Mahindra and Mahindra MAHM.NS MM IN

AUTOS & AUTO PARTS

NOMURA
EQUITY RESEARCH

Street yet to capture value from MVML

Volume momentum continues to remain strong

November 18, 2011

Rating Remains	**Buy**
Target price Increased from 803	INR 896
Closing price November 18, 2011	INR 738
Potential upside	+21.4%

Action: Maintain Buy with increased TP of INR896

MM's stock has declined 12% post 2Q results due to weaker-than-expected margins. In our view, stand-alone margins and PAT will not move in line with volumes as the entity books only distribution margins on newer vehicles. A large part of income may get booked in MVML, a 100% subsidiary that manufactures new products. We estimate that MVML will make PAT of INR2.2b in FY13F and INR3b in FY14F and assign it a value of INR55/sh.

Catalysts: Value for MVML with successful new products

- Successful new products and value for MVML: MM will ramp up successful new products like XUV500. It will also launch more new products in UVs and the LCV space from MVML. As MVML becomes more significant we believe street will start ascribing value to it.
- Strong rural incomes: With support from the benign policies of the government and sharp increases in MSPs for agricultural crops (17% for FY12), rural incomes should continue to stay strong and drive demand for MM's UVs and tractors. Shortage of labour due to implementation of a rural-employment guarantee scheme will drive further mechanisation in farms, in our view.

Valuation: SOTP-based valuation of INR896 with 21% upside.

We have increased our stand-alone EPS (ex subsidiary dividends) estimates by nearly 10% for FY12F to factor in stronger demand. MVML contributes an additional ~7%. We value the stand-alone business at INR653/sh and MVML at INR55/sh based on 12x one-year forward EPS. We value other investments at INR188/sh based on market value.

31 Mar	FY11		FY12F		FY13F		FY14F
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	234,768	268,991	305,332	303,559	352,557		398,525
Reported net profit (mn)	26,621	25,098	27,294	27,643	30,340		34,416
Normalised net profit (mn)	25,446	25,098	27,294	27,643	30,340		34,416
Normalised EPS	45.27	44.65	48.56	49.18	53.98		61.23
Norm. EPS growth (%)	19.4	1.0	7.3	10.1	11.2		13.4
Norm. P/E (x)	16.3	N/A	15.2	N/A	13.7	N/A	12.1
EV/EBITDA (x)	12.6	10.6	11.4	9.3	10.1		8.8
Price/book (x)	4.0	N/A	3.4	N/A	2.9	N/A	2.5
Dividend yield (%)	1.9	N/A	2.0	N/A	2.2	N/A	2.5
ROE (%)	29.4	22.4	24.2	21.2	22.8		22.1
Net debt/equity (%)	17.4	5.9	13.7	3.1	8.2		1.5

Source: Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*

Anchor themes

High agri-commodity prices should continue to drive stong growth in rural incomes. Government schemes for rural job guarantees have created a shortage of farm labour, which should lead to more mechanisation at farms.

Nomura vs consensus

Our target price and estimates (including for MVML) are 5% ahead of consensus.

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

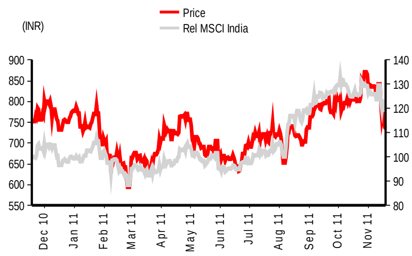
Key data on Mahindra and Mahindra

Income statement (INRmn)

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Revenue	**186,021**	**234,768**	**305,332**	**352,557**	**398,525**
Cost of goods sold	-127,037	-166,778	-225,662	-263,875	-299,857
Gross profit	**58,984**	**67,990**	**79,670**	**88,682**	**98,668**
SG&A	-21,155	-23,280	-29,567	-33,051	-36,483
Employee share expense	-11,985	-14,456	-17,347	-19,602	-21,954
Operating profit	**25,845**	**30,254**	**32,756**	**36,030**	**40,231**
EBITDA	**29,552**	**34,393**	**37,719**	**42,170**	**47,548**
Depreciation	-3,708	-4,139	-4,963	-6,140	-7,317
Amortisation					
EBIT	25,845	30,254	32,756	36,030	40,231
Net interest expense	-278	503	-693	-326	448
Associates & JCEs					
Other income	1,994	3,264	3,945	4,323	4,725
Earnings before tax	**27,560**	**34,021**	**36,008**	**40,026**	**45,404**
Income tax	-7,590	-8,575	-8,714	-9,686	-10,988
Net profit after tax	**19,970**	**25,446**	**27,294**	**30,340**	**34,416**
Minority interests					
Other items					
Preferred dividends					
Normalised NPAT	**19,970**	**25,446**	**27,294**	**30,340**	**34,416**
Extraordinary items	908	1,175	0	0	0
Reported NPAT	**20,878**	**26,621**	**27,294**	**30,340**	**34,416**
Dividends	-6,240	-8,026	-8,158	-9,068	-10,287
Transfer to reserves	**14,638**	**18,595**	**19,136**	**21,272**	**24,130**
Valuation and ratio analysis					
FD normalised P/E (x)	19.5	16.3	15.2	13.7	12.1
FD normalised P/E at price target (x)	23.6	19.8	18.5	16.6	14.6
Reported P/E (x)	18.6	15.6	15.2	13.7	12.1
Dividend yield (%)	1.6	1.9	2.0	2.2	2.5
Price/cashflow (x)	19.3	12.6	12.1	10.6	9.3
Price/book (x)	5.0	4.0	3.4	2.9	2.5
EV/EBITDA (x)	14.4	12.6	11.4	10.1	8.8
EV/EBIT (x)	16.5	14.3	13.2	11.8	10.4
Gross margin (%)	31.7	29.0	26.1	25.2	24.8
EBITDA margin (%)	15.9	14.6	12.4	12.0	11.9
EBIT margin (%)	13.9	12.9	10.7	10.2	10.1
Net margin (%)	11.2	11.3	8.9	8.6	8.6
Effective tax rate (%)	27.5	25.2	24.2	24.2	24.2
Dividend payout (%)	29.9	30.2	29.9	29.9	29.9
Capex to sales (%)	3.8	4.1	5.5	4.7	4.2
Capex to depreciation (x)	1.9	2.4	3.4	2.7	2.3
ROE (%)	31.9	29.4	24.2	22.8	22.1
ROA (pretax %)	19.2	18.0	15.7	15.1	15.1
Growth (%)					
Revenue	42.1	26.2	30.1	15.5	13.0
EBITDA	170.5	16.4	9.7	11.8	12.8
EBIT	222.6	17.1	8.3	10.0	11.7
Normalised EPS	157.9	19.4	7.3	11.2	13.4
Normalised FDEPS	157.9	19.4	7.3	11.2	13.4
Per share					
Reported EPS (INR)	39.65	47.36	48.56	53.98	61.23
Norm EPS (INR)	37.92	45.27	48.56	53.98	61.23
Fully diluted norm EPS (INR)	37.92	45.27	48.56	53.98	61.23
Book value per share (INR)	148.63	183.48	217.52	255.36	298.29
DPS (INR)	11.85	14.28	14.51	16.13	18.30

Source: Nomura estimates

Relative performance chart (one year)



Source: ThomsonReuters, Nomura research

(%)	1M	3M	12M
Absolute (INR)	-8.6	2.9	-5.4
Absolute (USD)	-12.2	-8.3	-16.7
Relative to index	-6.3	2.5	14.1
Market cap (USDmn)	8,080.0		
Estimated free float (%)	73.4		
52-week range (INR)	877.3/584.19		
3-mth avg daily turnover (USDmn)	34.39		
Major shareholders (%)			
LIC	14.4		
Ridge Business Center	4.2		

Source: Thomson Reuters, Nomura research

Notes

Stand-alone margins to decline as only distribution income will be booked on newer products going ahead; M&M + MVML margins give a better picture, in our view

Cashflow (INRmn)

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
EBITDA	29,552	34,393	37,719	42,170	47,548
Change in working capital	-4,119	3,413	2,005	2,622	2,726
Other operating cashflow	-5,341	-4,808	-5,462	-5,690	-5,814
Cashflow from operations	**20,093**	**32,998**	**34,261**	**39,102**	**44,460**
Capital expenditure	-6,999	-9,731	-16,667	-16,667	-16,667
Free cashflow	**13,094**	**23,267**	**17,595**	**22,436**	**27,793**
Reduction in investments	-6,116	-29,273	-8,333	-8,333	-8,333
Net acquisitions					
Reduction in other LT assets	0	0	0	0	0
Addition in other LT liabilities	2,438	1,106	0	0	0
Adjustments					
Cashflow after investing acts	**9,416**	**-4,899**	**9,261**	**14,102**	**19,460**
Cash dividends	-6,240	-8,026	-8,158	-9,068	-10,287
Equity issue	7,024	7,906	0	0	0
Debt issue	-6,896	-6,376	824	-3,776	-7,951
Convertible debt issue					
Others	-1,616	110	0	0	0
Cashflow from financial acts	**-7,728**	**-6,387**	**-7,333**	**-12,844**	**-18,237**
Net cashflow	**1,688**	**-11,286**	**1,928**	**1,258**	**1,222**
Beginning cash	15,744	17,432	6,146	8,074	9,332
Ending cash	17,432	6,146	8,074	9,332	10,555
Ending net debt	11,369	17,907	16,803	11,769	2,596

Source: Nomura estimates

Notes

We expect strong operating cashflows to continue in FY12-14F

Balance sheet (INRmn)

As at 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Cash & equivalents	17,432	6,146	8,074	9,332	10,555
Marketable securities	0	0	0	0	0
Accounts receivable	12,581	13,547	17,201	20,827	23,555
Inventories	11,888	16,942	21,262	25,511	28,847
Other current assets	18,523	24,799	28,670	30,161	33,356
Total current assets	**60,424**	**61,435**	**75,208**	**85,832**	**96,314**
LT investments	63,980	93,253	101,586	109,920	118,253
Fixed assets	37,027	43,718	55,422	65,949	75,298
Goodwill					
Other intangible assets	41	0	0	0	0
Other LT assets	0	0	0	0	0
Total assets	**161,472**	**198,406**	**232,216**	**261,701**	**289,865**
Short-term debt					
Accounts payable	33,673	47,159	59,793	69,109	78,161
Other current liabilities	18,292	20,516	21,733	24,405	27,338
Total current liabilities	**51,965**	**67,676**	**81,525**	**93,514**	**105,499**
Long-term debt	28,802	24,053	24,877	21,101	13,151
Convertible debt					
Other LT liabilities	2,438	3,544	3,544	3,544	3,544
Total liabilities	**83,205**	**95,272**	**109,946**	**118,159**	**122,193**
Minority interest					
Preferred stock	0	0	0	0	0
Common stock	2,910	3,276	3,276	3,276	3,276
Retained earnings	75,358	99,858	118,994	140,266	164,396
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	**78,268**	**103,134**	**122,270**	**143,542**	**167,672**
Total equity & liabilities	**161,473**	**198,406**	**232,216**	**261,701**	**289,865**
Liquidity (x)					
Current ratio	1.16	0.91	0.92	0.92	0.91
Interest cover	92.9	na	47.2	110.6	na
Leverage					
Net debt/EBITDA (x)	0.38	0.52	0.45	0.28	0.05
Net debt/equity (%)	14.5	17.4	13.7	8.2	1.5
Activity (days)					
Days receivable	22.6	20.3	18.4	19.7	20.3
Days inventory	32.3	31.5	31.0	32.3	33.1
Days payable	97.8	88.5	86.7	89.2	89.6
Cash cycle	-42.9	-36.6	-37.3	-37.1	-36.2

Source: Nomura estimates

Notes

We expect net/debt to equity to come down over FY12-14F

Driven by strong volume growth momentum

We now expect tractor-segment demand to stay stronger than we did earlier. We expect auto-sector demand to remain robust backed by the newly launched XUV500. Its order book was full for the following four months within 10 days of its launch even though it was only launched in five cities. We expect the company to open bookings as the capacity ramps up over the next three months.

Backed by the XUV500, we expect profitability at MVML to increase significantly; the street is missing this, in our view. Going ahead, we believe that M&M +MVML margins and PAT will provide clearer picture of business profitability.

Volume growth momentum – much stronger than expected

We have increased our FY12F volume growth estimates by 8.2% to factor in the strong growth momentum in both the tractor segment and in the UV segment and the stronger-than-expected sales performance of the Maximo model.

We have done a state-wise analysis to arrive at our new full-year tractor growth forecast of 18% in FY12F (12% earlier). We note that tractor sales are very skewed with some states, such as Uttarakhand, Kerala and Orissa, reporting declines of 20% or more in H1FY12, while others, such as Maharashtra, Gujarat, Tamil Nadu and Rajasthan, reporting volume growth of more than 40%. In fact, Gujarat had 86% growth in H1FY12.

Overall, for the country as a whole, the trend is pointing towards 18% volume growth in FY12. Our channel checks with dealers across 5-6 key states also suggest that tractor sales growth remain strong at higher than 20%. We believe that strong farm incomes driven by higher MSPs will lead to strong volume growth in FY13F. We are building in 10% tractor growth in FY13F.

The sales run-rate of M&M's Maximo model is around 6,000 units/month currently, as compared with our earlier expectation of around 4,000/month; accordingly, we have changed our FY12F forecasts for the Maximo.

Our FY13F volume growth estimates for all segments remain largely unchanged. Overall, we now expect 11.2% volume growth in FY13F.

Fig. 1: Volume growth estimates

	New			Old		% change	
Volumes (Nos.)	**FY12F**	**FY13F**	**FY14F**	**FY12F**	**FY13F**	**FY12F**	**FY13F**
UVs+LCVs	291,361	329,310	364,064	279,392	312,919	4.3%	5.2%
Maximo	68,243	78,479	90,251	48,000	55,200	42.2%	42.2%
Tractors	252,447	277,692	305,461	237,155	260,870	6.4%	6.4%
3W	72,509	76,134	79,941	69,854	73,347	3.8%	3.8%
Gio	12,000	13,200	14,520	9,450	9,923	27.0%	33.0%
Total	**696,560**	**774,815**	**854,237**	**643,851**	**712,259**	**8.2%**	**8.8%**
	New			**Old**			
Volumes (YoY)	**FY12F**	**FY13F**	**FY14F**	**FY12F**	**FY13F**		
Uvs+LCVs	20.6%	13.0%	10.6%	15.7%	12.0%		
Maximo	92.4%	15.0%	15.0%	35.3%	15.0%		
Tractors	18.0%	10.0%	10.0%	10.9%	10.0%		
3W	12.0%	5.0%	5.0%	7.9%	5.0%		
Gio	33.3%	10.0%	10.0%	5.0%	5.0%		
Total	**23.4%**	**11.2%**	**10.3%**	**14.0%**	**10.6%**		

Source: Nomura estimates

Fig. 2: State-by-state analysis of tractor growth in India

	Volume Mix				Growth						
	FY08	FY09	FY10	FY11	FY09	FY10	FY11	Q2FY12	H1FY12	Implied H2	FY12F
AP	14.5	12.7	8.7	9.2	(12.3)	(8.7)	25.8	11.8	24.4	2.9	12.8
Assam	0.4	0.5	0.9	0.8	22.5	125.5	8.7	68.0	58.5	16.7	32.2
Bihar	4.3	5.8	7.2	5.7	33.9	65.5	(6.2)	4.4	(3.6)	3.3	(0.3)
Chattisgarh	2.2	2.9	2.5	2.7	33.3	16.4	25.9	6.0	4.2	3.8	4.0
Goa											
Gujarat	8.3	6.6	6.1	8.5	(19.4)	20.8	68.0	93.4	85.6	46.7	62.0
Haryana	7.9	7.4	7.2	5.0	(5.5)	27.6	(16.2)	33.7	6.2	14.7	10.4
HP	0.3	0.3	0.3	0.3	1.8	33.4	16.0	28.1	2.7	19.7	11.6
J&K	0.4	0.4	0.4	0.4	(15.9)	45.9	30.8	37.5	10.2	13.8	12.1
Jharkhand	1.0	1.2	1.4	1.4	25.8	55.4	15.2	(7.7)	(2.6)	(1.0)	(1.8)
Karnataka	5.7	4.5	6.0	5.9	(19.4)	73.8	18.4	22.3	27.7	20.4	23.6
Kerala	0.2	0.1	0.1	0.1	(38.7)	57.0	14.3	(22.7)	(19.3)	-	(11.5)
MP	6.3	8.0	8.3	10.1	26.7	37.9	44.9	24.0		20.3	(0.2)
Maharashtra	9.6	8.4	8.6	11.2	(11.6)	34.6	55.8	53.7	40.5	24.3	30.2
Orissa	1.7	1.7	2.0	2.3	2.1	56.2	39.8	(24.0)	(43.3)	(7.7)	(23.9)
Punjab	6.0	6.6	7.2	5.5	10.8	44.2	(7.8)	4.1	(9.5)	3.8	(3.5)
Rajasthan	9.8	8.5	7.9	7.3	(12.6)	23.5	10.5	53.5	46.5	38.4	42.3
TN	5.6	4.8	3.9	4.3	(14.2)	9.2	30.5	41.5	49.1	25.4	34.4
UP	13.2	17.0	18.3	16.0	29.7	43.2	4.5	17.6	6.2	13.4	10.0
Uttarakhand	0.8	0.6	0.6	0.5	(25.2)	24.9	4.1	(2.8)	(22.6)	(10.4)	(15.9)
WB	1.8	2.0	2.3	2.7	13.7	50.0	42.6	(12.0)	2.4	(15.4)	(7.5)
Others								67.3	63.5	50.5	
India	100.0	100.0	100.0	100.0				9.0	20.0	15.3	17.9

Source: Nomura research

The government has increased MSPs (minimum support price) of all major agri commodities by around 17% in FY12F, which should support farm incomes, in our view. We note that MSPs guaranteed for the FY12 crops (to be sold in FY13) for crops such as wheat and masur (lentil) are 10-15% higher than current market prices, thus providing visibility on income growth.

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Fig. 3: Higher MSPs of food commodities

Commodity	Variety	Price (INR/quintal)		YoY	CAGR			
		2010-11	2011-12		2	3	4	5
Paddy	Common	1,000	1,080	8.0%	6.6%	8.3%	13.8%	13.2%
	Grade "A"	1,030	1,110	7.8%	6.4%	8.0%	13.2%	12.7%
Coarse Cereals		880	980	11.4%	8.0%	5.3%	13.0%	12.7%
Maize		880	980	11.4%	8.0%	5.3%	12.1%	12.7%
Wheat		1,120	1,285	14.7%	8.1%	6.0%	6.5%	11.4%
Barley		780	980	25.6%	14.3%	13.0%	10.8%	11.6%
Gram		2,100	2,800	33.3%	26.1%	17.4%	15.0%	14.1%
Arhar (Tur)		3,000	3,200	6.7%	18.0%	27.3%	19.9%	17.8%
Moong		3,170	3,500	10.4%	12.6%	11.6%	19.8%	18.2%
Urad		2,900	3,300	13.8%	14.4%	9.4%	18.0%	16.8%
Masur (Lentil)		2,250	2,800	24.4%	22.4%	14.4%	13.3%	12.6%
Sugarcane		108	139	29.1%	3.5%	19.4%	14.4%	11.6%
Cotton	F-414/H-777/J-34	2,500	2,800	12.0%	5.8%	3.8%	11.7%	9.6%
Groundnut-in-shell		2,300	2,700	17.4%	13.4%	8.7%	14.9%	12.2%
Rapeseed/Mustard		1,850	2,500	35.1%	16.9%	11.0%	8.6%	7.8%
Sunflower Seed		2,350	2,800	19.1%	29.1%	19.3%	16.7%	13.3%
Soyabean	Black	1,400	1,650	17.9%	10.6%	6.9%	16.0%	12.9%
Safflower		1,800	2,500	38.9%	23.1%	14.9%	10.9%	9.5%
Copra	Milling	4,450	4,525	1.7%	0.8%	7.3%	5.7%	4.7%
	Ball	4,700	4,775	1.6%	0.8%	6.9%	5.4%	4.5%
Sesamum		2,900	3,400	17.2%	9.2%	7.3%	21.1%	16.9%
Nigerseed		2,450	2,900	18.4%	9.8%	6.4%	23.7%	18.9%
Average				**16.8%**	**12.1%**	**10.3%**	**13.5%**	**12.1%**

Source: Press Information Bureau, Nomura research

MVML to become a key value driver going forward

MVML's contribution in MM's sales should increasingly rise, we estimate. With this a part of the profit may get booked in MVML, a 100% MM-owned subsidiary, which does manufacturing for MM. In our view, a larger portion of the margins from new products from MVML may get booked in MVML itself as it is more tax-efficient for the company. We thus believe that stand-alone margins may not improve much from current levels despite higher volumes. Thus the Street would have to look at the combined profitability of MM+MVML rather than MM stand-alone for valuation purposes.

In our view, the FY13F PAT at MVML+MM combined could be higher by 7% compared that for MM alone. There could be large upsides to our estimates in the event that there is a reversal of the tax-incentive policy of the Maharashtra government. Effective 17 March 2011, the Maharashtra government reduced the sales tax incentives to be effective only for vehicles sold within Maharashtra rather than for those sold throughout entire country.

Industry has been arguing that lowering the tax incentives after the investments have been made is unfair. Significant tax incentives were available in other states and the decision to invest in Maharashtra was based on higher tax incentives. Discussions on the matter are ongoing.

Fig. 4: MVML – Key figures

M&M + MVML estimates	FY12F	FY13F	FY14F
Sales	310,288	358,819	406,075
EBITDA	41,819	47,706	54,059
EBITDA margin (%)	13.5	13.3	13.3
Net profit	27,497	30,749	35,583
EPS	48.9	54.7	63.3
MVML as % of M&M + MVML			
Volumes	11.2	14.1	14.7
EBITDA	9.8	11.6	12.0
Net profit	6.8	7.1	8.5
EPS	6.8	7.1	8.5

Note: Net profit and EPS excludes subsidiary dividends
Source: Company data, Nomura research

Change in stand-alone estimates – factoring in strong volume growth

We have increased our volume assumptions by 8.8% in FY13F. Due to higher ASPs, driven largely by price increases and a better product mix, our revenues estimates have increased by 13.5% in FY12F and 16.1% in FY13F. As the stand-alone financials will include only the distribution margins for sales of models (Maximo, XUV500, Genio) produced at company's Chakan plant – stand-alone EBITDA margins would come down, in our view. Consequently, we have reduced our EBITDA margins by 80 bps in FY12F and by 120 bps in FY13F.

Overall, we have increased our FY13F EPS estimates (ex- subsidiary dividends) by 10.4%.

Our FY12F stand-alone EPS estimates are 1.6% lower than consensus. This is because we build in lower profitability (only distribution margins) on models produced at the Chakan plant. If we look at combined M&M + MVML, our EPS estimates are around 5% higher for the current year (FY12F). We believe that with the launch of the XUV 500, MVML should become more significant and the Street should start ascribing value to it.

Fig. 5: Change in stand-alone estimates

	New			Old		% change	
	FY12F	FY13F	FY14F	FY12F	FY13F	FY12F	FY13F
Total Volumes	696,560	774,815	854,237	643,851	712,259	8.2	8.8
YoY(%)	23.4	11.2	10.3	13.4	10.6		
Revenues (INR mn)	305,332	352,557	398,525	268,991	303,559	13.5	16.1
OPM	12.4	12.0	11.9	13.2	13.2	(0.8)	(1.2)
EBITDA (INR mn)	37,719	42,170	47,548	35,398	39,927	6.6	5.6
Standalone EPS* (INR)	45.6	50.8	57.9	41.7	46.0	9.4	10.4
Cash EPS (INR)	54.4	61.8	71.0	50.7	57.3	7.3	7.7

*EPS is after excluding subsidiary dividends, which is used for the purpose of valuation

Source: Nomura estimates

Fig. 6: Our estimates are above consensus

INR mn	Nomura			Consensus			% difference		
Standalone	FY12F	FY13F	FY14F	FY12F	FY13F	FY14F	FY12F	FY13F	FY14F
Sales	305,332	352,557	398,525	286,795	331,709	372,985	6.5	6.3	6.8
EBITDA	37,719	42,170	47,548	38,085	45,035	50,843	(1.0)	(6.4)	(6.5)
EBITDA margin (%)	12.4	12.0	11.9	13.3	13.6	13.6	(0.9)	(1.6)	(1.7)
Net profit	27,294	30,340	34,416	27,735	32,663	37,713	(1.6)	(7.1)	(8.7)
EPS (INR)	48.6	54.0	61.2	49.3	58.1	67.1	(1.6)	(7.1)	(8.7)
EPS (INR) - M&M + MVML	51.9	57.8	66.6	49.3	58.1	67.1	5.1	(0.5)	(0.7)

Source: Bloomberg, Nomura research

Reiterate Buy with a revised TP of INR896; 21% upside from current levels

We have increased our target price by 11% to INR896 from INR803 earlier. Our target-price increase is driven primarily by: 1) an increase in FY13F stand-alone EPS (ex-subsidiary dividends) estimates by 10.4% as we build in higher volume growth, and 2) we now value MVML at INR55 based on 12x one-year forward EPS. We earlier valued it at INR10.4/sh at the historical book value of investments. The key reason for the change in valuation methodology for MVML is that a larger part of M&M's automotive profits will come through this subsidiary due to strong growth in Maximo volumes and the launch of the XUV500. Hence, we assign MVML a multiple similar to that assigned to the standalone business.

A roll forward of our target price to November 2012 from March 2012 earlier has also added around INR42 to our target price. However, we have reduced our valuation of other subsidiaries by 22% to INR188 to factor in the lower market price of listed subsidiaries.

We value MM at INR896 based on a sum-of-the-parts (SOTP) methodology. We value the stand-alone auto business at INR653 based on 12x one-year forward (average of FY13F and FY14F) standalone EPS (ex-subsidiary dividends) of INR54.4. We value MVML at INR55 based on 12x one-year forward (average of FY13F and FY14F) EPS of INR4.6. We value the investments in other subsidiaries at INR188/share, after a 20% holding discount.

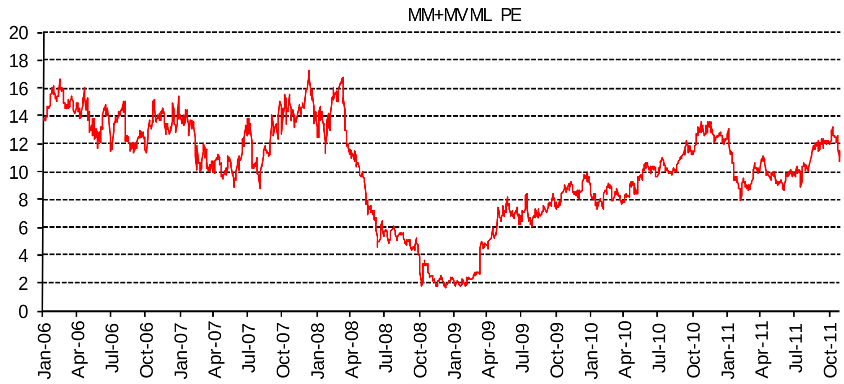
Fig. 7: Price target build up

	% holding of M&M	Value/share (INR)	Current Price (INR)
M&M standalone	100.0	653	
MVML (Mahindra Vehicle Manufactures Ltd)	100.0	55	
Other subsidiaries			
Tech Mahindra	48.1	62	580
MMFS	60.1	67	648
MUSCO	50.7	1	49
Mahindra Holidays and Resorts	83.1	38	308
Mahindra Life Spaces	51.1	10	281
Mahindra Forgings	50.7	5	60
Ssangyong Motors*	70.1	32	5,050
Unlisted Subsidiaires		19	
Total		235	
O/S shares (mn)		562	
Value of other subsidiaries (INR/sh)		**235**	
After holding company discount @20%		**188**	
Target price (INR/sh)		**896**	

Note: *pricing of subsidiaries based on market price as of 17th Nov 2011 except for Tech Mahindra which is based on Nomura's TP of INR580/sh; Ssangyong Motors price indicated in KRW

Source: Bloomberg, Company data, Nomura research

Fig. 8: PE ratio



Note: PE ratio is based on EPS of M&M + MVML (ex-subsidiary dividends)

Source: Bloomberg, Nomura research

Fig. 9: Valuation comparison

			Price	EPS CAGR	EPS			P/E			P/E on cash EPS			ROE(%)		
Company	Ticker	Rating	INR	FY11-13E	FY11	FY12F	FY13F	FY11	FY12F	FY13F	FY11	FY12F	FY13F	FY11	FY12F	FY13F
Ashok Leyland	AL IN	Buy	25.2	8.1%	2.4	2.1	2.8	10.6	12.2	9.1	7.4	7.5	6.1	16.5	13.4	16.6
Bajaj Auto	BJAUT IN	Neutral	1,692.4	9.2%	90.4	101.1	107.7	18.7	16.7	15.7	17.9	16.0	15.1	85.2	51.4	42.7
Hero MotoCorp	HMCL IN	Neutral	2,193.4	21.2%	100.5	122.6	147.7	21.8	17.9	14.9	18.8	12.2	10.6	60.0	79.5	88.1
M&M*	MM IN	Buy	738.0	12.1%	43.5	48.9	54.7	12.6	11.2	10.1	10.6	9.2	8.1	28.3	25.9	24.5
Maruti Suzuki	MSIL IN	Neutral	940.6	-3.6%	78.3	60.6	72.8	12.0	15.5	12.9	8.5	10.0	8.3	15.7	9.9	10.7
Tata Motors	TTMT IN	Buy	170.3	1.4%	28.5	27.4	29.4	6.0	6.2	5.8	3.9	3.8	3.4	67.7	38.5	31.3
TVS Motor	TVSL IN	Buy	63.3	38.9%	4.1	6.1	7.9	15.5	10.4	8.0	9.5	7.8	7.6	20.9	26.2	27.6

Note: pricing as of 18th Nov, 2011; * Includes MVML but excludes other subsidiary values

Source: Bloomberg, Nomura estimates

Key risks

- Impact of slower GDP growth — our volume growth expectations are based on Nomura's India GDP growth expectations of 7.9% for FY13F. In the event that the GDP growth is slower, there would be a downside risk to our volume estimates.
- Higher excise duty on diesel vehicles — in the event that the government decides to impose a higher excise duty on diesel vehicles (to compensate for higher subsidies on diesel); there could be downside risks to our estimates.
- Higher-than-expected raw-material costs — we have assumed a scenario of stable commodity prices; however, if commodity prices were to go higher from current levels, there could be downside risks to our estimates.

2Q FY12 results - strong volume growth offset the impact of lower margins

M&M declared adjusted PAT of INR7.7bn, around 3% below our estimates. However, adjusted EBITDA margins came in at 12.3% lower than our and consensus estimates of 13.8% and 13.6%, respectively, due to higher raw-material costs.

Takeaways from the conference call

- M&M does not believe that commodity prices for the company have peaked in 2QFY12, although the increase in prices will taper down in 3QFY12.
- The UV segment grew by c.15% in 2QFY12 and M&M has maintained its market share. As per the company, due to strong demand, it has reasonable pricing power in the automotive segment.
- As per the company, tractor industry growth continues to surprise on the upside. Company expects tractor industry to grow at 17-18% in FY12F with an upside bias. However, pricing power in the segment is under constraint primarily due to higher interest rates.
- Management believes that there is no such lending pressure in the tractor segment as income for farmers remains strong due to strong Kharif production this year and increases in minimum support prices (MSP), based on its interactions with financial services companies.
- The company will ramp-up the production capacity of the XUV500 to 3,000 units by January 2012 (from around 2,000 units currently) and would further increase to 5,000 units by June 2012.
- Currently, there is a capacity constraint on the MDi engines used in Bolero, 4-wheeler pick-ups and in Xylo. Management estimates that it has lost around 2,000-2,500 units/month in 2QFY12 and expects that the situation will gradually improve by end FY12.

Key result highlights

M&M declared adjusted PAT of INR7.69bn (Nomura: INR7.9bn; consensus: 7.6bn) below our estimates on higher raw-material costs. There was a forex loss of INR320mn in the quarter on revaluation of ECBs. Adjusted for this, EBITDA margin came in 12.3% lower than our and consensus expectations of 13.8% and 13.6%, respectively. Margins in the automotive segment dipped to 9.9% from 10.7% in 1QFY12. Farm equipment segment margins were at 15.3% vs. 16% in the previous quarter (not adjusted for forex losses).

- Net sales at INR73.6bn were slightly higher than our estimate of INR72.5bn.
- EBITDA margins came in 12.3% lower than our estimate of 13.8%.
- RM/sales came in at 72.6%, compared to our estimate of 71.3%.
- Employee cost/sales came in at 5.8%, compared to our estimate of 5.6%; employee costs includes a charge of INR259.5mn on account of amortisation of ESOPs.
- Other income at INR2.3bn was higher than our estimate of INR1.45bn.
- Other expenses/sales came in at 9.3%, compared to our estimate of 9.3%.

Fig. 10: Comparison with consensus

	INR m			% difference from	
	Actual	Consensus	Nomura	Consensus	Nomura
Net Sales	73,606	72,584	72,477	1.4%	1.6%
EBITDA	9,060	9,854	10,027	-8.1%	-9.6%
Margin	12.3%	13.6%	13.8%		
Adj Net Profit	7,694	7,621	7,901	1.0%	-2.6%

Source: Company data, Bloomberg, Nomura estimates

Fig. 11: 2QFY12 results

INR mn	2QFY11	1QFY12	2QFY12	QoQ	YoY	2QFY12F
Net Sales	**53,617**	**67,335**	**73,606**	9.3	37.3	**72,477**
(Inc.)/Dec in Fin. Goods	(2,408)	(2,583)	(2,547)			-
Raw Materials	38,901	50,919	55,960			-
Net RM	36,494	48,336	53,414	10.5	46.4	51,676
Staff	3,582	4,034	4,302	6.6	20.1	4,034
Other costs	5,318	5,992	6,831	14.0	28.5	6,740
Total Cost	45,394	58,362	64,546	10.6	42.2	62,450
Operating Profit	**8,223**	**8,973**	**9,060**	1.0	10.2	**10,027**
Change (%)	7.1	15.7	10.2			21.9
OPM (%)	*15.3*	*13.3*	*12.3*	-1.0	-3.0	*13.8*
Non-Operating Income	1,998	249	2,315	830.9	15.9	1,449
Extraordinary Income	727	-	-			-
Extraordinary Expense	-	-	320			-
Interest	(91)	(20)	49			(20)
Gross Profit	**11,038**	**9,242**	**11,006**	19.1	-0.3	**11,495**
Less: Depreciation	970	1,099	1,257	14.4	29.6	1,099
PBT	**10,068**	**8,143**	**9,749**	19.7	-3.2	**10,397**
Tax	2,483	2,095	2,376	13.4	-4.3	2,495
Effective Tax Rate (%)	*24.7*	*25.7*	*24.4*			*24.0*
PAT	7,585	6,049	7,374	21.9	-2.8	7,901
Change (%)	7.9	7.6	-2.8			4.2
Adj PAT	**7,098**	**6,049**	**7,694**	27.2	8.4	**7,901**

Source: Company data, Nomura estimates

Fig. 12: Ratios

	2QFY11	1QFY12	2QFY12	QoQ	YoY	2QFY12F
RM / Sales	68.1	71.8	72.6	0.8	4.5	71.3
Gross margins	31.9	28.2	27.4	-0.8	-4.5	28.7
Staff cost / sales	6.7	6.0	5.8	-0.1	-0.8	5.6
Other exp / sales	9.9	8.9	9.3	0.4	-0.6	9.3

Source: Company data, Nomura estimates

Global economics: What if things get worse before they get better?

As the news coming out of Europe suggests that downside risks to our baseline economic forecasts have not dissipated, our global economics team have run a scenario analysis to see what would happen in the event of a market meltdown or unforeseen shocks or policy errors.

The **bear** case assumes:

- US GDP averages -1% in 2012 and Euro area GDP averages -3% in 2012 before both recover to 2% growth in 2013.
- CRB commodity price index falls 15% in 2012, but rebounds by 15% in 2013.

What if things get much worse than this? After all, we know that in 2009, US GDP fell 3.5% and Euro area GDP fell 4.2%. Although our global economics team does not see such a situation as plausible at the moment, they have run the numbers to see the hypothetical impact of such an extreme macro environment on Asian economies to provide some perspective. This **extreme** scenario assumes:

- US GDP averages -4% in 2012 and Euro GDP averages -6.5% before both recover to 1% growth in 2013.
- CRB commodity price index falls 40% in 2012, and does not rebound in 2013.

Fig. 13: Real GDP growth forecasts: baseline and downside scenarios

(% y-y)	2012F			2013F		
	Base case	Bear case	Extreme case	Base case	Bear case	Extreme case
Australia	4.6	3.5	1.0	3.1	2.4	2.2
China	8.6	8.0	7.2	8.4	8.6	8.1
Hong Kong	4.5	1.0	-4.5	4.2	4.5	5.5
India	7.9	7.2	6.6	8.1	8.4	8.8
Indonesia	7.0	5.5	4.0	7.0	5.6	5.2
Malaysia	5.1	2.5	-3.2	5.0	3.5	3.2
New Zealand	3.5	3.0	2.0	3.6	3.4	3.2
Philippines	5.7	4.0	1.0	6.5	4.5	4.0
Singapore	5.3	-0.5	-2.5	5.5	3.8	3.6
South Korea	5.0	-2.0	-5.0	4.0	4.0	5.0
Taiwan	4.7	1.0	-4.0	5.2	5.0	5.5
Thailand	4.7	2.6	-2.8	4.8	3.3	3.0
Asia ex Japan, Aus, NZ	7.6	6.2	4.7	7.4	7.5	7.4

The global bear case does not look too bad for much of Asia and in fact is marginally better than the base case for China and India in 2013 because we would expect a V-shape rebound for the region after initial shock, thanks to the likely decline in commodity prices and the ample room Asia has to ease monetary and fiscal policies. We would also expect the Fed to resort to further quantitative easing, which once again would likely precipitate strong net capital inflows into Asia. In the extreme case, however, even these strengths will be tested.

What does this mean for M&M

We note that MM's volume growth is sensitive to economic growth. As explained in the exhibit below, in a bear case our target price could come down by 25% and in the worst case it could come down by 47%.

Fig. 14: Scenario Analysis on MM

	Base Case		Bear Case		Worst Case	
	FY12	FY13	FY12	FY13	FY12	FY13
Total volume grow th	23.2%	11.2%	17.9%	5.3%	14.9%	0.9%
PE multiple		12.0		10.0		9.0
Holding co. discount for subsidary valuation		20%		30%		40%
Target Price (INR)		**896**		**673**		**476**
% downside				-25		-47
Standalone EPS (INR)	**45.6**	**50.8**	**43.1**	**45.2**	**41.4**	**37.2**
% downside			-6	-11	-9	-27

Source: Nomura research

Appendix A-1

Analyst Certification

I, Nishit Jalan, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

Issuer Specific Regulatory Disclosures

Mentioned companies

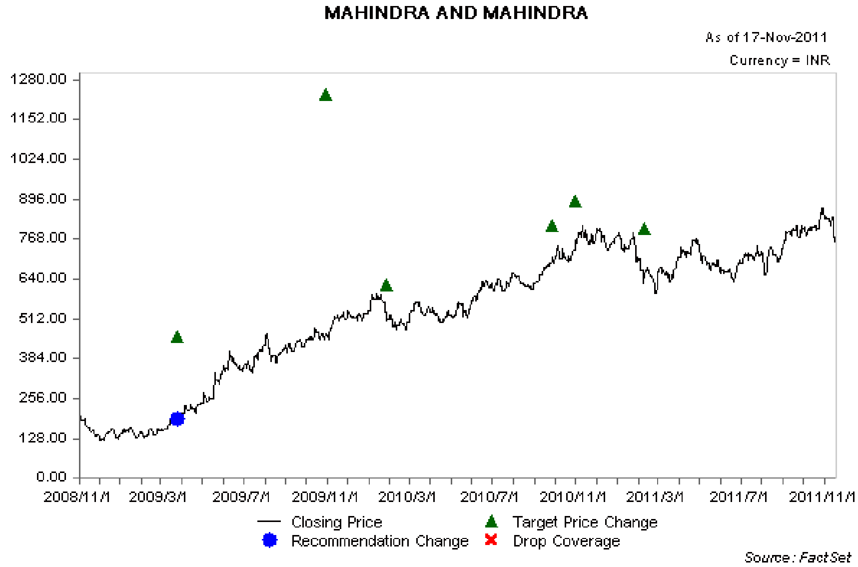
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Mahindra and Mahindra	MM IN	INR 738	18-Nov-2011	Buy	Not rated	

Previous Rating

Issuer name	Previous Rating	Date of change
Mahindra and Mahindra	Not Rated	27-Mar-2009

Mahindra and Mahindra (MM IN) **INR 738 (18-Nov-2011)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
10-Feb-2011		803.00	654.40
01-Nov-2010		892.00	765.90
27-Sep-2010		814.00	694.15
27-Jan-2010		622.00	505.95
30-Oct-2009		1232.00	460.98
27-Mar-2009		455.00	192.65
27-Mar-2009	Buy		192.65

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value MM at INR896 based on a sum-of-the-parts (SOTP) methodology. We value the standalone auto business at INR653 based on 12x one-year forward (average of FY13F and FY14F) standalone EPS (ex-subsidiary dividends) of INR54.4. We value MVML at INR55 based on 12x one-year forward (average of FY13F and FY14F) EPS of INR4.6. We value the investments in other subsidiaries at INR188/share, after a 20% holding discount.

Risks that may impede the achievement of the target price Key risks • Impact of slower GDP growth — our volume growth expectations are based on Nomura's India GDP growth expectations of 7.9% for FY13F. In the event that GDP growth is slower, there could be a downside risk to our volume estimates. • Higher excise duty on diesel vehicles — in the event that government decides to impose higher excise duty on diesel vehicles (to compensate for higher subsidies on diesel), there could be downside risks to our estimates. • Higher-than-expected raw material costs — we have assumed a scenario of stable commodity prices; however, if commodity prices were to go higher from current levels, there could be downside risks to our estimates.

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STOCKS

A rating of '**Buy'**, indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months. A rating of '**Neutral'**, indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months. A rating of '**Reduce'**, indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months. A rating of '**Suspended'**, indicates that the rating, target price and estimates have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including, but not limited to, when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the company.
Benchmarks are as follows: **United States/Europe**: Please see valuation methodologies for explanations of relevant benchmarks for stocks (accessible through the left hand side of the Nomura Disclosure web page: http://go.nomuranow.com/research/globalresearchportal);**Global Emerging Markets (ex-Asia):** MSCI Emerging Markets ex-Asia, unless otherwise stated in the valuation methodology.

SECTORS

A '**Bullish'** stance, indicates that the analyst expects the sector to outperform the Benchmark during the next 12 months. A '**Neutral'** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next 12 months. A '**Bearish'** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next 12 months.
Benchmarks are as follows: **United States**: S&P 500; **Europe**: Dow Jones STOXX 600; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia.

Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

STOCKS

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Target Price - Current Price) / Current Price, subject to limited management discretion. In most cases, the Target Price will equal the analyst's 12-month intrinsic valuation of the stock, based on an appropriate valuation methodology such as discounted cash flow, multiple analysis, etc.
A '**Buy'** recommendation indicates that potential upside is 15% or more. A '**Neutral'** recommendation indicates that potential upside is less than 15% or downside is less than 5%. A '**Reduce'** recommendation indicates that potential downside is 5% or more. A rating of '**Suspended'** indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the subject company.

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Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009

STOCKS

A rating of '1' or '**Strong buy'**, indicates that the analyst expects the stock to outperform the Benchmark by 15% or more over the next six months. A rating of '2' or '**Buy'**, indicates that the analyst expects the stock to outperform the Benchmark by 5% or more but less than 15% over the next six months. A rating of '3' or '**Neutral'**, indicates that the analyst expects the stock to either outperform or underperform the Benchmark by less than 5% over the next six months. A rating of '4' or '**Reduce'**, indicates that the analyst expects the stock to underperform the Benchmark by 5% or more but less than 15% over the next six months. A rating of '5' or '**Sell'**, indicates that the analyst expects the stock to underperform the Benchmark by 15% or more over the next six months.
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SECTORS

A '**Bullish'** stance, indicates that the analyst expects the sector to outperform the Benchmark during the next six months. A '**Neutral'** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next six months. A '**Bearish'** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next six months.
Benchmarks are as follows: **Japan**: TOPIX; **United States**: S&P 500, MSCI World Technology Hardware & Equipment; **Europe**, by sector - *Hardware/Semiconductors*: FTSE W Europe IT Hardware; *Telecoms*: FTSE W Europe Business Services; *Business Services*: FTSE W Europe; *Auto & Components*: FTSE W Europe Auto & Parts; *Communications equipment*: FTSE W Europe IT Hardware; **Ecology Focus**: Bloomberg World Energy Alternate Sources; **Global Emerging Markets**: MSCI Emerging Markets ex-Asia.

Target Price

A Target Price, if discussed, reflect in part the analyst's estimates for the company's earnings. The achievement of any target price may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings differ from estimates.

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