that a 100bp increase in GM affects EPS by 9%. Vis-à-vis, a 5% change in volume will change earnings by 5.5%.

MM: Sensitivity analysis

Sensitivity Matrix (FY12F)	Change in EPS (%)
Revenue (base case - Rs277bn)	
Impact of 5% change in passenger volume	5.4
Impact of 5% change in tractor volume	4.2
Gross Margin (base case - 28.9%)	
Impact of 100bp change in GM	9

Source: Kim Eng Securities

B/S and cash flow – Negligible debt and free CF of Rs46bn in 2 years

Flexible to fund new investments/acquisitions

MM has one of the best B/S in the auto sector and corporate sector in India. Its capital efficiency reflects in its high ROCE (30%) and ROE (27%). This is after investing substantially in promoting businesses such as financial services, software, auto parts, and holiday resorts.

MM is comfortably placed to meet CAPEX of Rs70bn over the next 3 years from internal CF and balance debt. We forecast net D/E of 0.1x for FY11.

Free CF will rise in FY12F and FY13F due to no incremental investments

MM's free CF became positive last year due to less CAPEX and investments. For FY11E, we forecast free CF to reduce due to large CAPEX and investment. However, For FY12F and FY13F, free CF would rise sharply because investments will come down.

Efficient working capital boosts free CF

Further, efficient working capital management boosts MM's free CF. MM exploits its brand power to collect receivables in less than 1 month but pays its suppliers after 3 months. Its inventories are also low at 1 month. Therefore, even with an increase in sales, incremental working capital investments are negative.

MM: Cash flow statement

Yr to Mar (Rs bn)	FY09	FY10	FY11F	FY12F	FY13F
EBITDA	**13.1**	**31.4**	**37.7**	**45.8**	**54.2**
Accounts receivable	-0.4	-2.1	-1.2	-2.5	-2.3
Inventory	0.2	-1.3	-3.4	-2.6	-2.3
Other working capital	8.7	-0.7	12.6	7.9	7.0
Operating cash flow	**21.6**	**27.3**	**45.7**	**48.6**	**56.6**
Interest expenses	-0.5	-0.3	0.4	-0.4	-0.3
TAX	-2.0	-7.6	-8.6	-10.0	-11.9
Residual cash flow	**19.2**	**19.5**	**37.5**	**38.2**	**44.4**
CAPEX	-13.4	-7.0	-16.4	-16.8	-16.4
change in investments	-16.6	-3.2	-20.4	-1.5	-1.3
Free Cash Flow	**-10.8**	**9.2**	**0.7**	**19.8**	**26.7**

Source: Company Data, Kim Eng Securities

Rs50bn CAPEX to increase capacity 50% to 1m

Capacity rising 25% pa

In the past 4 years, MM's production capacity for passenger and commercial vehicles grew 83% to 450k units pa and its tractor capacity grew 60% to 250k.

By FY13, we forecast CAPEX of Rs50bn to increase total capacity by 50% to 1m units.

MM: Production Capacity ('000)

Segment (Yr to Mar)	FY07	FY09	FY11F	FY13F
4-wheeled vehicles	192	250	390	640
3-wheelers	54	72	60	60
Tractors	158	233	250	350
Total Capacity	**404**	**555**	**700**	**1,050**

Source: Company Data, Kim Eng Estimates

Valuation – PER re-rating warranted

Large investments require MM to be valued on 'sum-of-the-parts'

MM is a conglomerate with investments in numerous businesses. In the absence of detailed information on various investments (few are not publically listed), we use "sum-of-the-parts" valuation method to estimate fair value of the company. We value:

- The auto business using the PER and discounted CF methods
- The other investments at market price

Auto business valuation – using PER multiple

A 12x PER FY12 implies price of Rs614

We apply 12x PER to FY12F EPS of Rs51.1 to estimate the value of the auto business at Rs614/sh. Historically, auto stocks traded at PER of 15x–20x. Our PER rating of 12x FY12F is in line with peers in the auto sector. Tata Motor (TTMT) also trades at cheap PER of 8x FY12F and is due for re-rating. MM deserves higher PER than TTMT due to its strong rural presence and diversified earnings from tractors and other sectors, apart from its SUV business.

MM: PER comparison with peers

		CMP	Mcap	FY12F		
Company	Ticker	(Rs)	(US$bn)	EPS(Rs)	PER(x)	P/BV(x)
Tata Motors	TTMT	1,242	16.3	164.1	7.6	2.7
Mahindra & Mahindra*	MM	711	9.7	51.1	13.7	3.4
Maruti Suzuki	MSIL	1,271	8.2	78.1	16.3	5.5
Bajaj Auto	BJAUT	1,459	9.4	103.3	14.1	2.5
Hero Honda	HH	1,603	7.1	116.0	13.8	5.2

*Source: Kim Eng Securities, Bloomberg, *including value of investments*

Auto business valuation – using discounted CF method

Our model assumes weighted average cost of capital (WACC) of 12.3%, debt/equity of 0.1x and terminal growth rate of 5%.

DCF valuation of core business at Rs662/sh

MM: Discounted CF valuation

Yr to Mar (Rs bn)	FY11F	FY12F	FY13F	FY14F	FY15F	Terminal Value
PV of free cash flows	1	20	27	33	42	585
PV of forecasted period	79					
PV of terminal value	325					
Enterprise value	404					
Net Debt	16					
Equity Value	388					
No of shares (m)	587					
Value per share (Rs)	662					

Source: Kim Eng Securities

Investments – Valued at market price

MM has significant investments in other group companies, 6 of which are listed. Of its other investments in group companies, the largest is in Mahindra Systech, an auto components supplier, and its recent investment in Ssangyong.

To arrive at the value of investment for MM in other businesses, we have applied a 30% liquidity discount to the market price of listed companies and valued the unquoted companies at book price.

MM: List of major investments

Investments	MM Stake (%)	Mcap (Rs bn)	Value (Rs bn)
MM Financial Services (MMFS)	60	81.6	49.0
Mahindra Forgings (MFOL)	51	6.0	3.0
Mahindra Holidays & Resorts (MHRL)	83	30.0	25.0
Mahindra Lifespace Developers (MLIFE)	51	16.1	8.2
Mahindra Ugine Steel Co (MUS)	51	1.8	0.9
Tech Mahindra (TECHM)	48	87.3	42.1
Other Investments (at book value)			68.4
Mahindra Systech			*25.1*
Mahindra subsidiary companies			*22.1*
Ssanyong Motor Company			*20.8*
EPC Irrigation			*0.4*
Total (Rs bn)		**222.8**	**196.7**

Source: Company data

We prefer the 'sum-of-the-parts' method for our TP of Rs845/sh. We conservatively chose the PER method because it reflects the near-term potential better.

MM: 'Sum-of-the parts' valuation

Per share value	Rs/sh
Investments (30% discount)	232
Core business (PER (x) 12 FY12F)	614
MM target price	**845**

Source: Company data, Kim Eng Securities

Recommendation – Strong BUY

We rate MM as a Strong BUY because:

- It has low sensitivity to rising interest rates and fuel prices, given that tractors form half of its earnings.
- It has a strong inorganic and organic growth strategy across each of the main business segments to gain market share over the next 3 years and a sound team in place to execute the strategy.
- It has a flexible B/S for growth and a proven track record of capital allocation to extract better long-term RoI.
- It is one of the few corporate groups in India with high corporate governance standards, which make it a favorite with investors.

Annexure

Annexure 1: MM Automotive and Tractor products

Passenger Vehicles

Scorpio

Xylo

Bolero

Thar

Logan


4-Wheel Pick-ups/Trucks

Gio

Maxximo

Genio

Bolero Camper

Maxx


3-Wheelers

Alfa

Champion


Tractors

Yuvraj

Arjun

Sarpanch

Bhoomiputra

Shaan

Swaraj


Ssangyong

Korando-C

Rexton

Chairman W


Mahindra Navistar

DI 3200

Loadking

Tourister-i

MN 25


Mahindra Two Wheelers

Rodeo

Duro

Stallio


Mahindra Reva

Reva-i


Source: Company data

Annexure 2: MM consolidated FY10 sector-wise results (Rsm)

Business	Ownership %	Revenue	Net Profit	Description
Automotive	100.0	112,760	12,610	MM is the largest UV company in India with a market share of 63%
Farm Equipments	100.0	89,930	14,070	MM is the largest tractor company in India (41% market share) and the world, by volume
IT Services	51.0	48,250	10,260	TECHM is the largest software solutions provider for global telecom sector from India
Systech	100.0	25,460	-1,080	MSAT is involved in auto components and engineering services
Financial Services	60.0	15,700	5,240	MMFSL is the largest rural financial service company in India. It focuses on financing of UV's and tractors
Steel Trading & Processing	51.0	5,900	830	MUS specializes in specialty steel, stampings and rings
Hospitality	60.0	4,990	1,580	MHRL is the leader in the leisure holidays and vacation industry in India
Infrastructure	60.0	4,150	1,220	MLIFE specializes in developing SEZ's
Others	-	8,750	-1,080	
Total		**315,890**	**43,650**	
Consolidated PAT excl M.I			**24,790**	

Source: Company Data

STANDALONE QUARTERLY FINANCIALS (Year To Mar)

PROFIT & LOSS (Rs bn)	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenue	45.0	53.0	51.6	54.3	61.2
Cost of sales, ex depr	30.1	35.8	35.9	36.5	42.4
Depreciation	1.0	0.9	1.0	1.0	1.0
Selling, Admn. & R&D expenses	8.1	8.7	7.9	8.9	9.6
Operating profit	**5.7**	**7.5**	**6.8**	**8.0**	**8.2**
Other income / expense	0.2	0.2	0.2	2.0	0.4
Interest expensed	0.1	0.0	-0.2	-0.1	0.0
Profit before tax	**5.9**	**7.7**	**7.2**	**10.1**	**8.7**
Tax	1.7	2.0	1.6	2.5	2.5
Minorities	0.0	0.0	0.0	0.0	0.0
Net Profit before extra.	**4.1**	**5.7**	**5.6**	**7.6**	**6.2**
Extraordinary gain	0.0	0.0	0.0	0.0	1.2
Net Profit after extra	**4.1**	**5.7**	**5.6**	**7.6**	**7.3**
EPS (Rs)	7.6	10.2	9.9	13.3	12.5
Recurring EPS (Rs)	7.6	10.1	9.9	13.3	10.5
Fully diluted no. of share (m)	547	566	566	570	587

Ratios (%)	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Gross margin	30.8	30.6	28.5	31.1	29.1
Operating margin	12.7	14.2	13.1	14.7	13.4
Net margin	9.2	10.8	10.9	14.0	12.0
SG&A / Sales	18.1	16.5	15.4	16.4	15.7
Effective Tax rate	-29.6	-25.8	-22.0	-24.7	-28.7

Source: Company data

STANDALONE AS YEARLY FINANCIALS (Yr To Mar)

PROFIT & LOSS (Rs bn)	FY09	FY10	FY11F	FY12F	FY13F
Revenue	130.9	186.0	235.9	277.8	315.9
Cost of sales, ex depr	-92.4	-123.5	-164.1	-192.2	-217.3
Depreciation	-2.9	-3.7	-4.1	-5.4	-6.4
Selling, Admn. and R&D Expenses	-27.6	-33.0	-37.0	-43.2	-48.5
Operating profit	**8.0**	**25.8**	**30.7**	**37.0**	**43.8**
Other income / expense	2.2	1.9	2.8	3.4	4.1
Net Interest expensed	-0.5	-0.3	0.4	-0.4	-0.3
Profit before tax	**9.7**	**27.5**	**33.9**	**40.0**	**47.5**
Tax	-2.0	-7.6	-8.6	-10.0	-11.9
Net profit (Recurring)	**7.7**	**19.9**	**25.4**	**30.0**	**35.6**
Extraordinary gain / (loss)	0.9	1.0	1.3	0.0	0.0
Net profit (Reported)	**8.7**	**20.9**	**26.7**	**30.0**	**35.6**
EPS (Rs)	15.9	38.0	46.1	51.1	60.7
Recurring EPS (Rs)	14.2	36.1	43.8	51.1	60.7
Fully diluted no. of share (m)	566	566	587	587	587

KEY ASSUMPTIONS	FY09	FY10	FY11F	FY12F	FY13F
Volume (nos in '000)					
Passenger Vehicles	106	151	180	207	239
Commercial Vehicles	92	121	167	203	236
Exports	9	11	20	22	25
Total Standalone AS Volume	207	282	367	431	499
Tractors	120	175	215	238	262
Auto Subsidiaries/JV's Volume	25	85	183	366	448
Revenue (Rs bn)					
Standalone	86.9	117.9	155.2	187.9	217.4
Tractors	43.3	66.6	85.8	94.8	104.5
Other Operating Income	12.0	12.1	17.4	22.5	25.7
Total Gross Revenue (Rs bn)	142.3	196.6	258.4	305.2	347.6
Subsidiaries/JV's Revenue (Rs bn)	8.4	9.8	14.7	258.4	328.4
Vehicles Production Capacity (nos in '000)	322	364	450	550	700
Tractors Production Capacity (nos in '000)	233	233	250	300	350

RATIOS (%)	FY09	FY10	FY11F	FY12F	FY13F
Gross margin	27.2	31.6	28.7	28.9	29.2
Operating margin	6.1	13.9	13.0	13.3	13.9
Net margin	5.9	10.7	10.8	10.8	11.3
SG&A / Sales	21.1	17.7	15.7	15.6	15.3
Effective tax rate	20.5	27.6	25.3	25.0	25.0
Book value per share (Rs)	93.0	138.3	168.0	207.4	253.1
ROA	5.5	12.3	12.7	13.0	13.5
ROE	18.1	31.9	30.2	27.3	26.4
Dividend yield	0.7	1.3	1.3	1.5	1.9

CASHFLOW (Rs bn)	FY09	FY10	FY11F	FY12F	FY13F
EBITDA	13.1	31.4	37.7	45.8	54.2
Accounts receivables	-0.4	-2.1	-1.2	-2.5	-2.3
Inventory	0.2	-1.3	-3.4	-2.6	-2.3
Working capital	8.7	-0.7	12.6	7.9	7.0
Operating cash flow	**21.6**	**27.3**	**45.7**	**48.6**	**56.6**
Interest expenses	-0.5	-0.3	0.4	-0.4	-0.3
TAX	-2.0	-7.6	-8.6	-10.0	-11.9
Residual cash flow	**19.2**	**19.5**	**37.5**	**38.2**	**44.4**
Fixed assets	-13.4	-7.0	-16.4	-16.8	-16.4
Change in investments	-16.6	-3.2	-20.4	-1.5	-1.3
Free cash flow	**-10.8**	**9.2**	**0.7**	**19.8**	**26.7**
Dividend payments	-2.8	-2.8	-5.5	-5.6	-6.1
Others	5.8	6.9	0.5	-1.3	-2.7
Net change in Cashflow	**327.4**	**116.8**	**-4.3**	**12.9**	**17.9**
Net Debt Beg	-17.3	-24.8	-11.4	-15.7	-2.8
Net Debt/Cash End	**310.2**	**92.0**	**-15.7**	**-2.8**	**15.1**

BALANCE SHEET (Rs bn)	FY09	FY10	FY11F	FY12F	FY13F
Cash & equivalent	15.7	17.4	13.1	21.0	33.9
Receivables	10.4	12.6	13.8	16.3	18.6
Inventories	10.6	11.9	15.3	17.9	20.1
Other current assets	13.8	18.5	22.9	26.8	30.2
Fixed assets (net)	25.7	27.4	38.3	47.9	56.6
Investments	57.9	64.0	85.2	87.7	90.2
Capital WIP	6.5	9.6	11.0	12.9	14.3
Other assets	0.1	0.0	0.0	0.0	0.0
Total assets	**140.8**	**161.5**	**199.7**	**230.6**	**264.0**
Working capital - liabilities	48.0	52.0	69.0	80.7	91.1
Debt	40.5	28.8	28.8	23.8	18.8
Deffered tax	-0.4	2.4	3.3	4.3	5.5
Shareholders' Funds	**52.6**	**78.3**	**98.6**	**121.7**	**148.6**

Source: Company data, KESI estimates

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Recommendation definitions

Our recommendation is based on the following expected price performance within 12 months:

+15% and above: BUY
-15% to +15%: HOLD
-15% or worse: SELL

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