

# Profits to flatten

## Downgrade rating to Underperform

Downgrade rating to Underperform from Buy, with a PO of Rs 527. This is based on cut in standalone EPS forecasts by 4%-7% over FY11-12E, on rising cost pressures and adverse sales mix, and (2) expected de-rating to 12x FY11E P/E (from 13x earlier) on slower growth prospects.

## Business fundamentals may be strong

M&M is well positioned in Utility vehicles and Tractors given limited competition, and improving in Commercial vehicles. While we do not see any threat to growth as well as market share in UVs (17% CAGR) or CVs, following commissioning of new unit and successful introductions in light vehicles (29% CAGR), we expect tractor sales to decelerate to 5% growth annually following previous year's acquisition-led aberrational growth of 44%.

## But margin pressures will drag earnings down

Over FY10-12E, we estimate sharper margin contraction of 178bps to 13.4%, compared to earlier 14%, driven by (1) higher input costs, given relative sensitivity of commodity prices to its business segments, and (2) adverse sales mix, with expected shift to relatively less profitable UVs and CVs business. As a result, we forecast flat EPS in FY11, well below consensus estimates.

## PO cut to Rs 527

Our revised sum of parts value mainly reflects lowered value of standalone operations of Rs 381/share, compared to earlier Rs 431/share. Value of subsidiaries slightly lower (due to Tech Mahindra PO) at Rs 146/share.

## Estimates (Mar)

(Rs)	2008A	2009A	2010E	2011E	2012E
Net Income (Adjusted - mn)	17,998	14,698	23,162	23,384	26,835
EPS	37.64	27.71	43.66	44.08	50.58
EPS Change (YoY)	14.2%	-26.4%	57.6%	1.0%	14.8%
Dividend / Share	6.00	5.00	7.50	9.00	10.00
Free Cash Flow / Share	(60.09)	(17.44)	1.22	5.34	6.91
GDR EPS (US\$)	0.935	0.602	0.968	0.978	1.12
GDR Dividend / Share (US\$)	0.149	0.109	0.166	0.200	0.222

## Valuation (Mar)

	2008A	2009A	2010E	2011E	2012E
P/E	14.38x	19.54x	12.40x	12.28x	10.70x
Dividend Yield	1.11%	0.924%	1.39%	1.66%	1.85%
EV / EBITDA*	10.61x	9.59x	7.36x	6.94x	6.13x
Free Cash Flow Yield*	-10.00%	-3.22%	0.226%	0.987%	1.28%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 2.

# Bank of America Merrill Lynch

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## Stock Data

Price (Common / GDR)	Rs541.35 / US\$25.36
Price Objective	Rs527.00 / US\$11.50
Date Established	31-Mar-2010 / 31-Mar-2010
Investment Opinion (Common)	C-3-7
Investment Opinion (GDR)	C-3-7
Volatility Risk	HIGH / HIGH
52-Week Range	Rs181.68-Rs599.50
Market Value (mn)	US\$6,369
Shares Outstanding (mn)	530.5 / 530.5
Average Daily Volume	2,171,393
BofAML Ticker / Exchange	MAHF / BSE
BofAML Ticker / Exchange	MAHMF / LIN
Bloomberg / Reuters	MM IN / MAHM.BO
ROE (2010E)	26.9%
Net Dbt to Eqty (Mar-2009A)	96.9%
Est. 5-Yr EPS / DPS Growth	5.0% / 5.0%
Free Float	73.0%

## Key Changes

(Rs)	Previous	Current
Inv. Opinion	C-1-7	C-3-7
Inv. Rating	BUY	UNDERPERFORM
Price Obj.	581.70	527.00
2010E Rev (m)	315,067.3	309,598.0
2011E Rev (m)	365,530.3	366,075.3
2012E Rev (m)	416,701.6	422,512.2
2010E EPS	44.47	43.66
2011E EPS	48.69	44.08
2012E EPS	56.04	50.58
2010E EBITDA (m)	48,332.5	47,757.2
2011E EBITDA (m)	54,627.9	50,631.5
2012E EBITDA (m)	62,477.5	57,379.8

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Refer to important disclosures on page 7 to 10. Analyst Certification on Page 5. Price Objective Basis/Risk on page 5. Link to Definitions on page 5. 10924463

## iQprofile<sup>SM</sup> Mahindra & Mahindra

Key Income Statement Data (Mar)	2008A	2009A	2010E	2011E	2012E
<b>(Rs Millions)</b>					
Sales	237,744	267,564	309,598	366,075	422,512
Gross Profit	85,315	94,177	105,263	128,126	147,879
Sell General & Admin Expense	(52,187)	(57,512)	(57,506)	(77,495)	(90,500)
Operating Profit	27,306	29,172	38,538	40,405	46,178
Net Interest & Other Income	814	(5,867)	(7)	(71)	1,008
Associates	100	113	280	280	280
Pretax Income	28,220	23,418	38,811	40,613	47,466
Tax (expense) / Benefit	(7,387)	(5,605)	(11,735)	(12,749)	(14,870)
Net Income (Adjusted)	17,998	14,698	23,162	23,384	26,835
Average Fully Diluted Shares Outstanding	478	531	531	531	531

### Key Cash Flow Statement Data

Net Income	17,998	14,698	23,162	23,384	26,835
Depreciation & Amortization	5,822	7,493	9,219	10,227	11,202
Change in Working Capital	(15,646)	(12,008)	(15,367)	(15,277)	(19,373)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(2,238)	(998)	1,135	0	0
Cash Flow from Operations	5,936	9,186	18,150	18,334	18,663
Capital Expenditure	(34,665)	(18,437)	(17,500)	(15,500)	(15,000)
(Acquisition) / Disposal of Investments	(3,514)	(15,714)	(11,500)	(12,500)	(10,000)
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(38,179)	(34,150)	(29,000)	(28,000)	(25,000)
Shares Issue / (Repurchase)	(202)	3,440	0	0	0
Cost of Dividends Paid	(2,869)	(2,653)	(3,979)	(4,244)	(4,509)
Cash Flow from Financing	29,072	30,518	14,190	13,531	18,349
Free Cash Flow	(28,729)	(9,251)	650	2,834	3,663
Net Debt	81,530	103,134	114,049	123,478	128,562
Change in Net Debt	23,691	21,604	10,915	9,430	5,084

### Key Balance Sheet Data

Property, Plant & Equipment	76,255	87,199	95,479	100,752	104,550
Other Non-Current Assets	13,723	30,004	41,504	54,004	64,004
Trade Receivables	37,678	36,653	42,411	50,147	57,878
Cash & Equivalents	17,280	22,833	26,173	30,038	42,051
Other Current Assets	114,327	145,004	164,012	184,022	207,527
Total Assets	259,263	321,692	369,579	418,964	476,009
Long-Term Debt	98,810	125,967	140,222	153,516	170,613
Other Non-Current Liabilities	4,780	4,780	4,780	4,780	4,780
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	66,823	84,467	93,866	106,336	118,198
Total Liabilities	170,412	215,213	238,867	264,632	293,590
Total Equity	88,851	106,479	130,712	154,332	182,419
Total Equity & Liabilities	259,263	321,692	369,579	418,964	476,009

### iQmethod<sup>SM</sup> - Bus Performance\*

Return On Capital Employed	14.8%	10.9%	13.4%	12.1%	12.3%
Return On Equity	32.8%	21.4%	26.9%	22.1%	21.2%
Operating Margin	11.5%	10.9%	12.4%	11.0%	10.9%
EBITDA Margin	13.9%	13.7%	15.4%	13.8%	13.6%

### iQmethod<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	0.3x	0.6x	0.8x	0.8x	0.7x
Asset Replacement Ratio	6.0x	2.5x	1.9x	1.5x	1.3x
Tax Rate (Reported)	26.2%	23.9%	30.2%	31.4%	31.3%
Net Debt-to-Equity Ratio	91.8%	96.9%	87.3%	80.0%	70.5%
Interest Cover	4.6x	3.9x	3.6x	3.4x	3.6x

### Key Metrics

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 2.

### Company Description

Mahindra & Mahindra (M&M) is the flagship company of the Mahindra Group. It has two main operating divisions, autos and farm equipment. Autos includes Utility vehicles, light commercial vehicles and three-wheelers, and farm equipment includes tractors and agricultural implements. The company also has investments in standalone entities operating in the areas of hospitality, trade & financial services, auto components, IT, telecom and infrastructure development

### Investment Thesis

Downgrade rating to Underperform as we expect stock to de-rate on below consensus estimates of flat profit next year, driven by lower margins due to higher input costs and adverse sales mix.

### Stock Data

Shares / GDR	1.00
Price to Book Value	3.0x

### Key Changes (GDR)

(US\$)	Previous	Current
Inv. Opinion	C-1-7	C-3-7
Inv. Rating	BUY UNDERPERFORM	
2010E EPS	0.99	0.97
2011E EPS	1.08	0.98
2012E EPS	1.24	1.12

**Table 1: Revision of estimates**

(Rs bln)	Old			New			Revision		
	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E
Net Sales	177.8	214.1	246.3	177.2	212.9	243.5	-0.3%	-0.5%	-1.1%
EBITDA	26.0	30.0	34.5	26.9	28.5	32.5	3.1%	-4.9%	-5.6%
EBITDA Margin	14.7%	14.0%	14.0%	15.2%	13.4%	13.4%	50bps	-62bps	-64bps
PAT	19.0	19.2	22.1	19.6	18.4	20.6	2.9%	-4.0%	-6.8%

Source: BofA Merrill Lynch Global Research

**Table 2: Revision of volumes**

('000 nos)	Old			New			Revised growth rate		
	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E
Volumes									
Uvs & CVs	247	311	366	234	294	343	44.9%	25.7%	16.7%
Three wheelers	45	40	36	45	40	40	0.0%	-9.8%	0.0%
Tractors	152	159	167	172	181	190	44.3%	5.0%	5.0%
Total	444	511	570	451	515	573	38.5%	14.2%	11.3%

Source: BofA Merrill Lynch Global Research

**Table 3: M&M standalone financials**

(Rs mn)	FY09	FY10E	FY11E	FY12E
Net Sales	130,937	177,245	212,940	243,475
Other Income	2,703	2,698	3,071	3,117
<b>Total Income</b>	<b>133,640</b>	<b>179,943</b>	<b>216,011</b>	<b>246,592</b>
Operating Profit	10,926	26,855	28,494	32,548
Interest income (exp)	-453	-356	-626	-639
Depreciation (Provision)	-2,915	-3,763	-4,872	-5,499
<b>Profit before Tax &amp; Extra Ord.</b>	<b>10,262</b>	<b>25,433</b>	<b>26,067</b>	<b>29,527</b>
Extraordinary Items	103	1,632	0	0
Profit before Tax	10,365	27,066	26,067	29,527
Tax	-1,997	-7,468	-7,674	-8,898
Profit after Tax	8,368	19,598	18,393	20,629
<b>Recurring net profit</b>	<b>8,285</b>	<b>18,416</b>	<b>18,393</b>	<b>20,629</b>
EPS (Rs)	15.6	34.7	34.7	38.9
<b>OPM</b>	<b>8.3%</b>	<b>15.2%</b>	<b>13.4%</b>	<b>13.4%</b>

Source: BofA Merrill Lynch Global Research

**Table 4: Sum of the parts valuation**

	<b>Basis</b>	<b>Imputed Multiple (x)</b>	<b>Current value/share</b>
<b>Core Business</b>		12.0	<b>416</b>
Less: dividend from Subsidiaries			(35)
<b>Standalone</b>			<b>381</b>
<b>Subsidiaries</b>			<b>146</b>
Tech Mahindra	P/E	15.0	104
M&M Financial	Price to Adj BV	1.0	22
Mahindra Life Space Dev	Book value	1.0	28
Mahindra Holidays	DCF	84%	28
<i>Less: Holding company discount</i>		20%	(36)
<b>Consolidated Value/Share (Rs)</b>			<b>527</b>

Source: BofA Merrill Lynch Global Research

## Price objective basis & risk

### M & M (MAHHF / MAHMF)

Our PO of Rs527(US\$11.5 for GDR) is based on sum of parts of constituent businesses. Value core business at 12x FY11E EPS (earlier 13x), at Rs 381/share, and key operating subsidiaries at Rs 146/share. We have imputed a holding company discount of 20pct to subsidiaries. Downside risks: Slowdown in the economy and increasing competition that would adversely affect volume growth, and rising input costs.

## Link to Definitions

### Industrials

Click [here](#) for definitions of commonly used terms.

## Analyst Certification

I, S.Arun, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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### India - Autos Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
BUY	Apollo Tyres Ltd	XAPYF	APTY IN	S.Arun
	Eicher Motors	XEICF	EIM IN	S.Arun
	Maruti Suzuki India	MUDGF	MSIL IN	S.Arun
	Tata Motors Ltd.	TTM	TTM US	S.Arun
	Tata Motors Ltd.	TENJF	TTMT IN	S.Arun

31 March 2010

**India - Autos Coverage Cluster**

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
	TVS Motor	XFKMF	TVSL IN	S.Arun
<b>NEUTRAL</b>				
	Bajaj Auto	XBJBF	BJAUT IN	S.Arun
	Hero Honda	HRHDF	HH IN	S.Arun
<b>UNDERPERFORM</b>				
	Ashok Leyland	XDBVF	AL IN	S.Arun
	M & M	MAHHF	MM IN	S.Arun
	M & M -G	MAHMF	MHID LI	S.Arun
<b>RVW</b>				
	Bharat Forge	XUUVF	BHFC IN	S.Arun

**iQmethod<sup>SM</sup> Measures Definitions**

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

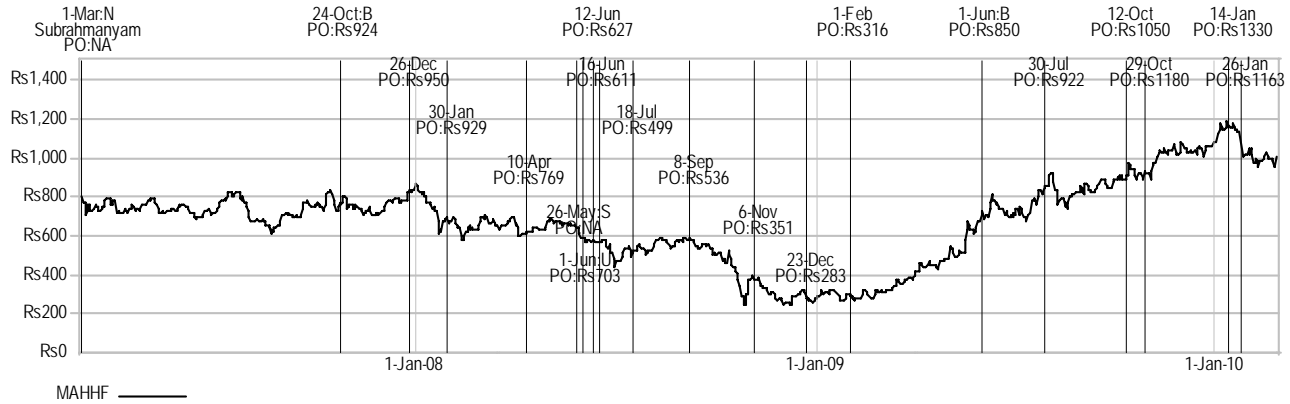
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### MAHMF Price Chart

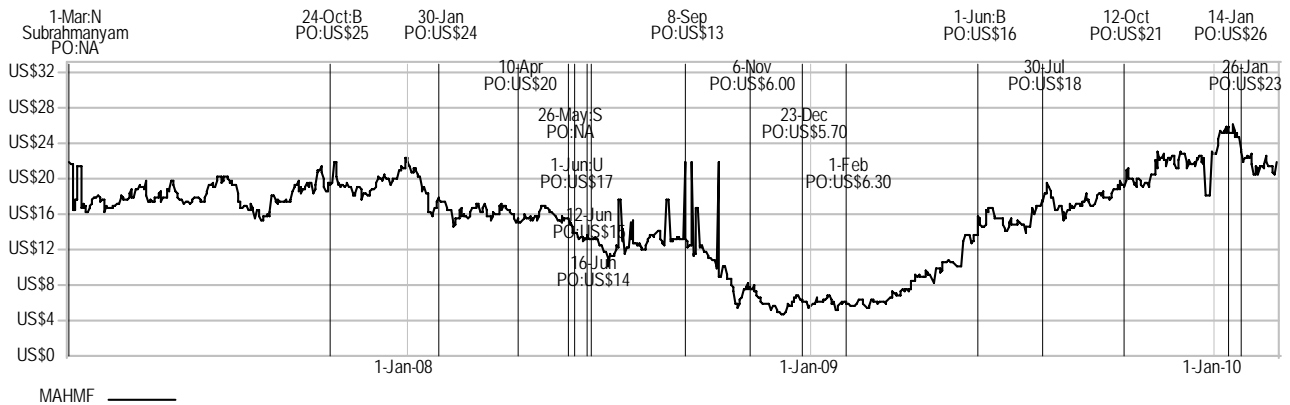


B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

\*Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of February 28, 2010 or such later date as indicated.

BofAML price charts do not reflect analysts' coverage of the stock at prior firms. Historical price charts relating to companies covered as of December 31, 2008 by former Banc of America Securities LLC (BAS) analysts are available to BAS clients on the BAS website.\*

### MAHMF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

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### Investment Rating Distribution: Autos Group (as of 01 Jan 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	45	59.21%	Buy	26	70.27%
Neutral	17	22.37%	Neutral	8	61.54%
Sell	14	18.42%	Sell	9	75.00%

### Investment Rating Distribution: Global Group (as of 01 Jan 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1699	50.78%	Buy	904	58.82%
Neutral	841	25.13%	Neutral	491	65.03%
Sell	806	24.09%	Sell	368	49.80%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

\* Ratings dispersions may vary from time to time where BofAML Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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