

Mahindra & Mahindra

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In conversation with B Mishra, VP, Manufacturing & Marketing of Mahindra & Mahindra's (M&M) Farm Equipment Sector (FES) we got an update on the state of the tractor industry as well as M&M performance

Key takeaways of our meeting

Inventory rationalisation initiatives

Industry-wide dealer inventory levels are still ruling at over 55,000 units. With most manufacturers having initiated inventory rationalisation moves, channel inventory has declined gradually since FY02. M&M began the process of inventory correction way ahead of its competitors, which is reflected in its low inventory levels at two months sales. M&M opines that it would take at least another six months to a year before industry inventory levels come down to comfortable levels. As a result, tractor volumes at the wholesale level could start picking up by 3Q to 4Q of FY04.

Tractors close to a bottom

With industry volumes (manufacturer dispatches) at near seven-year lows, M&M is certain that industry volumes are close to a bottom. However, any pick up in volumes would clearly depend on how quickly a few of the other players (like Punjab Tractors) are able to liquidate excess pipeline inventory, given the huge levels of inventory they currently carry.

For the longer-term, the company admits that certain structural impediments to tractor demand still need to be addressed. These relate to improving farm productivity, getting remunerative prices for foodgrains, improved management of foodgrain stock all aimed at increasing the investible surplus at the hands of the farmers.

Southern, Eastern states growth target areas

As regards growth distribution between geographies, M&M is targeting the southern (Andhra Pradesh and Karnataka) and eastern states (Eastern UP, Bihar and Madhya Pradesh), where the growth potential (primarily comprising first-time buyers) is the strongest. The reason being that these markets are characterised by low levels of farm mechanisation (tractors' density stands at just 7/000 hectares). As opposed to this, much of the demand in the developed northern markets of Punjab and Haryana comes from replacement demand thanks to the states' high level of mechanisation (30/000 hectares). However, even in such markets, M&M is not unduly worried of tractor demand being saturated as replacement cycles are much shorter than the rest of the country (replacement cycle under five years as compared to nearly 15-20 years in other states).

Adherence to TMA guidelines would improve pipeline inventory, sales quality

Strict enforcement of TMA guidelines will help improve both pipeline inventory as well as quality of sales. The TMA guidelines would enforce tighter credit periods and abolish the practice of forward sales have already been implemented in a number of states in the West and South. By end 1QFY04, most other states like Uttar Pradesh, Bihar, Madhya Pradesh, Tamil Nadu and West Bengal will come under the purview of TMA. What's also encouraging is that unlike previous attempts, most of the manufacturers seem to be adhering to these guidelines. In line with this, M&M is currently implementing a 'Pull System' of production wherein a new tractor is manufactured only after a corresponding delivery has been made.

PTL acquisition to broad base M&M's product portfolio

Punjab Tractors (PTL) acquisition would help broad base the product portfolio. According to M&M, acquisition of PTL will help fill product portfolio gaps, especially in the lower end of the price spectrum. Most of M&M's tractors are positioned at the premium end of the market while those of PTL mainly occupy the economy segment of the tractor market. Moreover, PTL's strong brand equity in the northern belt (high tractor density states) would prove beneficial in the longer run for M&M. However, given PTL's huge inventory levels (estimated at over a year's sales), M&M has made it clear that the acquisition price will be the key factor in deciding whether M&M goes through with its bid or not.

Our View

M&M is best positioned in the industry to benefit from an up tick in tractor demand that will accompany a revival in the rural economy thanks largely to M&M's relatively low inventory levels compared to the rest of industry. Furthermore, the company's constant focus on cost rationalisation (like gradually shifting out of high-cost production bases like Mumbai) would help improve tractor profitability and bring down break-even levels constantly in an environment of weak topline growth.

Stock Ratings Absolute Returns

Buy : > 25%
Out Performer : 16 - 25%
Market Performer : 0 - 15%
Under Performer : < 0%

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