AMBIT
Acumen at work

Mahindra & Mahindra

SELL

INITIATING COVERAGE | **MM IN EQUITY** | **June 13, 2016**

Ain't that tempting a collection

M&M has built a formidable rural franchise around tractors/financing but this does not contribute more than a third of the group valuation (₹430 of ₹1,285/share). Unlike its unchallengeable tractor business (competitive advantages built around brand, reach, and financing), M&M's automotive business (₹452/share) is just a collection of forays with limited chances of long-term success in many (especially 2Ws/trucks); strong UV franchise is finally being challenged by entry of global players with better styled products. This expansive yet weak automotive portfolio is characteristic of ineffective capital allocation at larger group level as well; so, we assign lower multiples to automotive and rural franchises (implied 7.3x FY18E EBITDA). Whilst loss in UV market share is the certain near-term catalyst, unwinding of capital invested (like divesture of auto ancillaries) is the key upside risk.

Competitive position: STRONG   Changes to this position: NEGATIVE

Capital allocation: A key risk

M&M allocates its core domestic UV/tractor cashflows (57% of FY15-end core net worth) to fund the group businesses across several spheres of mobility and unrelated non-mobility businesses. The track record has been mixed with some investments (Mahindra Finance, Tech Mahindra) generating strong returns but recent ones like 2Ws, trucks/buses clearly impacting consolidated return ratios. There are only limited instances of divestment of loss-making businesses.

Automotive: Several verticals, core domestic UVs facing headwinds

The core domestic UV business faces increasing competitive and regulatory headwinds, with (i) MNCs (strong product development) and large car makers (Maruti, Hyundai with distribution advantages) targeting the segment aggressively; (ii) significant regulations surrounding diesel vehicles. We expect 360bps market share loss over FY16-18. Apart from LCVs, where M&M is a leader, 2Ws, PVs and HCVs are relatively weak franchises.

Tractors: Strong franchise but contributes only 33% of EBITDA

M&M's long standing leadership (41% share) in domestic tractors has been built on brand (reliability, resale value) and distribution (30% higher than the second largest player's). Acquisition and turnaround of product-wise strong but financially weak Punjab Tractors and support from Mahindra Finance have further cemented M&M's leadership. The slow moving Indian tractor industry is concentrated in <50HP negating MNCs' technological advantages.

Reinvestment risk limits multiples

Capital allocation concerns force higher WACC and lower multiples; while there is no direct comparable, the stock trades at justifiable 25% discount to Maruti's FY18 EV/EBITDA given market share concerns in UVs and lower return ratios. Divestment of loss making entities is a key risk to our SELL stance. Rural pick-up cannot add more than 5% to valuation even if tractor volume growth was to be 30% (FY17) against base case of 15% (last 10-year CAGR of 6%).

Key financials (Standalone + MVML)

Year to March (₹ mn)	**FY14**	**FY15**	**FY16**	**FY17E**	**FY18E**
Operating Income	388,171	374,683	388,566	438,256	494,600
EBITDA	52,481	46,033	51,288	57,883	66,444
EBITDA margin (%)	*13.5%*	*12.3%*	*13.2%*	*13.2%*	*13.4%*
EPS (₹)	68.3	54.2	56.8	63.4	72.4
RoCE (post-tax) (%)	38%	24%	24%	23%	23%
RoE (%)	24%	17%	15%	15%	15%
P/E (x)	14.2	18.9	17.9	15.9	13.8

Source: Company, Ambit Capital research Note: MVML = Mahindra Vehicle Manufacturers Limited; Fair value of investments (₹435/share) reduced from current market price while calculating P/E multiple

Auto & Auto Ancillaries

Recommendation

Mcap (bn):	₹841/US$12
6M ADV (mn):	₹1,285/US$19
CMP:	₹1,381
TP (12 mths):	₹1,285
Downside (%):	7

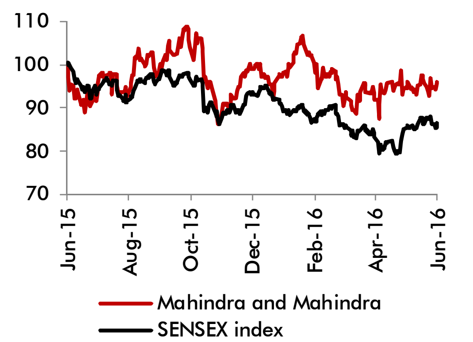
Flags

Accounting:	AMBER
Predictability:	AMBER
Earnings Momentum:	AMBER

Catalysts

- Market share losses in the domestic UV segment (360bps over FY16-18)
- Continuing investments in the loss making (₹ 15bn over FY17 and FY18)

Performance



Source: Bloomberg, Ambit Capital Research

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Snapshot of company financials

Profit and Loss (Standalone + MVML)

Year to Mar (₹ mn)	FY16	FY17E	FY18E
Net revenues	388,566	438,256	494,600
EBITDA	51,288	57,883	66,444
Depreciation	12,484	14,580	16,600
Interest expense	2,329	2,191	2,191
Adjusted PBT	44,384	49,535	56,562
Tax	11,964	13,352	15,246
Adjusted net profit	32,420	36,183	41,315
Reported net profit	32,978	36,183	41,315
Profit and Loss Ratios			
EBITDA Margin (%)	13.2%	13.2%	13.4%
Net profit margin (%)	8.3%	8.3%	8.4%
EV/ EBITDA (x)	10.1	8.9	7.8
P/E on adjusted basis (x)	17.9	15.9	13.8
EV/Sales (x)	1.33	1.18	1.04

Company Background

M&M was set up in 1945 as a steel trading company named Mahindra & Mohammed by brothers K.C. Mahindra and J.C. Mahindra and Malik Ghulam Mohammed. The company changed its name to Mahindra & Mahindra (M&M) in 1948. It started manufacturing and selling larger MUVs, starting with the assembly under license of the Willys Jeep in India. Soon established as the Jeep manufacturers of India, the company later commenced manufacturing light commercial vehicles (LCVs) and agricultural tractor. The company has over the years entered different businesses and now has presence in more than 20 business segments.

Balance Sheet (Standalone + MVML)

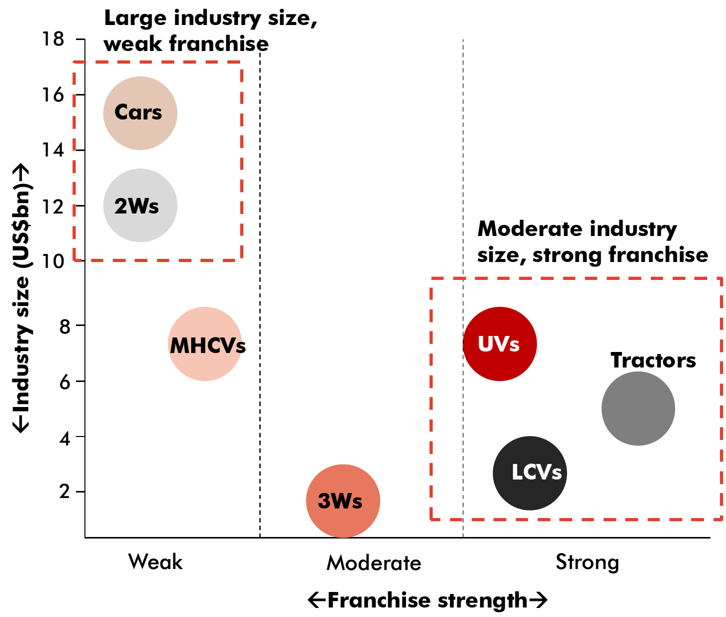
Year to Mar (₹ mn)	FY16	FY17E	FY18E
Total Assets	**389,833**	**415,797**	**461,695**
Fixed Assets	115,206	125,627	134,027
Current Assets	157,561	165,104	195,602
Investments	117,066	125,066	132,066
Total Liabilities	**389,833**	**415,797**	**461,695**
Total net worth	223,843	251,491	283,061
Total debt	39,524	39,524	39,524
Current liabilities	112,251	110,567	124,895
Deferred tax liability	14,216	14,216	14,216
Balance Sheet ratios			
RoCE	23.6%	23.3%	23.2%
RoE	15.3%	15.2%	15.5%
Gross Debt/Equity (x)	0.2	0.2	0.1
Net debt (cash)/ Eq (x)	(0.0)	0.0	(0.0)
P/B (x)	3.5	3.1	2.8

Cash flow (Standalone + MVML)

Year to March (₹ mn)	FY16	FY17E	FY18E
PBT	44,384	49,535	56,562
Depreciation	12,484	14,580	16,600
Tax	(9,257)	(13,352)	(15,246)
Net Working Capital	14,565	(20,244)	(3,249)
CFO	**57,154**	**24,286**	**47,949**
Capital Expenditure	(26,884)	(25,000)	(25,000)
Investment in subsidiaries	(12,933)	(8,000)	(7,000)
CFI	**(31,907)**	**(24,576)**	**(23,091)**
Issuance of Equity	(126)	0	-
Inc/Dec in Borrowings	(4,966)	-	-
Net Dividends	(8,469)	(7,779)	(8,535)
Interest paid	(2,329)	(2,191)	(2,191)
CFF	**(15,890)**	**(9,970)**	**(10,726)**
Net change in cash	9,358	(10,261)	14,131
Closing cash balance	**48,065**	**37,805**	**51,936**

Note: MVML = Mahindra Vehicle Manufacturers Limited; Fair value of investments (₹435/share) reduced from market price while calculating EV/EBITDA & P/E

A mismatch of opportunity and strength



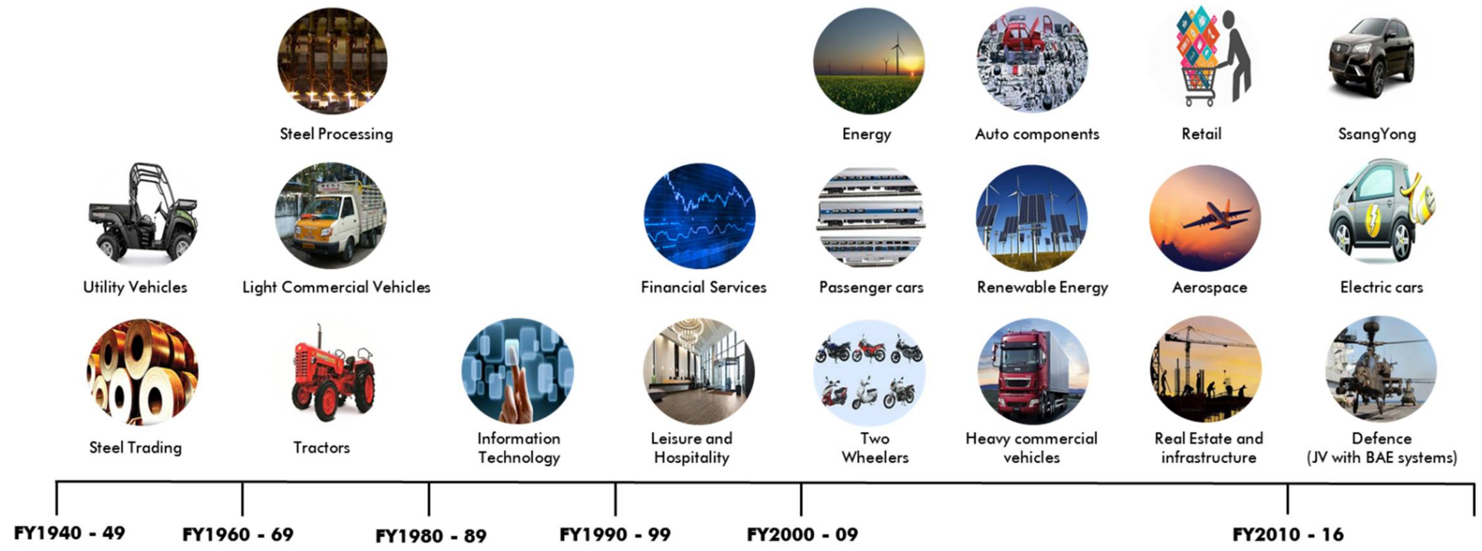
M&M has a mixed track record of success with investments

Name of the company	Amount invested (₹ bn)	Amount invested as a percentage of core business net worth
Successful investments		
Tech Mahindra	10.0	4.5%
MMFSL	1.5	0.7%
Mahindra Holidays	0.3	0.1%
Unsuccessful investments		
Mahindra Two-wheelers	18.6	8.4%
Mahindra Trucks & buses	18.9	8.5%
Mahindra Renault	Merged with standalone in FY10	
Yet to be proven investments		
SsangYong	21.3	9.6%
Mahindra Reva	3.8	1.7%
Divested business		
Mahindra Systech	Divested majority stake to CIE FY13	

M&M: A 'federation' of diverse businesses

M&M has a 'federation' structure which is different from a group like Tata. The latter has a promoter-owned entity, Tata Sons, which makes investments across businesses (e.g., Tata Motors for automobiles, Tata Consultancy Services for information technology and so on). M&M acts as an investment company for the Mahindra Group. Over the years, M&M has deployed capital in several segments. The group is currently invested in more than 20 businesses through several various entities with M&M as the flagship company.

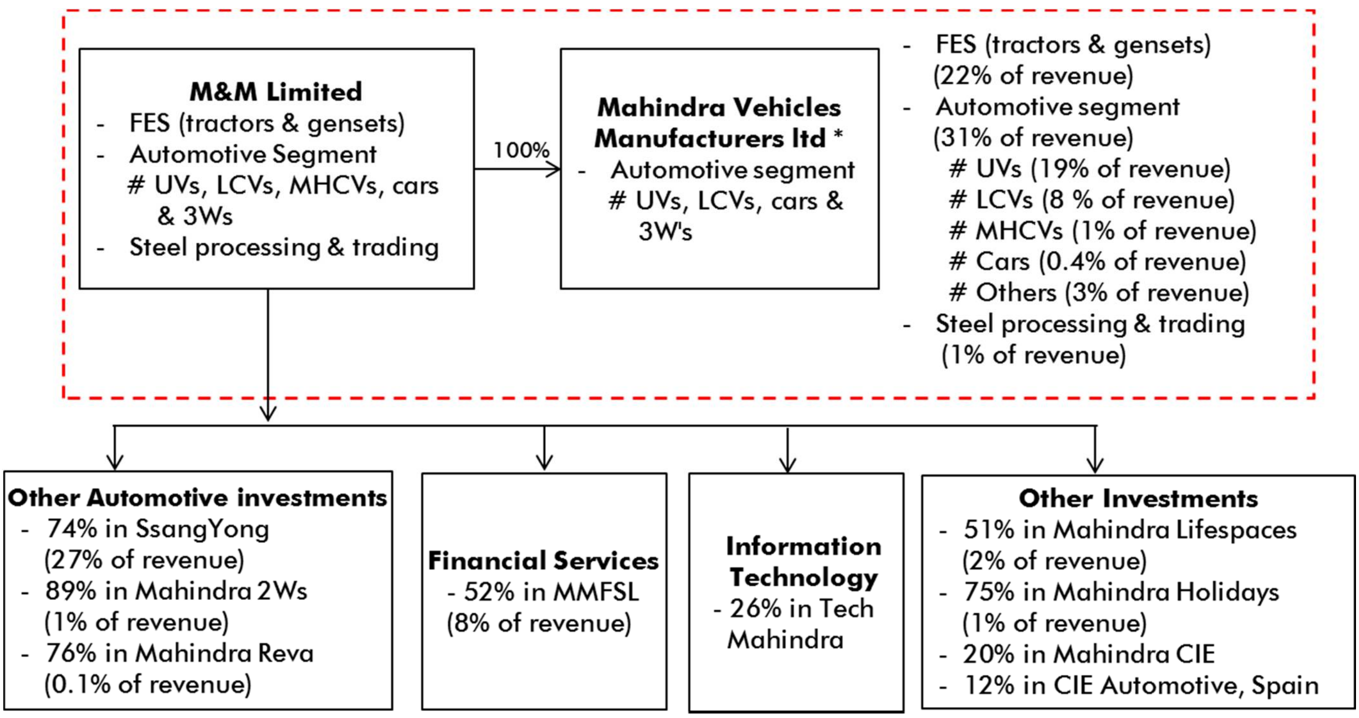
Exhibit 1: M&M has forayed into several businesses over the years



Source: Company, Ambit Capital research

The core business is made up of the automotive and tractor businesses (M&M standalone) and Mahindra Vehicle Manufacturers (MVML; created in FY08 to house the Chakan automobile manufacturing plant). Historically operated as independent entities, trucks/bus and car businesses have now been merged with the standalone business.

Exhibit 2: M&M is present in several businesses through several entities



Source: Company, Ambit Capital research. Note: The revenue estimates above are Ambit estimates for FY15; [dashed box] is the core automotive & FES division

As of FY15, 34% of the group's capital employed was deployed in the core automotive division (including UVs, LCVs, 3Ws, spare parts and related services excluding MHCVs) and the farm equipment sector (FES). These two businesses contributed 53% of the group's revenue and ~88% of EBITDA in FY15. In other words, 66% of the group's capital deployed in the non-core businesses contributed just 47% to the group's revenue and a meager 11% of EBITDA. The biggest drags on the group's FY15 profitability have been SsangYong (16% of capital employed) and the trucks & buses division (5% of capital employed).

Exhibit 3: M&M – a segment-wise overview

Segment	Brief description	Major companies included in the segment	Revenue share		Revenue CAGR	EBITDA share		EBITDA CAGR	Capital employed	
			FY08	FY15	(FY08-15)	FY08	FY15	(FY08-15)	FY08	FY15
Automotive (including MVML excluding MHCV merged with standalone)	Sale of UVs, LCVs, 3Ws, spare parts and related services	M&M (standalone) and MVML	35%	31%	15%	27%	56%	22%	28%	20%
SsangYong	Korean SUVs	SsangYong Motor	NA	27%	NA	NA	-3%#	NA	NA	16%
2Ws	Sales of Motorcycle and scooters	Mahindra Two-wheelers	NA	1%	NA	NA	-7%	NA	NA	1%
Trucks & buses	Sales of MHCV; MHCV engines	M&M (standalone); Mahindra Heavy Engines	NA	1%	NA	NA	-2%	NA	NA	5%
Mahindra Reva	Electric Vehicles	Mahindra Reva electric private limited	NA	0%	NA	NA	-1%	NA	NA	1%
Total Automotive			**35%**	**60%**	**26%**	**27%**	**43%**	**17%**	**28%**	**43%**
Farm Equipment	Sales of Tractors, spare parts and related services	M&M (standalone), Mahindra USA, Mahindra China, Mahindra Yueda (Yancheng)	22%	22%	17%	19%	33%	18%	18%	14%
IT Services ^	Services rendered for IT and Telecom	Tech Mahindra, Bristlecone	16%	NA	NA	25%	NA	NA	14%	NA
Financial Services	Financing, leasing and hire purchase of automobiles and tractors	M&M Financial Services, Mahindra Rural Housing Finance	5%	8%	26%	8%	21%	26%	14%	16%
Steel Processing & Trading	Trading and processing of Steel	Mahindra and Mahindra limited	3%	1%	8%	3%	2%	4%	2%	2%
Infrastructure	Operating commercial complexes, project management and development	Mahindra Lifespaces Developers	1%	2%	27%	2%	7%	29%	10%	8%
Hospitality	Sale of Timeshare	Mahindra Holidays & Resorts	1%	1%	12%	3%	2%	4%	2%	2%
Systech ^	Automotive components and other related products and services	Mahindra CIE	14%	1%	NA	10%	NA	NA	21%	NA
Others/Unallocable			3%	4%	19%	3%	-8%	NA	-10%	12%
Total			**100%**	**100%**	**17%**	**100%**	**100%**	**10%**	**100%**	**100%**

Source: Company, Ambit Capital research. Note: ^ Tech Mahindra and auto component subsidiaries are now associates of M&M and hence consolidated under equity method (do not impact the consolidated revenue, EBITDA and capital employed); # The adjusted EBITDA margin of by SsangYong in CY15 was 3.4%.

Capital allocation – a key risk

'There are a slew of unrelated businesses in the services sector. It is very clear that as an economy matures, the services sector takes the lion's share, any federation of companies that wants to leverage growth must develop competencies in these areas'.

- Mr. Anand Mahindra in November 2012

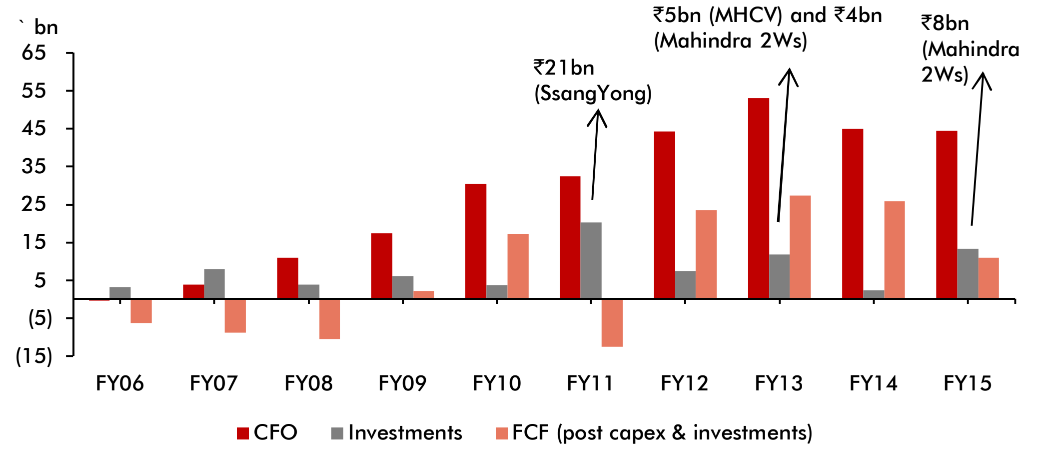
Capital allocation is the key risk associated with M&M. The company allocates capital from its core business to fund the group businesses, with 57% of core business net worth invested as at FY15-end. The group has invested in almost all spheres of the mobility business (UVs to two-wheelers to heavy trucks). It has also invested in a slew of non-mobility businesses, ranging from hospitality to IT, raising questions over the group's investment strategies. The company has had a mixed track record of success in its investments. Mahindra Finance, Tech Mahindra and Mahindra Holidays have generated significant RoIC, but the more recent forays like 2Ws and truck & buses have incurred significant losses, entailed heavy investments, and significantly hit return ratios. We find only one instance of divestment of a loss-making venture (auto components).

Nearly 57% of M&M core net worth (standalone + MVML) has been invested in more than 20 different businesses

Nearly 57% of core business net worth invested in subsidiaries/associates as at FY15-end

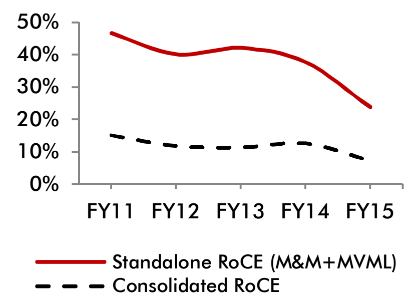
As at FY06-end, the amount of capital (equity, preference and loans/advances) invested in various subsidiaries and associates was ₹12.4bn, implying 35% of the then standalone net worth. Over the next 9 years, the amount of these investments increased by nearly 10x to ₹126bn (excluding investment in MVML but adding back investment in Mahindra Trucks & Buses that was merged with the standalone business w.e.f. FY14). The consistent investments in subsidiaries/associates have led to negative FCF (post capex and investments) in 4 years from FY06-15.

Exhibit 4: Core business cash flows have been consistently invested in various businesses



Source: Company, Ambit Capital research Note: Core business = M&M standalone + MVML

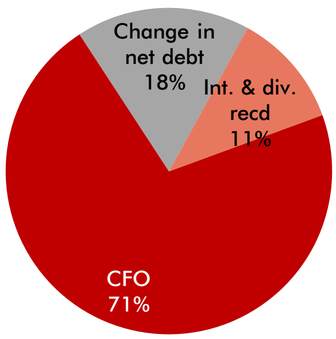
M&M's consolidated RoCE (post tax) has consistently underperformed that of standalone



Source: Company, Ambit Capital research

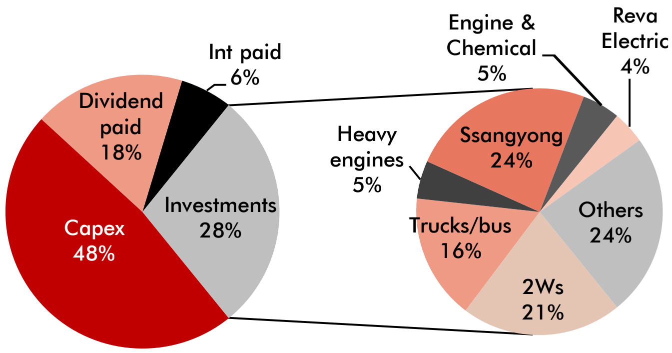
These investments accounted for nearly 57% of the standalone + MVML net worth as at FY15-end. The core business generated close to ₹313bn from internal accruals and increase in debt over FY06-15. Of these, nearly 28% has been invested in various subsidiaries and associates. The key areas in which core business cash flows have been invested are two-wheelers, SsangYong and trucks & buses amounting for nearly 67% of the total investments between FY06-15.

Exhibit 5: Core business generated funds (₹313bn) largely through internal accruals over FY06-15…



Source: Company, Ambit Capital research

Exhibit 6: …of which a significant amount (₹88bn) has been invested in subsidiaries and associates



Source: Company, Ambit Capital research

Philosophy of capital allocation – anything and everything?

The company has invested in various segments of the mobility business, ranging from utility vehicles to two-wheelers to heavy trucks & buses. The philosophy driving this is to acquire synergies of scale in R&D, logistics, etc. of a large mobility business. The group aims to eventually grow scale in each of the automotive verticals. Beyond the core business of mobility, the company has invested in unrelated businesses, primarily in the services sector. These range from hospitality to information technology. The group aims to develop competencies in the services sector expecting it to grow as the economy expands.

Mixed success in investments

M&M has had a mixed track record of success with regard to investments. The successful ventures – Mahindra Finance, Tech Mahindra and Mahindra Holidays – appear to be those that achieved organic growth. The company has had a mixed track record with regard to acquisitions, with Punjab Tractors and Satyam Computers turning out to be successful bets but Kinetic Scooters and auto component companies not performing as expected. Certain acquisitions like SsangYong and Reva are too early to be judged as a 'success' or a 'failure. As at FY15-end, an amount equivalent to about 17% of core business' net worth has been invested in businesses that are struggling (such as two-wheelers, truck/bus).

Exhibit 7: M&M has had a mixed track record of success with investments

Name of the company	Amount invested (₹ bn)	Amount invested as a percentage of core business net worth	Remarks
Successful investments			
Tech Mahindra	10.0	4.5%	**Emerges as a giant tech play** ■ TechM has had a successful track record of making acquisitions at reasonable valuations to gain new service lines and capabilities. This allowed the company to expand despite cancellation of contracts from its top client 'British telecom' in early 2010. ■ In 2009, TechM acquired 42.5% of the erstwhile Satyam Computer Services for US$600mn (equivalent to 70% of TechM's then market capitalisation). It was able to successfully turn around Satyam by gaining large customers and key employees that it had lost earlier.
Mahindra and Mahindra Financial Services Ltd	1.5	0.7%	**Benefits from M&M's parentage and rural focus** ■ Initially set-up in 1991 as a captive financing subsidiary for M&M's Tractor and UV businesses. Over the years, MMFSL has grown to become the largest rural NBFC in India with highest number of customer touch points. ■ It gained significant market share from the PSU banks in the 1990s and early 2000s due to its ability to process loan applications faster and less stringent documentation requirements. It also benefited from the strong parentage of M&M which allowed it to get a better credit rating and thereby source cheaper financing from the credit market.
Mahindra Holidays	0.3	0.1%	**A growing base of 'loyal' customers** ■ Club Mahindra has a unique business model where customers pay upfront for vacations to be delivered over 25 years. ■ Club Mahindra has built strong brand equity with customers (total 194k) enabling them to commit significant upfront payment. The initial cash flows is partly used for funding the capex of the resorts, doing away the need for external sources of funding.
Unsuccessful investments			
Mahindra Two-wheelers	18.6	8.4%	**Little room between well-entrenched Indian and Japanese incumbents** ■ Forayed into the 2W segment by acquiring 80% of the assets of Kinetic Motor Company in July 2008. It continued selling the legacy Kinetic scooter brands like Flyte before introducing two new scooters (125cc Rodeo and 125cc Duro) in September 2009 and motorcycle (Stallion) in September 2010. However, Stallion was inundated with serious product issues. ■ Despite substantial funds infusion from M&M and launching several new scooter/motorcycles models, MTWL has barely been able to make a mark in the 2W industry. There is little room to compete against the well-entrenched domestic and Japanese peers. In FY16, market share of MTWL in domestic scooters and motorcycle stood at just 1.7% and 0.6% respectively.
Mahindra Trucks & buses (including heavy engines)	18.9	8.5%	**Tough road to market share gain** ■ This business was a JV between M&M and American CV major Navistar started in 2005 for MHCV. However, the JV's market share in domestic MHCV goods could reach only 1.1% in FY12. Furthermore, the JV had an accumulated debt of ₹4.5bn as at FY12-end. Eventually, Navistar exited the JV by selling its stake to M&M in FY13. ■ In FY14, the company (post the exit of Navistar) was merged into M&M. The market share in MHCV segment stood at a meagre 2.3% in FY16. The key reason for underwhelming performance of this business has been the well-entrenched brand/service network of Tata Motors and Ashok Leyland.
Mahindra Renault	Merged with Standalone business in FY10		**Down and out** ■ This JV with Renault was set up in FY06 to cater to the Indian passenger car segment. The JV launched sedan 'Logan' in 2007. However, the product was unable to gain any significant market share. In 2010, Renault exited the JV by selling its stake to M&M. ■ Logan was re-named by M&M as 'Verito' and the business was merged in the M&M standalone entity in FY10. Till date, M&M has not been able to grab a significant market share (0.2% in FY16) in the very competitive passenger car segment.
Yet to be proven investments			
SsangYong	21.3	9.6%	**So far so good** ■ M&M acquired 70% stake in the Korean SUV maker SsangYong in FY11 for a consideration of ₹17bn. ■ Since its acquisition, M&M has infused close to ₹4.3bn over FY11-13. This much-needed investment helped revive the product development cycle at SsangYong. Over the last 5 years, SsangYong improved its market share in the Korean PV market from 2.2% in FY10 to 6.3% in FY15. Furthermore, it was also able to ramp up its export sales thanks to these new launches. ■ SsangYong's financial performance has witnessed improvement over the last five years with revenues delivering 10% CAGR and EBITDA 15% CAGR. However, rising competition from Hyundai (including Kia) and incremental costs from Euro VI are likely headwinds going forward.
Mahindra Reva	3.8	1.7%	**Is the future electrifying?** ■ M&M acquired majority stake in electric car maker Reva in FY11. It recently launched e2o in the UK. Further, it unveiled an electric powertrain version of Verito in June 2015. ■ This business is yet to realise its potential.
Divested business			
Mahindra Systech	Divested majority stake to CIE FY13		**CIE to the rescue** ■ M&M's focus on the auto component business started in 2005 and grew through a spate of acquisitions – domestic and overseas. Through the inorganic way, Systech division was able to scale up revenue to ₹35bn in FY08. ■ Profitability of the division, particularly the overseas subsidiaries (Mahindra Forgings Europe) fell sharply post the financial crisis of 2008/09. Moreover, on the domestic side, the division could not scale up its business beyond its key customer, M&M. ■ Eventually, M&M ceded control of the auto-component subsidiaries to CIE Automotive, a Spanish auto component company in return for retaining a minority stake (20%) in Mahindra CIE and a 12% stake in CIE Automotive.

Source: Company, Ambit Capital research. Core net worth = Standalone + MVML (added back MTB)

Instances of divestment of loss-making ventures are rare

"I assure you that if we get to the point where we do not see either the macro markets cooperating, and despite our good products, not achieving scale, if we see that the consumer is not voting to buy products and we are not getting recognition of our superior products, I promise you there is no hesitation in quitting businesses. There is no mental resistance to doing that"

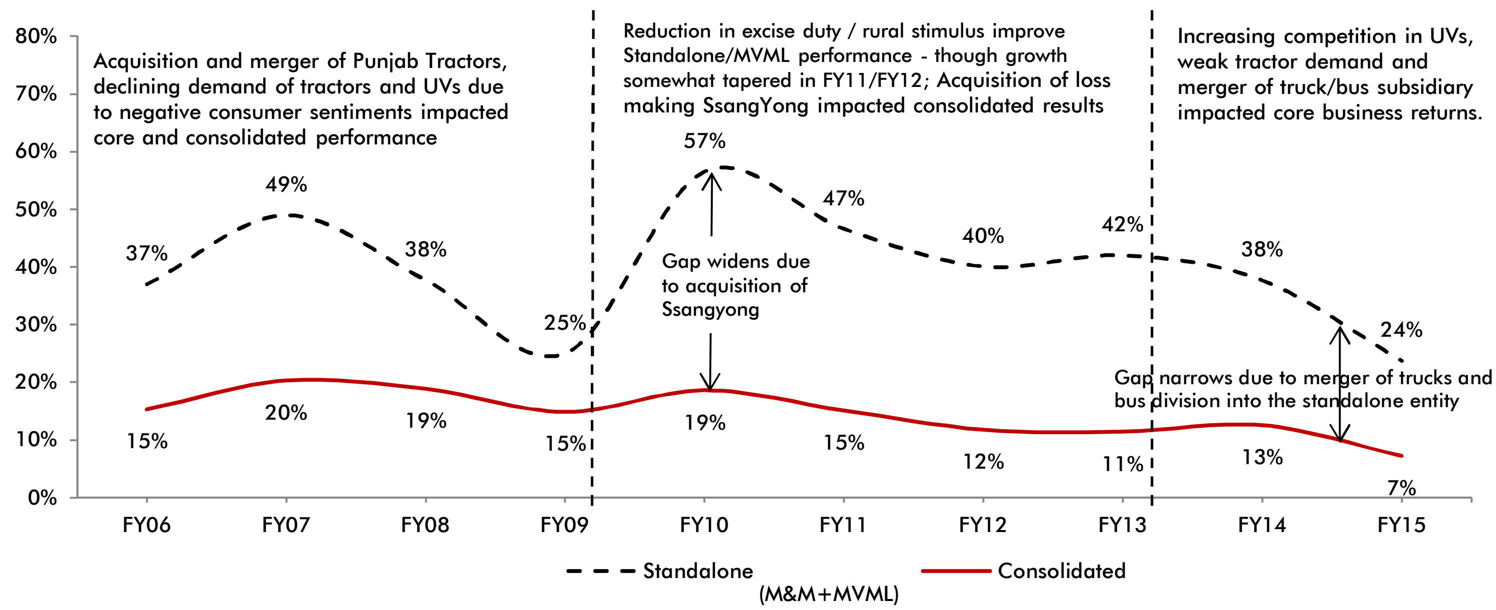
– Mr. Anand Mahindra in an investor interaction in November 2012

While M&M has outlined its philosophy regarding divestment of loss-making ventures, there have been only limited instances of implementation, like the auto component business where the company ceded operational/majority control to CIE Automotive. In most cases, the company actually bought back stake from partners in loss-making ventures (e.g., trucks & buses from Navistar and cars from Renault).

Investments have significantly hit consolidated return ratios

Because of sub-par return on several investments, M&M's consolidated RoCE has significantly and consistently lagged that of core business (M&M+MVML). This is despite improvement in RoCE of segments such as financial services and infrastructure. It is pertinent to note that even after merging the loss-making trucks & buses business with the standalone business in FY14, the difference between core business RoCE and consolidated RoCE has remained wide.

Exhibit 8: M&M's consolidated RoCE (post tax) has significantly and consistently underperformed standalone trends



Source: Company, Ambit Capital research

Automotive: UV leadership faces serious challenges from incumbents and MNCs

(60% of consolidated revenue; 43% of EBITDA)

M&M's auto division is a mélange of businesses with the purported aim of being a full-range mobility player, something no OEM has achieved globally. M&M itself has had limited success. It succeeded in UVs (38% market share) and LCVs (42%), but its two-wheeler, passenger car and trucks & buses businesses are clearly struggling, and it's early days for SsangYong. Further, M&M faces significant competitive headwinds in the core domestic UV business from both MNCs (product development advantages) and large passenger car incumbents like Maruti/Hyundai (distribution advantages). Also, significant environmental regulations on diesel vehicles pose risks given M&M's diesel bias. We expect M&M to lose 360bps market share over FY16-18 to 34.3%.

Attempting to be a full mobility provider meets limited success

"M&M has built a strong UV business over time and before the onset of serious competition. But spreading itself into other areas outside its core competence could be a distraction"

– A leading Indian automobile journalist

"Each customer has the potential to bring in more value. We are trying to get customers to move up the value chain along with M&M,"

– Dr. Pawan Goenka (Group President – Auto & Farm Sector)

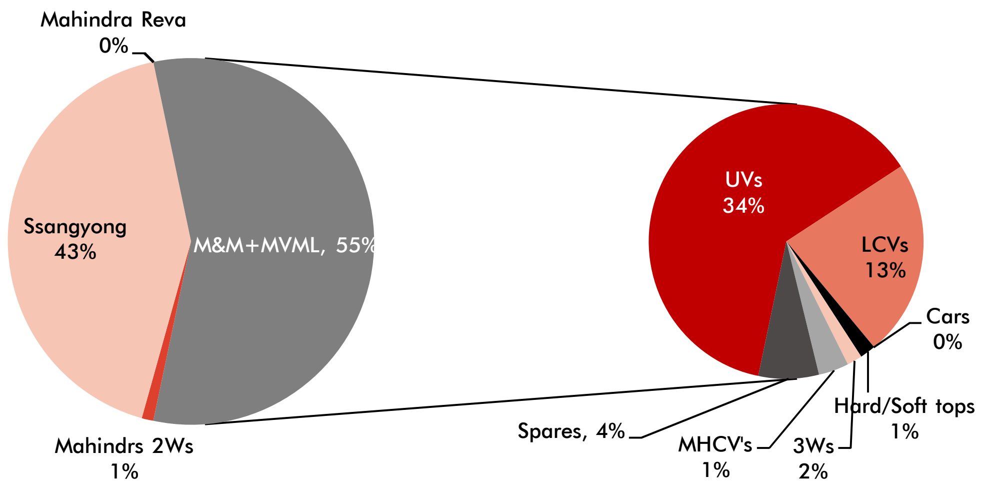
M&M is attempting what no other automaker in the world has done successfully – become a total mobility solution provider

Starting with utility vehicles, the company has over the years invested in several automotive segments like light commercial vehicles (or pick-ups), three-wheelers, cars and more recently two-wheelers, heavy trucks & buses and premium SUVs (this is even before considering its foray into aerospace). M&M seems to be attempting something that no other auto maker in the world has done successfully – becoming a total mobility solutions provider. Some players like Daimler and Honda have presence across automotive segments but none has the breadth of presence of M&M.

M&M has seen success in only a couple of automotive segments like utility vehicles (market share of 38% in FY16) and LCVs (market share of 42%). In a number of other segments like cars (market share of 0.2%), two-wheelers (market share of 0.9%) and MHCVs (market share at 2.4%), the company has failed to make a mark despite significant investments and presence for several years now. The reasons for lack of success in these segments have been discussed in detail on page 7. The company has also failed to sustain partnerships (with global players) for some of the automotive businesses like cars (Ford in the 1990s and Renault in mid-2000s) and heavy trucks (Navistar).

However, the Korean premium SUV maker, SsangYong, has seen some turnaround since its acquisition by M&M. Its market share has increased from 2.2% in 2010 to 6.3% in 2015, led by new launches. Similarly, its financial performance has witnessed improvement over the last five years with revenues delivering 10% CAGR and adjusted EBITDA 15% CAGR. However, intensifying competition from Hyundai (which commands nearly 80% market share in the Korean PV market), particularly in the compact UV space, and cost increases from introduction of Euro VI are likely to impact SsangYong's performance *(for a detailed discussion refer to Appendix B)*.

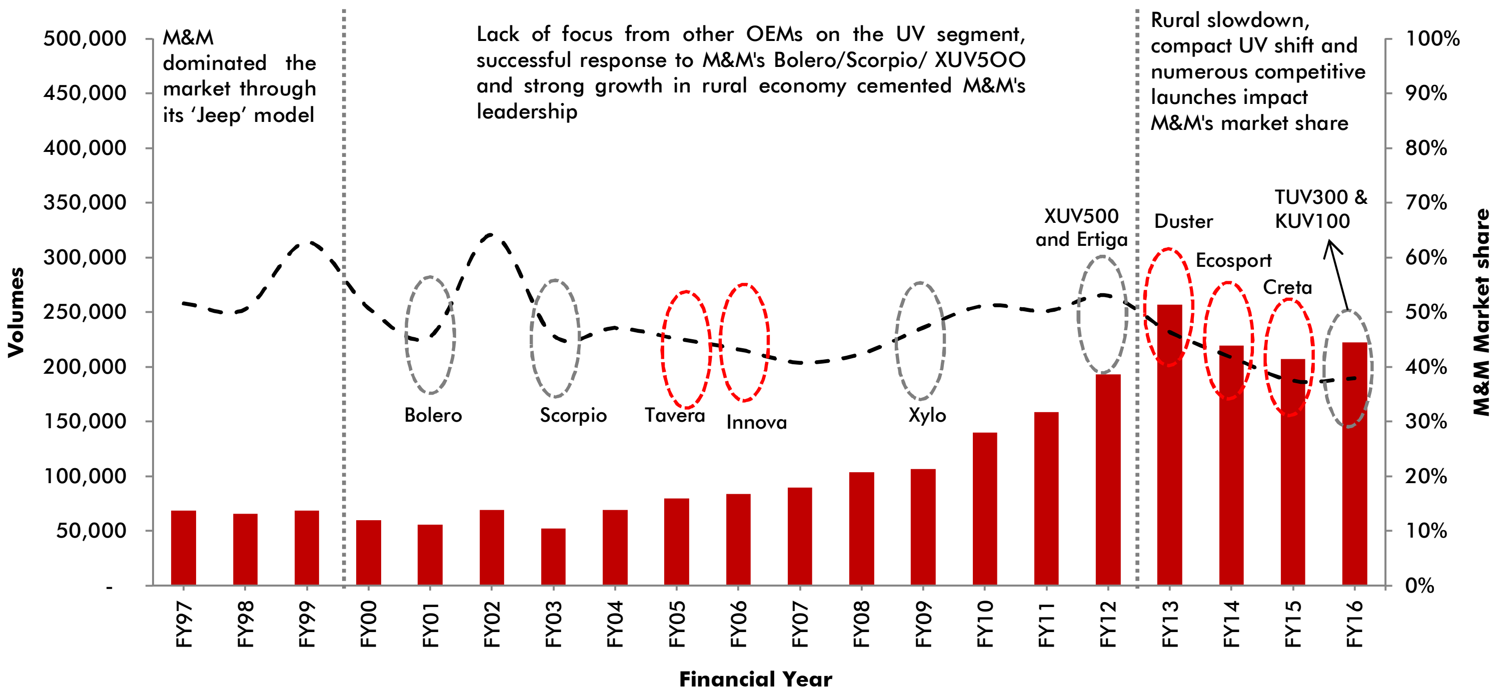
Exhibit 9: Presence across automotive segments, but success only in UVs and LCVs



Source: Company, Ambit Capital research

Facing competitive and regulatory headwinds in the core domestic UV business

Exhibit 10: M&M has lost significant market share in domestic UVs since FY13



Source: Company, Ambit Capital research Note: M&M's launches encircled in grey colour; Competitors' launches in Red

M&M's leadership in utility vehicles over the 1990s and 2000s was driven by:

M&M's steady dominance and growth in UVs largely went unnoticed by other OEMs in 2000s

- **Lack of focus from other players. For instance, Maruti did not launch any new UV for most part of this period; Tata Motors which posed a threat to M&M's UV dominance in the late 1990s surprisingly took nearly 10 years to introduce model updates for Sumo/Safari let alone any new UV launch;**
- M&M's Bolero and Scorpio found strong acceptance in rural/small towns; and
- Rural boom of the mid-2000s to early 2010s led by pro-rural measures of the UPA I and UPA II governments helped M&M's UV sales in rural areas (for a detailed discussion on M&M's historical performance in the UV segment, please refer to Appendix A on page 33).

Playing field significantly altered since FY13, leading to market-share loss

From FY13 to F16, M&M lost close to 1,500bps market share (from 53% to 38%) in the domestic UV segment. The key reasons for this are:

- **Several competitive UV launches get strong customer response**: Unlike the preceding decade which saw few competitive product launches, FY13-16 witnessed a number of UV launches from incumbents like Maruti and Hyundai as well as newer players like Renault and Ford. Maruti launched its multi-utility vehicle 'Ertiga' in April 2012, which saw strong customer response with more than 32k bookings in the month after its launch. Compact UV launches from Renault ('Duster', launched in July 2012) and Ford ('Ecosport', launched in June 2013) with significantly aggressive pricing, styling and features saw immediate success. New launches by peers continued in FY16 with Maruti's 'S-Cross' and Hyundai 'Creta', with the latter clocking monthly volumes of nearly 7k units.

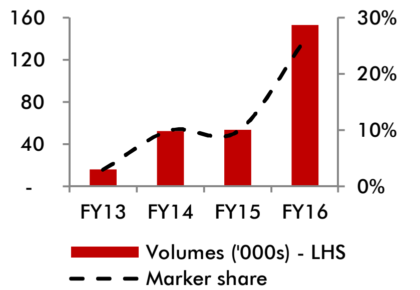
Significant competitive launches since FY12

Model	Year of launch	Sales in first year of launch
Ertiga	FY12	76k
Duster	FY13	47k
Ecosport	FY14	52k
Creta	FY16	72K in 10 first months

Source: SIAM, Company, Ambit Capital research

- **M&M's slow response to compact UV shift in urban markets**: While there is no standard definition of the term 'compact' UV, the generally accepted parameters are a five-seater or sub-4 metre UV costing less than a million rupees (US$15k). The compact UVs' share in the domestic UV market increased from 10% in FY14 to 26% in FY16. While M&M was the first to launch the sub-4 metre UV 'Quanto' in India in October 2012, the product met with only limited success (could never cross 3k units/month which was much lower than the peak monthly volumes of the more expensive XUV5OO). Some of the reasons for the failure were: (i) its seven seating arrangement with a body length of <4 metre rendered very little space for the rear seat passengers; and (ii) less sporty/stylish design than models like Duster and Ecosport. It took M&M nearly four years to come up with a new compact UV (TUV3OO) in September 2015. (*click here* for our strategy note, Why Companies Fail, dated 23 March 2016, for a detailed discussion).

Market share of compact UVs has been rising steadily



Source: SIAM, Company, Ambit Capital

- **Lack of gasoline UV variants from M&M:** Our channel checks suggest that gasoline variants have been gaining share in the UV segment in the recent years. This has been particularly true of the compact UV models in urban areas. The shift has been driven by the narrowing price gap between diesel and petrol, making it more economical to drive petrol models. Our interaction with dealers indicates that gasoline mix for Ertiga is now as high as 45% and for Ecosport it is close to 30%. M&M did not have gasoline UV offerings until KUV100 (launched in January 2016). This missing piece could have also played a part in M&M's UV market-share loss.

Gasoline variants now account for as high as 45% of Ertiga and 30% of Ecosport's sales mix

- **Slowdown in the rural economy**: The rural economy has been witnessing a significant slowdown since FY15 on the back of several factors. India witnessed weak south-west monsoon in two successive years, FY15 and FY16. Weakening global crop prices have added to the woes. Food inflation declined significantly from a high of 10% in August 2015 to 5% in March 2016. Another major factor was the slowdown in rural spending/support (MSPs, NREGA) by the new NDA Government, which is a material departure from the generous spends on rural India administered by the previous government. This may have particularly impacted the sale of M&M's rural models, Bolero and Scorpio, in FY15 and FY16.

The slowdown in rural economy in the last two years has played a role in M&M's market share loss

A modest franchise amid rising competition places M&M at further risk of market-share loss

Competition in the UV space continues to intensify

- **Continuing focus of most OEMs on the UV segment:** As highlighted in the preceding sections, global PV giants (but smaller players in India) such as Renault and Ford have witnessed significant success with their debut low-cost UV (e.g., Duster and Ecosport) in India. In FY16, Renault and Ford commanded a combined market share of ~12% in domestic UVs. This is nearly 3x their combined market share of ~4% in the passenger car segment. Buoyed by the success of these new launches, most OEMs are planning a slew of launches in the UV segment. The number of new UV launches unveiled in the Indian Auto Expo 2016 was the highest ever. Some of the launches lined up are indicated in the exhibit below.

Exhibit 11: SUVs recently launched and lined up for launch over the next 2 years

Model	Likely launch date	Likely price ex-showroom Delhi (₹ '000)
Maruti		
Brezza (launched)	Mar-16	699
Ignis	Oct-16	600
Wagon R MPV	Dec-16	550
Tata Motors		
Hexa	Nov-16	1,550
Nexon	Feb-17	775
Others		
Renault - Duster Facelift (launched)	Apr-16	900
Honda - BR-V (launched)	May-16	890
Toyota Innova Crysta (launched)	May-16	1,250
Ford - B-MAX MPV	Mar-17	800
Chevrolet – Spin	May-17	1,250
Hyundai – Carlino	FY18/FY19	800

Source: Ambit Capital research; Prices indicated above are expected price for the base variant

- **Large incumbents with strong distribution networks (Maruti, Hyundai) focusing on the UV segment:** Besides the newer players, strong incumbents in the passenger car space like Maruti and Hyundai are also focusing on the UV space. As discussed in the earlier sections, historically these players focused on the small and compact car segments in India. However, given the rising share of UVs in the Indian PV market and as a means to diversify beyond their core small/compact car segments, these players have now identified UVs as a key focus area to grow/retain their market share in India. These large car incumbents have well entrenched distribution networks extending into rural India. In fact, both Maruti and Hyundai continue to expand their rural reach every year. Some recent UV launches of Maruti (Ertiga and Brezza) and Hyundai (Creta) have witnessed strong customer response.

Exhibit 12: Porter analysis indicate rising competitive intensity in the Indian UV industry

Bargaining power of suppliers

MEDIUM

- Most of the vendors are smaller in size compared to the OEMs.
- While commodity prices are pass-throughs to OEMs, most vendors have low bargaining power for non-commodity pass-throughs.
- Vendor rationalisation/focus on quality can improve vendor bargaining power. However, this would be restricted to a few key vendors.

Bargaining power of buyers

MEDIUM

- Customers comprise of individual buyers who are unorganised/fragmented compared to OEMs
- In some cases, lack of distribution/service networks leads to limited choices in particular regions.
- On the other hand, customers are witnessing an increased number of options as new OEMs are penetrating more in the rural areas. Increasing adoption of research websites is also helping customers take more informed decision.

Competitive intensity

HIGH

- The competitive intensity in the UV segment has increased significantly since FY13. Nearly every OEM has now introduced/has a UV in its product portfolio.
- Furthermore, post the success of Renault Duster and Ford Ecosport, MNCs are increasingly focusing on the UV segment.
- Large car makers like Maruti and Hyundai have also started focusing on the UV segment as the means to diversify beyond their core car portfolio.

Barriers to entry

MEDIUM

- For a new OEM in the auto space, building brand and establishing distribution reach are the biggest challenges.
- The industry is highly capital intensive and technology oriented.
- However, the customer reception of UV products from the newer players has been positive in recent years, indicating customers' willingness to test newer brands in the segment.

Threat of substitution

LOW

- As of now, the only credible competition to UVs segment is premium sedans.
- Over the years, UVs have been gaining share globally as it is viewed as a more aspirational product (vs sedan)
- On the flip side, UVs are viewed as fuel guzzlers. Hence, any regulations surrounding emissions can have negative impact on UV industry sales.

Improving **Unchanged** **Deteriorating**

Source: Ambit Capital research

M&M comes across as a modest franchise under our IBAS framework

M&M scores the best in brand reputation in the Indian UV market. It also scores better than peers in architecture, driven by its low employee attrition and ability to retain top management. It also scores well on strategic assets with a well-entrenched rural distribution network (though not as good as Maruti's), support from Mahindra Finance, and a high degree of localisation in manufacturing.

However, M&M is weak in innovation as it lacks the R&D prowess of global peers. It also lacks the global peers' experience in operating in a more stringent regulatory environment (emission as well as safety), which would place it at a disadvantage when these regulations tighten in India. Success of global players like Renault and Ford in the Indian UV space has also raised questions on the importance of brand, distribution network, and other parameters on which M&M scores higher.

Exhibit 13: M&M has a strong brand but lacks the innovation strength of the global peers

Parameters	M&M	Maruti/ Hyundai	Foreign OEM's	Remarks
Innovation				
A) R&D spends as a % of sales?	3.9%	4.0% (Suzuki)	~4.5%	▪ M&M's R&D spend is lower than peers both as a a percentage of revenues and in absolute terms (Suzuki's R&D spend as a percentage of sales is similar to M&M but nearly 5x M&M's in absolute terms). ▪ M&M does not have the advantage of a strong parentage and has generally been unsuccessful in its partnerships with foreign OEMs. ▪ M&M has taken steps to address the R&D deficiency by consolidating all its R&D efforts at Mahindra Research Valley (Chennai). This has helped M&M shorten the product lifecycle to 3-4 years from 5-6 years earlier. But still a long gap with global peers.
Rank	◑	◕	●	
B) Advantage of a strong parentage with large balance sheet?	No	Yes	Yes	
Rank	◑	●	●	
Overall position in Innovation	◑	◕	●	
Brands/Reputation				
A) Market share in the UV segment (FY16)?	38%	11-16%	3%-12%	▪ The resale value for Bolero and Scorpio is the highest in the Indian UV industry. These models command strong brand following in rural India. ▪ Mahindra was ranked 1st in the 2015 JD power sales satisfaction index. Further, Bolero and XUV500 were ranked as the most dependable SUV and the most appealing SUV respectively in the 2015 survey. ▪ However, the criticality of brand as a competitive advantage in the UV space has been challenged in the recent years. A few global OEMs like Renault, Ford and Hyundai have been able to create a good reputation in the UV market.
Rank	●	◕	◑	
B) Are the company's brands recognised by industry as leaders via awards in UV Segment?	Yes	No	No	
Rank	●	◕	◕	
Overall position in Brands	●	◕	◕	
Architecture				
A) Does the company treat its employees better than competition?	Yes	No	No	▪ Foreign OEMs pay higher commissions to dealers but largely to compensate for their lower sales volumes. ▪ M&M, ranked 25th in the great place to work survey (FY15) was the only automobile OEM to feature in the survey. ▪ M&M has not seen any senior level exits over the past 2-3 years. Maruti lost its marketing and sales head Mayank Pareekh to Tata Motors in FY15. ▪ M&M has stock options for its senior management, while Maruti does not have any such incentives.
Rank	●	◕	◕	
B) Compensation to dealers?	Lower	Lower	Higher	
Rank	◕	◕	◕	
Overall position in Architecture	●	◕	◕	
Strategic Assets				
A) Distribution network in India (Number of touch points)?	750+	>3,000	300-400	▪ Maruti's network reaches 145k villages in India. Although M&M has a lower distribution reach, it has higher concentration in rural India. Newer players like Renault and Ford have smaller networks but are expanding at a rapid pace. ▪ MMFSL is increasingly diversifying its portfolio beyond M&M. For instance, MMFSL is now one of the largest financers for Maruti cars in the rural areas. ▪ The cost advantage of M&M due to high localisation is also fast fading as MNC OEMs are increasing localised content.
Rank	◕	●	◑	
B) Advantage of captive finance subsidiary?	Yes, but diminishing	No	No	
Rank	◕	◑	◑	
C) Low cost advantage of M&M due to high localisation?	Yes, but diminishing	Yes, but diminishing	No	
Rank	◕	◕	◑	
Overall position in Strategic Asset	◕	●	◑	
Overall Score	◕	◕	◑	

Source: Company, Ambit Capital research Note: ●=Strong, ◕=Moderate and ◑=Weak

Increasing regulations for diesel vehicles are a disadvantage

There has been a lot of regulatory and judicial activism surrounding diesel vehicles and, more prominently, large diesel vehicles (mostly SUVs) in recent times. Some of these actions are detailed in the exhibit below:

Exhibit 14: Rising regulatory actions against diesel vehicles

Authority	Month	Measure	Latest status
National Green Tribunal	Dec-15	Interim ban on registration of diesel vehicle in Delhi.	Ban continues in Delhi.
Supreme Court	Dec-15	Ban on registration of >2,000cc diesel vehicles in National Capital Region till March 31, 2015.	Ban was further extended on March 31, 2016 and April 30, 2016 till further order.
Finance Ministry (Annual Budget)	Feb-16	Levied an infrastructure cess of 2.5% on diesel cars of <4m length and <1500 cc engine capacity; and 4% on higher powered vehicles and SUVs.	M&M passed on this cess to customers w.e.f. 1 April 2016.
Kochi Bench of National Green Tribunal	May-16	Imposed ban on registration of new diesel passenger vehicles of >2,000cc across the state of Kerala. The bench also banned light vehicles (Cars) and heavy diesel vehicle which are more than 10 years old from plying in the six major cities of the state.	The ban on registration of >2,000cc diesel vehicle has been temporarily stayed by the Kerala high court for 2 months.

Source: Company, Ambit Capital research

The above actions surrounding diesel vehicles have not only impacted the sale of diesel SUVs in the above areas but also increased the price gap with petrol counterparts.

To mitigate the impact of these developments (refer to the first and second regulatory actions in the above Exhibit), M&M downsized its Scorpio and XUV500 engines to 1,990cc for the NCR market. While these steps can help address the regulatory concerns to some extent, we believe there are still significant risks of increasing regulations for diesel vehicles. For instance, there is a risk of the above restrictions being implemented also in the other parts of India, particularly the major cities. Further, there is a risk spreading to lower cc diesel vehicles.

Diesel vehicles have become a favourite whipping boy – Dr Pawan Goenka, in response to NGT ban on registration of >2,000 cc diesel vehicles in Delhi

BS-VI shift will widen price gap between diesel and petrol vehicles

On 19th February 2016, the Government of India issued draft norms for leapfrogging to Bharat stage-VI norms w.e.f. 1st April 2020, skipping BS-V altogether. Change in the emission norms from BS-IV to BS-VI would increase the price gap between diesel and petrol vehicles significantly. Between BSIV and BSVI, the cost of manufacturing a petrol vehicle is expected to increase by ~₹20k while the corresponding increase for a diesel vehicle would be ₹50k-100k. Besides the significant absolute increase in the price of diesel vehicles, BS-VI would increase the price difference between petrol and diesel vehicles (from ~₹100k now to ₹130k-180k).

SsangYong unlikely to be a game-changer for M&M's UV capability

Synergy benefits to M&M restricted to joint engine development

We believe synergy benefits between M&M and SsangYong would be limited to joint engine development. SsangYong has a petrol engine development capacity of 150k p.a. In May 2014, M&M and SsangYong signed an agreement to develop three new gasoline engine families – 1.2L, 1.5L and 1.6L – at a cost of ₹10bn. The first engine from this project, i.e. 1.2L engine has been deployed in the recently launched compact SUV 'KUV100'. Further, M&M is working on developing a 2.2L gasoline engine, which would be used in Scorpio and XUV500 and plans to launch petrol engines for all its vehicles by FY19 (contribution of SsangYong in these engines is not yet clear).

Exhibit 15: Mapping petrol and diesel vehicles of SsangYong and M&M

	SsangYong	Mahindra
Petrol (cc)		
1.2		KUV100
1.6	XLV, Tivoli	
2.0	Korando	
2.3	Actyon, Actyon Sports	
2.8, 3.6 and 5.0	Chairman	
3.2	Rexton, Rodius, Chairman	
Diesel (cc)		
1.2		KUV100
1.5		TUV300, Nuvosport
1.6	XLV, Tivoli	
2.0	Rexton, Korando, Actyon Sports, Rodius	Scorpio, XUV500
2.2	Rexton, Korando, Rodius	Scorpio, XUV500, Xylo
2.5		Scorpio, Bolero, Thar
2.7	Rexton	

Source: Company, Ambit Capital research

However, there are limited synergies in the following areas:

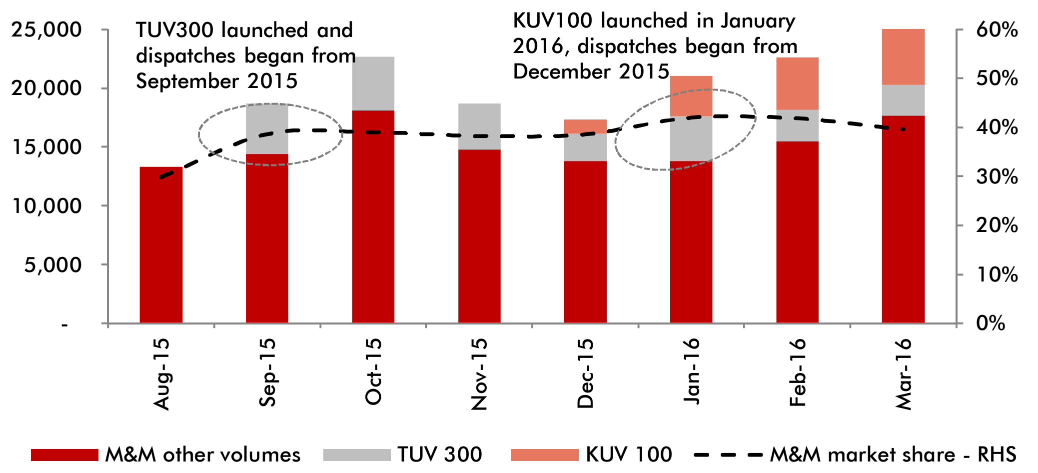
- **Common platform development:** M&M currently does not have any plans to develop common platforms with SsangYong. This would limit modularisation gains that may have occurred from platform sharing. Currently, SsangYong is only benefiting to a small extent by sourcing low-cost components from M&M's vendor network in India.
- **Access to SsangYong's global distribution network:** SsangYong has a dealership base across markets like Europe, South America, the Middle East and Africa. It has a network of 130 dealers in South Korea and exports to more than 90 countries via 1,200 dealers. It is particularly strong in Western Europe and Russia. We expect limited scope for M&M to leverage SsangYong's global distribution network as M&M lacks brand presence in SsangYong's key markets.
- **Access to Indian markets for SsangYong:** SsangYong's products are relatively premium and lack the brand equity of other premium car makers in India. Hence, it is unlikely that SsangYong's products (premium SUVs) would sell in large volumes in India. This can be corroborated from the fact that Rexton only managed to sell 5,000 units since its launch in 2013.

M&M's market share in domestic UVs to slip further

Bunching up of launches could lead to a volume recovery in FY17…

We expect M&M's UV volumes to witness growth of 19% in FY17. To address the portfolio gap in the compact UV segment, M&M launched 'TUV300' in September 2015 and followed it up with another super compact UV 'KUV100' in January 2016. In April 2016, M&M launched its third product in the UV segment 'Nuvosport' (a replacement of 'Quanto'). Thanks to these new launches, M&M has regained some part of the market share it lost in 2HFY16. Its share improved to 39.9% in 2HFY16 from a low of 35.5% in 1HFY16. On the other hand, to overcome the lack of petrol UV offerings, M&M introduced the 1.2 litre petrol engine in KUV100. The petrol engine has witnessed a good initial customer response with petrol mix in KUV100 as high as ~45%.

Exhibit 16: TUV300 and KUV100 led to a small revival in M&M's UV market share



Source: Company, Ambit Capital research

...but is not likely to sustain

We expect the recent compact UV launches to help M&M's UV volumes to grow by 19% YoY in FY17. However, due to stronger performance of peers like Maruti, we expect M&M to continue losing market share (200bps) in FY17. We expect M&M to lose close to 360bps market share between FY16 and FY18 (from 37.9% to 34.3%) on the back of factors discussed in the earlier section such as competitive launches from global players, increasing thrust on the UV segment from Maruti and Hyundai, and regulatory tightening in diesel SUVs which places M&M's portfolio at risk.

We expect M&M to post a relatively muted 8% volume CAGR in domestic UVs over FY17-20 as compared to UV industry growth of 12%.

Exhibit 17: M&M to lose 560bps market share in domestic UVs over FY16-20

	FY14	FY15	FY16	FY17E	FY18E	FY19E	FY20E
Industry volumes	525,839	552,135	586,664	735,452	823,706	922,550	1,033,257
YoY growth	*-5.0%*	*5.0%*	*6.3%*	*25.4%*	*12.0%*	*12.0%*	*12.0%*
M&M volumes	219,422	207,836	222,324	263,672	282,246	307,648	332,260
YoY growth	*-14.5%*	*-5.7%*	*7.5%*	*18.6%*	*9.0%*	*9.0%*	*8.0%*
M&M market share	**41.7%**	**37.5%**	***37.9%***	***35.9%***	***34.3%***	***33.3%***	***32.2%***

Source: SIAM, Ambit Capital research

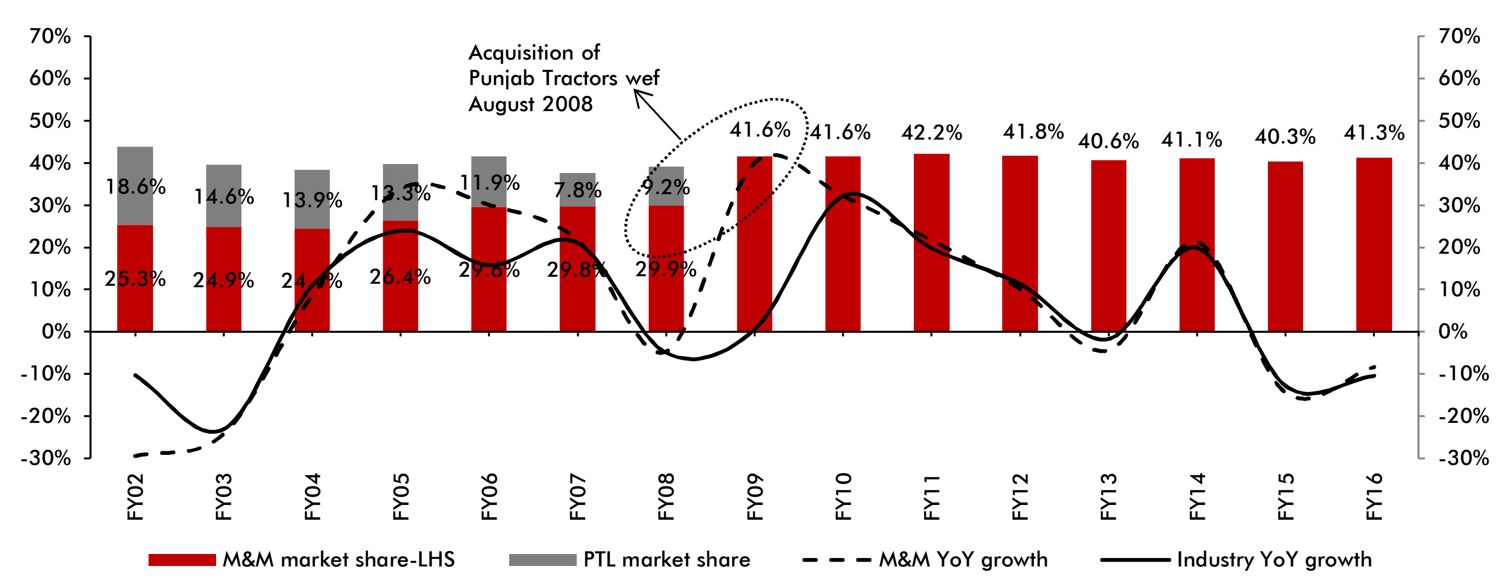
Tractors: Strong rural play but only 33% contribution to consolidated EBITDA

(22% of consolidated revenues, 33% of EBITDA)

M&M's sustained market leadership (41% share in FY16) in domestic tractors was built on brand (reliability, high resale value) and distribution network (dealer network 1.3x of second-largest player). Acquisition/turnaround of Punjab Tractors has complemented product portfolio (higher HP) and geographic reach (North and East India). Support of Mahindra Finance has boosted competitive edge. Diversified geographical/product presence keeps M&M insulated from volatility in region-wise or HP-wise performance. The Indian tractor industry is slow moving and likely to remain concentrated in <50HP segment, negating MNCs' technological advantages. We also see limited threat from low-cost players like Sonalika. Helped by a normal monsoon and a low base, we expect tractor industry to deliver 15% volume CAGR over FY16-18. Over the long term (FY18-26), we expect the industry to witness 8% CAGR led by penetration headroom in many non-north states.

Strong competitive advantages driven by sustained leadership

Exhibit 18: M&M's has maintained and grown its domestic tractor leadership over the last 15 years



Source: Company, Ambit Capital research. Note: PTL is Punjab Tractors Ltd

M&M has commanded market leadership in Indian tractors for more than three decades now. We believe such sustained leadership has been underpinned by strong competitive advantages surrounding brand, a viable and well-entrenched distribution network, a diversified geographical/product mix, and captive financing.

Exhibit 19: M&M leads the pack in all competitive parameters

	M&M (incl Swaraj)	TAFE-Eicher	Escorts	ITL	MNCs	Remarks
Brand	Strong	Relatively Strong	Moderate	Moderate	Relatively Strong	▪ M&M commands the strongest brand recall and resale values across segments. ▪ MNCs have relatively strong brand name in higher HP (>50HP) segment but the segment volume share is small.
Distribution	Strong	Relatively Strong	Relatively weak	Moderate	Weak	▪ M&M has the largest and most diversified distribution network. ▪ MNCs have the weakest distribution presence.
Geographical/product diversification	Strong	Relatively Strong	Relatively weak	Moderate	Weak	▪ M&M is the leading player across geographies/HP segments with evenly distributed revenues.
Captive financing	Strong	Weak	Weak	Weak	Weak	▪ M&M has the advantage of quasi-captive financing from MMFSL which ends up financing close to 30% of M&M tractors. ▪ None of the peers have any captive financing leave alone the reach of MMFSL.
Rank	Strong	Relatively Strong	Relatively weak	Moderate	Relatively weak	

Source: Industry, TMA, Company, Ambit Capital research Note: =Strong, =Relatively Strong, =Moderate, =Relatively weak, =Weak

We believe M&M's long-standing leadership in the Indian tractor industry of over 30 years has been built on the following competitive advantages:

- **Strong brand and well-entrenched 'viable' distribution network**

  M&M (including Swaraj) enjoys a trusted brand name in tractors driven by product reliability, easy availability of spares, and low maintenance cost. It has an extensive sales network spanning over 1,300 dealers and more than 2,500 sales and service points. This has established a significant gap with the second-largest player, TAFE (including Eicher), which has close to 1,000 dealers across its brands, Massey Ferguson, TAFE and Eicher. Higher sales of M&M's tractors have ensured that dealers are not only viable but also profitable. We believe this is a big entry barrier for new and smaller players to scale up their tractor business, particularly in regions where they have weak presence or brand recall.

M&M has a clear distribution edge over peers

Company	No. of Dealer outlets
M&M	1,300
TAFE	1,000
ITL	850
John Deere	380

Source: Industry, Ambit Capital research

- **Diversified presence across geographies and HPs**

  M&M has well-entrenched presence across regions and key states. This makes it relatively immune from volatility in regions or states unlike some peers which are too dependent on certain regions.

Exhibit 20: M&M enjoys leadership position across all geographies

Market share	North	South	East	West
M&M	35.5%	48.3%	48.6%	40.5%
TAFE+Eicher	28.7%	20.8%	16.1%	21.3%
Escorts	15.3%	4.0%	10.7%	7.8%
ITL	12.6%	6.8%	15.1%	12.6%
John Deere	3.4%	12.5%	4.2%	6.0%

Source: TMA, Ambit Capital research

Exhibit 21: Unlike peers, M&M is not too dependent on certain regions for its sales

Volume contribution	North	South	East	West
M&M	31%	22%	18%	29%
TAFE+Eicher	45%	17%	11%	27%
Escorts	54%	7%	16%	23%
ITL	39%	10%	19%	32%
John Deere	20%	38%	11%	29%

Source: TMA, Ambit Capital research

M&M has a presence across all HP categories, including the <20 HP segment with Yuvraj. M&M (including Swaraj) has the highest number of products in each HP category.

Exhibit 22: M&M has a strong product portfolio across all segments

No. of products in each segment	M&M (incl Swaraj)	TAFE+ Eicher	ITL	Escorts	New Holland	John Deere
<20HP	1	-	-	-	-	-
21-30HP	6	1	2	1	-	-
31-40HP	8	5	2	2	5	3
41-50HP	10	9	4	2	5	4
>50HP	6	4	4	1	4	4

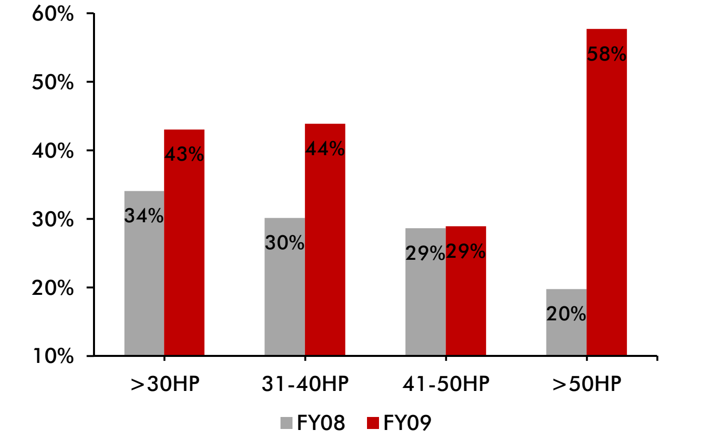
Source: Company, Ambit Capital research

- **Swaraj brand has strengthened M&M's market and product presence**

  The acquisition of Punjab Tractors (Swaraj brand) has worked well for M&M. Punjab Tractors had a strong brand presence in North India and particularly in the higher HP segment. However, the company was struggling due to lack of investments in product development, a bloating working capital, and labour issues. This resulted in rapid market-share loss for the brand. However, since its acquisition by M&M, the brand has been rejuvenated. Although M&M merged Punjab Tractors, it kept the Swaraj brand as a separate division, infused funds for product development, and tied up with Mahindra Finance for retail finance. This also coincided with increasing usage of tractors for commercial usage since the mid-2000s. The rugged positioning of Swaraj tractors further helped it regain market share.

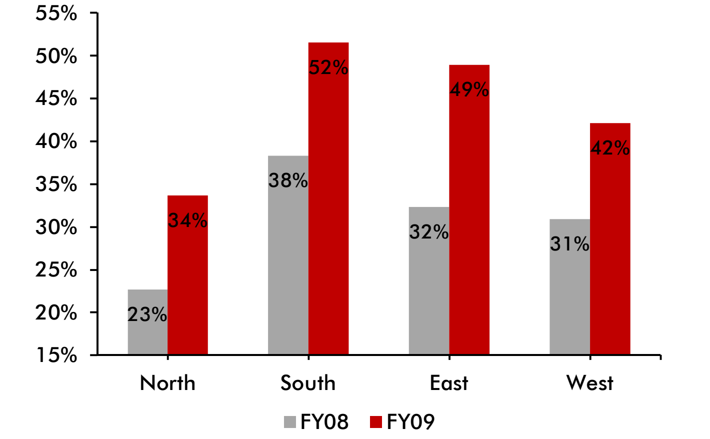
  The acquisition complemented M&M's leadership in terms of geographies and products. The brand has also provided a flanking strategy to M&M as Swaraj brand is priced cheaper than M&M's equivalent brand.

Exhibit 23: Swaraj has significantly enhanced M&M's presence in various HP segments



Source: Industry, Company, Ambit Capital research. Note: Above indicates market share; Punjab Tractors was acquired in July 2007 but was merged with M&M's FES division only in August 2008

Exhibit 24: Swaraj acquisition has strengthened M&M's market share, particularly in North and East India



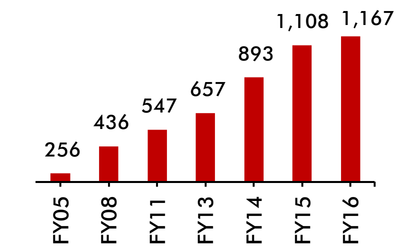
Source: Company, Ambit Capital research. Note: Punjab Tractors was acquired in July 2007 but was merged with M&M's FES division only in August 2008

- **Benefits from Mahindra Finance (MMFSL)**

  Over the years, MMFSL has grown to become the largest rural NBFC in India with the highest number of customer touchpoints. MMFSL gained significant market share from the PSU banks in the 1990s and early 2000s due to its ability to process loan applications faster given less stringent documentation requirements. Further, low penetration of private banks in rural areas also benefited MMFSL during this period. MMFSL has an extensive branch network with presence in 26 states and 5 union territories in India through 1,167 offices.

  The wide rural presence of MMFSL has lent strong competitive advantages to M&M's tractor division. As per primary checks conducted by our NBFC team, MMFSL finances nearly ~30% of Mahindra Tractors and ~80% of MMFSL tractor loan book comprises M&M tractors. While there is no restriction on MMFSL financing brands outside M&M, for business reasons, MMFSL has not been able to penetrate non-M&M tractor dealerships. This quasi-captive financing arm has helped M&M penetrate areas of the country where financing by mainstream banks remains challenged. None of M&M's peers has a financing arm (though they may have a financing tie-up with third-party banks/NBFCs). Furthermore, MMFS gives loans to borrowers who would not have otherwise met the stringent credit requirements of banks, thus facilitating M&M tractor sales.

MMFSL's increasing branch network



Source: Company, Ambit Capital research

We foresee limited threat from global players

Most global tractor companies now have a presence in India. John Deere operates independently in India (though it started as a JV with L&T). In 1998, New Holland began independent operations in India through a 100% subsidiary (after it split with Escorts in 1996). AGCO, on the other hand, remains a JV partner/investor in TAFE.

Despite independent presence for almost two decades, John Deere and New Holland have been unable to gain significant market share; together they have gained only 195bps over FY05-16 and accounted for only 10.6% of the domestic tractor market share as of FY16). The key reasons for this are:

- **India's low powered tractor market negates MNCs' technological advantages:** The <50HP tractor segment accounts for more than 90% of the domestic tractor market. This is in stark contrast to the trend in international markets, where the bulk of the market comprises higher HP tractors. In John Deere's home market, the US, the 'semi-professional segment' (<40HP) accounts for close to 50% of total volumes, whereas in Europe (New Holland's home market), 100-120HP tractors are the average size.

  New Holland and John Deere command strong market shares in the >50HP segment (24.6% and 10.5%, respectively) driven by their strength in higher HP tractors. However, their market share in the highest volume contributor segment (41-50HP) in India is significantly low (7.3% and 5.8%, respectively).

Foreign tractor players have only managed traction in niche >50HP tractor market

	Market size (FY16)	JD/NHI market share
<50HP	460,928	8.7%
>50HP	32,838	35.1%

Source: TMA, Ambit Capital research. Note: JD is John Deere and NHI is New Holland India

- **Channel sustainability poses key growth headwind for MNC players:** Our interaction with industry expects indicates that increasing the scale and viability of dealer network is challenging for the global peers given their low sales figures.

Given lower-than-expected traction in the domestic tractor industry, these MNC players have been increasingly utilising their Indian capacities for the global markets. For instance, John Deere's export volumes have witnessed 15% CAGR over the past five years and now account for nearly 27% of total tractors exported from India.

We expect limited threat from low-cost players like ITL

International Tractors Limited (ITL), the makers of the Sonalika brand of tractors, forayed into the tractor segment in October 1995. The company was able to garner a market share of 12% by FY16.

Our discussions with industry experts and tractor dealers indicate that Sonalika's market share growth has been driven by the following factors:

(a) Strong reverse engineering capabilities;
(b) Low-cost operations that have enabled the company to price its products competitively (an average 8-10% cheaper than peers). Our interaction with industry experts indicates that Sonalika has its own vendors (unlike peers) and, hence, is able to negotiate better prices. Furthermore, its lower employee expenses are led by a high proportion of contract labour/employees than peers; this not only helps it lower employee costs but also gives flexibility to downsize during downturns;
(c) ITL's market share gains have been primarily in the regions dominated by Escorts, i.e. Punjab, Haryana and, to some extent, Rajasthan. The company also gained share from the struggling Punjab Tractors in early to mid-2000s.

Whilst Sonalika has been able to gain market share in the recent years, we believe further market share gains for the brand faces the following headwinds:

(a) Relatively weak dealer relationships (our channel checks suggest that ITL dealers have the lowest margins in the industry with little/low credit);
(b) Low acceptance of the brand in South India (market share of 6.8% in FY16);
(c) ITL's market share itself has witnessed significant volatility over the years. Its market share touched 12% in FY06, dropped to 8.3% by FY10 and bounced back to 11.9% in FY16.

ITL has the best cost structure/EBITDA margin

	ITL	TAFE	TAFE-Eicher	Escorts
Revenues (₹ mn)	40,469	58,213	25,652	39,858
RM costs	66.1%	68.7%	68.7%	71.5%
Employee costs	4.2%	5.6%	6.4%	10.8%
P&F	0.5%	1.0%	0.6%	1.1%
Repairs	0.5%	0.6%	1.2%	1.5%
Advts	1.9%	6.2%	5.5%	3.6%
Others	6.8%	8.4%	6.1%	7.4%
EBITDA	***20.0%***	***9.5%***	***11.5%***	***4.0%***

Source: Company, Ambit Capital research
Note: Above financials pertain to FY15 standalone entity

We expect tractor demand to revive in FY17/FY18 (15% CAGR over FY16-18)

- **Signs of demand revival in the recent months**

  Domestic tractor industry volumes started recovering since February 2016, with February-April 2016 showing 13% YoY growth. This recovery has been led by a strong bounce-back in South India (up 61%) and a modest revival in East India (up 24%) and West India (up 10%). Our interaction with dealers indicates that the demand revival in southern India is led by a low base over the past few years (volume CAGR of -1% over FY11-FY16) and favourable rainfall in 2HFY16.

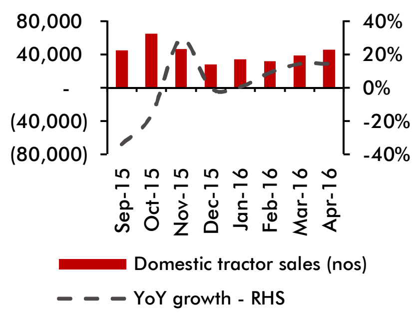
- **Low base of recent years should help growth**

  Domestic tractor industry volumes for FY16 were nearly 22% lower than FY14 levels. The demand slowdown has been particularly pronounced in North India (down 26%) and West India (down 22%). As a result, we believe volume trends in FY17 and FY18 would be subject to a favourable base.

- **A 'normal' monsoon can revive sentiment and replacement demand**

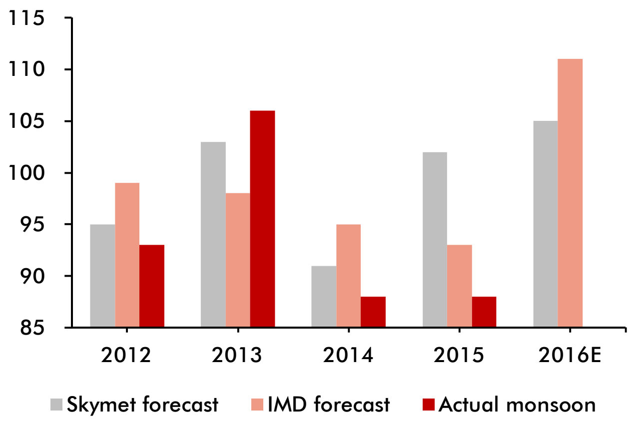
  As highlighted in the earlier section, one of the primary reasons for the sharp slowdown in tractor sales over the last two years was weak rainfall. However, forecasting agencies like Indian Meteorological Department (IMD) and Skymet have said in their recent estimates that the south-west monsoon would range at 105-106% of the long-term average. As seen in the past years, a normal or better-than-normal monsoon can help revive rural sentiment and replacement demand for tractors. An analysis of rainfall projections of the last four years by these agencies indicates that actual monsoon has always been in line with the projections of at least one of these agencies.

Industry volumes have been recovering since Feb-2016



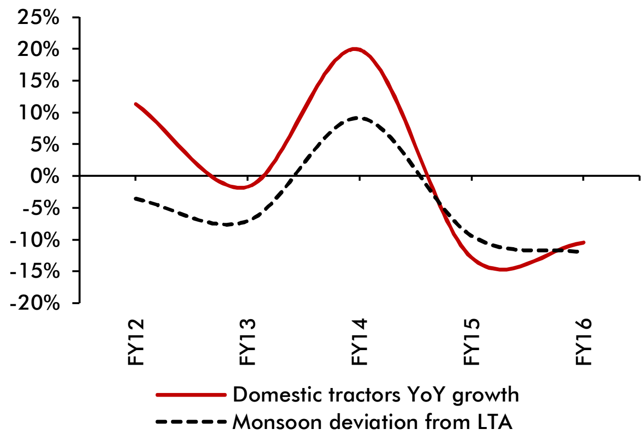
Source: TMA, Ambit Capital research

Exhibit 25: Skymet and IMD have forecast 'above normal' south-west monsoon this year (% of LTA)



Source: TMA, Ambit Capital research

Exhibit 26: Tractor growth shows strong correlation (92%) with monsoon deviation in the last 5 years



Source: TMA, Ambit Capital research

We build in domestic tractor industry volume growth of 15% for FY17 and FY18 (April 2016 industry growth has been 14%). At this growth rate, domestic industry volumes for FY18 at 653k units would be somewhat similar to FY14 volumes. We expect M&M to maintain its market share at 41.3% in FY17/FY18 driven by its competitive advantages discussed in earlier sections.

Exhibit 27: We expect M&M to retain its leadership position

	FY14	FY15	FY16	FY17E	FY18E
Tractor industry volumes	634,151	551,463	493,764	567,829	653,003
YoY growth	*20%*	*-13%*	*-10%*	*15%*	*15%*
M&M domestic volumes	259,907	222,334	203,734	234,294	269,438
YoY growth	*21%*	*-14%*	*-8%*	*15%*	*15%*
M&M market share	*41.0%*	*40.3%*	*41.3%*	*41.3%*	*41.3%*

Source: Company, Ambit Capital research

Core business to deliver 13% earnings CAGR over FY16-18

Exhibit 28: Key assumptions and estimates for the core business (standalone + MVML)

₹ mn	FY15	FY16E	FY17E	FY18E	Comments
Automotive Division					
UV Industry (units)	552,135	586,664	735,452	823,706	We expect UV industry volumes to witness 19% CAGR over FY16-18E driven by new launches.
YoY growth	*5%*	*6%*	*25%*	*12%*	
M&M UV volumes (units)	206,836	222,324	263,672	282,246	We expect M&M's UV volumes to grow by 19% in FY17 on back of full-year sales of newly launched compact UVs. However, we expect growth to taper to 9% in FY18 in the absence of further launches and rising competition.
YoY growth	*-6%*	*7%*	*19%*	*7%*	
M&M market share	*37.5%*	*37.9%*	*35.9%*	*34.3%*	
Net sales	242,204	262,522	294,683	327,438	Revenue growth will lag volume growth as the proportion of lower realisation compact UVs in the overall portfolio increases.
YoY growth	*-2%*	*8%*	*12%*	*11%*	
EBITDA	26,289	31,627	33,855	38,031	We expect EBITDA margin to decline by ~50bps in FY17 due to higher proportion of compact UVs in the portfolio, rising commodity prices, and expiry of excise duty benefits at Haridwar plant.
EBITDA margin	*10.9%*	*12.0%*	*11.5%*	*11.6%*	
EBITDA YoY growth	*-4%*	*20%*	*7%*	*12%*	We expect EBITDA to grow by ~10% over FY16-18E on volume growth, but offset to some extent by decline in EBITDA margin.
Farm equipment Division					
Tractor industry (units)	551,463	493,764	567,829	653,003	Tractor industry to grow by 15% each in FY17/18E helped by low base and our base case expectation of a normal monsoon.
YoY growth	*-13%*	*-10%*	*15%*	*15%*	
M&M volumes (units)	222,334	203,734	234,294	269,438	M&M to maintain its dominant market share due to its competitive advantages surrounding strong brand, wide distribution network, and captive finance.
YoY growth	*-14%*	*-8%*	*15%*	*15%*	
M&M Market share	*40.3%*	*41.3%*	*41.3%*	*41.3%*	
Net sales	133,468	127,413	144,942	168,530	Tractor business revenue growth to mirror volume growth in FY17 and FY18. Hiving off crop solutions business in FY16-end to marginally impact FES revenue growth in FY17.
YoY growth	*-7%*	*-5%*	*14%*	*16%*	
EBITDA	19,694	20,331	24,012	28,398	EBITDA margin improved in FY16 due to decline in commodity prices. Increase in volumes to drive operating leverage benefits in FY17 and FY18.
EBITDA margin	*14.8%*	*16.0%*	*16.6%*	*16.9%*	
EBITDA YoY growth	*-17%*	*3%*	*18%*	*18%*	We expect EBITDA to grow by ~18% from FY16-18E on volume growth and higher EBITDA margin.
M&M+MVML					
Net sales	374,683	388,566	438,256	494,600	Higher volumes in UV segment (offset to some extent by lower sales realisation) and recovery in tractor volumes to drive revenue uptick in FY17/FY18.
YoY growth	*-4%*	*4%*	*13%*	*13%*	
EBITDA	46,033	51,288	57,883	66,444	EBITDA CAGR of 13% over FY16-18 in-line with revenue CAGR as higher tractor margin is offset by declining margin for the automotive division.
EBITDA margin	*12.3%*	*13.2%*	*13.2%*	*13.4%*	
EBITDA YoY growth	*-12%*	*11%*	*13%*	*15%*	Strong tractor and UV volumes to drive EBITDA growth.
Adjusted PAT	30,876	32,420	36,183	41,315	PAT growth in line with EBITDA growth.
Adj PAT margin	*8.2%*	*8.3%*	*8.3%*	*8.4%*	
Closing working capital days	19	5	19	19	We expect working capital days to normalise from FY17
CFO	37,281	57,154	24,286	47,949	Increase in working capital days impact CFO in FY17; CFO generation to normalise in FY18
Capex	21,232	26,884	25,000	25,000	Capex requirement to remain elevated on account of product development in UV division, R&D on petrol engine development, and R&D on BS-VI technology.
Investment in subsidiaries	15,850	12,933	8,000	7,000	Continuous investments in loss-making subsidiaries like Mahindra 2Ws and Mahindra truck & buses. Also, Mahindra Reva Electric would need investments in technology. Further, Mahindra has plans in aviation and defence which could entail investments.
Free cashflow	199	17,338	(8,714)	15,949	Lower CFO generation and elevated capex spends to impact FCF in FY17.
Net debt / (cash)	5,782	(8,542)	1,719	(12,412)	Positive FCF to increase cash balance in FY18.

Source: Company, Ambit Capital research

Capital allocation risks lead to higher WACC

We use higher WACC of 14.5% (vs 14% for large auto OEMs) for discounting FCF of core businesses (auto/tractors) given capital allocation risks. Our DCF value of ₹452/share for automotive includes ₹427 for core (standalone automotive and MVML), ₹51 for SsangYong (market price less 30% holdco discount) and negative ₹26 for funds infusion in 2Ws and certain other loss-making entities. DCF value for FES is ₹430/share (in line with Ashok Leyland). We value profitable non-auto/non-FES subsidiaries/investments (Tech Mahindra, Mahindra Finance, Mahindra Holidays) at ₹403/share after 30% holdco discount. Our SOTP-based TP is ₹1,285. Given significant value contributions from automotive, FES and non-auto/tractor investments, there is no comparable peer. However, 25% discount (on FY18E EV/EBITDA) of M&M's aggregate multiple of core automotive/FES to Maruti is justified given market share risks in domestic UVs, lower return ratios, and capital allocation risks.

M&M SoTP valuation of ₹1,285/share

	₹/M&M share	Methodology
Automotive	452	6.5x FY18 EBITDA
FES	430	8.5x FY18EBITDA
Non-auto/FES inv.	403	Ambit TP/CMP less 30% disc
SoTP	**1,285**	

Source: Ambit Capital research

Assume 50bps higher WACC (14.5%) given capital allocation risks

As discussed in the earlier sections, M&M's cash flows are used for financing several group businesses. We have adequately factored in the likely investments over the next two years (we have assigned negative value to these cash outflows while calculating value of investments; see page 25). However, the structure raises risks of further allocation of core business cash flows into other businesses beyond FY18. We factor in this risk by building in a 50bps higher WACC for discounting free cash generated by the core businesses. Consequently, we use WACC of 14.5%, which is 50bps higher than 14% normally used by us for large auto OEMs.

Treatment of shares held by M&M Benefit Trust while calculating fair value

M&M Benefit Trust's shareholding (8.84% of M&M's outstanding share capital) is classified under 'promoter holding' but in essence belongs proportionately to all the shareholders.

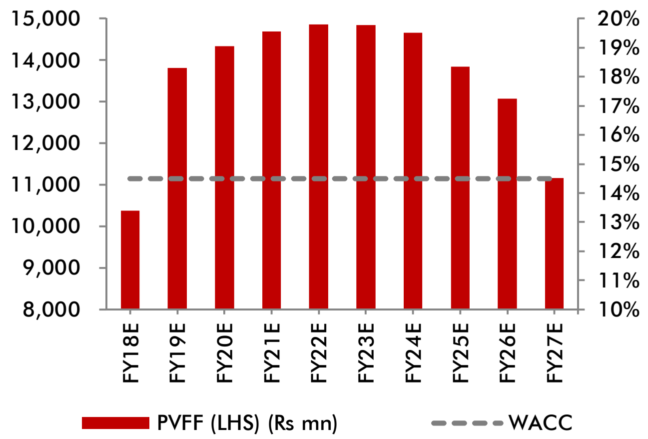
M&M Benefit Trust holds close to 8.84% of M&M's outstanding share capital. This trust's holding is a result of a merger of the erstwhile subsidiaries, Mahindra Holdings & Finance Limited and Punjab Tractors Limited, with M&M in FY09. At the time of the merger, M&M issued shares to the shareholders of these entities as consideration for the merger, resulting in issue of shares to itself (since it held the majority shareholding in these entities). Normally, these shares (issued to itself) ought to have been cancelled on the merger. However, M&M has followed the policy of keeping these shares in a trust (called M&M Benefit Trust) to be sold at a future date to raise funds. These shares are reflected in investments (as treasury stock investments) as well as the outstanding share capital. All the shareholders of M&M are beneficiaries of this trust in proportion to their respective shareholding in M&M. As a result, we are excluding these treasury shares from outstanding shares while calculating the fair value per share.

Automotive valued at ₹452/share – 30% discount to Maruti

As highlighted earlier, we believe there are strong long-term structural market share risks to M&M's UV business. We estimate M&M's domestic UV volumes to grow at 6% CAGR over FY18-27 compared with industry growth of 11% for the period, implying M&M's market share will decline from 34.3% in FY18 to 22.2% by FY27. We expect the automotive division's EBIT margin to remain flat over FY18-27 as the impact of rising competition will be offset by lower losses in the trucks & buses business.

Using a WACC of 14.5% and terminal growth of 4% (in line with our estimate of longer-term passenger and commercial vehicle growth rate in India), we arrive at FCF-based fair valuation of ₹427 per M&M share for the automotive division as on 1st June 2017. This implies EV/EBITDA multiple of 6.5x FY18E for the automotive division.

Exhibit 29: FCF profile of automotive division



Source: Company, Ambit Capital research

Exhibit 30: FCF estimates for automotive division (₹ mn)

PV of FCF for forecasting period (FY18- FY27)	**135,645**
Terminal value	110,513
Enterprise value	246,158
Less: net debt/ (cash) at 31 March 2016	1,719
Implied equity value	244,439
Fully diluted equity shares (mn nos)	571
Implied equity value (₹/share)	**427**

Source: Company, Ambit Capital research

This implied EV/EBITDA multiple (6.5x FY18E) for M&M's automotive division is at a discount of 30% to the multiple we assign to Maruti. We believe the discount to Maruti appears justified given: (i) significant risks and impact thereof on M&M's UV business; and (ii) lower margin and return ratios compared with Maruti, which are to some extent driven by low margin (or rather loss-making) businesses like trucks & buses included in the automotive division. Our WACC assumption for M&M's automotive division and Maruti, though, are similar at 14.5% (as we build in 50bps higher WACC for Maruti also due to Suzuki's decision to set up a 100% manufacturing Indian subsidiary).

We value SsangYong as a part of the automotive division of M&M. At the current market price less 30% holding company discount, SsangYong yields a value of ₹51/M&M share.

However, we believe nearly ₹15bn of core business cash flows (based on management guidance) would have to be infused in loss-making entities (Mahindra two-wheelers and Mahindra Heavy Engines) in FY18 (loss-making Mahindra trucks & buses gets valued as part of standalone automotive business). Consequently, we ascribe a negative value of ₹26/M&M share for these investments.

Exhibit 31: Valuation for the automotive division at ₹452/share

Particulars	Valuation Methodology	Target Multiple	FY18 EBITDA	Enterprise value	Net debt	Equity value	Value/share
		(x)	₹ bn	₹ bn	₹ bn	₹ bn	₹
Core Automotive division	DCF	6.5	38	246	2	244	427
SsangYong	CMP less 30% discount						51
Less: Investment in loss making automotive entities in FY18-19							(26)
SOTP-based target price							**452**

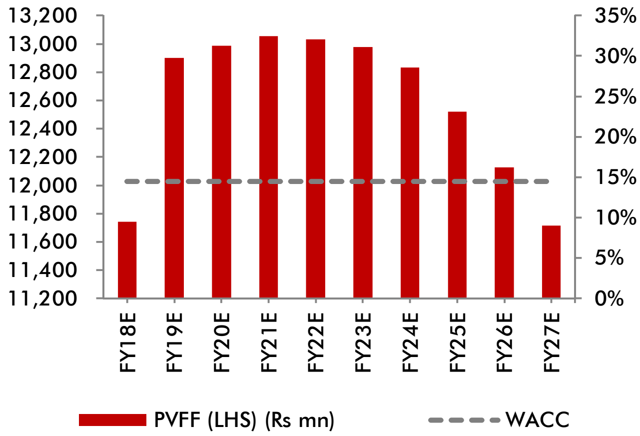
Source: Company, Ambit Capital research

FES valued at ₹430/share – in line with Ashok Leyland

We expect the tractor industry to deliver volume CAGR of 8% over FY18-27 and M&M to largely maintain its market share in the long term. Given the relatively benign competitive environment, we expect M&M's long-term EBITDA margin to sustain at FY18 levels of 16.8%. We maintain long-term gross block turnover at 3x (implying average capex spend of 3% of sales).

Using a WACC of 14.5% and terminal growth of 4%, we arrive at FCF-based fair valuation of ₹424/M&M share for the FES division as on 1 June 2017. This implies EV/EBITDA multiple of 8.5x FY18E. The implied EV/EBITDA multiple for M&M's FES division is at a premium of 40% to Escorts (ESC IN, mcap US$317mn, not rated) but at a 10% discount to VST Tillers (VSTT IN, mcap US$227mn, not rated). Escorts suffers from poor margin/return ratios and, hence, is somewhat justified in trading at a discount to M&M. VST has limited broker coverage (raising questions on the reliability of consensus estimates) and the stock has rallied by ~ 29% in the last 3 months.

Exhibit 32: FCF profile of FES division



Source: Company, Ambit Capital research

Exhibit 33: FCF assumptions for FES division (₹ mn)

PV of FCF for forecasting period (FY18- FY27)	**125,885**
Terminal value	116,020
Enterprise value	241,905
Less: net debt/ (cash) at 31 March 2016	-
Implied equity value	241,905
Fully diluted equity shares (mn nos)	571
Implied equity value (₹/share)	**424**

Source: Company, Ambit Capital research

The implied multiple of 8.5x is in line with the multiple we attribute to Ashok Leyland. We find similarities between M&M's FES division and a CV player like Ashok Leyland: (i) both industries (tractors and CVs) are cyclical and have witnessed significant ups and downs over the last 15 years; (ii) similar long-term volume growth expectations; (iii) ability of both the companies to maintain market share in their respective segments; and (iv) somewhat similar return ratios.

We value Swaraj Engines as a part of FES. At the current market price less 30% holding company discount, Swaraj Engines yields a value of ₹6/M&M share.

Exhibit 34: Valuation for the FES division at ₹430/share

Particulars	Valuation Methodology	Target Multiple	FY18 EBITDA	Enterprise value	Net debt	Equity value	Value/share
		(x)	₹ bn	₹ bn	₹ bn	₹ bn	₹
Core Automotive division	DCF	8.5	28	242	-	242	424
Swaraj Engines	CMP less 30% discount						6
SOTP-based target price							**430**

Source: Company, Ambit Capital research

Other business at ₹403/share – considering only profitable investments

Of the various investments made by M&M, we assign value only to the companies which are profit-making or face healthy prospects, mainly Tech Mahindra, MMFSL, Mahindra Holidays and a few others. The valuation methodologies for these investments are indicated in the exhibit below; for companies covered by Ambit (Tech Mahindra and Mahindra Finance), we use Ambit's target prices and for other cases we use the current market price. We assign a 30% holding company discount to M&M's value of these investments. Overall, the investments yield a value of ₹403/M&M share.

Exhibit 35: Investments valued at ₹403/share post a 30% holding company discount

Company	Valuation Methodology	Ambit TP/CMP	Value	
			(₹ bn)	₹/share
Tech Mahindra	Ambit TP less 30% discount	680	121	214
MMFSL	Ambit TP less 30% discount	276	56	99
MCIE	Ambit TP less 30% discount	240	10	19
CIE Automotive, S.A.	CMP less 30% discount	1,277	14	25
Mahindra Holidays and Resorts	CMP less 30% discount	407	18	33
Mahindra Life space Developers	CMP less 30% discount	444	6	11
EPC Industries Limited	CMP less 30% discount	152	1	3
Value of investments			**230**	**403**

Source: Company, Ambit Capital research Note: TP – target price; CMP – current market price

SOTP of ₹1,285/share, 7% downside

Adding the values of the core business (₹882/share) and other investments (₹403/share; net of investments in loss-making subsidiaries) we arrive at a 1st June 2017 SOTP of ₹1,285/share, implying 7% downside from the current market price. We initiate with a SELL stance on the company.

Exhibit 36: SOTP calculation

Particulars	SoTP	Revenue Share	Capital employed share
Core Automotive division (UVs, LCVs, Cars, 3Ws + MHCV)	427	32%	25%
SsangYong	51	27%	16%
Mahindra Reva	-	-	1%
Less: Investment in loss making entities (FY18-19)	(26)	1%	1%
Total Automotive division	**452**	**60%**	**43%**
Tractors	424	22%	14%
Swaraj Engines	6	0%	0%
Total FES division	**430**	**22%**	**14%**
Value of other investments	**403**	**18%**	**43%**
MMFSL	99	8%	16%
Tech Mahindra	214	NA	NA
Mahindra Holidays and Resorts	33	1%	2%
Mahindra Life space Developers	11	2%	8%
Others	46	7%	17%
Total	**1,285**	**100%**	**100%**

Source: Company, Ambit Capital research. Capital employed figure obtained from consolidated segmental reporting; Tech Mahindra is an associate of M&M and hence reported under equity method (do not impact the revenue, EBITDA and capital employed)

Discount to peers justified given lower earnings growth, return ratios and capital allocation risks

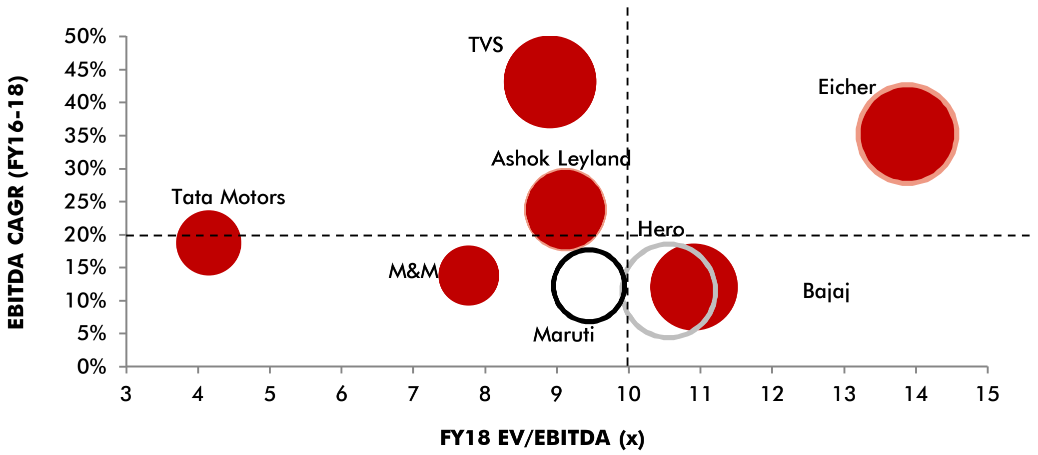
Excluding the value of investments in various subsidiaries/associates, M&M trades at a discount of 15% to the average FY17E EV/EBITDA and a discount of 12% on FY17 P/E of peers (other large auto OEMs). We believe this discount is justified given much lower-than-peers earnings growth expectations – FY16-18E EBITDA CAGR of 14% for M&M vs 20% for peers; FY16-18 net earnings CAGR of 13% for M&M vs 25% for peers. Also, M&M's return ratios are significantly lower than that of the peers (FY16 RoE of 15%, half the peer group average). Capital allocation risks associated with M&M are also a reason for discount.

Exhibit 37: Relative valuation

	Mcap	EV/EBITDA (x)			P/E (x)			CAGR (FY16-18)			Price perf (%)		RoE		
	US$ mn	FY16E	FY17E	FY18E	FY16E	FY17E	FY18E	Sales	EBITDA	EPS	3m	1 yr	FY16E	FY17E	FY18E
India															
M&M^	**12,786**	**10.1**	**8.9**	**7.8**	**17.9**	**15.9**	**13.8**	**13**	**14**	**13**	**11**	**14**	**15**	**15**	**15**
Maruti Suzuki	18,878	11.9	10.9	9.4	26.5	21.4	16.8	15	12	26	17	13	18	20	22
Tata Motors*	22,681	5.8	4.6	4.1	12.9	10.0	9.4	16	19	17	34	6	23	22	18
Bajaj Auto	11,244	13.7	12.4	10.9	21.2	18.9	16.5	13	12	13	12	18	31	31	32
Hero MotoCorp	9,239	13.1	11.8	10.6	19.7	17.7	16.2	13	11	10	10	23	43	40	37
Eicher Motors	7,566	25.4	16.8	13.9	49.5	29.7	24.2	28	35	43	(7)	9	39	46	41
Ashok Leyland	4,569	14.0	10.8	9.1	26.6	19.0	14.8	19	24	34	10	62	25	27	28
TVS	2,064	18.2	12.8	8.9	30.2	20.6	13.6	22	43	49	2	33	25	31	36
Average (Ex- M&M)		**12.8**	**10.6**	**8.8**	**22.9**	**17.9**	**14.6**	**16**	**20**	**25**			**28**	**29**	**29**
Global															
Deere & Co.	27,080	11.6	12.2	9.3	22.1	23.2	19.4	2	12	7	4	(6)	17	15	16
AGCO Corp.	4,473	10.6	10.5	9.7	23.3	20.8	18.4	2	5	13	4	6	6	6	7
Toyota	175,646	8.2	9.7	9.0	7.5	9.2	8.1	1	(4)	(4)	(6)	(32)	13	11	11
Daimler	70,906	2.2	2.3	2.2	7.0	7.2	6.8	4	1	1	(10)	(28)	18	16	15
BMW	52,616	6.2	6.2	6.0	7.5	7.4	7.2	3	2	3	(9)	(27)	16	14	13
Volkswagen	74,422	1.8	1.6	1.4	7.1	6.9	6.0	0	14	9	13	(40)	8	10	10
Ford	52,263	3.1	2.9	2.8	7.0	6.2	6.2	3	5	6	(0)	(10)	32	30	23
Hyundai	26,431	8.0	7.8	7.5	5.6	5.4	5.3	3	4	3	(7)	3	10	10	10
Renault	26,705	4.1	3.7	3.5	7.8	6.5	5.7	7	9	17	(4)	(14)	11	12	12
Average		**6.2**	**6.3**	**5.7**	**10.5**	**10.2**	**9.2**	**4**	**6**	**16**			**15**	**14**	**13**

*Source: Company, Ambit Capital research, Notes*normalised for R&D expenditure, ^ excluding the value of investments in listed entities; Note: Fair value of investments (₹435/share) reduced from current market price while calculating EV/EBITDA and P/E*

Exhibit 38: M&M's valuation discount is due to its lower earnings growth and return ratios compared with large OEMs

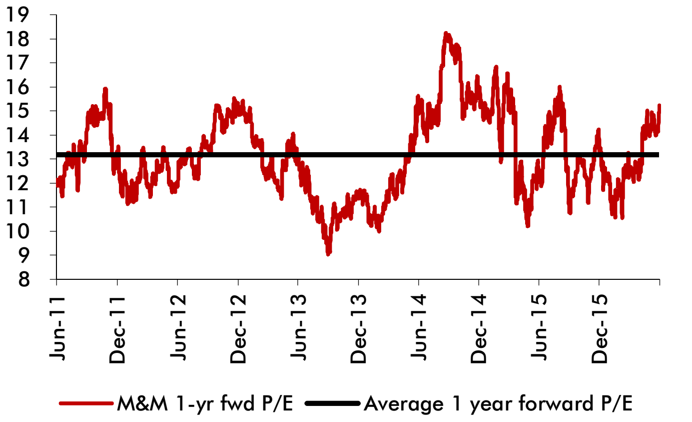


Source: Company, Ambit Capital research, Size of the bubble represents FY18 RoE; Fair value of investments (₹435/share) reduced from current market price while calculating EV/EBITDA; similarly book value of investments reduced while calculating RoE

Trading at a premium to historical averages

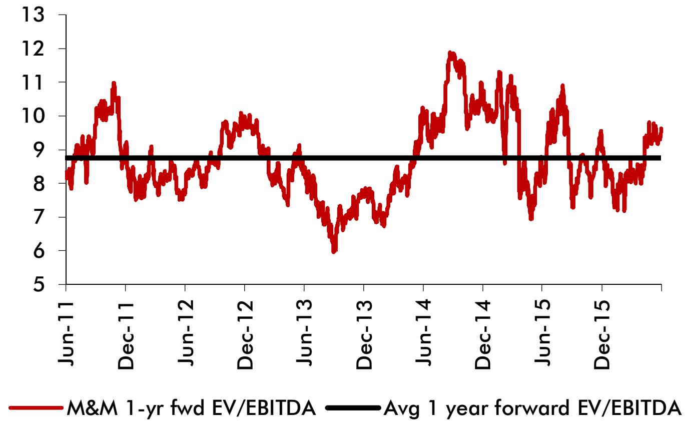
On a cross-cycle comparison, M&M (excluding value of investments in subsidiaries) is currently trading at a premium of 10% to the last 5 years' average EV/EBITDA and a 16% premium to the last 5 years' average P/E.

Exhibit 39: Cross-cycle one-year forward P/E



Source: Company, Ambit Capital research. Fair value of investments (₹435/share)reduced from current market price and dividends from these investments have been reduced from the net profit while calculating P/E

Exhibit 40: Cross-cycle one-year forward EV/EBITDA



Source: Company, Ambit Capital research. Fair value of investments (₹435/share)reduced from current market price while calculating EV/EBITDA

Catalysts

Market share losses in the UV segment

We expect M&M to lose 360bps market share in the UV segment from FY16-18 in spite of three new launches from September 2015 to April 2016. This will present key near term downside catalyst for the stock.

Continuing investments in the loss making

Company has guided to invest ₹25bn over FY16-18 in subsidiaries/associates, out of which it has already invested ₹13bn in FY16. We estimate company to invest ₹15bn over FY17-18 (this would go primarily into funding the loss making 2Ws and truck/bus businesses).

Key risks

Any divestment in loss-making businesses

We expect M&M to continue to invest in loss-making businesses like 2Ws, trucks & buses and heavy engines. Management has guided for a total investment of ₹25bn over FY16-18. Any divestment or unwinding of these loss-making businesses (similar to divestment of auto-component businesses) would present a key risk to our estimates and valuation.

Compelling launches in the UV segment

XUV500 gained significant popularity in the urban market due to its aggressive styling. More such launches which are well received by the urban market would pose a risk to our earnings and valuations. Further, good acceptance of M&M's petrol vehicles would pose a risk to our earnings and valuations.

Strong recovery in rural economy

Whilst the Government has indicated in its FY17 Budget that it plans to improve the rural economy and provide relief to the agricultural sector, we believe it is still early to conclude this. However, any significant increase in MSPs or change in policies in favor of the rural market could lead to a strong recovery in the rural economy. This would present a risk to our earnings and valuation.

Exhibit 41: FES volume sensitivity analysis

	Bear case		Base Case	Bull case	
Tractor Volume CAGR (FY16-18)	**5%**	**10%**	**15%**	**20%**	**25%**
Core business revenue CAGR (FY16-18)	10%	11%	13%	14%	16%
EPS CAGR (FY16-18)	9%	11%	14%	17%	19%
SOTP	**1,210**	**1,249**	**1,285**	**1,332**	**1,377**
Change from our base case	*-6%*	*-3%*		*3%*	*7%*
Upside/downside from CMP	*-12%*	*-10%*	*-7%*	*-4%*	*0%*

Source: Ambit Capital research

Exhibit 42: Explanation for our flags on the on the cover page

Field	Score	Comments
Accounting	**AMBER**	M&M's accounting score (using Ambit framework) is in-line with the sector average accounting score. Compared to peers in the automobile sector, it scores poorly on higher contingent liability (as % of net worth); higher miscellaneous expenditure (as a % of revenues) and weaker CFO to EBITDA conversion. On the positive side, its cash yield on investments and fixed asset turnover ratio are higher than peers' with average depreciation rate fairly consistent over the past 5 years.
Predictability	**AMBER**	Given that automobile companies publish their volume numbers on a monthly basis, generally no positive/ negative surprises are seen in results. However, the margins tend to be less predictable and are generally the source for actual results coming in above/below consensus expectations.
Earnings momentum	**AMBER**	Over the past four weeks, consensus has more or less maintained the revenue estimates for FY17 and FY18. However, there have been marginal downgrades (2-3%) to FY17/FY18 EBITDA on the back of weaker than expected EBITDA margin performance in the 4QFY16 results. The downgrade is higher at the PAT level to the tune of 5-6%.

Source: Company, Ambit Capital research

Balance sheet (Standalone + MVML)

Year to March (₹ mn)	FY14	FY15	FY16	FY17E	FY18E
Shareholders' equity	2,952	2,957	2,963	2,963	2,963
Reserves and surpluses	170,272	195,812	220,880	248,528	280,097
Total net worth	**173,224**	**198,769**	**223,843**	**251,491**	**283,061**
Debt	49,041	44,490	39,524	39,524	39,524
Deferred tax liability	10,512	11,509	14,216	14,216	14,216
Total liabilities	**232,777**	**254,768**	**277,583**	**305,231**	**336,800**
Gross block	131,096	141,067	167,951	192,951	217,951
Net block	73,283	72,005	86,405	96,825	105,225
CWIP	17,272	28,802	28,802	28,802	28,802
Investments (non-current)	88,283	104,133	117,066	125,066	132,066
Cash & cash equivalents	47,775	38,708	48,065	37,804	51,936
Debtors	24,017	24,241	23,497	30,018	33,877
Inventory	31,733	28,152	33,260	33,620	37,942
Loans & advances	51,103	54,428	52,738	63,663	71,847
Total current assets	154,628	145,528	157,561	165,104	195,602
Current liabilities	79,333	74,330	91,341	86,942	98,120
Provisions	21,355	21,369	20,909	23,624	26,775
Total current liabilities	100,689	95,700	112,251	110,567	124,895
Net current assets	**53,939**	**49,828**	**45,310**	**54,538**	**70,707**
Total assets	**232,777**	**254,768**	**277,583**	**305,230**	**336,800**

Source: Company, Ambit Capital research Note: MVML = Mahindra Vehicle Manufacturers Limited

Income statement (Standalone + MVML)

Year to March (₹ mn)	FY14	FY15	FY16	FY17E	FY18E
Revenues	388,171	374,683	388,566	438,256	494,600
% growth	*1%*	*-3%*	*4%*	*13%*	*13%*
Operating expenditure	335,690	328,651	337,279	380,374	428,156
EBITDA	52,481	46,033	51,288	57,883	66,444
% growth	*-2%*	*-12%*	*11%*	*13%*	*15%*
Depreciation	9,760	10,980	12,484	14,580	16,600
EBIT	42,721	35,053	38,804	43,303	49,844
Interest expenditure	3,611	3,039	2,329	2,191	2,191
Non-operating income	6,648	8,201	7,910	8,424	8,909
Adjusted PBT	45,758	40,215	44,384	49,535	56,562
Tax	7,235	9,339	11,964	13,352	15,246
Adjusted PAT	38,523	30,876	32,420	36,183	41,315
YoY growth	*9%*	*-20%*	*5%*	*12%*	*14%*

Source: Company, Ambit Capital research Note: MVML = Mahindra Vehicle Manufacturers Limited

Cash flow statement (Standalone + MVML)

₹ mn	FY14	FY15	FY16	FY17E	FY18E
PBT	45,758	40,215	44,384	49,535	56,562
Depreciation	9,760	10,980	12,484	14,580	16,600
Interest paid	3,611	3,039	2,329	2,191	2,191
Change in working capital	(8,792)	(3,767)	14,565	(20,244)	(3,249)
Direct taxes paid	(4,281)	(8,342)	(9,257)	(13,352)	(15,246)
Others	(6,121)	(4,844)	(7,352)	(8,424)	(8,909)
CFO	**39,936**	**37,281**	**57,154**	**24,286**	**47,949**
Net capex	(22,847)	(21,232)	(26,884)	(25,000)	(25,000)
Net investments	7,838	(15,850)	(12,933)	(8,000)	(7,000)
Others	6,648	8,201	7,910	8,424	8,909
CFI	**(8,361)**	**(28,881)**	**(31,907)**	**(24,576)**	**(23,091)**
Proceeds from borrowings	4,397	(4,552)	(4,966)	-	-
Change in share capital	(6,721)	(219)	(126)	0	-
Interest & finance charges paid	(3,611)	(3,039)	(2,329)	(2,191)	(2,191)
Dividends paid	(8,912)	(9,658)	(8,469)	(7,779)	(8,535)
Others				-	-
CFF	**(14,846)**	**(17,467)**	**(15,890)**	**(9,970)**	**(10,726)**
Net increase in cash	**16,728**	**(9,068)**	**9,358**	**(10,261)**	**14,131**
FCF	24,926	199	17,338	(8,714)	15,949

Source: Company, Ambit Capital research Note: MVML = Mahindra Vehicle Manufacturers Limited

Ratio analysis (Standalone + MVML)

	FY14	FY15	FY16	FY17E	FY18E
Revenue growth	1%	-3%	4%	13%	13%
EPS norm (dil) growth	8%	-21%	5%	12%	14%
EBITDA margin	13.5%	12.3%	13.2%	13.2%	13.4%
Net margin	9.9%	8.2%	8.3%	8.3%	8.4%
Dividend payout ratio (%)	22%	24%	21%	21%	21%
Net debt/Equity (x)	0.0	0.0	(0.0)	0.0	(0.0)
Working capital days	11	17	12	13	20
Gross block turnover (x)	3.0	2.7	2.3	2.3	2.3
RoCE (post tax) %	38%	24%	24%	23%	23%
RoIC %	38%	24%	24%	23%	23%
RoE	24%	17%	15%	15%	15%

Source: Company, Ambit Capital research Note: MVML = Mahindra Vehicle Manufacturers Limited

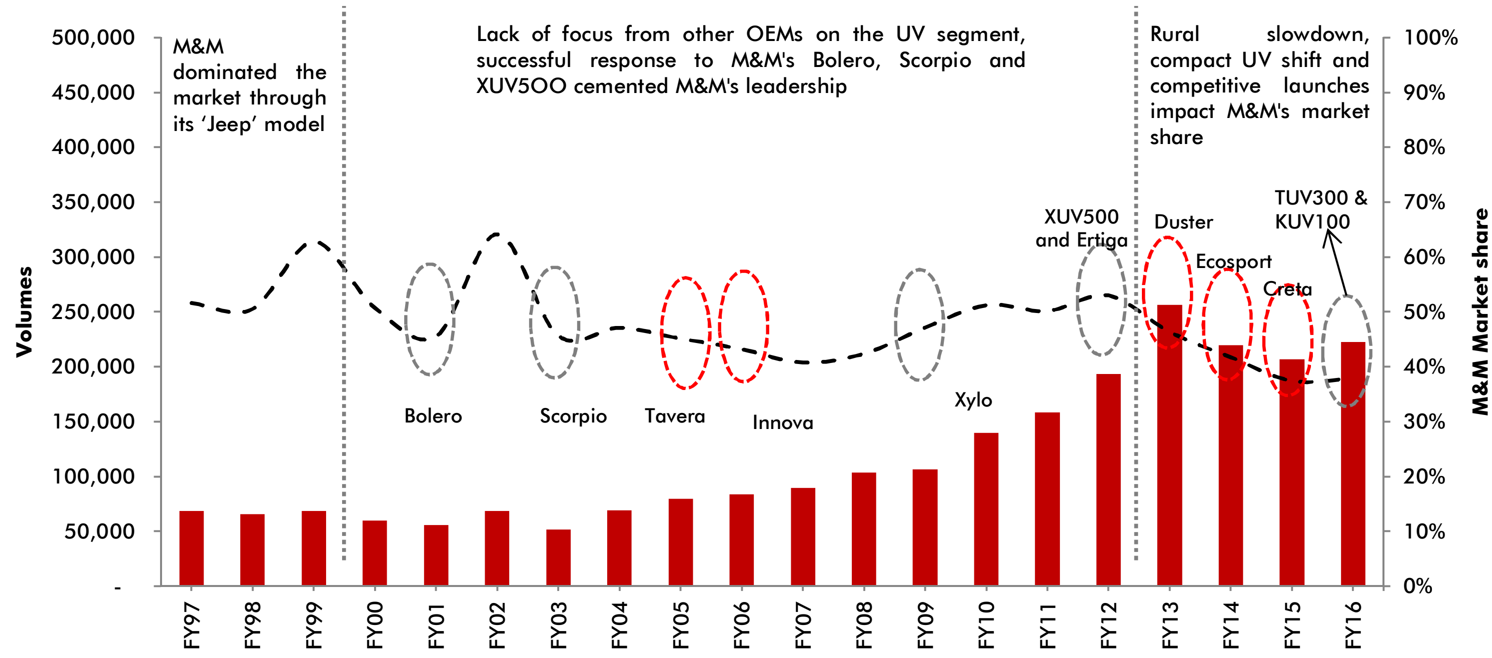
Valuation parameters (Standalone + MVML)

	FY14	FY15	FY16	FY17E	FY18E
EPS (₹)	68.3	54.2	56.8	63.4	72.4
BPS (₹)	307	349	392	441	496
DPS (₹)	15.3	13.1	12.0	13.2	15.0
P/E (x)	14.2	18.9	17.9	15.9	13.8
P/B(x)	4.5	4.0	3.5	3.1	2.8
EV/EBITDA (x)	9.8	11.2	10.1	8.9	7.8
EV/EBIT(x)	12.1	14.7	13.3	11.9	10.4

Source: Company, Ambit Capital research Note: MVML = Mahindra Vehicle Manufacturers Limited; Fair value of investments (₹435/share) reduced from current market price while calculating EV/EBITDA, EV/EBIT and P/E

Appendix A: Evolution of M&M's market share in domestic UVs

Exhibit 43: M&M UV market share in UV segment



Source: Company, Ambit Capital research

1990s: Evolving UV industry and players finding their feet

In the 1990s, UVs were predominantly used in India for commercial purposes by car rental agencies and taxi service providers. In 1995, the size of domestic PV industry was less than 300k units p.a. and of this UVs accounted for 49k units (i.e. 17% of the domestic PV industry volumes). M&M dominated the UV industry with its jeep models (Commander and Marshal), with a market share of 85% in 1995. The other players and UV models during this period were Hindustan Motors' Trekker and Maruti's Gypsy. In 1995, Tata Motors launched its debut UV – 'Sumo'. This launch helped expand the UV industry volumes from <50k units in 1995 to 133k units in FY97. Further, Tata introduced its second UV 'Safari' in 1998. While Mahindra's market share was impacted by these new launches, it retained its leadership with market share of 51% in FY2000.

Tata's Sumo/Safari launches challenged M&M's UV dominance in late 1990s

FY2000-2012: Bolero/Scorpio success helps M&M maintain leadership

UV industry saw relatively weak product actions during this period as most of the OEMs were focused on passenger car segment mainly small and compact cars. M&M launched two break-through products in the early 2000s. It first launched Bolero in 2000 and followed it up with Scorpio in 2002. Both these products helped drive M&M's UV sales, especially in rural/semi-urban areas. Other successful UV launches during this period were Toyota's Qualis (launched in FY01), General Motors' Tavera and Toyota's Innova launched in FY05 and FY06, respectively. Some peers' launches during the late 2000s such as Tata Motors' 'Aria' and Maruti's 'Grand Vitara' also failed to receive positive customer responses. In FY12, M&M launched its most premium SUV, XUV5OO, which gained significant customer traction, particularly in the urban markets, commanding a waiting period of as high as 4 months at one point. While M&M's market share averaged at 48.2% during 2000-12, its exit market share in FY2012 stood at an impressive 53%.

M&M cemented its leadership in 2000s led by Bolero, Scorpio but equally by lack of other players' focus on UVs

FY2013-16: Heightened competition, compact UVs shift and rural slowdown impact M&M's volumes/market share

Severe market erosion for M&M between FY12 to FY16 (from 53% to 38%) as several competitive options emerged and company was rather late to spot the compact UV shift

After reaching a 10-year high market share of 53% in FY12, M&M's market share declined to 38% in FY16 (from a peak annual volume of 256k units in FY13, M&M recorded sales of just 222k units in FY16). Some of the factors that impacted M&M's UV market share/volumes during this period were: (i) a slew of competitive launches, especially in the compact UV segment, where M&M did not have credible products until FY16; (ii) rising customer acceptance of gasoline-powered SUVs where M&M did not have any offerings; and (iii) rural slowdown in FY15 and FY16, which specifically impacted M&M's sales (as against other UV players) as M&M derives majority of its sales from the rural areas (combined volumes of Bolero and Scorpio declined by ~4% in FY15 and 15% in FY16). To address these product portfolio gaps, specifically in the compact UV segment, M&M launched TUV300 and KUV100 in 2HFY16 (the latter has a petrol option too). These launches helped M&M marginally improve its market share in FY16 to 38% (up 40bps YoY).

Appendix B: Tough road ahead for SsangYong in the Korean market

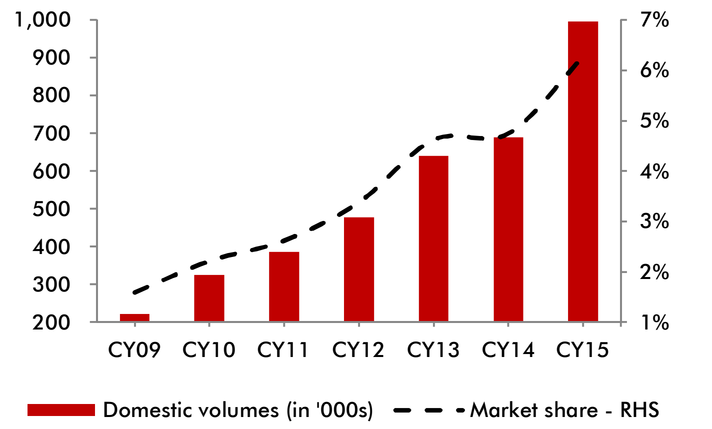
M&M's parentage helped revive SsangYong brand to some extent...

Prior to its acquisition by M&M, SsangYong was going through a rough phase due to under-investments in product development under parent Shanghai Automotive Industry Corporation (SAIC). This led to rapid market-share loss for SsangYong in the Korean SUV market. SsangYong's problems compounded in 2009 as demand for SUVs collapsed globally and the company faced severe labour unrest (including a strike that lasted for 77 days). The company reported losses of KRW1.1tn from FY08-10.

M&M acquired 70% stake in the Korean SUV maker SsangYong in FY11 for a consideration of ₹17bn. Since its acquisition, M&M has infused close to ₹4.3bn between FY11-13. This much needed investment helped revive the product development cycle at SsangYong. Over the last 5 years, the company introduced new products (re-launched Korando C in 2013; launched Tivoli and Tivoli Air in 2015). These launches have helped SsangYong improve its market share in the Korean PV market from 2.2% in FY10 to 6.3% in FY15. Furthermore, SsangYong was also able to ramp up its exports thanks to these new launches. China and Europe have emerged as key export markets for SsangYong, contributing close to 50% of exports and 16% of total volumes in CY15.

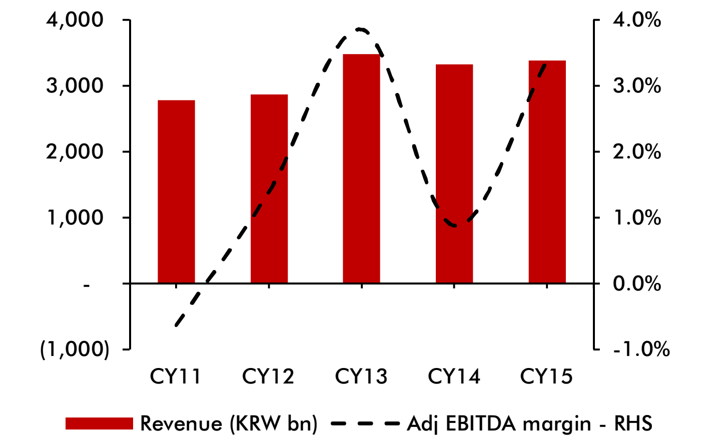
SsangYong's financial performance has witnessed improvement over the last five years with revenues delivering 10% CAGR.

Exhibit 44: New launches (aided by M&M's financial support) have helped SsangYong recoup market share...



Source: Company, Ambit Capital research

Exhibit 45: ...resulting in an improvement in financial performance



Source: Company, Ambit Capital research

Further market share gains/profitability improvement challenging...

The Korean PV market is dominated by Hyundai (along with Kia motors), which has a market share of ~80%. As against this, SsangYong's market share is 6.3%. While SsangYong has been able to gain market share in the recent years due to new launches, incremental market share gains hereon would be difficult. This is on account of intensifying competition from Hyundai in the compact SUV segment. For instance, Hyundai recently launched a fully-redesigned 'Tucson' in March 2016 and would be adding one more compact SUV 'ix25' in 2016. Further, Kia Motors has also launched its compact SUV "Sportage" in 2016. These new launches will be direct competition to SsangYong's products. Furthermore, the profitability of SsangYong would also get impacted due to full-year impact of cost increases due to introduction of Euro VI in Sep 2015.

Hyundai & SsangYong in Korea

bn KRW	Hyundai	SsangYong
Revenues from Korea	13,158	2,500
R&D spend	406	16

Source: Company, Ambit Capital research

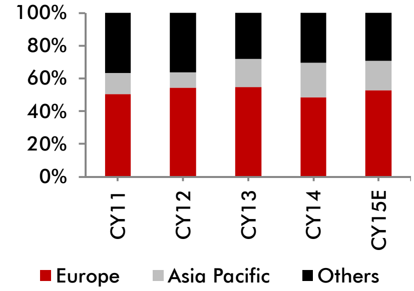
...with silver linings in few export markets

However, we believe SsangYong can gain some market share in export markets such as China. The Chinese market potential remains huge. SUVs account for 22% of Chinese PV sales. To increase its addressable market in China, SsangYong recently announced plans to establish a local manufacturing facility along with a local Chinese OEM either through contract manufacturing agreement or as a JV[1]. We believe this can help reduce the pricing gap between SsangYong's and competitors' products. China imposes a 25% tariff on imported vehicles and the market is also more competitive due to presence of a larger number of players. For instance, Korando C is priced 5-10% higher than Hyundai's Tucson which is made locally.

Resumption of exports to Russia will also be a leg-up for export volumes. SsangYong is a popular brand in Russia, which accounted for 50% export volumes in CY12 and CY13. Exports to Russia were halted in 2013 after a sharp depreciation in the Russian ruble due to geopolitical issues. Furthermore, EBITDA/vehicle in Russia is more than levels SsangYong enjoys in China.

Consensus expects revenue to grow by 9% CAGR over CY15-18 EPS, EBITDA margin to expand by 340bps from 3.4% to 6.7%, and EBITDA to witness 37% CAGR. At CMP the stock trades at 17.0x CY17 consensus earnings

Geography-wise export breakup of SsangYong



Source: Company, Ambit Capital research

Exhibit 46: SsangYong consensus expectations

Bn KRW	CY12	CY13	CY14	CY15	CY16E	CY17E	CY18E	CY15-18 CAGR
Revenue	2,874	3,485	3,327	3,390	3,694	4,002	4,409	9%
Adj EBITDA	40	134	29	115	179	243	297	37%
Adj EBITDA margin	1.4%	3.9%	0.9%	3.4%	4.8%	6.1%	6.7%	
PBT	(105)	(11)	(70)	(21)	52	104	144	
PAT	(105)	(11)	(70)	(21)	49	98	112	

Source: Company, Ambit Capital research

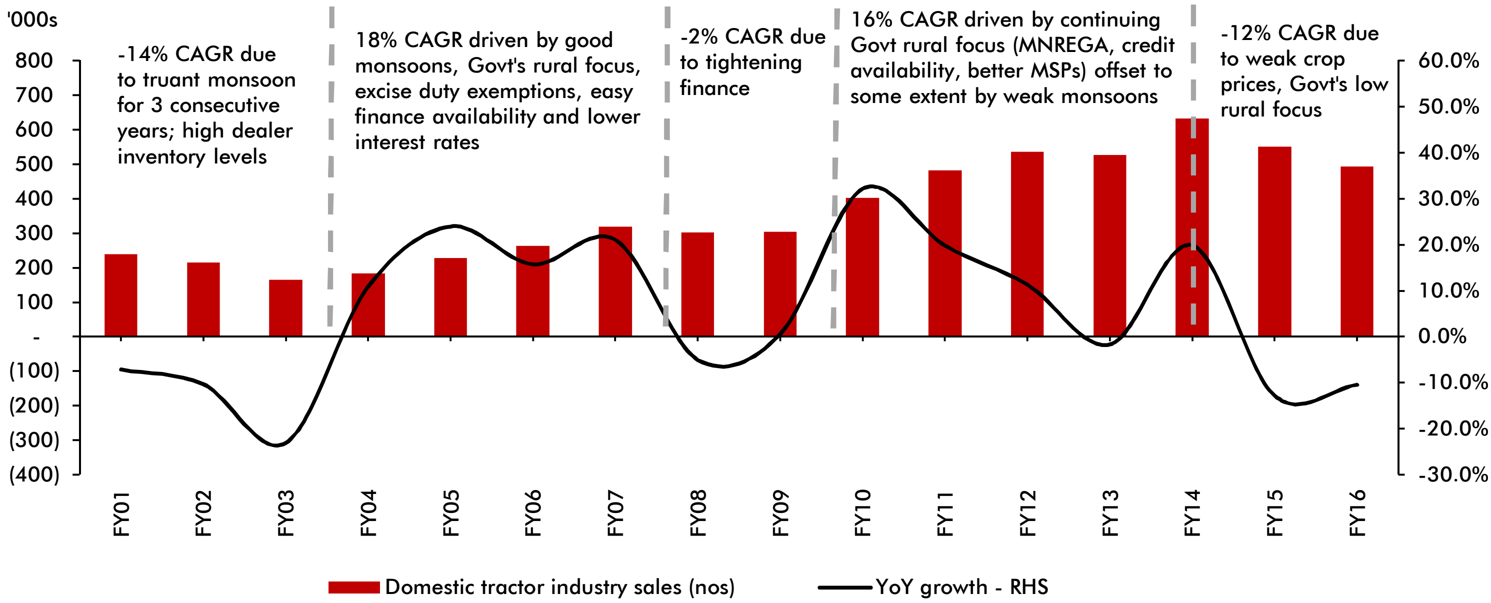
[1] http://goo.gl/FvgQ1K

Appendix C: Historical tractor growth and M&M's market share

Tractor growth has been dependent on God and Government

Indian tractor Industry posted 9% volume CAGR over the last 12 years: While the domestic tractor industry volumes have recorded close to 9% CAGR over the past 12 years, the growth has largely been contributed by two time periods, i.e. FY04 to FY07, when volumes grew at 18% CAGR and FY09-14 where volumes recorded 16% CAGR. The industry demand has been in extended contraction phase over the last two financial years (FY15/FY16) declining by 13% and 10% respectively.

Exhibit 47: Evolution of the domestic tractor industry over the last 15 years

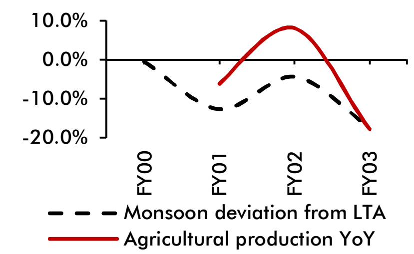


Source: TMA, Ambit Capital research.

FY00-03: Volume decline of nearly 40% over three years led by weak monsoon and inventory correction

The domestic tractor industry volumes declined 14% CAGR over FY00-FY03. This was mainly due to weak monsoon for three consecutive years (12%/5%/17% lower than the long term average). This impacted crop production (down 6% CAGR over FY00-03) and farm income levels. The fall in tractor volumes was particularly sharp in FY03 as the year witnessed one of the four worst ever droughts. Further in FY03, tractor manufacturers cut down sharply on wholesale volumes to bring them in line with the retail volumes (In the previous years, the industry had resorted to building up dealer inventory levels through boosting dealer credit and in-turn dealers had resorted to 'advance sales of tractors' to retail customers which had led to huge inventory build-up and collection problems).

Weak monsoon and crop production impacted volumes

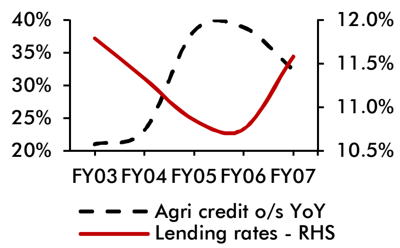


Source: CEIC, Ambit Capital research

FY04-07: Good monsoon and pro-rural policies of UPA-1 drive strong volume growth

The domestic tractor industry volume growth was robust during this period with a small recovery in FY04 and accelerating growth from FY05 to FY07. Besides the very low base of FY03 (volumes down 36% vs. FY2000 levels) and normal monsoon during this period (average rainfall 2% above normal levels between FY04-07), the pro-rural measures of the Central Government also drove tractor demand. Some of these measures were: (i) increasing credit disbursement towards the agricultural sector (o/s agri-credit grew at 33% CAGR over FY03-07; (ii) better credit terms with lower interest rates (lending rates declined from 11.8% in FY03 to 10.8% in FY06); (iii) complete exemption on excise duty on tractors (earlier 16%) w.e.f. July 2004; and (iv) rising minimum support prices (MSPs) for some key crops like wheat and paddy. In FY07, the domestic tractor industry volumes of 319k units were nearly 2x FY03 levels.

Rising agri-credit and lower lending rates helped tractor volume growth

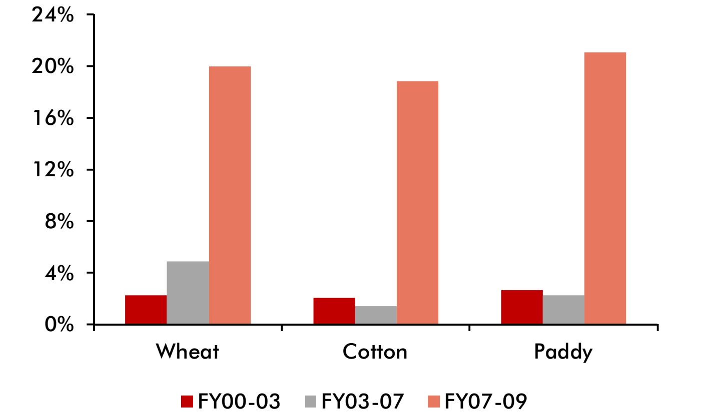


Source: CEIC, Ambit Capital research

FY08-09: Liquidity concerns momentarily impact tractor demand

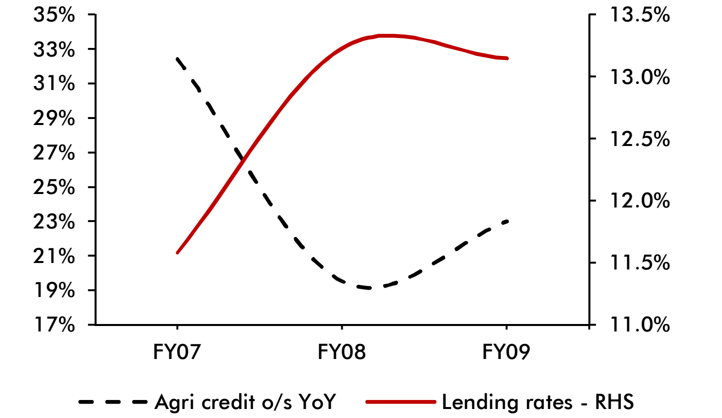
After witnessing strong volume growth for four consecutive years (FY04-07), domestic tractor industry volume growth slowed down in FY08 (down by 5% YoY) and FY09 (flat YoY). While the average monsoon during this period was above normal and MSPs for key crops continued to witnessed an upward trend (ahead of the general elections in May 2009), tractor demand suffered because of the slowdown in bank financing on account of higher NPAs, tightening of lending norms and global financial crisis. Put differently, the positive measures enlisted above somewhat helped arrest the decline in the tractor industry volumes over these two years.

Exhibit 48: MSP increases for key crops continued in FY08/09…



Source: CEIC, Ambit Capital research

Exhibit 49: …but outshone by declining agri-credit and firming lending norms/rates

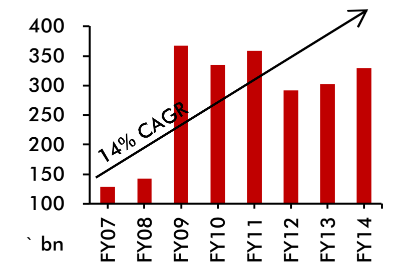


Source: CEIC, Ambit Capital research

FY10-14: Easing liquidity and continuing rural largesse (under UPA 2) drive demand resurgence

The industry witnessed a sharp rebound from FY10 with volumes witnessing a 21% CAGR over FY09-12 despite some weak spots like poor rainfall and crop production in FY10 (16% deviation from long-term average rainfall and 7% YoY decline in production). The strong growth during this time-period was driven by easing liquidity and increasing rural development spending such as MNREGA, housing and roads (particularly between FY10 and FY11). This not only increased the non-agricultural usage of tractors but also led to scarcity of labour for farm activities, resulting in increased demand for tractors. From FY12 to FY14, volume performance showed a mixed trend with the negative impact of slowdown in infrastructure spending and ban on quarrying operations offset by continued government support through high MSPs.

MNREGA was a key government rural measure propelling tractor demand

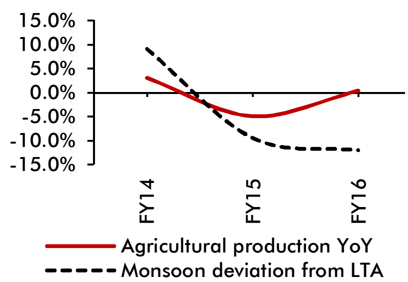


Source: Budget documents, Ambit Capital research

FY15-16: Weak/unseasonal rains and NDA's "rural reset" impact tractor demand

Industry volumes have been in a tail-spin over the last two years (decline of 13% in FY15 and 10% in FY16) due to a confluence of several negative factors. India witnessed two successive years of weak south-west monsoon. The situation was further exacerbated by unseasonal north-east rainfall which damaged Rabi crops across several states like Maharashtra, Gujarat, Madhya Pradesh, Punjab and Haryana. Adding to the woes was weakening global crop prices. Food inflation came down significantly in FY15 and FY16 (at 6% YoY and 5% YoY, respectively, vs 12% YoY in FY14) impacting farm incomes. Another major factor was the slowdown in rural spending/support (MSPs, NREGA) by the new Central Government (NDA), which was a material departure from the generous spends on rural India administered by the previous UPA Government.

Weak monsoons and crop production impact tractor sales



Source: CEIC, Ambit Capital research

M&M's Journey towards sustained market leadership

1960s: Moving away from imports to indigenous manufacturing

Immediately after Independence, most of the domestic tractor requirements were met through imports. The earliest players were Escorts, which distributed imported Massey Ferguson tractors in northern India, and TAFE, which acted as the southern India distributor of Massey Ferguson tractors. Similarly, Goodearth Company imported and distributed Eicher Tractors in India in early 1950s.

Indigenous manufacturing of tractors started in 1959 when Eicher came up with its first locally assembled tractors from its Faridabad facility. This was followed in 1961 by the JV between TAFE and Massey Ferguson. Similarly, Escorts began its indigenous manufacturing through JV with URSUS of Poland in 1961 (with TAFE and Massey Ferguson entering into JV, Escorts could no longer distribute the tractors of the latter). The current market leader M&M began its journey in tractors through International Tractors Company of India (ICTI) which was a JV between M&M, International Harvester (UK) and Voltas Limited.

Indian tractor industry - milestones

Year	Remarks
Pre-1960s	Until 1960, the demand was met entirely through imports
1959	Eicher sets up its facility in Faridabad
1961	TAFE, Escorts and M&M (through JVs) started local production
1968	Escorts entered into a JV with Ford, USA to manufacture Ford tractors in India.
1974	Punjab Tractors launched indigenously developed tractors
1983	M&M takes over leadership from Escorts
1990	Ford sells global tractor business to New Holland
1994	AGCO buys tractor division of Massey Ferguson
1995	Escorts & New Holland terminate their JV
1997	John Deere enters India (JV with L&T)
1998	New Holland enters India independently
1999	M&M buys Gujarat Tractors
2005	TAFE buys Eicher's tractor division
2007	M&M buys Punjab Tractors

Source: Industry, Ambit Capital research

1970s: Ford collaboration propels Escorts to market leadership

In 1968, Escorts entered into a technical and financial joint venture with Ford Motor Company, USA, to manufacture Ford tractors in India. The first tractor Ford 3000 rolled out in 1971. The years ahead saw Escorts emerge as the largest tractor manufacturer in India. In 1970s, Punjab Tractors (owned by the Government of Punjab) launched indigenously developed tractor models. In 1977, ITCI got merged with M&M to become its tractor division.

1980s to mid-1990s: Global realignments impact Indian JVs; M&M's long stint of leadership begins

In 1983, M&M took over the leadership in the domestic tractor industry from Escorts. In 1980s, Escorts' performance in tractor business was impacted by ownership issues surrounding the company and entry into several new businesses like two-wheelers (through collaboration with Yamaha).

In 1990, Ford Motor Company sold its global tractor business to New Holland. Similarly, in 1994, AGCO bought the tractor business of Massey Ferguson. In 1995, Escorts and New Holland mutually decided to terminate their JV, with Escorts buying out the entire stake of its partner.

Mid-1990s to now: Foreign players make independent entry; M&M cements its market leadership

In 1997, John Deere entered the Indian tractor company through a joint venture with Larsen & Toubro. Similarly, in 1998, New Holland began its independent operations in India through a 100% subsidiary. AGCO, on the other hand, remains a Joint Venture partner and investor in TAFE.

However, the entry of these players had little impact on M&M as it went around building its leadership. In FY99, M&M bought Gujarat Tractors (from the Gujarat State Government) which helped it gain market share in Gujarat. M&M continued to witness market share gains in 2000s on the back of capacity expansion, increasing presence in other geographies as well as new product introductions. Further, M&M bought the then struggling Punjab Tractors in 2007, which led to a significant increase in its market share (from 29.9% in FY08 to 41.6% in FY09).

M&M and TAFE together accounted for nearly 64% of the industry share in FY16. On the other hand, MNCs like John Deere (6%) and New Holland (4%) have not been able to gain significant market share in domestic tractors.

State-wise analysis indicates further headroom for tractor penetration

As highlighted above, amongst the Indian states, certain states like Punjab, Haryana, UP and Bihar have reached high penetration levels. These states together contribute close to 30% of FY16 tractor sales. But there is headroom for growth/penetration in several big tractor states, particularly southern states and certain western states.

Exhibit 50: Dynamics and specific growth drivers for key states

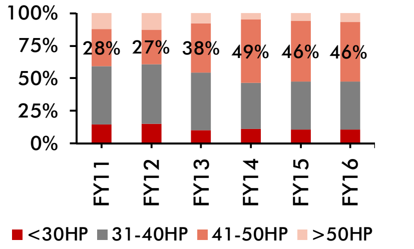
	% volume share	CAGR				Penetration		Remarks
		FY06-16	FY11-16	FY13-16	FY16	HP/ hectare	Tractors / '000 hectare	
North India	**36%**	**6%**	**1%**	**-5%**	**-18%**	**1.4**	**39**	
Uttar Pradesh	14%	5%	-1%	-5%	-22%	1.7	49	▪ Similar to Punjab and Haryana, Western UP is a highly penetrated region. ▪ Significant scope for penetration in eastern UP. ▪ Poor rainfall impacted FY16.
Rajasthan	12%	8%	12%	-1%	-5%	0.8	22	▪ Under-penetrated market. ▪ Healthy growth in last five year driven by significant rise in guar-gum prices (ingredient used in oil/gas exploration) due the demand-supply mismatch (post US Shale gas exploration). ▪ Guar prices have stabilised (reduced 91% from peak) in the last four years impacting tractors. ▪ Improvement in irrigation (post commissioning of Sardar Sarovar Dam) can drive long term growth
Haryana	5%	5%	-1%	-7%	-26%	3.1	89	▪ Has the highest tractor penetration at 2.5-3x national average.
Punjab	4%	4%	-8%	-14%	-32%	2.5	73	▪ Major beneficiaries of the Green Revolution. ▪ High penetration also driven by well-developed irrigation systems and higher cropping intensity. ▪ Cotton crop damages impacted YoY growth in FY16
South India	**18%**	**3%**	**-1%**	**7%**	**15%**	**0.9**	**26**	
AP/Telangana	9%	7%	0%	12%	17%	1.0	29	▪ Current penetration in line with national average. ▪ Increase in irrigation levels and commercial activities are structural factors conducive to long term growth
Karnataka	7%	3%	3%	11%	-3%	0.9	25	▪ Lower than national average penetration. ▪ Improvement in currently low irrigational intensity and higher than national average land holding size provides growth opportunities
Tamil Nadu	3%	-2%	-7%	-8%	82%	0.9	26	
East India	**15%**	**12%**	**4%**	**3%**	**5%**	**0.9**	**25**	
Bihar	7%	14%	5%	1%	-2%	1.8	52	
West Bengal	3%	12%	0%	0%	1%	0.7	21	▪ Extremely low penetration levels.
Orissa	3%	7%	3%	11%	16%	0.6	16	▪ Increasing in irrigation intensity, government focus on Eastern India and increase in finance penetration can drive growth. ▪ Smaller size of land holdings is a key obstacle.
West India	**30%**	**8%**	**-1%**	**-5%**	**-18%**	**1.0**	**29**	
Madhya Pradesh	10%	8%	0%	-12%	-24%	1.2	35	▪ Marginally higher than India level penetration. ▪ Larger land holdings and irrigation push (Sardar Sarovar Project) likely to drive tractor volume growth.
Maharashtra	9%	9%	-5%	-2%	-14%	0.8	23	▪ Deficient rainfall, sugarcane payment arrears and crop damage impacted FY16 volumes
Gujarat	8%	6%	-1%	-3%	-15%	1.2	35	▪ Low tractor penetration. ▪ Large part of the state dependent on monsoon. ▪ Significant investments in irrigation to drive tractor growth. ▪ Deficient rainfall and no subsidies released by the state impacted FY16 volumes
Chhattisgarh	3%	13%	6%	2%	-16%	0.9	25	
India	**100%**	**6%**	**0%**	**-2%**	**-10%**	**1.1**	**31**	

Source: TMA, Ambit Capital research

Proportion of non-farm usage to remain at current levels

Over the past few years, tractors are being increasingly used for non-farming activities including construction, transportation of materials as well as people, quarrying and haulage. All these factors have helped to increase the utilisation of tractors and thus added to tractor demand. Based on our discussions with industry experts, the usage of tractors for non-farm purposes now accounts for nearly 35-40% of the total usage. Whilst tractors would continue to be used for non-farm purposes, we do not expect any major increase in the proportion of tractors for non-farm purposes from the current levels as tractors cannot completely substitute commercial vehicles given: (i) high mileage gap with CVs; and (ii) trucks can carry higher payload than tractors.

Share of 41-50HP has increased to 46% vs 28% in FY11



Source: TMA, Ambit Capital research

Domestic tractor industry can deliver 8% volume CAGR over FY18-27

Several structural factors supportive of long-term growth

Post the recovery in FY17 and FY18 (CAGR of 15%), we expect domestic tractor industry volumes to deliver a CAGR of 8% over FY18-27. We expect this long-term growth in the domestic tractor industry to be driven by following factors:

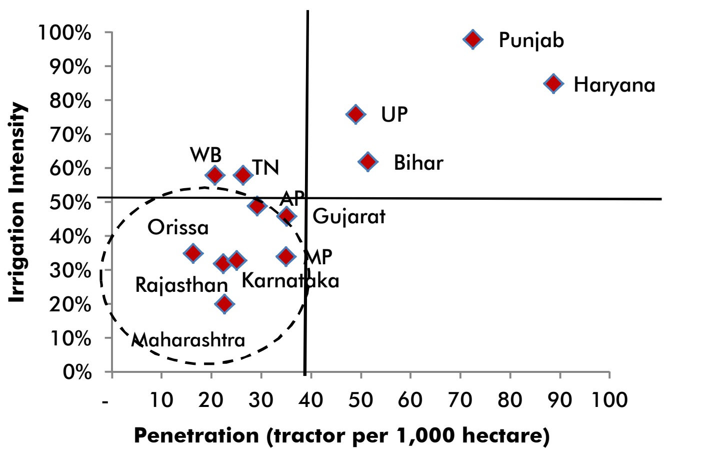
- **Increasing farm mechanisation and usage of tractors:** Increase in tractor usage from traditional activities like land preparation/haulage to other activities like cultivation, weeding and spraying. Also rising proportion of new generation farmers are pushing up mechanisation levels by adopting better farming methods and increasing use of agricultural implements. Also, shortage of manual labour continues to be a structural factor helping the shift towards tractors.
- **Rising irrigation levels and lower dependence on rainfall:** A key impediment to the tractor industry growth in several states is high dependence on rainfall. As discussed in earlier section, tractor sales volumes have significant correlation with the level of rainfall as it impacts the production levels and to some extent the farmers' sentiments. Put differently, high level of irrigation dependence in states like Punjab and Haryana has been one of the key reasons for relatively high tractor penetration in these states.
- **Improving agricultural credit:** Currently ~75% of tractors are purchased on credit and hence credit availability is a key demand drier for the tractor industry. Agricultural credit has grown at 12% CAGR over the past five years and continues to be backed by several government initiatives to promote the sector. This has been an indirect aid to tractor volumes. Increasing focus of NBFCs and private players is expected to sustain finance availability.

State/region-wise analysis indicate penetration headroom in several non-north states

The average penetration level currently at the all-India level is close to 1.1hp/hectare. This is lower compared to that in the developed markets like Germany (9.8 hp/hectare) and Italy (8.2 hp/hectare).

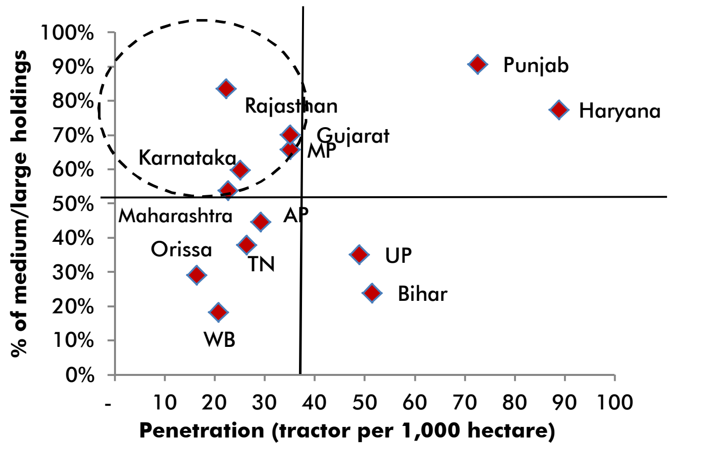
One of the factors often cited for lower penetration in India is that a significant portion of farm landings are smaller in size (<2 hectares) which renders the cost of owning/maintaining a tractor untenable. While this is indeed a valid point, even after considering >2 hectares as the addressable arable land, the penetration works out to be substantially lower than other countries.

Exhibit 51: States with low penetration (circled) and low irrigation levels well suited for long-term growth…



Source: Company, Ambit Capital research

Exhibit 52: …just like states with low penetration and decent levels of medium and large farm holdings (circled)



Source: Company, Ambit Capital research

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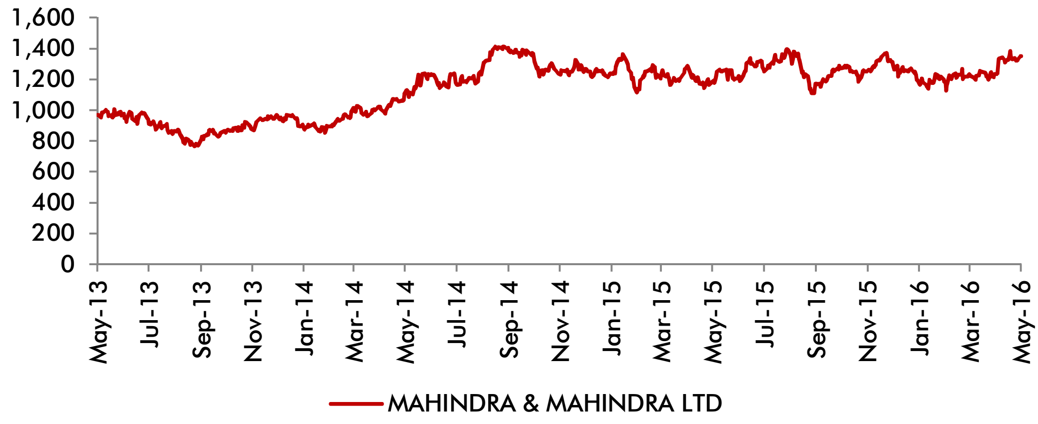

Source: Bloomberg, Ambit Capital research

Explanation of Investment Rating

Investment Rating	Expected return (over 12-month)
BUY	>10%
SELL	≤10%
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UNDER REVIEW	We will revisit our recommendation, valuation and estimates on the stock following recent events
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