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Merchant Banking Services Ltd
(A Subsidiary of Indian Bank)

MAHINDRA & MAHINDRA LTD.

December 30, 2011

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Mahindra & Mahindra Ltd (M&M) is the flagship brand of the $12.5 billion Mahindra Group, which operates with a portfolio comprising a wide spectrum of vehicles from two wheelers to heavy trucks, SUVs to school buses. M&M over the years has strengthened its position as one of the country's premier utility vehicle (UV) and farm Equipment manufacturer with market share of over 50% in UV and 40% in tractors, respectively. It has recently entered 3-wheelers and CV segment. M&M is targeting sale of about 550,000 tractors in FY12E.

Investor's Rationale

During Q2FY12 net sales of M&M surged by 37.6% to ₹73,068 million from the ₹53,113 million in the year-ago quarter, driven by 35.9% and 35.5% growth in its automotive and farm equipment segment, respectively. Though operating margins for the current fiscal are likely to stay under pressure under tight liquidity and rising input cost scenario, we expect the revenues of M&M to reach ~₹300-320 billion in the coming two year.

At a time, when consecutive rate hikes, high inflationary data, strikes and costlier fuel prices have crippled the Indian auto sales manufacturers, M&M has emerged as the only automotive player to have beaten the slowdown comprehensively with a growth of 21% in 2011. Considering M&M's aggressive growth strategies to expand its global footprint with a range of new variants in the four-wheeler segment, we expect M&M to mark 11-14% rise in its FY12E sales realization.

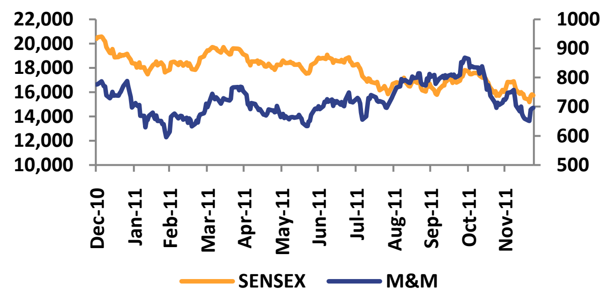
M&M complement the tag of no. 1 tractor manufacturer in the world in terms of volumes, occupying more than 40% of the domestic tractor market. With tractor demand fairly stable despite ongoing economical slowdown, the company is targeting sale of about 550,000 tractors next year. Beside, with the industry providing sufficient headroom for growth, we expect sales from the farm equipment segment of M&M to grow 17-18% by the end of FY12.

M&M acquisition of SYMC Motors (SYMC) gives the UV product line of the company an extension into the premium SUV segment with an established foothold in the markets of South America, Russia etc. The management expects 50% volume growth at 113,000-114,000 units for SYMC in CY11 and aims to sell 160,000 units by 2013 and 300,000 units by 2015-16 from the unit.

Market Data	
Rating	**BUY**
CMP (₹)	683
Target (₹)	**830**
Potential Upside	~22%
Duration	Long Term
52 week H/L (₹)	874.7/585.1
All time High (₹)	874.7
Decline from 52WH (%)	21.9
Rise from 52WL (%)	14.3
Beta	1.0
Mkt. Cap (₹ bn)	401.1
Enterprise Val (₹ bn)	419.0

Fiscal Year Ended	FY10A	FY11A	FY12E	FY13E
Revenue (₹bn)	185.2	234.9	279.6	321.5
Net Profit(₹bn)	20.9	26.6	27.0	31.2
Share Cap (₹bn)	2.8	2.9	2.9	2.9
EPS (₹)	36.9	45.3	45.9	53.2
PE (x)	18.5	15.1	14.9	12.8
P/BV (x)	4.9	3.9	3.3	2.7
EV/EBITDA (x)	11.9	10.8	9.9	8.1
ROE (%)	26.7	25.8	21.9	21.1
ROCE (%)	27.1	26.6	23.4	23.7

One year Price Chart

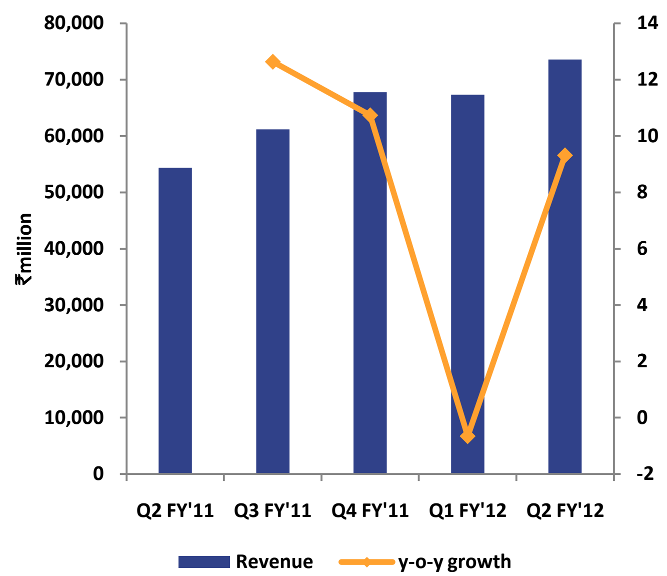


Shareholding Pattern	Sep'11	Jun'11	Diff.
Promoters	25.2%	24.9%	0.32
Institutional	47.0%	46.2%	0.81
General Public	8.0%	8.3%	(0.31)
Others	19.8%	20.6%	(0.82)

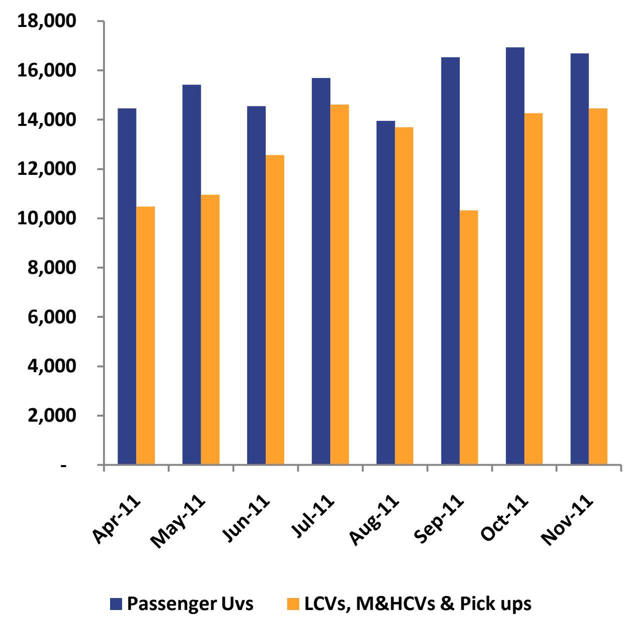
High volume in tractor segment drives Q2FY12 revenue

During Q2FY12, M&M net sales surged by 37.6% to ₹73,068 million from the ₹53,113 million in the year-ago quarter, driven by 35.9% and 35.5% growth in its automotive and farm equipment segment revenue, respectively. Besides, the operating expenditure of the company increased by ~43% to ₹64,866 million mainly due to the increase in raw material cost and employee expenses by ~33% and 20% respectively. The strong volume growth across the vehicle and tractors segment despite of a difficult market situation and a tight control on expenses has helped lift the EBITDA by 6.3% to ₹8,202 million from ₹7,719 million in the corresponding quarter last year. Further, owing to the sharp rise in the interest and depreciation charges, the net profit margin (NPM) dropped by 375bps to 9.7%. M&M's standalone net profit at ₹7,374 million declined 2.8% from ₹7,585 million in the corresponding period preceding year, due to a foreign exchange loss. The company has suffered a foreign exchange net loss of ₹320 million, as the rupee fell 8.8% against the dollar in the July-September quarter. Going further, we expect the revenues of M&M to reach ~₹321 billion in the coming two year, making a contribution of ~950-980 basis points to its present EBITDA margins.

Volume growth fuels up sales



Auto Sales volume trend



Robust November sales volume, higher realizations to drive performance in FY12E

M&M's November total sales volume in the automotive segment reported a robust growth of 53% (y-o-y) at 40,722 units, with a significant contribution of 38,159 units from the domestic terrain. A high volume growth of 46% in the passenger Utility Vehicles (UVs) segment led the domestic four-wheeler sales while sales volume in the three wheeler segment grew 32% during the month. M&M's UV and three wheeler export during the month also grew 71% at 2,563 units against 1,500 units a year ago.

Meanwhile, M&M's Farm Equipment Sector division reported a 3% fall in tractor sales to 17,527 units in November with domestic sales falling 5% to 16,175 units backed by issues related to the credit flow to the domestic farm sector. The company's tractor export increased 33% to 1,352 units during the month against 1018 units sold to overseas market in the same period prior year.

At a time, when consecutive rate hikes, high inflationary data, strikes and costlier fuel prices have badly hampered the Indian auto sales numbers; M&M has emerged as the only automotive company to have beaten the slowdown comprehensively with a growth of 21% in 2011. Backed by significant demand for M&M's premium sports utility vehicle, XUV500, the company is aggressively working to double its production to clear its order backlog of 9,500 units by January 2012. Considering, M&M's ability to outperform the industry numbers despite strong economic headwinds and its proposed variants in both two-wheeler and four wheeler segment, we expect M&M to mark 11-14% rise in its FY12E sales realization.

Increased focus in the tractor segment to drive M&M growth in FY13

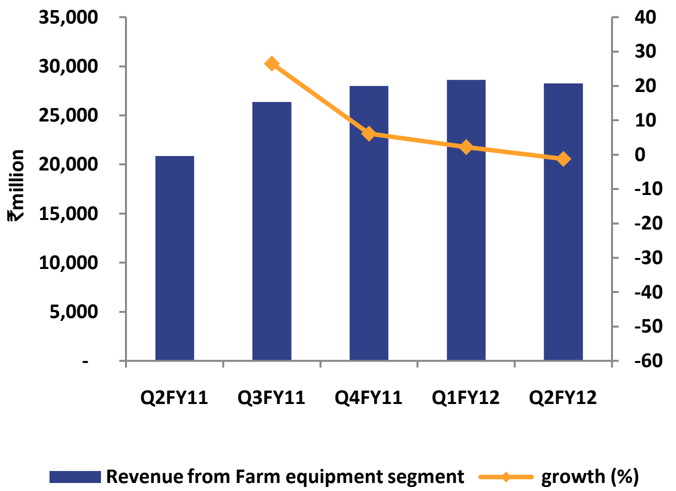
M&M complement the tag of no. 1 tractor manufacturer in the world in terms of volumes supported by 1,300 dealers with over 2,200 service points, 7 tractor plants and 1 foundry. The tractor segment has been fairly stable during the ongoing economical slowdown and has registered a growth of 20% in the current fiscal. M&M with more than 40% share in the tractor industry of the country has gone a long way in keeping pace with the industry growth.

The company is targeting sale of about 550,000 tractors next year. Market share movements have been slower with a 0.5% to 1% change in a year. However, it was successful in penetrating newer villages that accounted ~10,000 units in such markets.

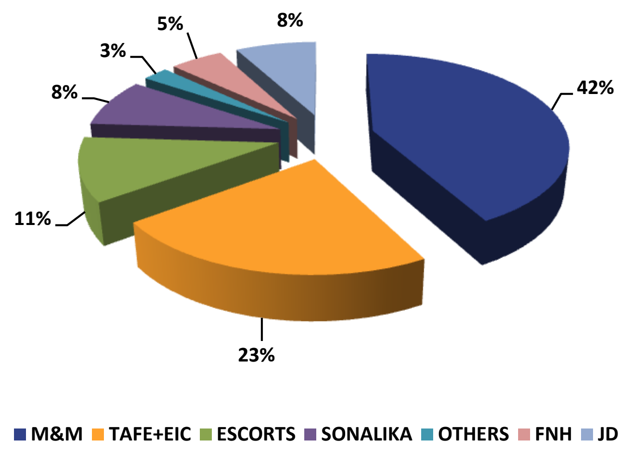
Growing focus in the tractor division will also provide further assistance to M&M as slowdown in rural consumption has not been experienced yet. Besides, the strong replacement demand will be a key support in the near term as it accounts for ~40% of sales.

India's tractor industry is well poised to register 10-12% growth in FY13 and with labor shortage driving the farm mechanization; the industry is likely to register a 20% growth in the coming three years. With the industry providing sufficient headroom for growth, we expect sales from the farm equipment segment of M&M to grow 17-18% by the end of FY12.

Total farm revenue trend



M&M dominates domestic Tractor segment with over 40% stake



Macro factors- to drive the expected demand for farm equipment

- The quantum of tractors bought using cash payments has increased to 20-25% of sales in India, compared with 10% earlier, which reflects buoyancy in rural incomes.
- About 40% of the current tractor demand is from the replacement market.
- Though there is some concern about rural economy and consumption is slowing down, M&M has not seen any slowdown in rural consumption.
- Shortage in farm labour has also acted as a key catalyst for tractor demand.
- Tractors are no longer a luxury for the rich farmers, but a tool for better cost management.

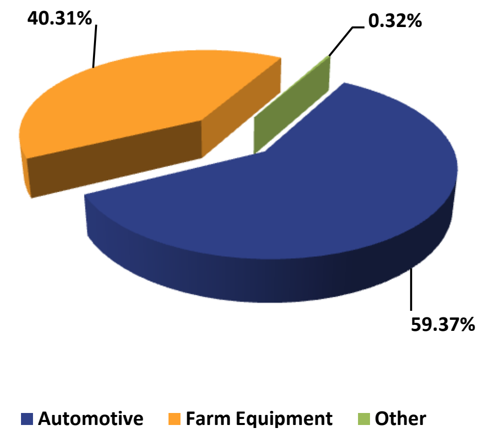
New launches, foray into new segments to augment future growth

In FY11, M&M registered domestic volumes growth of 24% led by new product launches and strong performance from existing product ranges. It launched Gio, Xylo, Thar, Maximmo, Yuvraj, Genio and Arjun MAT, during the year which is likely to power the company's growth in future. Besides, M&M has also lined-up new launches, which would help bring additional volumes. It is ready to enter the market with a new SUV, 4-seater electric car, re-launch of Stallio motorcycle, two new versions of Verito, one SUV with SsangYong in India, aerospace components and mine protected vehicle (MPV-I).

M&M's recently launched XUV500 SUV received remarkable response from the domestic consumers. Priced at ₹10.8 lakhs, the company has rightly positioned XUV500 in the market for people who desires something above ₹7 lakhs and below ₹15-20 lakhs. As a result, M&M's the XUV500 has gone a long way to set a booking record of 8,000 units in just 10 days of being launched in 5 cities of the country.

To cater the same, on the production front, Mahindra is ramping up XUV500 SUV production at their Chakan plant. The company is likely to restart bookings of the SUV, which was stopped in October, from January 2012.

Segmental revenue contribution in H1FY12



Issue of change in sales-tax incentive scheme by Maharashtra Govt. likely to be resolved in Sept'11

M&M Maharashtra government had withdrawn set-off of sales tax on sales outside the state from mid-March 2011. This has contracted M&M's EBITDA margin by 60-80 bps in Q1FY'12. Due to higher volumes and revenues from Chakan plant, the impact of withdrawal of set-off of sales tax might be higher in the coming quarters, but M&M expects the issue of VAT-related changes in Maharashtra to be resolved by September 2011.

SYMC to add value in premium UVs

Acquisition of SYMC Motors (SYMC) gives the UV product line of the company an extension into the premium SUV segment. SYMC has a distribution network of over 130 dealers in Korea and ~1,200 dealers in more than 90 countries. The acquisition gives M&M access to SYMC's popular product portfolio with an established foothold in the markets of South America, Russia, Eastern and Western Europe, and Africa which bodes well for M&M's plans to launch a global SUV this year. The management has guided ~50% volume growth at 113,000-114,000 units for SYMC in CY11, with the recent launch of Korando-C. Thus, the acquisition of Korean company SYMC augurs well for M&M in the long term, placing it on a new growth trajectory.

As debt woes continue to plague one of its largest markets Europe SYMC is eyeing to enter emerging markets including India, China and Russia playing a bigger role in a bid to boost volumes in 2012 with a year-on-year volume growth of 40%. The company aims to sell 160,000 units by 2013 and 300,000 units by 2015-16.

M&M-SYMC have finalised a combined future product portfolio strategy, which will see 3 new platforms and 4 new products coming in from both partners. The new sourcing strategy for M&M-SYMC is being put into place, which will see both companies sourcing an enormous $20 billion of components over the next 5 years. This huge sourcing is expected to bring in economies of scale and reduce the cost for the duo.

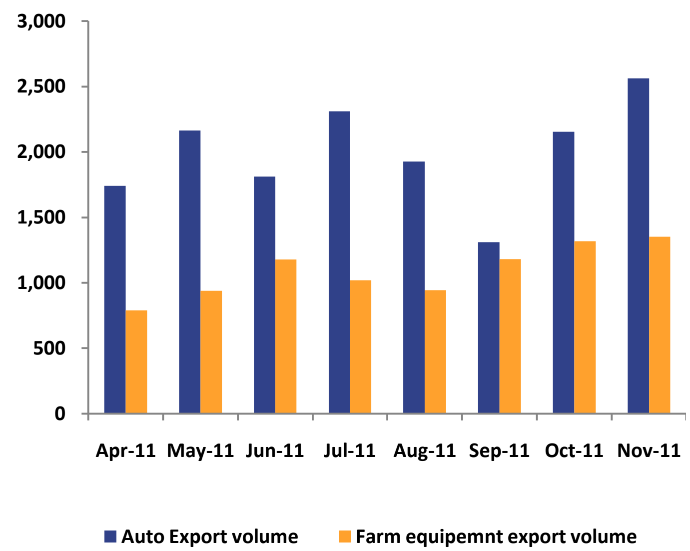
Strategic growth plan for MahindraNavistar to drive M&M future growth

Mahindra Navistar Automotives Limited (MNAL), which is a 51:49 joint venture between M&M and Navistar Inc., is planning to launch at least two new models—a 49-tonne tractor trailer and a 25-tonne tipper for the mining sector in H2FY12E. Intending to establish a pan India presence, the company further intends to increase its current 48 dealership across various cities to around 100 by adding 50 new dealers by the end of FY13E. With a targeted growth of 9% in the second half of FY12E, the company is planning to see cash break-even in the next 12 months. Further, the company is planning to invest around ₹2.50 billion to add few more variants in the heavy-duty goods commercial vehicles segment, which in turn will help the company ramp up volumes and use its factory capacity fully in the next three years.

M&M eyes to enter larger South Asian market

The largest utility vehicle maker of the country is planning to set up an assembly plant in Southeast Asia in the next few years as a part of its strategy to expand its global presence through its entry to markets in Thailand and Indonesia. Currently, M&M exports vehicles to Malaysia and is aiming to expand to other markets in ASEAN region. Over the next four to five years, M&M sees at least 15-20% of its total export volumes coming from this region. In FY11, M&M exported 17,000 units of utility vehicles and pick-ups and around 11,000 tractors. The company is aiming to double overseas revenues to more than $1 billion by 2013 and is aiming two-fold increase in volumes to 100,000 units.

Farm equipment exports growth outpaces auto export



Realizations to improve on back of price hike

M&M has declared a price hike in its vehicles by 3% with effect from January 2012. The company has raised its prices by 1.5-2% in September and had hiked twice in 2011, to offset the increase in raw material prices. Besides, commodity prices are expected to soften in coming quarters on verge of global slowdown concerns. This will enable the company to improve its margins, which got hampered in the previous quarters. On account of the falling rupee and rising input costs, M&M would also hike prices of its sports utility vehicle XUV500 by up to ₹55,000 with effect from 1 Jan'12.

M&M to launch its first compact Car in 2012

M&M is eyeing to launch its first compact car after it acquired Reva Electric Car Company in 2001. The SUV-maker is aggressively working to launch its first compact car in the country Reva NXR by 2012. With a mileage of about 9.6 km for every ₹3 spent, the Reva NXR, ensures nine times the mileage generated by the country's most fuel-efficient petrol-powered car. At a time, when petrol prices are breaking new highs M&M expects its Reva NXR to seek significant attention from the consumers who spend ₹7,000-8,000 every month on petrol.

Beside, M&M is also establishing one of world's biggest manufacturing bases for electric cars of 30,000 units per annum near Bangalore, which is likely to commence production in FY13. With increased demand for electric cars, M&M apart from its marketing strategy to sell its Reva NXR through an expanded network of 100 outlets in India, the company is also mulling over rolling its new electric car model in countries like Norway, which houses the highest consumer market for electric cars in the world.

After M&M lead development in the electric car market of India, many other car makers are also developing concept vehicles to cater to the emerging demand for Electric vehicles in India in the years to come. Polaris India, a major multi terrain vehicle manufacturing company is planning to introduce electric cars to Indian market. Considering the rising fuel prices, the impact on power and utilities companies of the electric vehicle market is likely to attain consumer attention in medium to long term.

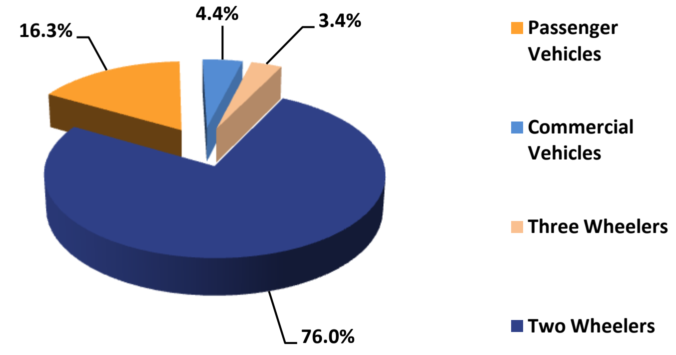
Indian Automobile Industry

The Indian automobile industry, with an estimated current turnover of ₹1,821 billion, stands out to be the seventh largest in the world, accounting for nearly 6% of the country's GDP. The sector has witnessed phenomenal growth over the last ten years, supported by a slew of new product introductions by vehicle manufacturers and growing consumer confidence. A robust transportation system plays a key role in the country's rapid economic and industrial development, and the well-developed Indian automotive industry justifies this catalytic role by manufacturing over 17.5 million vehicles and exporting about 2.33 million every year, with two-wheelers dominating the industry with a market share of 76%.

YTD sales growth moderates on rising consumer borrowing cost

In the first five months of FY12, the industry witnessed cumulative production growth of 15.92%, despite persistent pressure of high finance cost, high commodity prices and high fuel prices. Meanwhile, sales on home ground reported sluggish growth at 13.26%, due to rising consumer borrowing cost. During April-August 2011, the passenger vehicles segment of the country grew marginally at 1.94%, while commercial Vehicles segment registered growth of 17.80%, pushed by 27.44% growth in the Light Commercial Vehicles sales. Three-Wheelers sales recorded de-growth of 0.27%, while two-wheelers growth numbers swelled to 15.94%, helped by 13.64% and 15.71% sales growth in Scooters and Motorcycles segment, respectively. At the same time, overall automobile exports rose 30.93%.

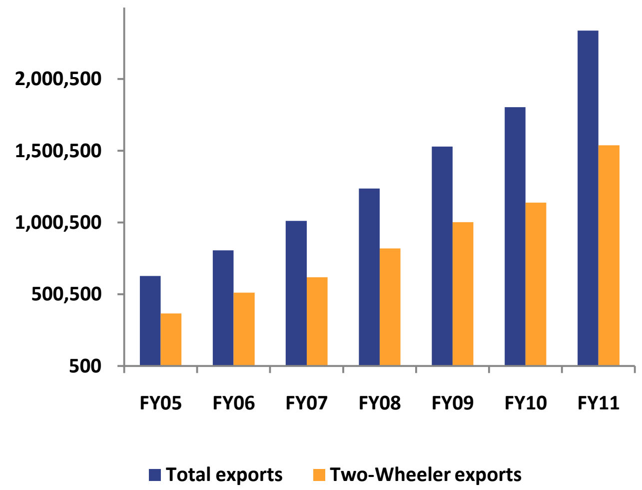
Domestic market share in FY11



Low manpower costs in India attract global auto manufacturers

In recent times, India has emerged as one of the favorite investment destinations of global automobile manufacturers like Nissan and Ford, due to the availability of trained and skilled manpower at competitive costs. French car maker, Renault SA is planning to make India an exclusive manufacturing and export hub for its sport utility vehicle, Duster. To occupy the top position in the Indian luxury segment, German auto major, Mercedes Benz is planning to introduce up to 10 new brands in the next three years in India. Meanwhile, leading luxury car brand, BMW has lined up a series of new brands to be launched in the Indian sub-continent.

Two-wheeler export growth outpaces total export growth of the industry



Outlook

In FY11, the industry had registered a turnover of ₹1,821 billion, reflecting a growth of 34.2% with sales of 15,513,156 units. However, in FY12, some moderation in the growth rates is expected due to the successive increases in the interest rates that have made it more expensive for the customers to purchase vehicles. The Indian automobile industry is expected to clock turnover in the range of ₹2,040 billion to ₹2,100 billion, up by 12-15%. As per Society of Indian Automobile Manufacturers (SIAM) the size of the domestic passenger vehicles market is likely to touch 5.6 million units by 2017, up from 2.2 million units per annum currently. The industry body, which has projected a domestic sales growth of 11-13%, also expects the country to report exports of 1.3 million units in the next 5 years.

Balance Sheet (Standalone)

(₹billion)	FY10A	FY11A	FY12E	FY13E
Share Capital	2.8	2.9	2.9	2.9
Reserve and surplus	75.5	100.2	120.4	144.9
Net Worth	78.3	103.1	123.3	147.8
Loan Funds	28.8	24.1	29.8	29.8
Net Deferred Tax Liability	2.4	3.5	3.5	3.5
Capital Employed	**109.5**	**130.7**	**156.7**	**181.2**
Gross fixed assets	52.8	62.3	74.5	90.1
Less: accumulated depreciation	25.4	28.4	33.2	39.0
Capital Work in Progress	9.6	9.9	10.0	10.0
Net Fixed assets	37.0	43.7	51.3	61.1
Investment	64.0	93.3	93.3	93.3
Net Current Assets	8.5	-6.2	12.1	26.8
Capital Deployed	**109.5**	**130.7**	**156.7**	**181.2**

Profit & Loss Account (Standalone)

(₹billion)	FY10A	FY11A	FY12E	FY13E
Net Sales	**185.2**	**234.9**	**279.6**	**321.5**
Other income	3.2	4.3	4.0	2.4
Total Income	**188.3**	**239.3**	**283.6**	**323.9**
Expenses	155.0	200.4	242.1	275.2
EBITDA	**33.3**	**38.9**	**41.5**	**48.7**
EBITDA Margin %	17.7	16.2	14.6	15.0
Depreciation	3.7	4.1	4.8	5.8
EBIT	**29.6**	**34.7**	**36.7**	**42.9**
Interest	1.6	0.7	0.5	1.0
Profit Before Tax	**28.1**	**34.0**	**36.2**	**41.9**
Tax	7.6	8.6	9.2	10.7
Profit after Tax	**20.9**	**26.6**	**27.0**	**31.2**
NPM %	11.1	11.1	9.5	9.6

Key Ratios

	FY10A	FY11A	FY12E	FY13E
EBITDA Margin (%)	17.7	16.2	14.6	15.0
NPM (%)	11.1	11.1	9.5	9.6
ROCE (%)	27.1	26.6	23.4	23.7
ROE (%)	26.7	25.8	21.9	21.1
ROA (%)	20.5	20.9	17.5	17.8
EPS (₹)	36.9	45.3	45.9	53.2
P/E (x)	18.5	15.1	14.9	12.8
BVPS (₹)	138.3	175.6	210.0	251.7
P/BVPS (x)	4.9	3.9	3.3	2.7
EV/Operating Income(x)	2.1	1.8	1.5	1.2
EV/EBITDA (x)	11.9	10.8	9.9	8.1

Valuation and view

M&M has maintained a strong sales growth, even as other automobile companies, especially the passenger car makers, have seen a sharp slowdown, due to expensive loans and high fuel prices. The company has benefitted, primarily on the back of predominant focus on diesel vehicles, strong brand and product mix, and foray into new segments, coupled with new launches.

With the upcoming festive season, good monsoon and better penetration, M&M is likely to report robust earnings in coming quarters. Thus, considering the above aspects we rate the stock as 'BUY' at the current market price of ₹683. The current market price of ₹683, implies a P/E of ~14.9x FY'12 EPS of ₹45.9 and 12.8x on FY'13E EPS of ₹53.2 respectively.

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