

Company Flash

1 November 2007 | 7 pages

Mahindra & Mahindra (MAHM.BO)

Oct Sales – Festive Season Drives UV Growth, Tractors Still Weak

- Oct sales +18% YoY** — UVs continued to show robust performance (+42% y/y) albeit a low base last year partially offset by weak tractor sales (-16% y/y). Scorpio sales rose 37% y/y after a sedate 6% growth last month. Excluding Scorpio, UV sales grew 43% y/y. 3-wheeler sales rose 6% y/y; we believe M&M has been able to gain market share from Bajaj in this segment.
- Tractor sales decline 19% YoY** — Domestic tractor sales witnessed the sharpest fall this fiscal (-19% y/y) partly offset by strong growth in exports (+87% y/y). Management expects slight decline in tractor growth for this fiscal as North and West regions continued to remain weak.
- New product launches** — Management reiterated that its Ingenio (new UV platform) is on track and will be launched at end of FY08 or early FY09. Management also said that it plans to launch MHCV trucks by FY10 and new SUV by FY11.
- Update on Punjab Tractors** — Management suggested that integration of Punjab Tractors has been completed. The company plans to utilize the 50% spare capacity available at Mohali to meet future demand.
- Maintain Buy (1L)** — Recovery in tractor sales and listing of unlisted subsidiaries remain key triggers to the stock in our view. Key downside risks include 1) lower than forecast volume growth, 2) continued margin pressure due to escalating input costs.

Buy/Low Risk	1L
Price (01 Nov 07)	Rs756.00
Target price	Rs945.00
Expected share price return	25.0%
Expected dividend yield	1.5%
Expected total return	26.5%
Market Cap	Rs185,620M US\$4,736M

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

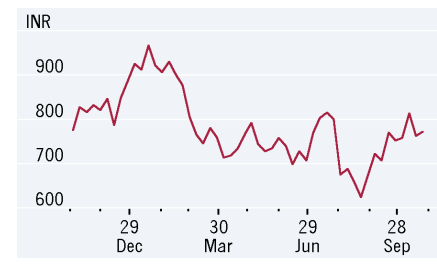


Figure 1. M&M- Oct 07 Sales

	Oct-07 Nos	% change yoy	% change over Sep	FY08 YTD Nos	% chg yoy
UVs	16,711	41.8	36.5	83,189	25.3
LCVs	817	7.8	(12.2)	6,290	34.5
3-wheelers	3,836	5.8	19.6	20,289	6.3
Exports (Auto sector)	1,101	17.6	(15.4)	6,297	25.3
Logan	2,214			14,708	
Auto division	24,679	44.2	24.2	130,773	37.4
Tractors (Dom + Exp)	11,186	(16.4)	29.0	60,704	(5.6)
Total	35,865	17.6	25.7	191,477	20.0

Source: Company

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

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Mahindra & Mahindra

Company description

Mahindra and Mahindra manufactures utility vehicles, light commercial vehicles and tractors. It has 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 (1L) with a target price of Rs945. Tractor sales are benefiting from relatively low penetration levels and the government's emphasis on increasing credit to the agriculture sector. Apart from dominance of the lower end of the market, where competition has been limited, M&M's utility vehicle business is also benefiting from product initiatives, particularly the launch of the Scorpio and Bolero models and variants of these, which have enabled M&M to tap into the urban markets for passenger vehicles. Moreover, we also recognize management's efforts to retain market share within segments like three-wheelers, given the stiff competition in this segment. We 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. Their efforts have met with substantial success particularly in the tractor segment, wherein they are currently ranked No. 4 (in terms of unit sales) globally. 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). Given recent initiatives to unlock value in subsidiaries – MMFSL and Tech Mahindra being the primary examples – we incorporate the value of key subsidiaries within our sum-of-parts valuation.

Valuation

Our target price of Rs945 is based on a sum-of-parts methodology. We value M&M's core business at Rs468 (9x FY09E core CEPS). We also incorporate value for M&M's listed subsidiaries (Rs378/share), its auto component business (Rs57/share) and M&M's investments in other subsidiaries (including Mahindra Holidays at Rs41/share). Our core multiple of 9x, is supported by an 11% CAGR in core cash earnings (excluding dividends from group companies) for M&M over FY07E-09E. We value the key subsidiaries / associates / auto component initiatives at Rs477/share. At our core target price (of Rs468) the stock would trade at around 10.2x FY08E core EPS (excluding dividends from subsidiaries) and should be supported by 11% CAGR in earnings over FY07E-09E. We have chosen to use P/CEPS as our primary valuation metric to ensure proper 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 passenger cars, commercial vehicles and auto components segments, which should fructify over the next 2-3 years.

Risks

We rate M&M shares Low Risk, in line with our quantitative model which tracks 260-day historical share price volatility. Key Risk factors to our investment thesis which could prevent the shares from reaching our target price include: Any substantial rise in interest rates that could curb demand for farm equipment and utility vehicles. 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. Escalating competition within the UV segment, which might lead to an increase in discounts and result in margin pressure.

Appendix A-1

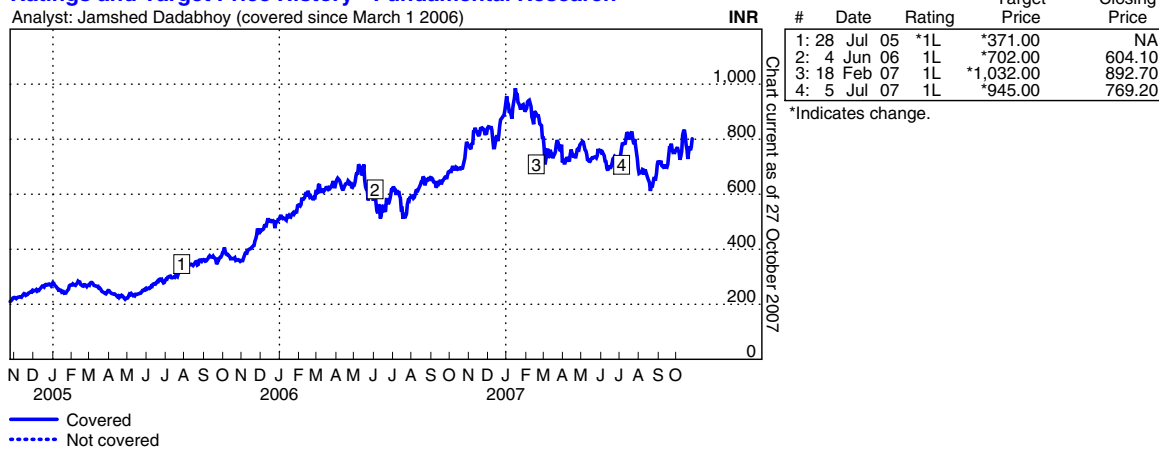
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Analyst: Jamshed Dadabhoy (covered since March 1 2006)



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