

April 9, 2008

Rating	Outperformer
Price	Rs609
Target Price	Rs740
Implied Upside	21.5%
Sensex	15,587

(Prices as on April 8, 2008)

Trading Data

Market Cap. (Rs bn)	160.1
Shares o/s (m)	262.7
Free Float	77.4%
Avg. Daily Vol ('000)	116.9
Avg. Daily Value (Rs m)	79.2

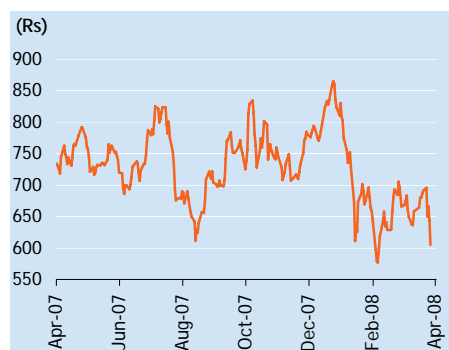
Major Shareholders

Promoters	22.6%
Foreign	26.3%
Domestic Inst.	33.7%
Public & Others	17.4%

Stock Performance

(%)	1M	6M	12M
Absolute	(8.5)	(16.0)	(14.6)
Relative	(6.1)	(5.1)	(35.9)

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



Source: Bloomberg

Mahindra & Mahindra

Aggressive capex to suppress returns

We recently organised a roadshow with Mahindra & Mahindra (M&M) to help our institutional investors understand the company's capex plans, new product launches and the various initiatives its subsidiaries are undertaking. Key highlights of the event are as follows:

- **Expansion plans:** M&M has chalked out an aggressive capacity expansion plan of about Rs75bn over the next three years, in addition to an investment of Rs15bn in its subsidiaries. A major chunk (Rs50bn) of the amount would be spent in its core auto business, allocated equally between the new Chakan facility and for new product development. The company is slated to introduce five new models in the next 2-3 years.
- **Spiralling raw material cost:** Rising raw material prices are expected to impact margins in FY09, but the management believes that it would be able to maintain double digit margins going forward.
- **Lull in economic sentiment:** The management believes that the auto sector would also slowdown with the slowing down of the overall economy, and expects the domestic auto sector to post a moderate 10% growth in FY09. During this period, the off-take from tractors is also expected to be subdued with the segment expected to post 6-8% CAGR over the next three years.
- **Valuation:** On sum-of-parts valuation, the stock trades at 4.9x FY10E core EPS of Rs46.9, excluding Rs381 a share as the sum-of-its-parts. While the core business is expected to take a couple of years to generate steady returns, we believe these are attractive levels to invest in a long term (12 - 18 months) growth story. Maintain Outperformer.

Key financials (Y/e March)	FY07	FY08E	FY09E	FY10E
Revenue (Rs m)	178,418	204,986	240,105	270,713
Growth (%)	41.7	14.9	17.1	12.7
EBITDA (Rs m)	29,283	31,458	35,535	40,607
PAT (Rs m)	16,144	16,763	18,004	20,929
EPS (Rs)	57.0	63.8	68.5	79.7
Growth (%)	45.7	12.0	7.4	16.3
Net DPS (Rs)	11.5	12.0	13.5	14.0

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08E	FY09E	FY10E
EBITDA margin (%)	16.4	15.3	14.8	15.0
RoE (%)	37.6	30.3	26.0	24.6
RoCE (%)	14.9	12.4	11.3	10.8
EV / sales (x)	1.2	1.1	1.1	0.9
EV / EBITDA (x)	7.6	7.0	7.2	6.3
PE (x)	10.7	9.6	8.9	7.6
P / BV (x)	2.0	1.6	1.4	1.2
Net dividend yield (%)	1.9	2.0	2.2	2.3

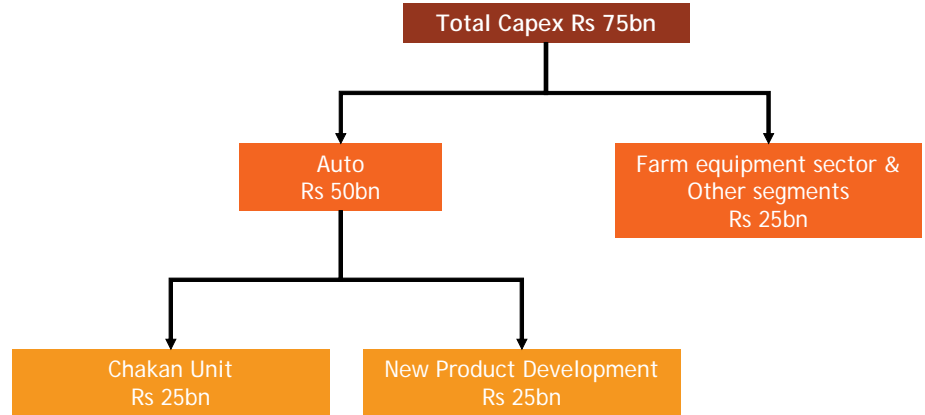
Source: Company Data; PL Research

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Aggressive capacity expansion

M&M has chalked out an aggressive capacity expansion plan with an outlay of about Rs25bn each year over the next three years till FY11. In addition to the total Rs75bn the company is investing, an investment of Rs15bn in subsidiaries is planned. Of the Rs75bn, about Rs50bn has been earmarked for the auto sector, while the rest has been allocated for FES and other segments. The company's new Chakan unit will see an investment of Rs25bn, while the balance Rs25bn will be utilised for new product development. The Chakan facility will have a capacity of about 350,000 units, including 50,000 unit capacity to be rolled out from the Mahindra International (MIL) JV.

Aggressive capex plan



Source: Company Data, PL Research

Chakan unit capacity details

Products	Capacity in units
Low tonnage vehicle (LTV) - mass market platform	90,000
M&HCV - JV with MIL	50,000
SUV - Scorpio successor	50,000
Ingenio and Logan variants	90,000
Global platform	50,000

Source: Company data

New product launches on the card

The company plans to unveil five new products over the next 2-3 years. The much awaited *Ingenio* (MUV) will be launched by December 2008 and would be positioned between the *Scorpio* and the *Bolero*. The mass market LTV (positioned to be competing with Tata's *ACE*) is expected to be launched by January 2010. M&M also plans to launch M&HCVs from its MIL JV; a new SUV, which would be a successor to the *Scorpio* and a vehicle (UV) for the global market.

New product launches

Product	Likely schedule
Ingenio	Dec'08
New LTV	Jan'10
M&HCV	FY'10 end
SUV	FY'11
Global Product	FY'11

Source: Company data

Rising raw material cost - a key concern

The management has indicated that rising raw material prices is one of its major concerns. The company believes that given such a scenario, it will be difficult for it to sustain 13% margin levels, though it is confident of maintaining double digit margins going forward. This can be achieved by commonly sourcing raw material (in case of tractors for M&M and Punjab Tractors), sourcing components from low cost destinations and by addressing other costs overheads like marketing and S&D.

Slowdown in FES segment

The domestic tractor industry had witnessed a robust 20% four-year CAGR growth till FY07, primarily due to aggressive lending by banks and financial institutions during the year. However, rising NPAs in select regions like UP has also forced lending institutions to withdraw from certain regions and adopt a more cautious approach, leading to a slowdown in credit, which has in turn led to a slowdown in the sector in FY08. The management now believes that FY09 would again be a muted year for the industry and expects 6-8% CAGR over the next three years.



Punjab Tractors - an update

M&M is in the process of reducing inventories at the dealer level, and receivables of Punjab Tractors (PTL). The company has already recovered about Rs2bn from the total Rs5bn worth of receivables. PTL now has a market share of 10% in tractors, taking M&M's total market share to 40%.

Systech restructuring

The forging business under the Mahindra Forgings (MFL) arm is one of the major verticals of Systech. MFL has undertaken a major restructuring exercise, in which three of its subsidiaries Jeco, Schenoweiss and Stokes have been merged with MFL in January 2008. The Systech Group is expected to easily surpass its target of achieving US\$1bn in revenue by FY10. The group has already posted revenue in excess of US\$850m in FY08.

Mahindra Holidays listing delayed

The listing of Mahindra Holidays and Resorts (MHRIL) has been delayed as M&M awaits SEBI nod for the same and for market conditions to stabilise. Two private placements in January 2008 have already given a benchmark valuation of about US\$1bn to MHRIL.

Valuation

With margins under pressure and mediocre volume outlook, we have revised our EPS estimates downwards by 8% for FY09 and 7% for FY10.

Returns from the company's aggressive capex plans would take a couple of years to flow in. However, its core UV business has outperformed the industry in FY08 by posting a robust 18.4% growth, and this trend is expected to continue going forward with its newly launched *Scorpio* and *Bolero* doing well.

MHRIL listing and the successful restructuring of MFL would be positive triggers going ahead, while synergies from Punjab Tractors would soon start to accrue. The stock has corrected by as much as 30% over the last one quarter. We believe this correction has been overdone and there is a lot of value in the stock. On sum-of-parts valuation, the stock trades at 4.9x FY10E core EPS of Rs46.9, excluding Rs381 per share as the sum-of-its-parts. Maintain Outperformer.



SOTP Valuation

Company	M & M holding (%)	Mcap (m)	M & M Mcap value share (m)	Sum-of-parts (Rs.)
Tech Mah.	45.0	86,096	38,743	147
M&M FSL	67.7	22,334	15,124	58
Mah. Gesco	55.0	12,417	6,829	26
MUSCO	50.7	2,057	1,043	4
MASL	60.6	3,418	2,071	8
Mah Intertrade	100.0	2,075	2,075	8
Mahindra Holidays & Resorts	94.0	37,105	34,879	133
Others			5,888	22
Total				406
Holding company discount @30%				284
Cash and investments			25,703	98
Total				382



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PL's Recommendation Nomenclature

BUY	: > 15% Outperformance to BSE Sensex	Outperformer (OP)	: 5 to 15% Outperformance to Sensex
Market Performer (MP)	: -5 to 5% of Sensex Movement	Underperformer (UP)	: -5 to -15% of Underperformance to Sensex
Sell	: <-15% Relative to Sensex		
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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