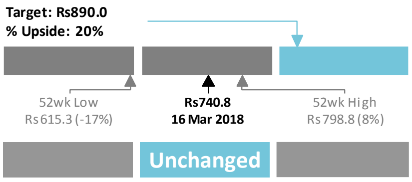
Mahindra & Mahindra (MM IN)

Target Price	Rs890.0
Current Price	Rs740.8
% Upside	20%

UV Market Share Recovery the Likely Key Catalyst for the Stock

Automobiles & Components
India
19 Mar 2018

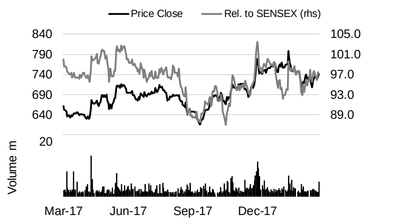
BUY



Basic Share Information

Market cap	Rs920.9b / US$14.18b
Daily traded value (3mth)	US$32.74m
Shares outstanding	1,195m
Free float	74%
Net debt-to-equity	4.1%
1 yr high	Rs798.8
1 yr low	Rs615.3
Foreign shareholding	33.7%

Price/Volume



Source: Bloomberg

	1mth	3mth	12mth
Absolute	-0.4%	-0.1%	12.2%
Absolute USD	-2%	-1.5%	13.5%
Relative to SENSEX	0.6%	-0.8%	-1.7%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Multiple Earnings Drivers in Place

Summary: We attended Mahindra and Mahindra's (M&M) first investor relations meeting in Chennai and our key takeaways are: 1) M&M plans to launch three new models (U321 MPV, S201 compact SUV, and G4 Rexton) in FY3/19; 2) it has recently launched a new tractor brand, Trakstar, positioned below its nearest competitors, which should help it to strengthen its leading position in tractors; 3) it aims to break even in the CV business by FY3/19 on its sustained industry outperformance over the last three years; 4) it is ready to launch gasoline engine options for all of its models in coming years, which should help it to become fuel agnostic; 5) it is on track to be BSVI compliant well before the April 2020 deadline; and 6) it is continuing to invest in electric vehicles (EVs), and its recent tie-up with LG Chem (051910 KS) should help it to leverage its first-mover advantage in EVs in India. On the back of steady volume growth across segments, we expect M&M to post a 14% NP CAGR over FY3/18–20. We reiterate our BUY rating on the stock due to its attractive valuations relative to peers.

Target Price and Catalyst: Our sum-of the-parts (SoTP)-based target price is Rs890. A recovery in UV market share and steady tractor sales are likely to be key upside catalysts for the stock.

Earnings: We expect M&M to deliver a 10% volume CAGR in UVs on the back of three new launches, and 13% in tractors over FY3/18–20. Led by operating leverage benefits, we expect M&M to post a 14% earnings CAGR over FY3/18–20.

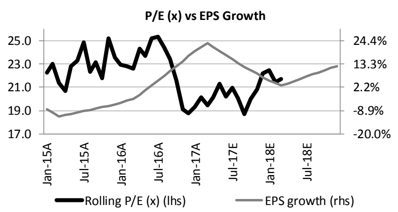
Valuation: After adjusting for the value of its subsidiaries, the standalone entity is currently trading at 14.4x our FY3/19 earnings estimate, which we think is attractive relative to its peers. We value M&M's core business at 16x one-year forward core EPS. Our valuation multiple represents a 10% premium to M&M's long-term median average of 15x and is in line with the premium currently enjoyed by the BSE Sensex. We value the company's investment in its key listed subsidiaries at their current market capitalizations. We have assigned a 25% holding company discount to M&M's investments in each of these subsidiaries. Other investments have been valued at book value. Our SoTP-based target price of Rs890 implies upside potential of 20% from the last close. We reiterate our BUY rating on the stock. We expect a revival in market share in the UV segment to be the upside trigger for the stock. A slower recovery in tractor or UV volumes than we currently expect, or a sharp rise in input costs, are the main downside risks to our estimates.

	Mar-16A	Mar-17A	Mar-18E	Mar-19E	Mar-20E	Trend
Total turnover (Rsm)	408,751	437,854	474,949	562,335	643,428	
Operating profit (Rsm)	35,518	36,131	44,975	51,510	58,201	
Pre-tax profit (Rsm)	42,845	51,875	58,190	67,118	76,535	
Net income to ord equity (Rsm)	32,046	39,556	40,733	46,983	53,574	
Adjusted net profit (Rsm)	31,599	35,782	40,733	46,983	53,574	
Net profit growth	(3.5%)	23.4%	3.0%	15.3%	14.0%	
P/E (x)	27.62	22.38	21.73	18.84	16.52	
Adj P/E (x)	28.01	24.74	21.73	18.84	16.52	
Adj EV/EBITDA (x)	7.49	5.63	5.00	4.66	4.38	
P/B (x)	3.95	3.45	3.08	2.75	2.44	
ROE	15.4%	16.5%	15.0%	15.4%	15.7%	
Dividend yield	0.8%	0.9%	1.0%	1.2%	1.3%	
EPS HTI (Rs)	26.82	33.10	34.09	39.32	44.83	
Adj EPS (Rs)	26.44	29.94	34.09	39.32	44.83	
Consensus EPS (Rs)	27.87	29.14	34.35	39.55	44.14	
HTI EPS vs Consensus	(3.8%)	13.6%	(0.8%)	(0.6%)	1.6%	

Source: Company data, Bloomberg, HTI estimates

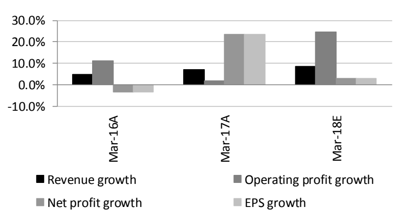
Click here to download the working model

Valuation



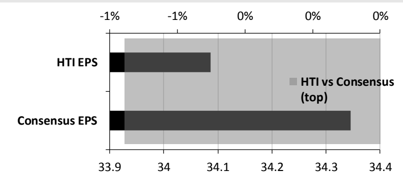
Source: Company data, Bloomberg, HTI estimates

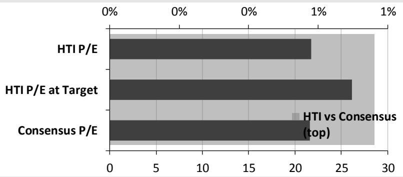
Earnings Trends



Source: Company data, Bloomberg, HTI estimates

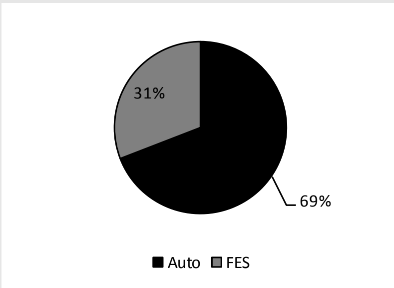
Earnings: HTI vs Consensus





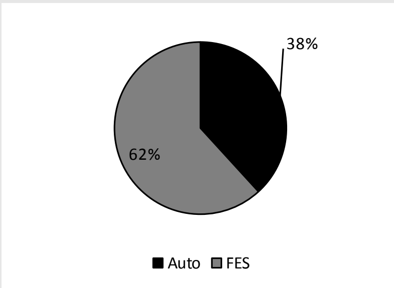
Source: Company data, Bloomberg, HTI estimates

FY3/17 Sales Breakdown



Source: Company data

FY3/17 EBIT Breakdown



Source: Company data

Investment Thesis

BUY

- M&M is set to launch three new UVs (two of which in the mass market segment) with a completely differentiated styling, which are expected to help revive lost market share in UVs.
- Such has been its strong performance in the tractor segment that M&M has gained market share across all segments and regions and is the only player to have gained share in the last three years.
- Management's decision to launch a new tractor brand to compete with peers at the lower end of the spectrum is likely to strengthen its leading position in tractors.
- Its recent tie-up with LG Chem to source battery packs should help to leverage its first-mover advantage in this upcoming segment in India.
- The company is aiming for breakeven in the CV business, which would, in turn, help improve standalone performance.
- On the back of its new launches, its focus on core brands, and steady growth in tractors, we forecast a 14% CAGR for earnings over FY3/18–20.
- Adjusted for the value of its subsidiaries, the core standalone business is currently trading at 14.4x our FY3/19 earnings estimate, which we think is attractive relative to peers.

Company Snapshot

Mahindra & Mahindra is a well-diversified US$11.4bn global conglomerate with operations in 20 different industries, including automobiles, farm equipment, information technology, finance and insurance, auto components, construction equipment, hospitality, and logistics. Of these, the key business segments for the parent are automobiles and the farm equipment segment (FES). M&M is the only company in the Indian automobile industry with a presence in the passenger vehicle, two-wheeler, commercial vehicle, and three-wheeler segments. As of end-FY3/16 the company was a market leader in the utility vehicle market in India with a 38% share and in the Indian tractor market with a 41% share. M&M is increasingly focusing on the provision of end-to-end solutions for farmers. Its key subsidiaries include Tech Mahindra (TECHM IN), Mahindra & Mahindra Financial Services (MMFS IN), Mahindra Holidays and Resorts (MHRL IN), Mahindra Lifespace Developers (MLIFE IN), Ssangyong Motor (003620 KS), and Mahindra Two Wheelers (unlisted).

Key Investment Metrics

Revenue Growth

Low | **Medium** | High

We forecast a 14% revenue CAGR for FY3/18–20 supported by a 13% volume CAGR for tractors and a 10% CAGR for the UV segment. We expect volume growth to be driven by new product launches and recovery in rural demand spurred by the government's push on improving farmer prosperity in the recent budget, and improved sowing.

Profit Margins

Low | **Medium** | High

We expect EBITDA margin in FY3/18 to improve by 120bps YoY to 12.5% on strong growth in the tractor segment. However, we expect EBITDA margin to normalize to 11.7% by FY3/20 on the ramp-up of its lower-margin auto segment over the next two years.

Shareholder Returns

Low | **Medium** | High

We expect a 14% NP CAGR for FY3/18–20. On robust internal cash generation, we expect its dividend payout to steadily improve in coming years.

Balance Sheet Risks

High | Medium | **Low**

We think M&M's balance sheet is strong, with a debt-to-equity ratio of just 10.7% as of the end of FY3/17. In our view, M&M should generate sufficient operating cash flow each year to fund its capex over our forecast period.

Barriers to Entry

Low | Medium | **High**

M&M's key operating segments are automobiles and tractors. Barriers to entry in each of these segments are high given that new entrants would need several years to establish their brands, to develop requisite scale, and to establish a distribution network for their operations to remain viable.

International Exposure/Breakdown

High | Medium | **Low**

M&M's parent company has little exposure outside of India, as exports contributed only 7% to total volumes in FY3/17.

FX Exposure

High | Medium | **Low**

Net forex exposure was 4% of net sales in FY3/17. As a result, currency fluctuations have only a small impact on M&M's operations.

Corporate Governance

Low | Medium | **High**

We think M&M is a professionally managed company with a sound corporate governance track record. We also believe the company's disclosure policies are among the best in India and it has a well composed board (eight of its 11 directors are independent).

Our Model Assumptions

We forecast a 14% revenue CAGR for FY3/18–20 on a recovery in UV sales and steady growth in tractors

After a 120bp YoY improvement in FY3/18, we expect EBIDTA margin to stabilize at 11.7% by FY3/20 due to a recovery in the relatively low-margin UV business

Profit & Loss (Rsm)	Mar-16A	Mar-17A	Mar-18E	Mar-19E	Mar-20E
Total turnover	408,751	437,854	474,949	562,335	643,428
Cost of sales	(295,162)	(318,027)	(341,963)	(407,693)	(468,415)
Gross profit	**113,589**	**119,826**	**132,986**	**154,642**	**175,012**
Total operating costs	(78,071)	(83,695)	(88,011)	(103,132)	(116,812)
Operating profit	**35,518**	**36,131**	**44,975**	**51,510**	**58,201**
Operating EBITDA	46,199	49,403	59,544	67,394	75,151
Depreciation and amortisation	**(10,681)**	**(13,272)**	**(14,569)**	**(15,884)**	**(16,950)**
Other recurring income	8,499	13,425	14,767	16,981	19,526
Interest expense	(1,861)	(1,456)	(1,552)	(1,372)	(1,192)
Exceptional income - net	687	3,775	-	-	-
Pre-tax profit	**42,845**	**51,875**	**58,190**	**67,118**	**76,535**
Taxation	(10,799)	(12,319)	(17,457)	(20,135)	(22,960)
Net income to ord equity	**32,046**	**39,556**	**40,733**	**46,983**	**53,574**

Source: Company, HTI estimates

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Key P/L Takeaway

We project a 14% net earnings CAGR over FY3/18–20 on strong revenue growth

On the back of three new launches in the UV segment in FY3/19 and a focus on its three core brands, we expect UV segment volumes to recover from FY3/19. Overall, we expect M&M to deliver an 11% volume CAGR, which, in turn, should drive a 14% revenue CAGR over FY3/18–20. We expect M&M's EBITDA margin to improve by 120bps YoY in FY3/18 on the back of an improved product mix in favor of the tractor segment. However, we expect EBITDA margin to stabilize at 11.7% by FY3/20 due to a recovery in its relatively low-margin UV segment. Further, we expect the tax rate to increase from 24% in FY3/17 to 30% throughout our forecast period due to a lower investment allowance and reduced deductions allowed for R&D investments than in the past, in accordance with the recent budgetary provisions. As a result, we project a 14% net earnings CAGR over FY3/18–20.

Our Model Assumptions

We expect negative working capital over FY3/18–20

Debt to equity remains comfortable, and was around 0.1x as of end-FY3/17

Balance Sheet (Rsm)	Mar-16A	Mar-17A	Mar-18E	Mar-19E	Mar-20E
Total cash and equivalents	22,870	16,870	14,238	17,909	26,517
Inventories	26,879	27,156	29,450	34,885	39,912
Accounts receivable	25,116	29,185	31,650	37,490	42,893
Other current assets	53,074	44,425	51,089	58,752	67,565
Total current assets	**127,940**	**117,636**	**126,427**	**149,036**	**176,887**
Tangible fixed assets	91,581	96,726	107,157	116,273	124,322
Total investments	135,474	179,022	194,022	209,022	224,022
Total non-current assets	**227,055**	**275,748**	**301,179**	**325,294**	**348,344**
Total assets	**354,996**	**393,383**	**427,606**	**474,331**	**525,232**
Short-term debt	3,481	5,034	5,034	5,034	5,034
Accounts payable	66,747	71,563	77,608	91,929	105,178
Other current liabilities	40,981	30,802	31,418	32,046	32,687
Total current liabilities	**111,209**	**107,399**	**114,061**	**129,010**	**142,900**
Long-term debt	14,954	22,340	19,340	16,340	13,340
Other liabilities	4,601	6,949	6,949	6,949	6,949
Total non-current liabilities	**19,555**	**29,289**	**26,289**	**23,289**	**20,289**
Total liabilities	**130,764**	**136,688**	**140,349**	**152,298**	**163,188**
Common stocks	2,963	2,968	5,936	5,936	5,936
Retained earnings reserve	221,269	253,728	281,320	316,096	356,107
Shareholders' equity	**224,232**	**256,696**	**287,256**	**322,032**	**362,043**
Total equity	**224,232**	**256,696**	**287,256**	**322,032**	**362,043**
Total liabilities & shareholders' equity	**354,996**	**393,383**	**427,606**	**474,331**	**525,232**

Source: Company, HTI estimates

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✓ **Key B/S Takeaway**
We believe the balance sheet is strong with minimal leverage

M&M's balance sheet remains healthy, with the debt-to-equity ratio comfortable, at around 0.1x as of end-FY3/17. We also expect M&M to post negative working capital over FY3/18–20. Cash generation remains strong, so we expect debt to fall gradually over our forecast period.

Our Model Assumptions

We expect capex to be funded by internal accruals during FY3/18–20

Free cash flow should remain positive through FY3/18–20

Cash Flow (Rsm)	Mar-16A	Mar-17A	Mar-18E	Mar-19E	Mar-20E
Operating profit	**35,518**	**36,131**	**44,975**	**51,510**	**58,201**
Depreciation and amortisation	10,681	13,272	14,569	15,884	16,950
Changes in working capital	(1,902)	(1,059)	(4,762)	(3,989)	(5,354)
Other operating cash flow	11,047	18,655	16,320	18,353	20,719
Operating cash flow	**55,345**	**66,999**	**71,102**	**81,759**	**90,516**
Interest paid	(1,861)	(1,456)	(1,552)	(1,372)	(1,192)
Tax paid	(15,995)	(9,971)	(17,457)	(20,135)	(22,960)
Cash flow from operations	**37,489**	**55,573**	**52,092**	**60,251**	**66,363**
Capex	(21,180)	(18,416)	(25,000)	(25,000)	(25,000)
Other investing cash flow	(4,092)	(43,548)	(15,000)	(15,000)	(15,000)
Cash flow from investing activities	**(25,273)**	**(61,964)**	**(40,000)**	**(40,000)**	**(40,000)**
Dividends paid to ordinary shareholders	(7,453)	(7,453)	(8,074)	(8,962)	(10,755)
Proceeds from issue of shares	7,088	982	-	-	-
Increase in debt	(5,350)	10,492	(3,000)	(3,000)	(3,000)
Other financing cash flow	(1,861)	(1,456)	(1,552)	(1,372)	(1,192)
Cash flow from financing activities	**(7,575)**	**2,565**	**(12,627)**	**(13,335)**	**(14,947)**
Cash at beginning of period	20,648	22,870	16,870	14,238	17,909
Total cash generated	**2,223**	**(6,000)**	**(2,632)**	**3,672**	**8,607**
Implied cash at end of period	**22,870**	**16,870**	**14,238**	**17,909**	**26,517**
Free cash flow	**16,309**	**37,157**	**27,092**	**35,251**	**41,363**

Source: Company, HTI estimates

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Key Cash Flow Takeaway

We expect operating cash flow to be sufficient to fund capex over our forecast period

We project capex remains steady at Rs25bn per year during FY3/18–20. We also expect management to invest Rs15bn a year in its subsidiaries over this period. In our view, the company should generate sufficient operating cash flow to fund these capex requirements. We believe M&M should be able to gradually reduce its debt in coming years.

Our Model Assumptions

We estimate a 14% CAGR for adjusted NP over FY3/18–20

We expect EBITDA margin to normalize over FY3/19–20 after peaking in FY3/18

We expect the tax rate to increase from FY3/18 due to a lower investment allowance and reduced deductions available for R&D than in the past

Key Driver Takeaway

We expect a 14% earnings CAGR over FY3/18–20 on steady volume growth

Per Share Data	Mar-16A	Mar-17A	Mar-18E	Mar-19E	Mar-20E
EPS (Rs)	26.82	33.10	34.09	39.32	44.83
Adj EPS (Rs)	26.44	29.94	34.09	39.32	44.83
FDEPS (Rs)	51.60	63.69	65.58	75.64	86.26
Revenue per share (Rs)	342.1	366.4	397.5	470.6	538.4
Operating EBITDA per share (Rs)	38.66	41.34	49.83	56.40	62.89
BVPS (Rs)	187.6	214.8	240.4	269.5	303.0
DPS (Rs)	6.24	6.76	7.50	9.00	10.00
Recurrent cash flow per share (Rs)	31.37	46.51	43.59	50.42	55.53
Shares in issue (million)	1,195	1,195	1,195	1,195	1,195
Year end adjusted shares in issue (m)	1,195	1,195	1,195	1,195	1,195

Key Ratios	Mar-16A	Mar-17A	Mar-18E	Mar-19E	Mar-20E
Valuation Measures					
P/Sales (x)	2.17	2.02	1.86	1.57	1.38
P/E (x)	27.62	22.38	21.73	18.84	16.52
Adj P/E (x)	28.01	24.74	21.73	18.84	16.52
P/CF (x)	23.61	15.93	16.99	14.69	13.34
P/B (x)	3.95	3.45	3.08	2.75	2.44
Adj EV/EBITDA (x)	7.49	5.63	5.00	4.66	4.38
Dividend yield	0.8%	0.9%	1.0%	1.2%	1.3%
Growth					
Revenue growth	5.0%	7.1%	8.5%	18.4%	14.4%
Operating profit growth	11.0%	1.7%	24.5%	14.5%	13.0%
Net profit growth	(3.5%)	23.4%	3.0%	15.3%	14.0%
Margins					
Gross margin	27.8%	27.4%	28.0%	27.5%	27.2%
Operating EBITDA margin	11.3%	11.3%	12.5%	12.0%	11.7%
Operating margin	8.7%	8.3%	9.5%	9.2%	9.0%
Pretax profit margin	10.5%	11.8%	12.3%	11.9%	11.9%
Tax rate	25.2%	23.7%	30.0%	30.0%	30.0%
Net profit margin	7.8%	9.0%	8.6%	8.4%	8.3%
Key Ratios					
ROE	15.4%	16.5%	15.0%	15.4%	15.7%
ROA	9.4%	10.6%	9.9%	10.4%	10.7%
Capex/revenue	5.2%	4.2%	5.3%	4.4%	3.9%
Current ratio (x)	1.15	1.10	1.11	1.16	1.24
Creditor days	82.77	82.13	82.84	82.30	82.18
Debtor days	22.49	24.33	24.32	24.33	24.40
Inventory days	33.33	31.17	31.43	31.23	31.19
Sales/avg assets	1.19	1.17	1.16	1.25	1.29
Credit analysis					
EBITDA/interest paid (x)	24.83	33.94	38.35	49.10	63.02
OCF/interest paid (x)	20.15	38.17	33.55	43.90	55.65
Debt/EBITDA (x)	0.40	0.55	0.41	0.32	0.24
Debt/equity	8.2%	10.7%	8.5%	6.6%	5.1%
Net debt to equity	(2.0%)	4.1%	3.5%	1.1%	(2.2%)

Source: Company, HTI estimates

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We forecast a 14% revenue CAGR over FY3/18–20 on volume recovery in the UV segment led by new launches and steady growth in the tractor segment. We expect M&M's EBITDA margin to improve 120bps YoY in FY3/18 on an improved product mix in favor of the tractor segment. However, we expect EBIDTA margin to stabilize at 11.7% by FY3/20 on a recovery in its relatively low-margin UV segment. Overall, we project M&M posts a 14% net earnings CAGR over FY3/18–20.

Company Outline and Operational Review

We recently attended M&M's first investor relations meeting in Chennai, and the following are our key takeaways.

Auto Segment: UV Market Share to Recover on New Launches

All three of its new models should be launched in FY3/19, two of which before the Diwali festival

- M&M has readied three new products for launch in FY3/19: the U321, S201, and G4 Rexton.
- The launches are to be spaced out over FY3/19, with two of the three models planned to be launched before Diwali.
- The addressable market size for the S201 is 22,000 units per month and for the U321 is 14,000–15,000 units per month.
- The key differentiating factor is the differential design for both of these models relative to other M&M models. While the S201 comes from the well-established Tivoli platform of Ssangyong, the U321 has been designed by Detroit-based engineers.
- Also, given that the S201 segment already has well entrenched players, management is aware that it needs to get its positioning right and also needs some differentiating edge to be competitive in this segment.
- The U321 is in a segment where there are very few other competing models, according to management.
- The G4 Rexton would be a complete-knocked-down (CKD) product (hence minimal product risk) in the Rs2.5mn-plus price segment, and hence is unlikely to be a volume driver.
- These new launches are expected to help revive lost market share.

M&M is also ready with new petrol engine options for all of its variants, to be launched in coming years

- The company currently has only two petrol options (the 1.2l three-cylinder, which is to be launched on the S201, and the 2.2l four-cylinder mHawk engine launched on the XUV and the Scorpio engine). It also intends to launch the following petrol engines soon: 0.6l single-cylinder engine; 1.2l three-cylinder; 1.5l four-cylinder; and 2l four-cylinder.
- Showcasing its readiness with multiple fuel variants, M&M showcased its entire range of gasoline and diesel engine options. It intends to launch each of its models in gasoline variants over the next few years, which should make the company engine agnostic.
- M&M's total dealer network in FY3/18 is expected to ramp up from 3,430 outlets in FY3/17 to 6,126 outlets in FY3/18.

Distribution Network (Number of Outlets)

	FY17	FY18	FY19
Primary & Secondary	1,500	1,756	4,500
Mahindra Mitra Technician	1,629	4,000	4,500
CQ & IOCL Synergy Workshops	112	180	300
Gramveer	189	190	200
Total Outlets	**3,430**	**6,126**	**7,300**

Source: Company data

M&M continues to enjoy a leading position in the SCV segment

- M&M plans to stay focused in the sub-3.5T segment. Its strong brands, the Jeeto, Supro, and Bolero BMT have helped it to maintain its leadership, with a 50% market share.

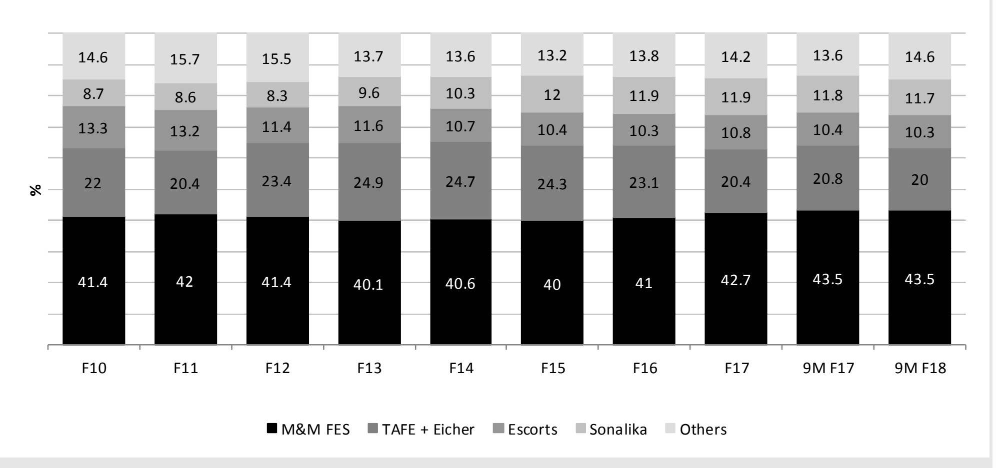
- It is the only player with a formidable customer service promise that includes: 1) buyback for at least Rs400,000 after four years; 2) free maintenance for the first two years; 3) servicing guarantee within two hours; and 4) warranty of two years or 100,000km.
- M&M has indicated that it expects to end this year with auto segment sales of 540,000 units. Total capacity in the automobile (PV) segment stands at 750,000 units, and it can expand to 1mn without any significant capex.
- It has already launched Euro6-compliant products in the US, and hence has the technical knowhow to be BSVI compliant in India. It now has to work on positioning its product to suit Indian conditions.

Tractor Segment: Launching New Brand to Strengthen Market Leadership

- On Crisil estimates, the tractor industry is expected to post an 8–10% volume CAGR over FY3/18–22, after posting an 8.6% volume CAGR over the last decade.
- The tractor industry continues to be under-penetrated (management says that penetration stands at just 4–5%), offering huge growth potential.
- Over the last three years, M&M has been the only player in the industry to have seen market share improvement, by 200bps to 42.7%.

M&M is the only player to have gained market share in tractors in the last three years

Market Share



Source: Company data

- Management has indicated that it expects its tractor market share to remain stable YoY at 42.7% in FY3/18.
- In FY3/18, M&M has reduced dealer inventory stock by five days. However, peers still have 10 days of finished goods stock at the dealer level, implying some headroom for outperformance by M&M in the coming year.

M&M continues to enjoy the widest distribution network in the industry

- M&M continues to enjoy the widest distribution network in the industry. It currently has 2,000 dealer touch-points, compared with an average of 1,000 at peers. M&M currently has a dealer touch-point every 28km.
- It also boasts an extremely strong sales force of 6,500 well trained sales personnel.

The Swaraj brand also has a well distributed presence across India

- Against the widely held perception that Swaraj is a brand focused on North India, management indicated that Swaraj's presence is well spread across the country (35% of its volumes come from North India, 27% from West and Central, 24% from South and 14% from East). The Swaraj brand also has a separate dealer network covering 1,450 locations across India.

- Farm machinery in India is expected to be a large opportunity in coming years as there are hardly any organized players in this segment, and M&M is well positioned to participate in the segment in coming years.
- To assume tractor industry growth higher than guidance of 8–10% in FY3/19 would be too optimistic at present.
- M&M already has two well established brands, Mahindra and Swaraj, which are continuing to perform well. It intends to introduce another brand, Trakstar, at the lower end of the value chain.

Trakstar

- M&M has renamed its Mahindra Gujarat Tractors Ltd subsidiary as Gromax. It has always had this subsidiary, but management has never focused on this entity.

M&M has recently launched a new brand, Trakstar, with a new identity and a separate distribution channel

- It plans to use this subsidiary to keep competition at bay, and intends to launch tractors from this subsidiary, to be branded under the Trakstar range.
- The Trakstar range of tractors is to be positioned below even the likes of brands from Escorts, TAFE, and Sonalika, and priced 3–5% lower than the next critical competitor.
- It does not intend to use the Mahindra name in this brand, to minimize the chances of potential cannibalization.
- It intends to establish a separate dealer network and a sales force for this third brand.

The objective of the new brand is to gain share in the lower end

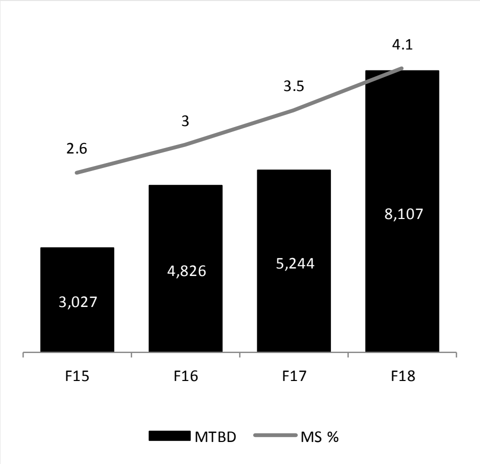
- The objective in establishing this brand is to gain market share at the low end of the value chain.
- It has already launched this brand in five states, with 100-strong dealer networks.
- It intends to launch tractors under this brand in the 30–50 HP segment, covering as much as 80% of the industry.
- With the launch of this third brand and the strong presence of its two well-established brands, M&M aims to gain 300–500bp market share over the next three to five years.

CV Segment: Aiming for EBIDTA Breakeven by FY3/19

- Although over a low base, M&M has now outperformed in the MHCV industry for three consecutive years.

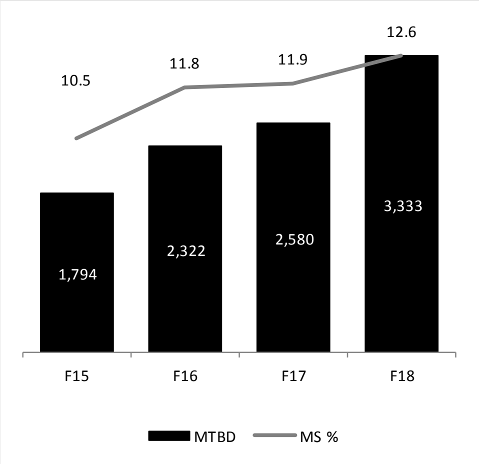
M&M has consistently outperformed the CV industry in the last three years

MHCV Performance



Note: *MTBD = Mahindra Truck and Bus Division; MS = Market share
Source: Company data

LCV Performance



Source: Company data

- It is seeing a steady pick-up in CV demand, led by the implementation of an overloading ban in certain states and an infrastructure push, amongst other factors.
- M&M is now the number-three brand in the fast-growing tractor trailer segment.
- M&M has underperformed in the bus segment as it is only present in the school bus segment and the industry lost peak season sales of school buses in Q1 due to capacity constraints following the BSIV transition.
- This business currently has 370-plus touch-points and 129 authorized service centers.

The Blazo brand is well established and offers formidable customer service

- The Blazo truck brand has been well received by the market. There are already more than 10,000 Blazo range trucks in the market. In terms of customer benefits, M&M offers a lucrative policy that includes: 1) a fuel-efficiency guarantee; 2) guaranteed availability of 150 fast-moving parts from MPARTS Plaza, or the customer gets them free; 3) guaranteed 36-hour service turnaround or the customer gets Rs3,000 per day; and 4) a record warranty of 600,000km, or six years, for HCV trucks. Despite these aggressive offers, hardly any trucks have come back with servicing issues, according to management.

Due to a strong pick-up in CV volumes, M&M is aiming for EBIDTA breakeven in this segment by FY3/19

- M&M is working on a new range of LCV, ICV, and MCV products in the 5.5T–16.2T segment with three engine and three transmission options. It intends to launch these products from H1 FY3/19 over the next 15–18 months.
- With these new launches, M&M would become a full-range CV player in India.
- M&M has earmarked capex of Rs6bn in this business.
- M&M aims to achieve EBIDTA breakeven in this business in FY3/19.

Despite strong demand, discounts remain high, a key cause of concern

- The key concern for management is that, despite strong demand and industry running at good capacity utilization, discounts remain high.

Mahindra Electric: Tie-Up with LG Chem to Strengthen EV Offerings

- Apart from the Energy Efficiency Services Limited (EESL, unlisted) order, it has recently received an order from Bhagirathi for a 1,000 EV car fleet.
- Given the government thrust on EVs, M&M is well placed for the launch of multiple EV solutions in India. It already has more than 4,000 units of EVs on Indian roads, 50 patents, 68.2mn km of EV mobility, and presence in more than 18 cities.

India EV Potential by Segment

'000 Units	Year 2030
3W	1,000
LCV	330
Bus	50

Source: Company data

- It has a network of 51 experienced EV dealerships across India.
- It has invested about Rs6bn in EVs, and has earmarked Rs9bn for EVs over the next three to five years. This excludes any investment in new product development, but includes new technology development and a new R&D center.

M&M's first product from its tie-up with LG Chem should be launched in two years' time

- M&M has recently tied up with LG Chem for the manufacture of EV battery packs in India. The alliance with LG Chem should help M&M to design and set up an EV manufacturing line in India to suit Indian requirements across product segments. The first product from the alliance should be launched in two years, and is to be a high-voltage vehicle.

- After this tie-up, M&M would have an EV range covering products launched on 12V to 650V delivering 10–70Kw/hr and capability to manufacture vehicles across segments from 3Ws to buses. It has already earmarked a fresh Rs5bn for investment in Chakan for this, as part of the Rs9bn mentioned above.
- M&M is looking at strategic technology tie-ups in India related to motors and motor controllers (it is in advanced talks with a Korean player for power electronics).
- Installed capacity for EVs is expected to ramp up to 12,000 units per year by September 2018. It expects a further ramp-up to 50,000 units by October 2019, and finally to 70,000 units by FY3/20.

Existing Product Offerings

	eAlfa mini Rickshaw	e2OPlus Hatchback	e-Supro Minivan	e-Verito Sedan
Seating Capacity	D+4	4 Adults	D+7	D+4
Range (kms)	85	140	140	140
Top Speed (km/hr)	25	80	85	85
Voltage	12 V	48 V	72 V	72 V
Battery	Lead-Acid	LFP	LFP	LFP
Motor Peak Power	1.5Kw	19kW	30kW	30kW

Source: Company data

On the back of its technical tie-ups, M&M plans to launch a slew of EV products across segments with improved driving ranges

Upcoming Products

	eRick / TREO Auto	e-KUV	Model 1 SUV	Model 2 Sedan	eCosmo Bus	Bus 2
Seating Capacity	D+4, D+3	D+4	D+4	D+4	D+32	D+40
Range (kms)	80-100	120	250	156	100	150
Top Speed (km/hr)	25-45	100	150	110	70	70
Voltage	48 V	72 V	380 V	380 V	650 V	650 V
Battery	LFP	LFP	NMC	NMC	LFP	LFP
Motor Peak Power	<5kW	30kW	90kW	50kW	165kW	165kW

Source: Company data

Three Potential US$1bn Businesses

Business 1: Agri and Food

- This industry opportunity is expected to rise from US$190bn in FY3/17 to US$250bn by FY3/22.
- M&M sees huge potential in this industry, where it can work in the fields of food processing, efficient supply chains, advisory services, input quality and cost management, soil and water management, branding, and exports.

M&M's agri business has grown at a 50% CAGR in the seven years since FY3/11

- M&M created a new agri vertical to cater to this high-potential industry in FY3/11. The agri business itself has grown at a 50% CAGR in the last seven years.
- M&M has already launched Samriddhi centers, which aim to help improve farmers' productivity, and Saboro, which helps farmers to get the best prices for their produce.
- M&M continues to be one of the largest exporters of grapes.
- In the input business, it is working in the fields of seeds, agri chemicals, micro irrigation, and seed potatoes, amongst others.
- In the output segment, it is working in fruits (it is already a strong player in grapes, and is now set to enter bananas and pomegranates), and vegetables.

M&M aims to expand its agri business 5x, to US$1bn, in the next five years

- It sees huge potential in this business, which it aims to grow 5x in the next five years, to US$1bn (4.8x target growth in agri inputs, which includes EPC, crop-care, seeds, and seed potatoes, to US$300mn and 5.4x in foods, which includes fruits and vegetables, Africa, and Saboro Health Food Café, to US$700mn).

Business 2: Africa

- With oil prices now stabilizing at high levels, African economies look to be on the cusp of a recovery, according to management.
- It currently has 71 business unit combinations, eight plants, four local offices, and 74 employees.

Management expects the Africa business to turn around in the next three to four years

- Over FY3/14–18, while the macro environment was not supportive, M&M reached the number-two position in tractors in Nigeria, with a market share of 33%. It grew by 45% over FY3/15–17 in South Africa in the auto segment, and has increased its share from Indian exports from 15% in FY3/17 to 21%.
- Given the huge potential for growth and a conducive macro environment, management now intends to focus on specific segments in 10 focus markets (South: autos and farms; North: autos and farms; West: farms and gensets; and East: farms), add seven new assembly plants, launch new products, and penetrate retail financing.
- Management believes that, on these initiatives, the Africa business can start to turn around in the next three or four years.

Business 3: Powerol Business

- This business consists of different products including gensets, powertrains, etc., and services including telecoms, retail, etc.
- This business has consistently delivered a double-digit PBIT margin.
- Over the years, the company has diversified its revenue segments, with the telecoms contribution declining from 82% of revenues in FY3/07 to 26% currently.
- This business has so far sold over 400,000 gensets, the company remains the second-largest player in the genset market, and it has a 60%-plus market share in the telecoms segment.

M&M aims to ramp up its Powerol business to US$1bn in the next four to five years

- It is also working on such solutions as a waste-to-energy solution. This business has the potential to ramp up to a Rs10bn business by FY3/23.
- Overall, it aims to ramp revenues up to US$1bn over the next four to five years in this business on growth in its current business, growth from new engines and powertrains, and also inorganic growth.

Update on Ford Alliance

M&M is in advanced negotiations with Ford over platform-sharing, input into product development, and raw material sourcing

- M&M is currently working with Ford (F US) on a partnership in eight streams. They are in advanced discussions in four of the eight work areas.
- They are discussing collaboration in platform-sharing, aggregates, powertrain, inputs in product development, and sourcing.
- It intends to make announcements as and when any of these collaborations come to fruition.

M&M is on track to be BSVI compliant by April 2020

Other Highlights

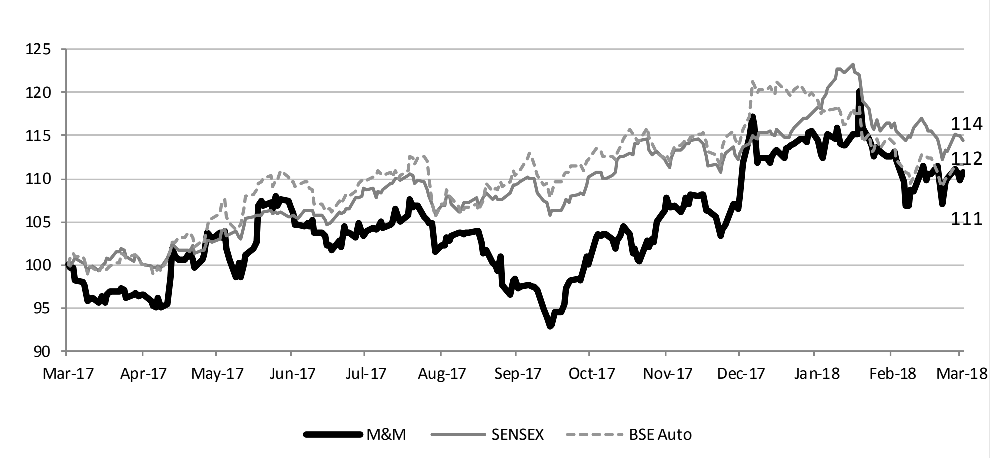
- M&M is on track to comply with all upcoming norms, including BSVI regulations scheduled for implementation from April 2020, upcoming safety norms, and the CAFÉ norms by 2022.
- Management thinks it should be able to launch an upgraded Bolero that would comply with all upcoming safety and emission norms.
- One natural headwind that M&M vehicles suffer in achieving emission compliance is that the weight of its vehicles is much higher than the competition given their unique value proposition of being highly durable and rugged. M&M intends to maintain this USP and hence is working on other means to comply with upcoming regulations, such as reduced friction, as well as alternate technologies. Given that emission norms apply to the entire fleet, its first-mover position in the EV segment should help it to meet emission regulations at the portfolio level.
- Given the current focus on the electrification of existing products, investment does not appear to be large. It has invested just Rs1bn in the E2O+, and requires Rs1–2bn to electrify existing products.
- M&M aims to launch the Electric Treo, showcased at the Auto Expo, in the next four to six months.

M&M has underperformed Sensex in the last 12 months on declining UV market share

Outlook and Valuation

M&M's stock has underperformed the BSE Sensex over the last 12 months. As highlighted in the chart below, while the stock is up 11% in the last 12 months, this underperforms the Sensex, which is up 14% in the same period.

M&M vs Index Stock Performance (March 2017=100)



Source: Bloomberg

The key investor concern has been the sharp deterioration in market share in the UV segment over the last few years. Another concern is that tractor sales growth may decelerate in FY3/19 after two consecutive years of double-digit growth.

We expect M&M's UV segment volumes to recover due to new launches and the focus on its core brands

We believe M&M's UV market share has likely bottomed out in FY3/18, and we expect it to recover its lost market share, albeit gradually, following its three new launches lined up for FY3/19. With a new design touch for its models, by Ssangyong engineers for the S201 and by Detroit engineers for the U321, we expect these models to be high on style, while being cost competitive, as always.

The launch of a new tractor brand and a recently refreshed product portfolio should help to strengthen its segment-leading position

In tractors, while the industry has seen two years of positive growth to FY3/18, management expects 8–10% industry growth for FY3/19 because of: 1) normal reservoir levels, which would likely aid the winter crop; 2) government focus on doubling farm income by 2022 by a slew of initiatives designed to aid rural prosperity, and hence demand for tractors; and 3) an ever-increasing labor shortage, which is likely to continue to drive even small farmers towards increased mechanization. Further, the introduction of the new Trakstar should help the company to improve market share, thereby strengthening its leadership position in tractors.

As a result, we expect both of M&M's key segments to see strong growth in coming years. We expect M&M to post a 10% volume CAGR for UVs over FY3/18–20 and a 13% volume CAGR for tractors over FY3/18–20. Steady revenue growth is likely to drive a strong 14% earnings CAGR over FY3/18–20.

We think the standalone business is attractively valued relative to peers

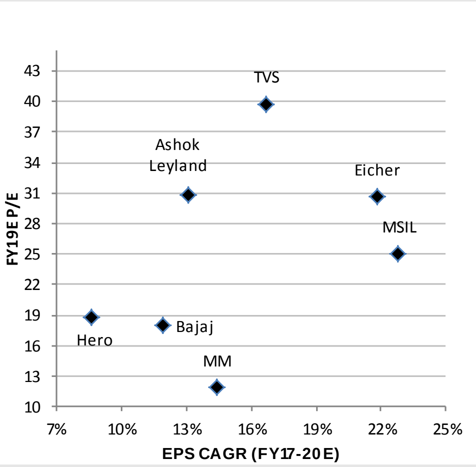
M&M has multiple investments in various group companies and we value its overall investment book at Rs268 per share. If one adjusts this from the current price of M&M, the standalone entity is currently trading at 14.4x our FY3/19 earnings estimate, which we think is attractive relative to its peers, as highlighted below.

Peer Comparison (15 March 2018)

Company	CMP	Market cap	EPS CAGR	ROE (%)		P/E		P/B (x)		Div Yield
	INR	INR Bn	FY17-FY20E	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E	FY17 %
Auto OEMs										
Maruti Suzuki India Ltd	8,838	2,669	23%	23	24	25.1	19.6	5.3	4.4	0.6
M&M#	735	878	14%	15	15	11.9	10.4	1.7	1.5	2.0
Ashok Leyland	151	441	13%	20	21	30.9	26.1	5.8	5.1	1.0
Eicher Motors Ltd	28,696	779	22%	33	31	30.6	25.9	9.1	7.3	0.3
Bajaj Auto Ltd	2,949	853	12%	23	23	18.0	15.9	3.8	3.4	1.9
TVS Motor Co Ltd	644	306	17%	24	26	39.8	31.3	8.9	7.4	0.5
Hero MotoCorp Ltd	3,641	727	9%	31	30	18.8	16.8	5.4	4.7	2.3

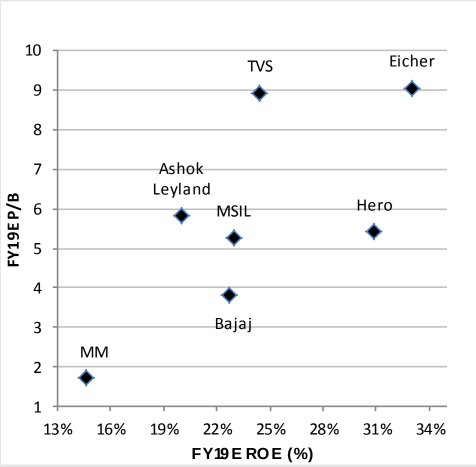
Ratios for M&M are for the standalone entity
Source: Company data, Bloomberg, HTI estimates

PER vs EPS CAGR



Source: HTI estimates

PBR vs ROE



Source: HTI estimates

We value M&M using a SoTP analysis. We have assigned a one-year forward PER of 16x to the core business. Our valuation multiple for the core business represents an about 10% premium to M&M's long-term average of 15x, and is in line with the premium at which the market is currently trading to its historical average.

We reiterate our BUY rating with a SoTP-based target price of Rs890

SoTP Valuation

SOTP	Basis of valuation	Per share val
Core business	16x FY3/20E core EPS	6
Tech Mahindra	CMP	[illegible]
MMFS	CMP	[illegible]
Mahindra Lifespace	CMP	[illegible]
Mahindra Holidays	CMP	[illegible]
MCIE (including stake in CIE, Spain)	CMP	[illegible]
Ssangyong	CMP	[illegible]
Swaraj Engines	CMP	[illegible]
Other Investment Book (incl cash in hand)	Book value	[illegible]
Price (INR)		**8**

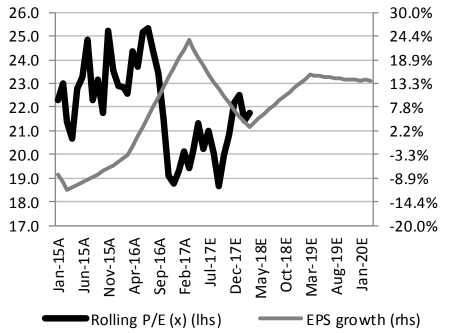
Source: HTI estimates, Bloomberg

We value the company’s investment in its key listed subsidiaries (Tech Mahindra, Mahindra and Mahindra Financial Services, Mahindra Holidays & Resorts India, Mahindra Lifespace Developers, and Ssangyong Motor) at their current market capitalizations. We have assigned a 25% holding company discount to M&M’s investments in each of these subsidiaries. Other investments have been valued at book value. Our SoTP-based target price of Rs890 implies upside potential of 20% from the last close. We reiterate our BUY rating on the stock.

Risks to Our Rating and Target Price

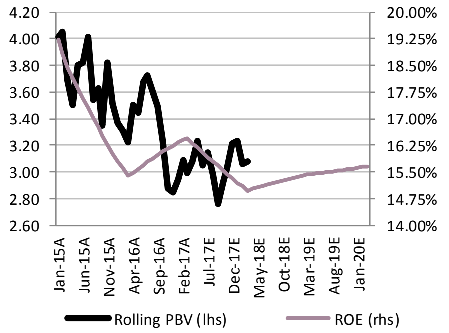
- A slower pick-up in UV and tractor volume growth than we expect represents a downside risk to our earnings estimates.
- While the monsoon has been normal this year, any impact on crop output due to factors such as unseasonal rainfall could be negative for rural sentiment.
- A sharp increase in raw material costs from current levels would be negative for our earnings assumptions.

P/E (x) vs EPS Growth (%)



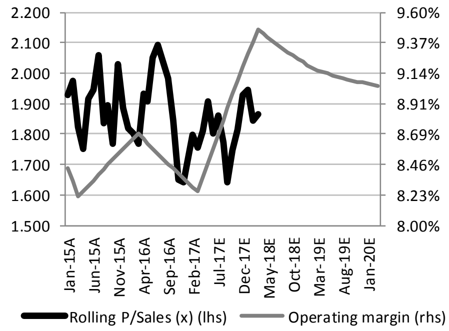
Source: Company data, Bloomberg, HTI estimates

P/B (x) vs ROE



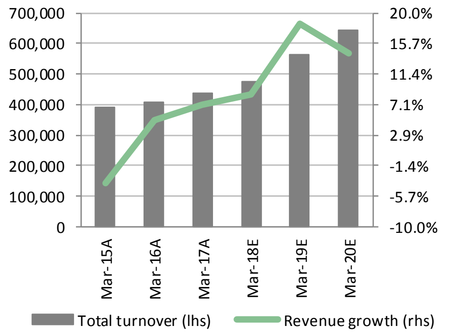
Source: Company data, Bloomberg, HTI estimates

PSR (x) vs OPM (%)



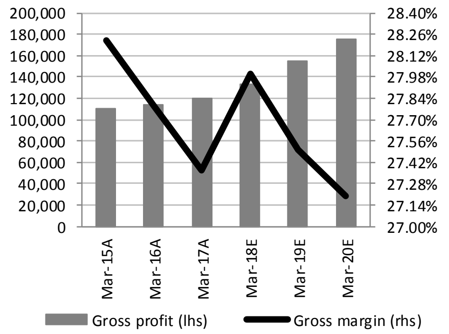
Source: Company data, Bloomberg, HTI estimates

Turnover and Growth



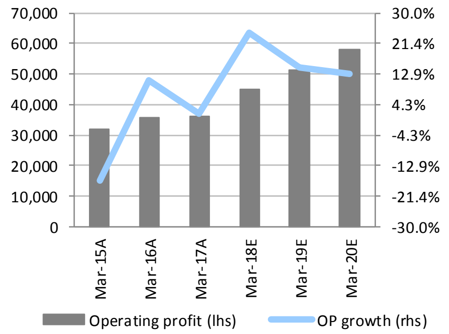
Source: Company data, Bloomberg, HTI estimates

Gross Profit and Margin



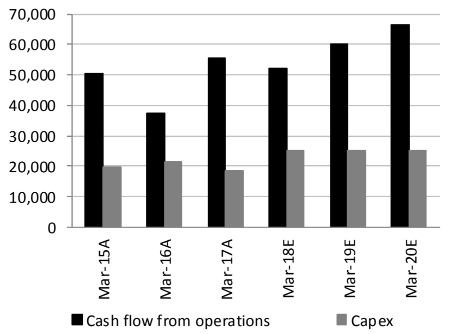
Source: Company data, Bloomberg, HTI estimates

Operating Profit and OP Growth



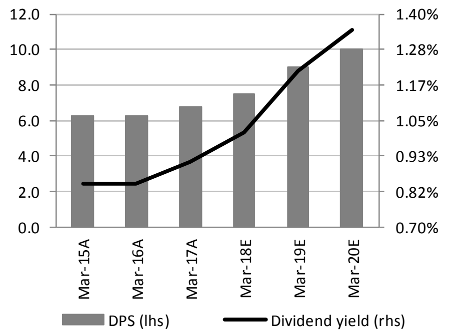
Source: Company data, Bloomberg, HTI estimates

CF from operations vs Capex (Rsm)



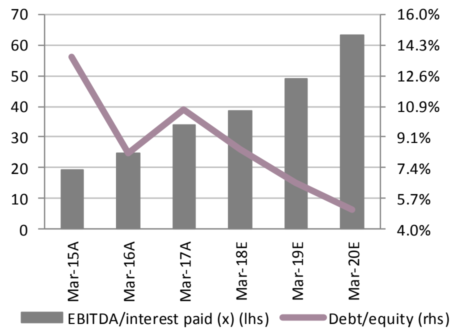
Source: Company data, Bloomberg, HTI estimates

Dividend Payout and Yield (Rs)



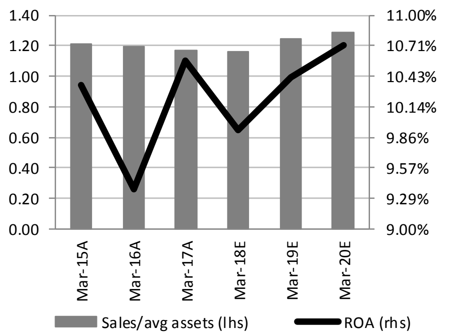
Source: Company data, Bloomberg, HTI estimates

Debt to Equity (%) and Interest Cover (x)



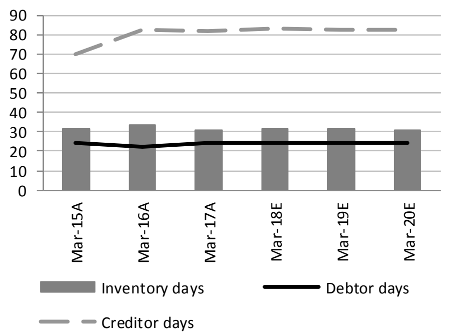
Source: Company data, Bloomberg, HTI estimates

ROA (%) and Asset Turnover (x)



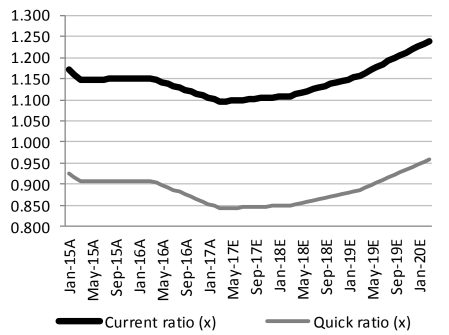
Source: Company data, Bloomberg, HTI estimates

Cash Operating Cycle



Source: Company data, Bloomberg, HTI estimates

Current Ratio (x) vs Quick Ratio (x)



Source: Company data, Bloomberg, HTI estimates

Revenue Growth

We forecast a 14% revenue CAGR for FY3/18–20 supported by a 13% volume CAGR for tractors and a 10% CAGR for the UV segment. We expect volume growth to be driven by new product launches and recovery in rural demand spurred by the government's push on improving farmer prosperity in the recent budget, and improved sowing.

Profit Margins

We expect EBITDA margin in FY3/18 to improve by 120bps YoY to 12.5% on strong growth in the tractor segment. However, we expect EBITDA margin to normalize to 11.7% by FY3/20 on the ramp-up of its lower-margin auto segment over the next two years.

Shareholder Returns

We expect a 14% NP CAGR for FY3/18–20. On robust internal cash generation, we expect its dividend payout to steadily improve in coming years.

Balance Sheet Risks

We think M&M's balance sheet is strong, with a debt-to-equity ratio of just 10.7% as of the end of FY3/17. In our view, M&M should generate sufficient operating cash flow each year to fund its capex over our forecast period.

Key Takeaway

We reiterate our BUY rating on M&M due to its attractive valuations relative to peers

Investment Thesis – Target Price – Share Price Catalysts

We expect M&M's UV volumes to recover in FY3/19 on the three new model launches lined up over the next 12 months and its focus on core brands. In tractors, we expect positive growth momentum to continue over the next couple of years on a recovery in rural demand spurred by the government's push to improve farmer prosperity in the recent budget, and improved sowing. Based on its new launches, focus on core brands, and steady growth in tractors, we expect M&M to post a 14% net earnings CAGR over FY3/18–20. Adjusted for the value of its subsidiaries, the core standalone business is currently trading at 14.4x our FY3/19 earnings estimate, which is attractive relative to peers, in our view. We reiterate our BUY rating on the stock with an SoTP-based price target of Rs890. A recovery in UV market share and steady tractor sales are likely to be the key upside catalysts for the stock. A slower recovery in tractor or UV volumes than we currently expect, or a sharp rise in input costs are the main downside risks to our estimates.

APPENDIX

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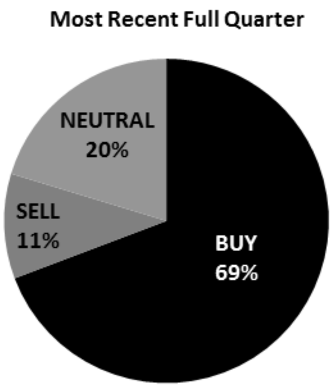
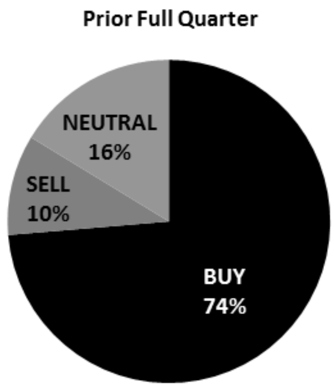
BUY ≥ 15% absolute upside performance expected within the next 12 months

SELL ≥ 15% absolute downside performance expected within the next 12 months

NEUTRAL: A stock under coverage with insufficient upside or downside to justify a BUY or SELL rating. For purposes only of FINRA/NYSE ratings distribution rules, our Neutral rating falls into a hold rating category.

Rating Distribution





Haitong International Equity Research Ratings Distribution, as of December 31, 2017

	BUY	Neutral (hold)	SELL
HTI Equity Research Coverage	69%	20%	11%
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*Percentage of investment banking clients in each rating category.

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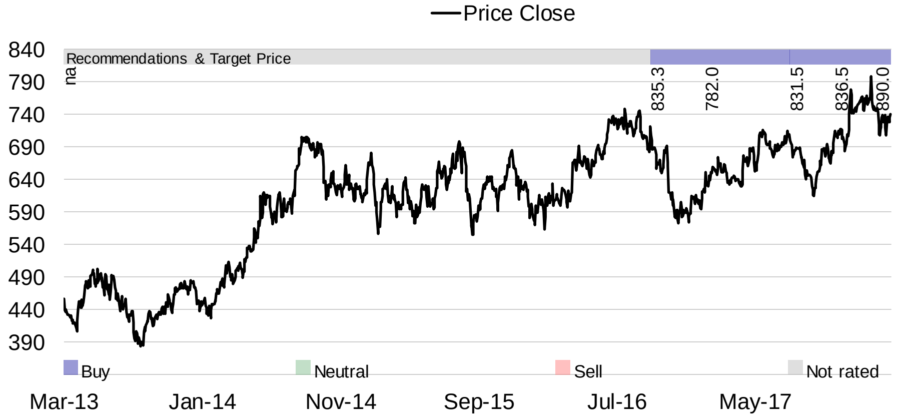
Recommendation Chart



Date	Recommendation	Target (Rs)	Price (Rs)
2018-02-12	Buy	890.0	746.0
2017-11-14	Buy	836.5	714.8
2017-08-07	Buy	831.5	700.4
2017-02-01	Buy	782.0	651.2
2016-10-04	Buy	835.3	707.7

Source: Company data Bloomberg, HTI estimates

Definitions for Key Investment Metrics

Business Growth

This is the metric which matches the top line in our report.

Business profit

This is the metric which best represents operating profit in our report

Shareholder Returns

Return on Equity

Balance Sheet Risk

Net Debt to Equity