

Equities

14 November 2011 | 15 pages

Mahindra & Mahindra (MAHM.BO)

2QFY12: Results Miss the High Ask

- Company Update
- Target Price Change
- Estimate Change

■ **PAT at Rs 7.4bn was ~8% below our estimates** — reflecting an EBITDA miss of ~13% (EBITDA of Rs8.7bn, 11.9%, down 145bps Q/Q). This includes an MTM f/x loss of ~Rs320m, sans which EBITDA would have been ~Rs9.1bn (12.3%). Both key cost heads – employee expenses/raw materials - were higher than estimates; the former on account of ~Rs260m of amortization of ESOPs, the latter due to lower than expected price hikes (revenues were ~1% below estimates). Mitigating these impacts were a) ~13% YoY growth in income from subs and JVs and b) lower tax rate of 24.4% (vs 25.7% in 1QFY12). Per mgmt, PAT was ~Rs 7.59bn (ex MTM losses).

■ **Incentives – and why they matter** — we estimate MM's quarterly incentives are ~Rs400-500m (pre tax). FY11 incentives / grants booked were ~Rs1.8bn, ~6% of PBT and ~50-70 bps from a quarterly EBITDA margin perspective. We reckon the miss in MM's nos is accentuated, given the change in norms since end 4Q11. We expect this to continue for another 2Qs, before the nos. reflect in the base.

■ **Segmental trends: slight margin contraction in both tractors and UVs** — Auto and FES reported EBIT margins of 9.9% / 15.3%, down 80/70bps Q/Q respectively. Given that both businesses are operating at high levels of utilization, we reckon this is on account of cost pressures, rather than leverage. Mgmt noted in the con call that pricing in the tractor industry is constrained, though volume growth remains v. robust (>20%). We reckon this trend (weak pricing) needs to be watched closely.

■ **Con call takeaways** — a) Mgmt is positive on the XUV500 outlook – production will be increased from 2,000 / mth in 3Q to 3,000 / mth in 4Q, b) Tractor inventory levels remain low, c) elevated working capital reflects ramp-up before festive season, d) tractor vol growth to moderate in 2H12, e) 1H pickup vols impacted by engine supply constraints.

■ **Pare earnings/target price** — We tweak earnings by 3-8% over FY12-14 to reflect a) higher input cost pressures, b) higher other expenses, but c) also raise tractor volume forecasts over FY12-14, reflecting robust 1H12 trends. SOTP-based target price of Rs870 values parent at Rs737/share, subs at Rs133/share. Maintain Neutral.

Neutral	2
Price (14 Nov 11)	Rs790.40
Target price	Rs870.00
	<i>from Rs888.00</i>
Expected share price return	10.1%
Expected dividend yield	1.5%
Expected total return	11.6%
Market Cap	Rs485,286M
	US\$9,705M

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



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2010A	19,970	34.00	122.3	23.2	5.7	30.5	1.2
2011A	24,961	42.50	25.0	18.6	4.5	27.5	1.5
2012E	26,725	43.53	2.4	18.2	3.7	23.4	1.5
2013E	33,050	53.83	23.7	14.7	3.2	24.4	2.4
2014E	39,314	64.03	19.0	12.3	2.7	24.8	2.3

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	23.2	18.6	18.2	14.7	12.3
EV/EBITDA adjusted (x)	15.5	12.7	11.1	8.8	7.2
P/BV (x)	5.7	4.5	3.7	3.2	2.7
Dividend yield (%)	1.2	1.5	1.5	2.4	2.3
Per Share Data (Rs)					
EPS adjusted	34.00	42.50	43.53	53.83	64.03
EPS reported	35.55	45.33	43.53	53.83	64.03
BVPS	138.31	175.61	213.82	247.65	293.22
DPS	9.36	12.02	12.19	18.84	17.93
Profit & Loss (RsM)					
Net sales	185,888	234,944	285,721	343,734	399,699
Operating expenses	-160,044	-204,521	-253,058	-303,338	-351,720
EBIT	25,845	30,423	32,663	40,396	47,980
Net interest expense	-1,569	-709	-1,022	-736	-263
Non-operating/exceptionals	4,191	5,482	3,991	4,406	4,702
Pre-tax profit	28,468	35,196	35,633	44,066	52,419
Tax	-7,590	-8,575	-8,908	-11,017	-13,105
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	20,878	26,621	26,725	33,050	39,314
Adjusted earnings	19,970	24,961	26,725	33,050	39,314
Adjusted EBITDA	29,552	34,562	37,548	46,331	54,964
Growth Rates (%)					
Sales	41.6	26.4	21.6	20.3	16.3
EBIT adjusted	222.6	17.7	7.4	23.7	18.8
EBITDA adjusted	170.5	17.0	8.6	23.4	18.6
EPS adjusted	122.3	25.0	2.4	23.7	19.0
Cash Flow (RsM)					
Operating cash flow	20,467	34,173	38,554	48,114	49,483
Depreciation/amortization	3,708	4,139	4,884	5,934	6,984
Net working capital	-4,119	3,413	6,945	9,130	3,184
Investing cash flow	-14,708	-40,103	-24,971	-20,934	-21,984
Capital expenditure	-8,592	-10,830	-12,174	-20,934	-21,984
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	-6,957	-6,503	-6,979	-23,187	-23,599
Borrowings	-11,726	-4,749	-2,695	-10,000	-11,050
Dividends paid	-6,238	-8,026	-8,531	-13,187	-12,549
Change in cash	-1,198	-12,433	6,604	3,993	3,900
Balance Sheet (RsM)					
Total assets	161,438	198,406	236,100	262,284	293,385
Cash & cash equivalent	17,432	6,146	12,750	16,743	20,643
Accounts receivable	12,581	13,547	19,775	19,165	22,268
Net fixed assets	37,027	43,719	51,008	66,008	81,008
Total liabilities	83,170	95,272	110,526	116,847	121,182
Accounts payable	32,601	45,940	64,593	69,258	80,281
Total Debt	28,802	24,053	21,358	11,358	309
Shareholders' funds	78,268	103,134	125,574	145,437	172,202
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	15.9	14.7	13.1	13.5	13.8
ROE adjusted	30.5	27.5	23.4	24.4	24.8
ROIC adjusted	46.7	44.9	46.5	49.6	46.3
Net debt to equity	14.5	17.4	6.9	-3.7	-11.8
Total debt to capital	26.9	18.9	14.5	7.2	0.2

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2Q12 Results: Miss the High Ask

M&M's 2QFY12 PAT at Rs 7.4bn was ~8% below our estimates. EBITDA at Rs8.7bn (margin ~11.9%, down 145bps Q/Q) missed our estimates by ~13%. Adjusted EBITDA would've been ~Rs9.1bn (12.3%) accounting for MTM f/x loss of ~Rs320m. Employee expenses were 5% above estimates, reflecting ~Rs260m of amortization of ESOPs, while raw material cost/sales was higher owing to lower than expected price hikes (revenues were ~1% below estimates). Mitigating these were a) ~13% YoY growth in income from subs and JVs and b) lower tax rate of 24.4% (vs. 25.7% in 1QFY12). Per mgmt, PAT was ~Rs 7.59bn (ex MTM losses).

Figure 1. Mahindra & Mahindra -- Volumes/Earnings Revisions

	Old			New			Deviation		
	FY2012E	FY2013E	FY2014E	FY2012E	FY2013E	FY2014E	FY2012E	FY2013E	FY2014E
UV Volumes	268,295	322,983	364,429	268,295	322,983	364,429	0.0%	0.0%	0.0%
LCVs	50,000	60,000	75,000	50,000	60,000	75,000	0.0%	0.0%	0.0%
Tractors	248,499	278,726	307,380	252,549	288,042	323,076	1.6%	3.3%	5.1%
3 Wheelers	84,280	94,394	103,833	84,280	94,394	103,833	0.0%	0.0%	0.0%
Total Volumes	651,074	756,103	850,642	655,125	765,418	866,337	0.6%	1.2%	1.8%
Net Revenues	284,152	341,104	395,712	285,721	343,734	399,699	0.6%	0.8%	1.0%
EBITDA	38,504	48,345	58,915	37,548	46,331	54,964	-2.5%	-4.2%	-6.7%
EBITDA Margin (%)	13.6%	14.2%	14.9%	13.1%	13.5%	13.8%			
PBT	36,519	46,140	56,541	35,633	44,066	52,419	-2.4%	-4.5%	-7.3%
Tax (Rs)	9,130	11,535	14,135	8,908	11,017	13,105	-2.4%	-4.5%	-7.3%
PAT	27,389	34,605	42,406	26,725	33,050	39,314	-2.4%	-4.5%	-7.3%
PAT Margin (%)	9.6%	10.1%	10.7%	9.4%	9.6%	9.8%			
Fully Diluted EPS (ex dividends from subsidiaries)	42.5	54.2	67.0	41.3	51.7	61.9	-2.9%	-4.7%	-7.5%

Source: Citi Investment Research and Analysis estimates

We cut our target price to Rs870 from Rs888, primarily reflecting increasing cost pressures (raw material costs and SG&A expenses), even as we slightly increase our tractor volume assumptions, reflecting strong volume trend over 1HFY12

Figure 2. Mahindra & Mahindra: Sum-of-the-Parts Valuation

Core Business at 12x March 13e CEPS	Rs 737
Listed Subsidiaries at 25% discount to market price	
Tech Mahindra	Rs 45
M&M Financial Services	Rs 49
Mahindra Forge	Rs 4
Mahindra Life space	Rs 8
Mahindra Holidays	Rs 28
Total	Rs 133
SOTP Valuation for Mahindra and Mahindra	Rs 870

Source: Citi Investment Research and Analysis

Figure 3. Mahindra and Mahindra: Volume Trends

	2QFY11	1QFY12	2QFY12	% Chg YoY	% Chg QoQ
Passenger UVs	41,605	44,407	47,523	14.2%	7.0%
4 Wheel pick-ups (incl Gio +Maxximo)	23,841	31,056	39,454	65.5%	27.0%
3-wheelers	16,497	14,058	19,091	15.7%	35.8%
LCVs&MHCVs	2,948	2,952	3,247	10.1%	10.0%
Exports (Auto sector)	3,835	5,717	7,239	88.8%	26.6%
Verito	3,403	3,807	4,900	44.0%	28.7%
Auto division	92,129	101,997	121,454	31.8%	19.1%
Tractors (Domestic + Exports)	45,509	60,152	57,394	26.1%	-4.6%
Total	137,638	162,149	178,848	29.9%	10.3%

Source: Company, Citi Investment Research and Analysis

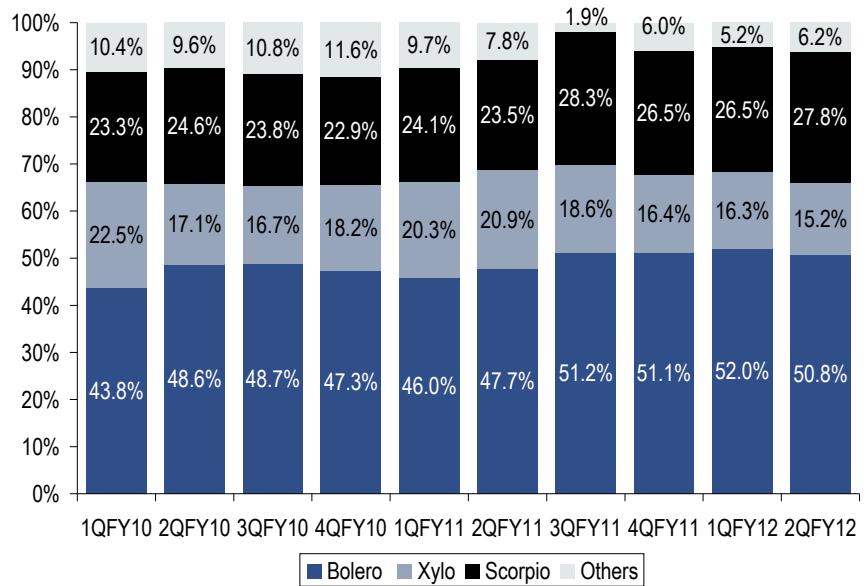
Figure 4. Mahindra and Mahindra: 2QFY12 Results (Rs mn)

	2QFY11	1QFY12	2QFY12	% Chg YoY	% Chg QoQ	CIRA Comments
Gross Sales	58,848	72,694	79,672	35.4%	9.6%	
Less: Excise duty	5,231	5,359	6,066	15.9%	13.2%	
Net sales	53,617	67,335	73,606	37.3%	9.3%	Marginally (~1%) below estimates
Decrease/(Increase) in Stocks	(2,408)	(2,583)	(2,547)			
Raw Materials	38,901	50,919	55,960	46.4%	10.5%	~1% below estimates
Staff costs	3,582	4,034	4,302	20.1%	6.6%	~5% above estimates. Includes ~Rs 260mn on account of amortization of employee stock options granted in earlier years.
Other Expenses	5,318	5,992	7,151	34.5%	19.3%	~10% above estimates. Reflects ~Rs 320mn loss on revaluation of USD denominated ECBs, following depreciation of INR vs USD
Total Expenditure	45,394	58,362	64,866	42.9%	11.1%	~1% above estimates
EBITDA	8,223	8,973	8,740	6.3%	-2.6%	~13% below estimates. Reflects revenue miss of ~1% + greater than expected Other Expenses (due to Rs 320mn forex loss)
Interest	(91)	(20)	49	-154.0%	-344.5%	
Other income	1,998	249	2,315	15.9%	830.9%	~29% above estimates. Buoyed by ~13% YoY growth in dividend income from subsidiaries / JVs
EBDT	10,311	9,242	11,006	6.7%	19.1%	-7.3%
Depreciation	970	1,099	1,257	29.6%	14.4%	15% above estimates
PBT	9,341	8,143	9,749	4.4%	19.7%	-9.5%
Exceptionals	(727)					
Tax	2,483	2,095	2,376	-4.3%	13.4%	~15% below estimates. Tax rates
PAT	7,585	6,049	7,374	-2.8%	21.9%	-7.5%
PAT (pre exceptionals)	7,100	6,049	7,374	3.9%	21.9%	~8% below estimates
Profit Margins						
EBITDA Margins (%)	15.3	13.3	11.9			
Other income / EBDIT (%)	19.5	2.7	20.9			
Other income / PAT (%)	28.1	4.1	31.4			
EBIT (%)	12.3	10.8	9.4			
EBDT (%)	0.2	0.1	0.1			
Pre tax margins (%)	15.9	11.2	12.2			
Tax / PBT (%)	26.6	25.7	24.4			
Net profit margins (%)	13.2	9.0	10.0			
Cost ratios (Net sales)						
Raw materials / sales	68.1	71.8	72.6			
Staff costs / sales	6.7	6.0	5.8			
Other expenses / sales	9.9	8.9	9.7			

Source: Company, Citi Investment Research and Analysis

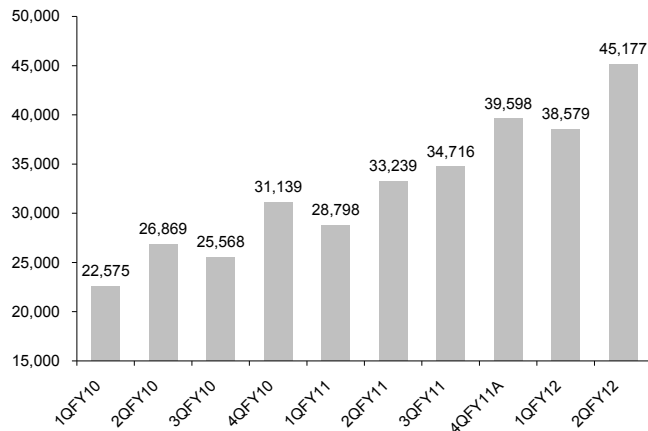
Product mix has improved slightly with the Scorpio gaining ~130bps share QoQ in the UV portfolio. Xylo sales have been lower, as was evident from the discounts offered on the model during the festive season. "Others" includes 505 units of the newly launched XUV 500 in September.

Figure 5. Mahindra & Mahindra: Product mix in domestic passenger UV segment



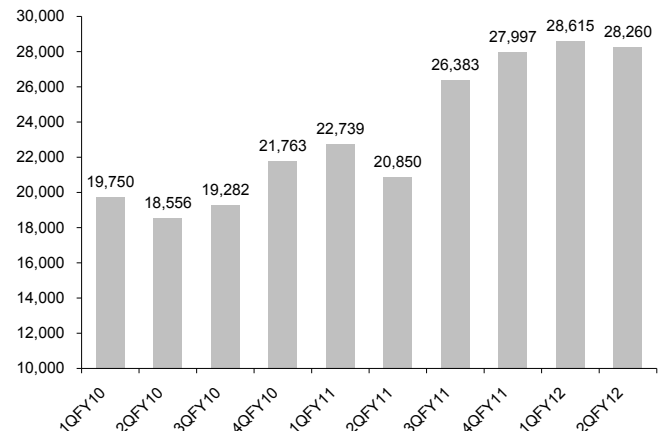
Source: CRISIL, Citi Investment Research and Analysis

Figure 6. M&M : Automotive Segment Revenue (Rs m)



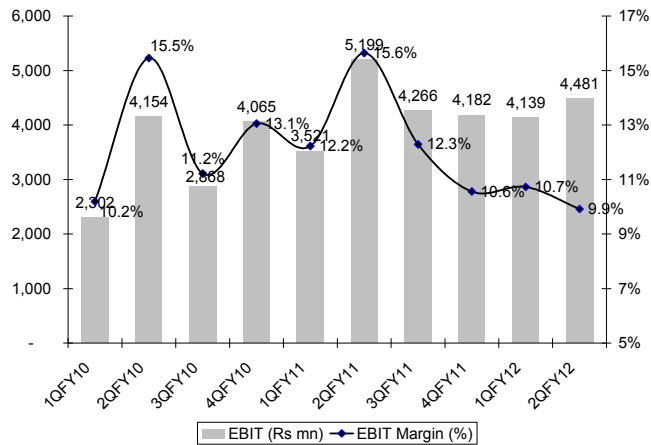
Source: Company, Citi Investment Research and Analysis

Figure 7. M&M : Farm Equipment Segment Revenue (Rs m)



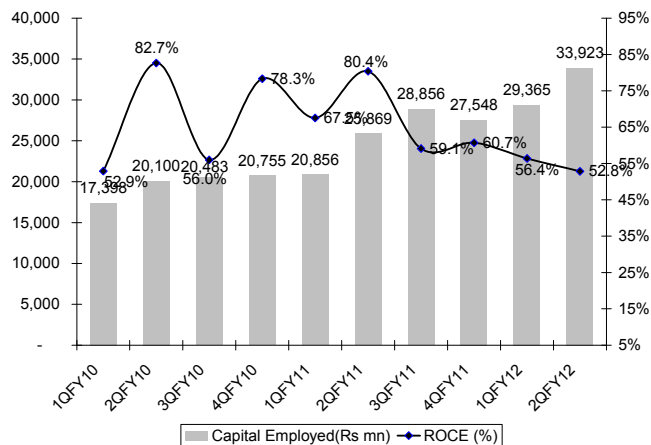
Source: Company, Citi Investment Research and Analysis

Figure 8. M&M : Automotive Segment EBIT Trend



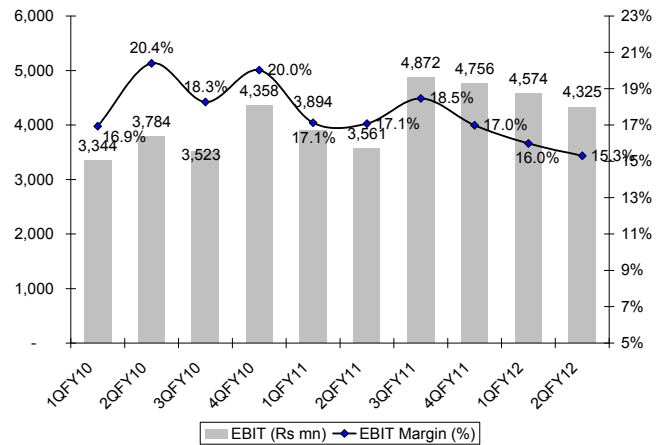
Source: Company, Citi Investment Research and Analysis

Figure 10. M&M : Automotive Segment ROCE Trend



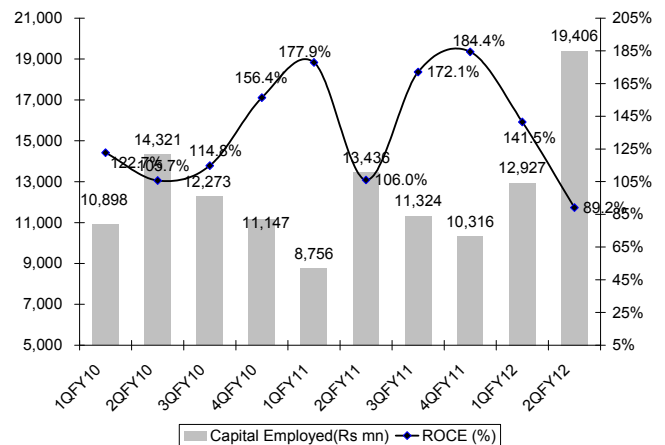
Source: Company, Citi Investment Research and Analysis

Figure 9. M&M : Farm Equipment Segment EBIT Trend



Source: Company, Citi Investment Research and Analysis

Figure 11. M&M : Farm Equipment Segment RoCE Trend



Source: Company, Citi Investment Research and Analysis

Figure 12. Mahindra and Mahindra : Profit and Loss Statement (Rs mn except per share data)

	FY 2010	FY 2011	FY 2012E	FY 2013E	FY 2014E
Net sales	180,248	227,582	280,721	338,134	393,499
% change YoY	42%	26%	23%	20%	16%
Other operating income	5,641	7,362	5,000	5,600	6,200
% change YoY	27%	31%	-32%	12%	11%
Total net revenues and other operating income	185,888	234,944	285,721	343,734	399,699
% change YoY	42%	26%	22%	20%	16%
Raw material expenses	123,329	162,639	202,119	241,766	279,385
% of Net Sales	68.4	71.5	72.0	71.5	71.0
Power and Fuel Expenses	1,209.7	1,439	1,727	2,073	2,487
% of Net Sales	0.7	0.6	0.6	0.6	0.6
Manpower costs	11,985	14,456	17,058	20,469	24,154
% of Net Sales	6.6	6.4	6.1	6.1	6.1
Other variable expenses	12,749.0	14,267	17,334	21,054	24,005
% of Net Sales	7.1	6.3	6.2	6.2	6.1
Other fixed expenses	6,377.8	7,697	9,336	11,242	13,705
% of Net Sales	3.5	3.4	3.3	3.3	3.5
Other Expenses - Expenses Capitalised	685.4	(115)	600	800	1,000
% of Net Sales	0.4	-0.1	0.2	0.2	0.3
Total Expenses	156,336	200,382	248,174	297,404	344,735
% of Net Sales	87%	88%	88%	88%	88%
EBITDA	29,552	34,562	37,548	46,331	54,964
EBITDA Margin (%)	16.4%	15.2%	13.4%	13.7%	14.0%
Other Income	3,284	4,307	3,991	4,406	4,702
Depreciation	3,708	4,139	4,884	5,934	6,984
EBIT	29,129	34,730	36,655	44,802	52,681
Interest Expense	1,569	709	1,022	736	263
Profit Before Tax	27,560	34,021	35,633	44,066	52,419
Tax Provisioning	7,590	8,575	8,908	11,017	13,105
Exceptional Expenses / Income	908	1,175	-	-	-
PAT	20,878	26,621	26,725	33,050	39,314
Pre - exceptional PAT	19,970	24,961	26,725	33,050	39,314
Profit Margins					
EBITDA (%)	16%	15%	13%	14%	14%
EBIT without other income (%)	16%	15%	13%	13%	13%
Pre - Tax Margins (%)	15%	15%	13%	13%	13%
Tax / PBT Margins (%)	28%	25%	25%	25%	25%
PAT (%)	11%	11%	10%	10%	10%
EPS FD (Rs)	34.0	42.5	43.5	53.8	64.0
CEPS FD (Rs)	40.3	49.5	51.5	63.5	75.4
EPS FD ex dividends from subsidiaries	31.7	39.4	41.3	51.7	61.9
CEPS FD ex dividends from subsidiaries	38.1	46.5	49.2	61.4	73.3

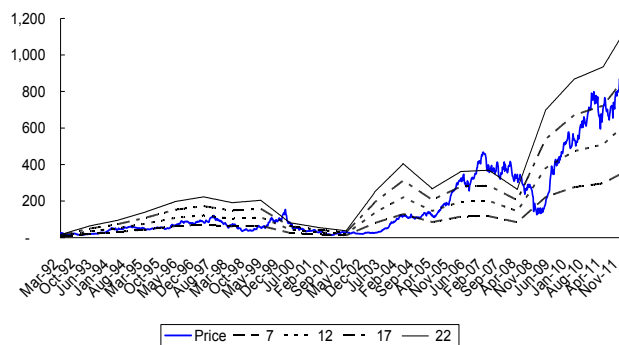
Source: Company, Citi Investment Research and Analysis estimates

Figure 13. Mahindra and Mahindra : Balance Sheet (Rs mn)

	FY 2010	FY 2011	FY 2012E	FY 2013E	FY 2014E
SOURCES OF FUNDS :					
Share Capital	2,830	2,936	2,936	2,936	2,936
Reserves & Surplus	75,438	100,198	122,638	142,501	169,266
Total Shareholders Funds	78,268	103,134	125,574	145,437	172,202
Total Debt	28,802	24,053	21,358	11,358	309
Deferred Tax Liabilities	2,403	3,544	3,544	3,544	3,544
Total sources of funds	109,473	130,731	150,476	160,339	176,055
APPLICATION OF FUNDS :					
Gross Block	52,763	62,277	77,277	92,277	107,277
Less: Accum. Depreciation	25,378	28,417	36,128	36,128	36,128
Net Block	27,385	33,860	41,150	56,150	71,150
Capital Work in Progress	9,642	9,859	9,859	9,859	9,859
Net Fixed Assets	37,027	43,719	51,008	66,008	81,008
Total Investments	63,980	93,253	106,050	106,050	106,050
Current Assets					
Inventories	11,888	16,942	18,486	21,788	24,886
Sundry Debtors	12,581	13,547	19,775	19,165	22,268
Cash and Bank Balance	17,432	6,146	12,750	16,743	20,643
Loans and Advances	18,014	23,732	28,000	32,500	38,500
Others	509	1,067	30	30	30
Total current assets	60,424	61,435	79,042	90,226	106,326
Current Liabilities					
Provisions	34,000	47,617	66,593	71,758	83,781
Provisions	17,965	20,059	19,031	30,187	33,549
Total current liabilities and provisions	51,965	67,676	85,624	101,945	117,330
Net Current Assets	8,458	(6,241)	(6,582)	(11,719)	(11,004)
Misc Expenses	7	-	-	-	-
Total Application of Funds	109,473	130,731	150,476	160,339	176,055

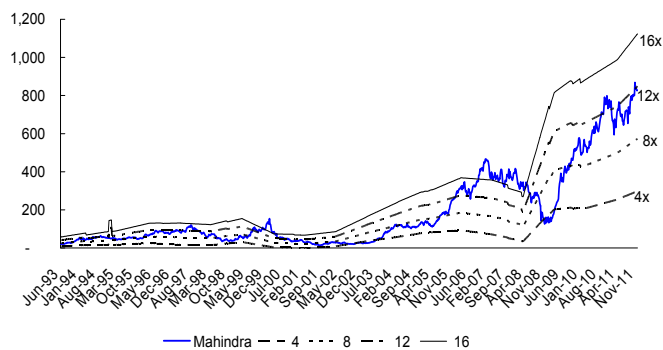
Source: Company, Citi Investment Research and Analysis estimates

Figure 14. M&M: 1 yr fwd P/ EPS (x)



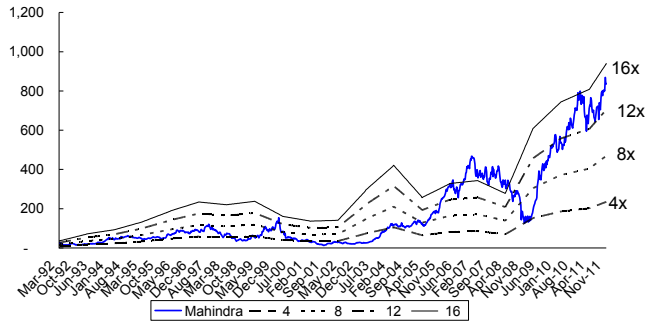
Source: Company, Citi Investment Research and Analysis

Figure 15. M&M: 1 yr fwd EV / EBITDA (x)



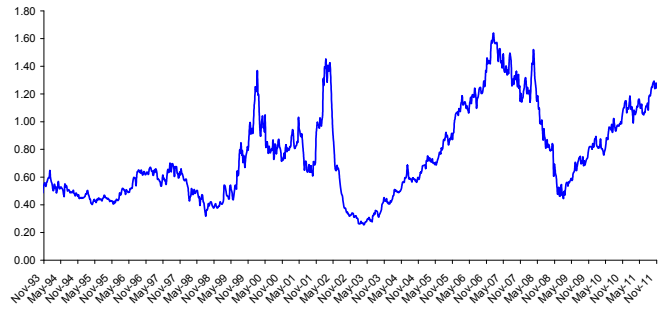
Source: Company, Citi Investment Research and Analysis

Figure 16. M&M: 1 yr fwd P / CEPS (x)



Source: Company, Citi Investment Research and Analysis

Figure 17. M&M: PE Relative to BSE Sensex



Source: Company, Citi Investment Research and Analysis

Mahindra & Mahindra

Company description

Mahindra and Mahindra (M&M) manufactures utility vehicles, light commercial vehicles and tractors in India. It has also made a foray into the MHCV segment. M&M is the market leader in both the utility vehicle and tractor segments.

Investment strategy

We rate M&M shares Neutral (2) with a target price of Rs870. M&M's utility-vehicle business should benefit from new product launches and strong product positioning for all its brands viz. Bolero, Scorpio and Xylo. We expect M&M's utility-vehicle business to maintain its market share over the next 12 months due to a stronger product profile. The UV business is also expected to be buoyed by new launches, notably the XUV500. The LCVs launched by the company, particularly the Maxximo, have garnered favorable response from customers. For the tractor business, we are now slightly cautious, given that India's tractor penetration has exceeded the global average, and after 4 consecutive years of volume growth >20% CAGR. In addition, following strong outperformance versus the market over the last quarter, we see that the aforementioned positives are fully reflected in the price, with limited upside from current levels.

Valuation

Our target price of Rs870 is based on a sum-of-parts methodology. We value M&M's core business at Rs737/share (12x March 2013E core CEPS, at a slight premium to its 10-year average multiple). We also incorporate value for M&M's listed subsidiaries at Rs133/share. Our subsidiary valuations are based on a 25% discount to market prices of the listed subsidiaries. We have chosen P/CEPS to value the core business to facilitate comparison with historical trading bands; the company is undertaking a significant product development and capital expenditure program.

Risks

Key downside risks to our investment thesis which could prevent the shares from reaching our target price include: a) any substantial rise in interest rates that could curb demand for farm equipment and utility vehicles, b) increase in raw material costs, especially Steel and Rubber, may put downward pressure on margins, c) given M&M's strong dependence on the rural economy, which has significantly benefited from the governments policies, a slight reversal in these policies could impact the outlook for tractors/change secular growth trajectory, and d) escalating competition within the UV segment (notably from Maruti R III concept), which might lead to an increase in discounts and result in margin pressure. Key upside risks to our investment thesis include: a) a significant uptick in Y/Y growth in tractors of 20%+ could imply meaningful upgrades into FY13, b) a benign commodity cost environment could buoy margins, c) higher than expected volumes, especially for new model / variants of UVs and pick-ups could result in volume uptick despite increasing competitive intensity

Appendix A-1

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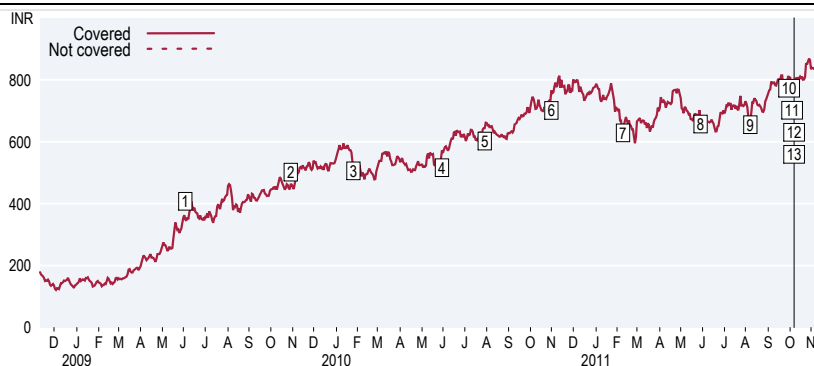
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Mahindra & Mahindra (MAHM.BO)

Ratings and Target Price History Fundamental Research

Analyst: Jamshed Dadabhoy



	Date	Rating	Target Price	Closing Price
1	3-Jun-09	*1L	*422.00	348.75
2	29-Oct-09	1L	*543.50	463.88
3	26-Jan-10	1L	*619.00	536.18
4	31-May-10	1L	*676.00	572.45
5	29-Jul-10	1L	*753.00	644.10

* Indicates change

	Date	Rating	Target Price	Closing Price
6	31-Oct-10	1L	*842.00	731.85
7	9-Feb-11	1L	*771.00	654.20
8	30-May-11	1L	*757.00	664.60
9	8-Aug-11	1L	*767.00	666.00
10	30-Sep-11	*2L	*895.00	802.55

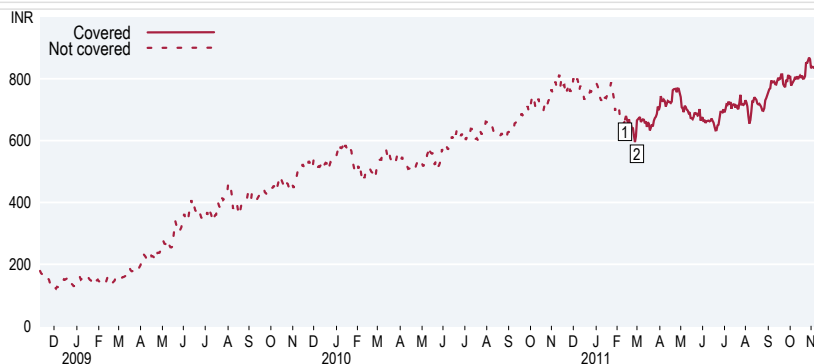
	Date	Rating	Target Price	Closing Price
11	5-Oct-11	2L	*888.00	784.45
12	7-Oct-11	Stock rating system changed		
13	7-Oct-11	*2	888.00	795.95

Rating/target price changes above reflect Eastern Standard Time

Mahindra & Mahindra (MAHM.BO)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Jamshed Dadabhoy



	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD MP	-	668.40

* Indicates change

	Date	Rating	Target Price	Closing Price
2	1-Mar-11	*REM MP	-	665.45

Rating/target price changes above reflect Eastern Standard Time

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