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Stock Rating
Overweight

Industry View
In-Line

Mahindra & Mahindra

Earnings to Shift to Third Gear

We are assuming coverage of Mahindra and Mahindra (M&M) with an Overweight rating within the context of our In-Line view of the Indian Commercial Vehicles. The stock trades at 10.0 times our F2008E EPS, a discount of 28% to the average for our four-wheeler coverage universe and a discount of roughly 30% to the F2008E market multiple of 14.8.

Our Overweight rating and price target of Rs800 are primarily driven by: 1) the strong growth forecast for domestic and export volumes in the Farm Equipment Division (12.6% CAGR F06-09E); 2) healthy growth in the UV segment (9.5% CAGR F06-09E), and 3) potential earnings growth and increase in value from the automobile JVs with Renault and Navistar.

Subsidiaries' contribution to consolidated earnings to provide floor to the price. We expect contribution from subsidiaries to be about 38% of consolidated profits by F2008. We estimate every 10% increase in subsidiaries' contribution would boost consolidated EPS by 4%, given the varying investments.

We derive price target using a sum-of-parts valuation method and relative price/earnings analysis. We estimate that the core farm equipment and automotive operations (tractors and UVs) will contribute nearly Rs96 bn, or Rs390 per share, while investments in major subsidiaries such as Tech Mahindra and Mahindra Finance would add Rs172 per share. Our valuation work does not factor in the value and earnings growth from the new passenger car and commercial vehicles joint ventures, which could increase the upside potential as we would see significant earning potentials from these ventures from F09 onwards. Key risks to our price target and valuation are slowdown in rural programs initiated by the government and a resultant drop in tractor volumes. Lower than expected exports (tractors and UVs) and higher commodity prices could constrain margin expansion.

Key Ratios and Statistics

Reuters: MAHM.BO Bloomberg: MM IN
India Four-Wheelers: Commercial Vehicles

Price target	Rs800.00
Shr price, close (Sep 7, 2006)	Rs644.70
Mkt cap, curr (mn)	Rs158,430
52-Week Range	Rs719.00-345.00

Fiscal Year (Mar)	2006	2007e	2008e	2009e
ModelWare EPS (Rs)*	43.0	51.9	64.2	82.8
Rev, net (Rs mn)	82,292	95,686	109,492	126,375
ModelWare net inc (Rs mn)	10,572	12,758	15,781	20,342
P/E	14.6	12.4	10.0	7.8
P/BV	4.6	3.7	2.8	2.2
Div yld (%)	1.6	1.6	1.8	2.0

* = Please see explanation of Morgan Stanley ModelWare later in this note.
e = Morgan Stanley Research estimates

Financial Summary

Profit and Loss Statement

(Rs Mn)	F2006	F2007E	F2008E	F2009E
Volumes	234,453	259,485	284,803	313,321
Total Income	82,292	95,686	109,492	126,375
COGS	72,438	83,932	95,486	109,553
Material Costs	57,138	65,879	75,054	86,024
Employee Costs	5,518	6,418	7,343	8,476
Power & Fuel	575	668	765	883
Manuf & Other Expenses	4,625	5,755	6,748	7,835
Admn, Selling & Distn	4,583	5,212	5,577	6,335
Operating Profit	9,854	11,753	14,006	16,822
Other Income	1,049	1,210	1,820	3,392
Depreciation	2,000	2,751	3,213	3,675
Interest	270	243	218	197
PBT	8,633	9,970	12,394	16,342
Adjusted Tax	2,163	2,072	2,732	3,603
Core PAT	6,470	7,898	9,662	12,739
Extraordinaries	2,101	1,133	0	0
Reported Standalone PAT	8,571	9,031	9,662	12,739
Share from JVs	0	94	76	289
Contribution from Subsidiaries	4,102	4,766	6,043	7,314
Consolidated PAT	10,572	12,758	15,781	20,342

Balance Sheet

	F2006	F2007E	F2008E	F2009E
Net Fixed Assets	15,544	19,437	22,867	25,835
Investments	15,757	15,757	15,757	15,757
Total Long Term Assets	31,301	35,193	38,623	41,591
Receivables	6,380	7,328	8,448	9,712
Inventories	8,419	9,455	10,629	12,062
Cash & Cash Eq	12,339	17,693	26,135	38,996
Other Current Assets	5,513	6,566	7,570	8,702
Total Current Assets	32,650	41,042	52,782	69,471
Net Current Assets	**12,010**	**17,263**	**25,499**	**38,294**
Misc Exp	181	181	181	181
Total Assets	**43,491**	**52,637**	**64,303**	**80,066**
Share Capital	2,409	2,409	2,409	2,409
Reserves & Surplus	30,781	40,817	53,467	70,270
Share Holders Funds	**33,190**	**43,226**	**55,876**	**72,679**
Deferred Tax	1,468	1,078	593	52
Secured Loans	2,167	2,167	2,167	2,167
Unsecured Loans	6,667	6,167	5,667	5,167
Total Debt	**8,834**	**8,334**	**7,834**	**7,334**
Total Liabilities	**43,492**	**52,637**	**64,303**	**80,066**

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research Estimates

Cash Flow Statement

(Rs Mn)	F2006	F2007E	F2008E	F2009E
Cash Flow From Operations				
Net Profit	12,673	13,891	15,781	20,342
Depreciation	2,000	2,751	3,213	3,675
Deferred Tax	(430)	(390)	(485)	(540)
(Incr)/Decr in Working Cap	(512)	101	207	66
Total	13,730	16,353	18,715	23,543
Cash Flow From Investing Activities				
(Incr)/Decr of FA	(2,796)	(6,643)	(6,643)	(6,643)
(Incr)/Decr of Investments	(4,620)	0	0	0
(Incr)/Decr in Others	63	0	0	0
Total	(7,352)	(6,643)	(6,643)	(6,643)
Cash Flow From Financing Activities				
Incr/(Decr) of Equities	1,746	(1,133)	(0)	(0)
Incr(Dec) of Sec. Loans	(1,201)	0	0	0
Inc/(Dec) of Unsec. Loans	(491)	(500)	(500)	(500)
Dividends	(2,782)	(2,722)	(3,131)	(3,539)
Total	(2,728)	(4,356)	(3,631)	(4,039)
Net Change in cash	3,650	5,354	8,442	12,861
Cash at begin of year	8,689	12,339	17,693	26,135
Cash at Year-end	12,339	17,693	26,135	38,996

Ratios

	F2006	F2007E	F2008E	F2009E
Per Share				
EPS	**43.0**	**51.9**	**64.2**	**82.8**
Standalone EPS	*26.3*	*32.1*	*39.3*	*51.8*
JV EPS	*-*	*0.4*	*0.3*	*1.2*
Subs Contribution	*16.7*	*19.4*	*24.6*	*29.8*
BVPS	135.1	175.9	227.4	295.8
DPS	10.1	10.0	11.5	13.0
Valuation				
P/E	15.0	12.4	10.0	7.8
P/BV	4.8	3.7	2.8	2.2
EV/EBIDTA	15.4	12.4	9.8	7.4
Returns (%)				
EBIDTA Margin	12.0	12.3	12.8	13.3
ROCE	17.2	16.8	16.8	17.8
ROE	23.6	20.7	19.5	19.8
ROA	16.7	16.4	16.5	17.6
NPM	7.9	8.3	8.8	10.1
Dividend Yield	1.6	1.6	1.8	2.0
Capitalisation & Coverage				
Total Debt/Equity	0.3	0.2	0.1	0.1
Equity/ Net Assets	0.8	0.8	0.9	0.9
Turnover / Gross Block	2.9	2.8	2.7	2.7

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research Estimates

Investment Case

Summary & Conclusions

We are assuming coverage of Mahindra and Mahindra (M&M) with an Overweight rating within the context of our In-Line view of the Indian Four-Wheeler (Commercial Vehicles) industry. The stock trades at 10.0 times our F2008E EPS estimate, a discount of 28% to the average for our four-wheeler coverage universe and a discount of roughly 32% to the F2008E market multiple of 14.8.

Our investment thesis and price target are primarily driven by the following:

Robust expansion forecast for Farm Equipment Division volumes. We expect overall tractor volumes to grow at a 12.6% CAGR over F2009 driven by strong export volumes (11.6% CAGR over F2009E) and domestic volumes (12.7% CAGR over F2009E).

Scorpio, Bolero, and Ingenio models in UV segment to deliver strong volumes. We estimate overall UV's to post 9.5% growth a year over F2006-09E driven by 50% exports growth and 7% in the domestic market. We expect '*Ingenio'* to be launched by end of F2008. We expect this growth to be partially offset by a decline in utility vehicle (UV)/pickup volumes, especially in the soft-top segment. We estimate UV volumes will increase at a 9.5% CAGR over F2006-09.

Investments in automobile joint ventures could be a significant earnings and value drivers in the medium term. The joint ventures are with Renault (for passenger cars – Logan) and Navistar (for commercial vehicles – International and Mahindra branded vehicles across the segments). We expect sales volumes of 25,000 units for passenger cars and 15,000 units for commercial vehicles by F2009.

Value unlocked from major subsidiaries to provide support to our valuations and target price. The major subsidiaries are Tech Mahindra (market cap of US$1.4 billion), Mahindra Finance Limited (market cap of US$425 million), and Mahindra Automotive Steel Limited (market cap of US$138 million). We expect subsidiaries to contribute about 38% of consolidated profits by F2008.

Valuation: M&M is currently the cheapest stock in our four-wheeler coverage universe, trading at 10.0 times our F2008E earnings per share, 28% below our coverage universe, and at a 32% discount relative to Sensex. Even with respect to its historical average, M&M trades at a 20% discount.

We derive our price target using a sum-of-parts valuation method and relative price/earnings analysis. We estimate that the core farm equipment and automotive operations (tractors and UVs) will contribute nearly Rs96 billion, or Rs390 per share, while investments in major subsidiaries such as Tech Mahindra and Mahindra Finance would contribute Rs172 per share based on current market cap. We have been conservative in our earnings estimates for the subsidiaries and believe that there is significant upside potential to our target price and earnings forecast if subsidiaries' earnings exceed our estimates. Our valuation work does not factor in the value and earnings growth from the new passenger car and commercial vehicles joint ventures as we would see significant earnings from these ventures only from F2009 onwards.

Key risks to our price target and valuation are a slowdown in rural programs initiated by the government and a resultant drop in tractor volumes. Lower than expected exports (tractors and UV) and higher commodity prices would constrain margin expansion.

Company Description

Mahindra & Mahindra Ltd. manufactures and markets general purpose utility vehicles, including medium and heavy commercial vehicles, jeeps, cars, agricultural tractors and other related products. With revenues of nearly US$2 billion in F2006, M&M is among the top five auto companies in India. M&M has several subsidiaries that are involved in businesses such as financing, telecom software, construction, steel and auto components

Industry View: In-Line

Indian Four Wheeler - M&HCV (goods) demand is entering an inflexion point in the demand cycle. We expect a soft landing of the demand cycle given the strong underlying economic indicators and structural changes (road development, freight movement moving on to a hub-and-spoke model) in the industry. Key risks to our soft landing thesis are declining economic fundamentals, increasing interest rates, increasing fuel prices and declining / stagnating freight prices.

MSCI Country: India

Asia Strategist's Recommended Weight: 1.9%
MSCI Asia/Pac All Country Ex Jp Weight: 6.5%

Investment Positives

Strong export and domestic tractor volumes to drive margin improvement. We estimate overall company margins to improve by 130 bps over F2006-09, primarily driven by strong growth in unit volumes in the domestic tractor market, and growth acceleration in other international markets (especially the US where M&M has nearly 5.5% market share in the sub-70 hp tractor category). We estimate overall tractor volumes to grow at a 13% CAGR over F2006-09, propelled by strong growth in domestic and export markets. We expect M&M to retain its significant market leadership in the 31-50 hp category while improving its market share for sub-30 hp models. We estimate every 100 bps decline in our CAGR estimates for overall tractor volumes to impact core EPS by roughly 50 - 60 bps.

Management indicated that pilot exports from the China market to the US market have already commenced and that it expects to increase the overall capacity utilization of the China plant to 50% through better domestic (China) sales and exports.

Exhibit 1
Tractors International Market

	M&M F06 Sales	Market Share	No of Dealers	Tractor Market	Product Offered
USA	10,006	5.50%	220	160,000	Sub 70HP
China	2,700	3.4%	130-140	80,000	Geared Tractors
Australia	200	2.0%	25	10,000	Sub 70HP

Source: Company data, Morgan Stanley Research

Exhibit 2
M&M Tractor Export Volumes

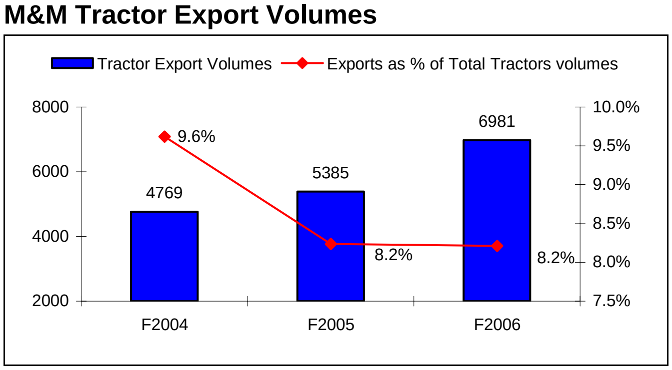
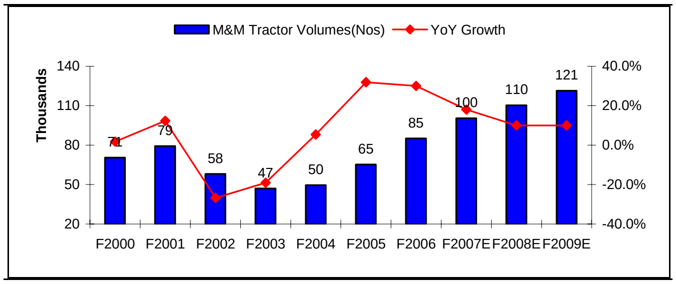


Exhibit 3
M&M Tractor Sales Trend



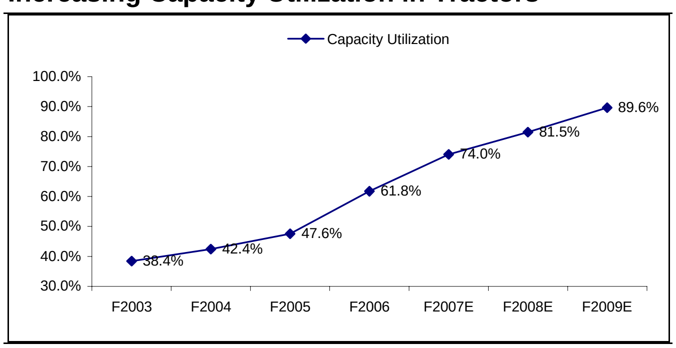
Source: Company data, Morgan Stanley Research

Exhibit 4
Sensitivity of EPS to Tractors Volumes Growth

	-200 bps	-100 bps	Base F2008E	+100 bps	+200 bps
CAGR Growth of Tractor vols (F06-09E)	10.60%	11.60%	12.60%	13.60%	14.60%
Change	*-2%*	*-1%*		*+1%*	*+2%*
Core EPS	38.9	39.1	39.3	39.5	39.8
Change	*-1.1%*	*-0.6%*		*0.5%*	*1.2%*

Source: Morgan Stanley Research

Exhibit 5
Increasing Capacity Utilization in Tractors



Source: Morgan Stanley Research
Note: Capacity at F2006 end of 135500 units assumed to be constant over F2006-2009E

Exhibit 6

M&M Tractor Market Share by Segment

Mahindra & Mahindra	F2001	F2002	F2003	F2004	F2005	F2006	F1Q07
Up to 30 hp	42.2%	32.0%	33.7%	28.7%	31.0%	37.8%	21.6%
31-40 hp	32.3%	26.6%	25.8%	28.0%	27.5%	27.6%	37.6%
41-50 hp	39.8%	32.6%	31.6%	23.5%	23.3%	28.8%	29.4%
51 hp and above	0.0%	0.0%	0.0%	9.5%	16.8%	19.7%	28.0%
Overall Market Share	33.6%	26.8%	27.4%	26.0%	26.4%	29.0%	32.7%

Source: Tractors Manufacturers Association, Morgan Stanley Research

Exhibit 7

M&M Market Share in Tractors by Region

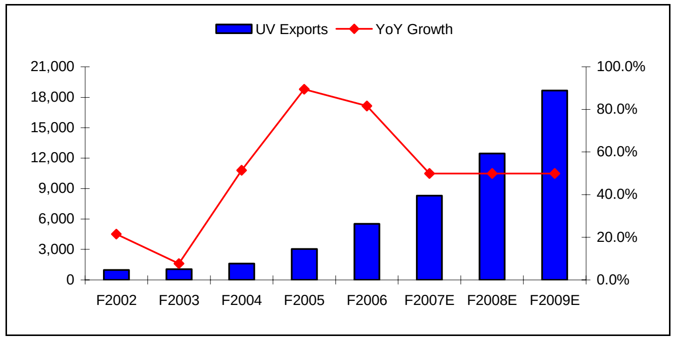
	F2001	F2002	F2003	F2004	F2005	F2006	F1Q07
North	29.1%	20.9%	21.1%	20.4%	21.4%	23.3%	25.4%
South	49.3%	42.1%	41.2%	39.4%	37.3%	39.3%	45.5%
East	29.8%	24.4%	26.6%	29.2%	28.3%	32.1%	36.5%
West	34.8%	28.7%	4.8%	4.4%	26.1%	29.5%	32.4%
Others	26.2%	46.9%	45.1%	31.0%	0.0%	4.8%	0.0%

Source: Tractors Manufacturers Association, Morgan Stanley Research

Strong exports of Scorpio to improve overall unit volumes and operational efficiency of the Nashik plant. M&M exports UVs to Spain, Egypt, Turkey and CIS. The other major overseas markets are Western Europe (sales of 1,000 units) and Malaysia (sales of 800 units). M&M is exploring several markets for its UVs including South Africa, Russia and Latin America. We estimate exports as a proportion of total sales volumes could rise to nearly 6% in F2009 as against just 2.4% in F2006.

Exhibit 8

UV Export Trends



Source: Company data, Morgan Stanley Research E = Morgan Stanley Research Estimates

Passenger car and commercial vehicle joint ventures to be significant earnings and value drivers in the medium and longer term. We estimate the automotive joint venture for producing passenger cars (with Renault) and commercial vehicles (with Navistar) to break even by F2009. Margins for the commercial vehicle joint venture are likely to be higher than those for the passenger car JV given the higher level of localization planned for commercial vehicle products. We estimate the joint ventures will contribute 1.4% of consolidated profits by F2009.

Exhibit 9

M&M Joint Ventures

Joint Venture	M&M Stake	Product Offered	Capacity	Timeline	Localization	Margin Assumption	Capital
JV with Renault	51%	Logan and variants of the model	60,000	F1Q08	70-75%	9%	Rs7 Bn
JV with Navistar	51%	LCVs and M&HCVs - both trucks and buses	60,000	F1Q08	90%	9.5%	Rs5 Bn

Source: Company data, Morgan Stanley Research

Exhibit 10

M&M Joint Venture Summary

	F2008E	F2009E
JV with Renault		
Cars Capacity	60,000	60,000
No of cars sold	15,000	25,000
Average realisation	*400,000*	*420,000*
Total revenues	**4,560**	**7,980**
EBITDA	**365**	**718**
EBITDA Margin	*8.0%*	*9.0%*
Core PAT	(138)	75
Share of M&M	(71)	38
JV with Navistar		
CV Capacity	60,000	60,000
CV Vehicles Sold	10,000	15,000
LCV business (transferred from M&M)	8,051	8,856
Avg Realization for CV Business	*547,695*	*547,695*
Avg Realization for LCV Business transferred	*430,474*	*439,083*
Net Sales	**8,943**	**12,104**
EBITDA	*805*	*1,150*
EBITDA margin	*9.0%*	*9.5%*
Core PAT	**288**	**491**
Share of M&M	**147**	**250**

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research Estimates

Subsidiaries' contribution to consolidated earnings to increase, providing a floor for the M&M stock price. We estimate the major subsidiaries (Mahindra Finance and Tech Mahindra) will contribute nearly 38% of consolidated profits by F2009. We believe any upside to our earnings growth estimates (16% for Tech Mahindra and 25% for Mahindra Finance) could further increase the upside potential while acting as a support level for the stock price.

Exhibit 11

M&M Finance: Abridged Financials

Rs Mn	F2005	F2006	F2007E	F2008E	F2009E
Interest Income	3,770	5,333	7,205	8,930	11,201
Interest Expenses	1,284	2,136	3,308	4,337	5,594
Net Interest Income	2,486	3,197	3,897	4,593	5,607
Total Income	**2,764**	**3,827**	**4,696**	**5,565**	**6,812**
Operating Expenses	876	1,390	1,601	1,799	1,979
Operating Profit	**1,888**	**2,437**	**3,095**	**3,766**	**4,833**
Provisions	560	816	1,074	1,289	1,639
PAT	**823**	**1,082**	**1,349**	**1,654**	**2,133**
Net Interest Spread	9.5%	7.7%	7.3%	7.0%	6.8%
Net Interest Margin (NIM)	10.6%	8.7%	8.0%	7.5%	7.2%
Overheads/ Average Assets	3.7%	3.8%	3.3%	2.9%	2.5%
Provs on Avg Assets	2.4%	2.2%	2.2%	2.1%	2.1%
Net Spread	4.5%	2.7%	2.5%	2.5%	2.5%

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research Estimates

We estimate all subsidiaries (including Mahindra System and Technologies, Mahindra Gesco, and Mahindra Ugine) to contribute about 38% of consolidated profits by F2008 (Exhibit 8). We estimate subsidiaries' earnings in aggregate to grow at 21% over F2006-09.

Exhibit 12

Subsidiaries' Contribution to Consolidated Profits

	F2004	F2005	F2006	F2007E	F2008E	F2009E
Contn from Subs	1,004	1,688	4,102	4,766	6,043	7,314
Consolidated Profits	4,255	6,709	10,572	12,758	15,781	20,342
Contn %	**23.6%**	**25.2%**	**38.8%**	**37.4%**	**38.3%**	**36.0%**

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research Estimates

Please refer to Appendix A for details on each subsidiary.

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Investment Negatives

Decline in soft-top UV volumes a drag on overall UV unit volumes. M&M is the largest player in the soft-top UV vehicles segment, where unit volumes dropped by nearly 22% in F2006. The fall in soft-top sales was primarily due to the introduction of Tata's Ace as these vehicles were primarily used as small goods carriers in the rural/semi-urban markets. We believe M&M has to introduce/launch new models/ variants at regular intervals to keep the buzz in the market and grow volumes. M&M plans to invest nearly Rs5.5 billion in the "Ingenio" project, and the plant, which is expected to commence production by 2008, will increase capacity at the company's existing plant at Nashik to 150,000 vehicles per annum. We estimate the new Ingenio model and significantly strong volumes from Scorpio to drive volume growth in this category. We estimate 9.5% growth in M&M UV volumes over F2006-09. We estimate that every 100 bps decline in UVs volumes growth would reduce Core EPS by 100 bps.

Exhibit 13

M&M Market Share in UV Business

M&M Market Shares	F2002	F2003	F2004	F2005	F2006
Soft Tops	79%	81%	76%	73%	71%
Hard Tops	33%	39%	43%	42%	42%
Passenger UVs	42%	45%	47%	46%	44%
Pick-ups	88%	76%	57%	58%	60%
UVs	47%	50%	49%	49%	48%

Source: Company data, Morgan Stanley Research

Exhibit 14

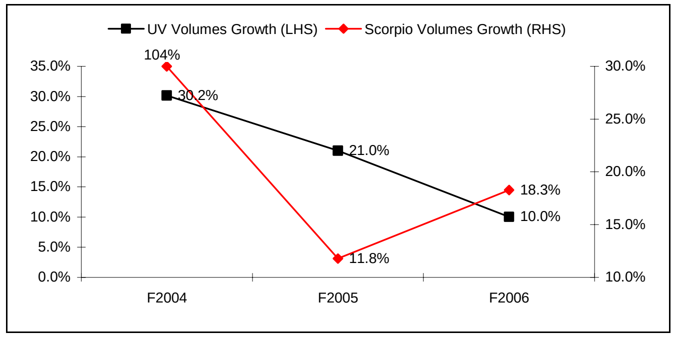
Declining Growth of M&M in UV Segment

	F2002	F2003	F2004	F2005	F2006
M&M Sales Volumes					
Soft Tops	15,521	13,642	14,224	15,363	11,489
Hard Tops	28,202	38,209	54,549	64,039	72,527
Passenger UVs	43,723	51,851	68,773	79,402	84,016
Pick Ups	12,197	17,001	22,661	31,736	30,678
Total Domestic UVs	55,920	68,852	91,434	111,138	114,694
Exports	635	1,061	1,607	3,046	5,534
M&M Growth rates					
Soft Tops		-12%	4%	8%	-25%
Hard Tops		35%	43%	17%	13%
Passenger UVs		19%	33%	15%	6%
Pick Ups		39%	33%	40%	-3%
Total Domestic UVs		**23%**	**33%**	**22%**	**3%**
Exports		67%	51%	90%	82%
Total (Domestic + exports)		**24%**	**33%**	**23%**	**5%**

Source: Company data, Morgan Stanley Research

Exhibit 15

UV Volume Growth with Scorpio Volume Growth



Source: SIAM, Morgan Stanley Research

Exhibit 16

Sensitivity of Core EPS to UV Volumes Growth

	-200 bps	-100 bps	Base F2008E	+100 bps	+200 bps
UVs CAGR Growth (F06-09E)	7.50%	8.50%	9.5%	10.50%	11.50%
Change	*-2%*	*-1%*		*+1%*	*+2%*
Core EPS	38.6	38.9	39.3	39.7	40.1
Change	*-1.8%*	*-1.1%*		*1.0%*	*2.0%*

Source: Morgan Stanley Research

Increasing competition in three wheelers could drive volumes down. M&M has a strong market presence (especially in the >0.5 tons category with 42%) in the three-wheeler cargo carriers. However, with the market moving away from bigger three wheelers (> 0.5 tons) and M&M having only one model in the smaller three wheeler category ('Champion Alfa'), we might see only modest growth going forward. We believe new models / variants launched in the smaller three-wheeler segment could be an upside potential to our estimates.

Exhibit 17

Big 3 Wheeler Market

	F2002	F2003	F2004	F2005	F2006
M&M	2,954	10029	17343	22943	18112
YoY		*240%*	*73%*	*32%*	*-21%*
Industry	52750	60,054	56,079	54,304	43,563
Market share	*5.6%*	*16.7%*	*30.9%*	*42.2%*	*41.6%*

Source: Company data, Morgan Stanley Research

Pricing pressure, higher raw material costs, lower unit volumes could constrain margin expansion. We estimate every 100 bps increase in raw material price would decrease earnings by nearly 8.5% (Exhibit 18). According to management, various cost reduction initiatives such as outsourcing, value engineering, target costing, global sourcing, productivity and process improvement and supplier base rationalization would help M&M sustain, if not expand margins, in the near term even if its not able to pass on the price increases due to higher raw material costs.

Exhibit 18

Sensitivity to Increases in Raw Material Prices

	-200 bps	-100 bps	Base F2008E	+100 bps	+200 bps
EBITDA Margin	14.7%	13.80%	12.8%	11.8%	10.9%
Change	*1.93%*	*1.01%*		*-1.0%*	*-1.9%*
Raw material cost	68.7%	69.70%	70.7%	71.7%	72.7%
Core EPS	**46.0**	**42.7**	**39.3**	**36.0**	**32.6**
% change	*17.1%*	*8.5%*		*-8.5%*	*-17.1%*

Source: Morgan Stanley Research E = Morgan Stanley Research Estimates

Valuation

Valuation and Target Price Discussion

We derive price target using a sum-of-parts valuation method and relative price/earnings analysis. We estimate that the core farm equipment and automotive operations (tractors and UVs) will contribute nearly Rs96 billion, or Rs390 per share which is based on historic relative P/E of 0.8 on a market multiple of 14.8x, while investments in major subsidiaries such as Tech Mahindra and Mahindra Finance would add Rs172 per share. Our valuation work does not factor in the value and earnings growth from the new passenger car and commercial vehicles joint ventures, which could increase the upside potential as we would see significant earning potentials from these ventures from F2009 onwards.

Exhibit 19

M&M Sum-of-Parts Valuation

Sum of parts	Rationale	Stake	Rs
Core business	Relative P/E of 0.8X on market multiple of 14.8X	100%	390
JV with Renault	Multiple of 12X on normalized earnings	51%	6
JV with International	Multiple of 12X on normalised earnings	51%	3
MBT	CMP of Rs541	46%	118
Mahindra Fin Services	CMP of Rs227	68%	54
Mahindra GESCO	CMP of Rs724	55%	50
Mahindra Ugine	CMP of Rs120	49%	8
MSAT	Multiple of 12X on normalised earnings		61
Other subsidiaries			35
Net Cash	F2008 net cash		74
Total			**800**

Source: Company data, Morgan Stanley Research

Exhibit 20

Subsidiaries' Contribution to Consolidated Profits

	F2004	F2005	F2006	F2007E	F2008E	F2009E
Contn from Subs	1,004	1,688	4,102	4,766	6,043	7,314
Consolidated Profits	4,255	6,709	10,572	12,758	15,781	20,342
Contn %	**23.6%**	**25.2%**	**38.8%**	**37.4%**	**38.3%**	**36.0%**

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research Estimates

M&M is currently the least expensive stock within our four-wheeler coverage universe, trading at 10.0 times our F2008 earnings estimate, 28% below our coverage universe average and at a discount of roughly 30% relative to the Sensex. Even with respect to its historical average, M&M trades at a discount of 20%.

Key risks to our price target and valuation include a slowdown in rural programs initiated by the government and a resultant drop in tractor volumes. Lower than expected exports of both tractors and UV and higher commodity prices would constrain margin expansion.

Scenario Analysis

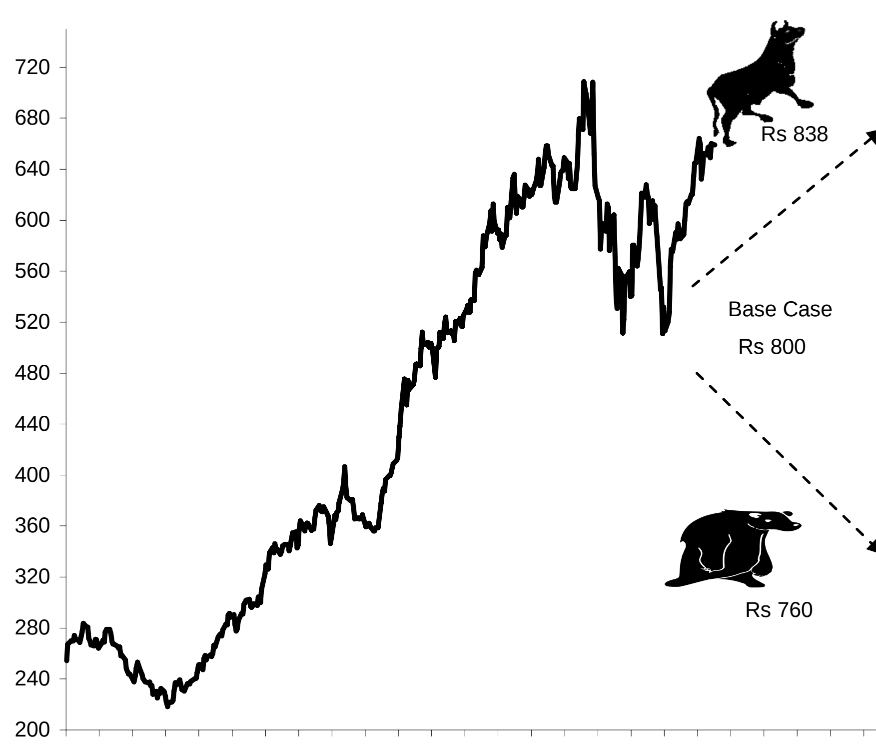
Our base-case valuation of Rs800, which is also our price target, assumes tractor sales grow at a 12.6% CAGR over F2006-09 and UV volumes expand at a 9.5% CAGR. We assume that subsidiaries post a 21% CAGR over the same period and contribute about 38% of consolidated profits in F2008. Each of our scenarios applies an appropriate P/E to our EPS for F2008E to derive fair value.

Our bull-case valuation of Rs838 assumes that strong growth in GDP and favorable government policies leads to sustained growth in tractors market, which enables M&M to post CAGR growth of 18% over F2006-09E in tractor volumes. There is a recovery in UV sales and M&M new project 'Ingenio' generates a good response which leads to M&M UV sales growing by 14% CAGR over F2006-09E. Subsidiaries continue their strong performance, posting a 25% CAGR over the same period and contributing nearly 39% of consolidated profits in F2008. Our valuation work does not factor in the value and earnings growth from the new passenger car and commercial vehicles joint ventures, which could increase the upside potential, as we would see significant earning potentials from these ventures from F2009 onwards. Since we are using market cap of key subsidiaries in our sum-of-the-parts valuation, the bull case scenario does not capture higher growth in subsidiaries earnings and resultant increase in subsidiary's market valuations.

Our bear-case valuation of Rs760 assumes a slowdown in economic growth and a modest monsoon, which would limit tractor volumes growth, and M&M would post tepid 7.6% CAGR growth in tractor volumes over F2006-09E. M&M Utility vehicles would continue to be out of favor, with Scorpio sales on a declining trend, and would therefore post weak 5% CAGR growth over F2006-09E. Subsidiaries would perform below expectations, posting a 17% CAGR and contributing an estimated 37% of consolidated profits for F2008.

Exhibit 21

Bull, Bear and Base Cases, F2007-F2009E



Nos in '000s	F2007	F2008	F2009
Tractor Volumes	104.59	120.27	138.32
UV Volumes	136.86	156.13	178.44
EBITDA Margin	12.2%	12.7%	13.2%
Core EPS (Rs)	33.4	42.2	56.9
Subs EPS (Rs)	21.3	27	32.7
Consol EPS (Rs)	55.1	69.5	90.8
P/E	15.3	12.1	9.3

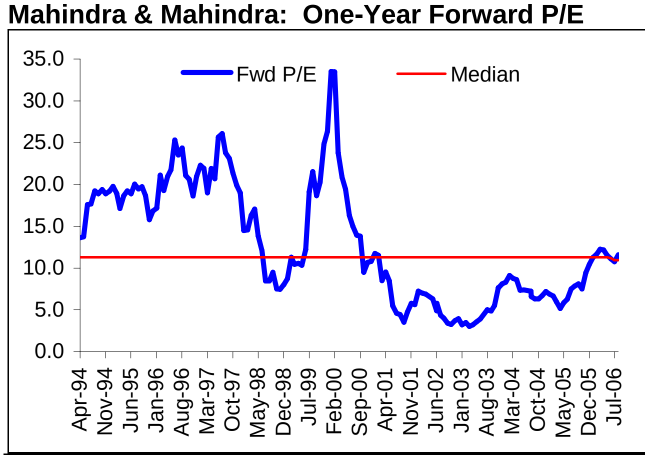
Nos in '000s	F2007	F2008	F2009
Tractor Volumes	100.33	110.37	121.40
UV Volumes	131.13	143.61	158.01
EBITDA Margin	12.3%	12.8%	13.3%
Core EPS (Rs)	32.1	39.3	51.8
Subs EPS (Rs)	19.4	24.6	29.8
Consol EPS (Rs)	51.9	64.2	82.8
P/E	15.5	12.5	9.7

Nos in '000s	F2007	F2008	F2009
Tractor Volumes	96.08	100.89	105.93
UV Volumes	125.39	131.66	139.40
EBITDA Margin	12.3%	12.9%	13.4%
Core EPS (Rs)	30.9	36.5	47.2
Subs EPS (Rs)	17.5	22.1	26.8
Consol EPS (Rs)	48.8	58.9	75.2
P/E	15.7	13.0	10.2

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research Estimates

Exhibit 10

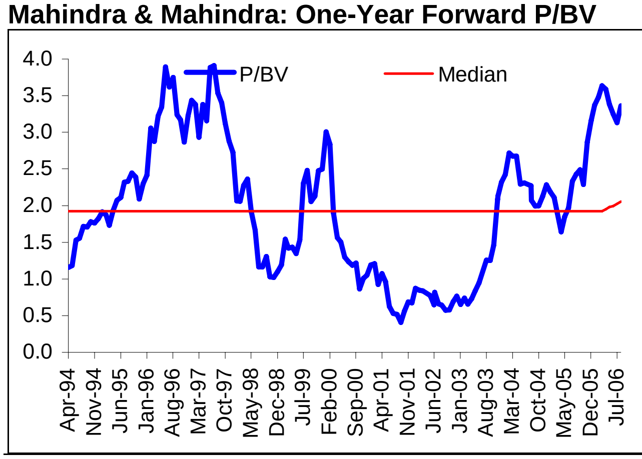
Mahindra & Mahindra: One-Year Forward P/E



Source: Bloomberg, Morgan Stanley Research

Exhibit 11

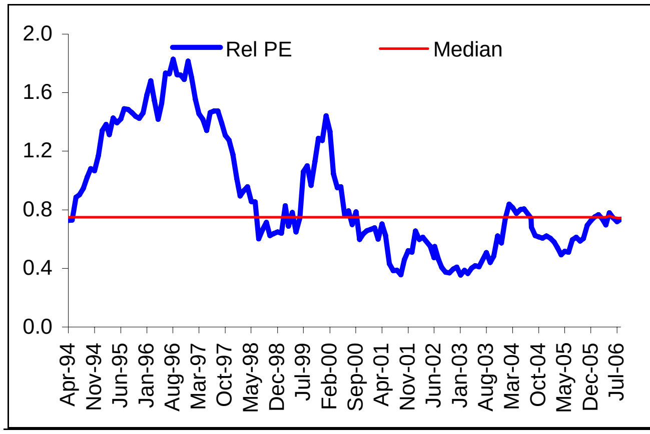
Mahindra & Mahindra: One-Year Forward P/BV



Source: Bloomberg, Morgan Stanley Research

Exhibit 12

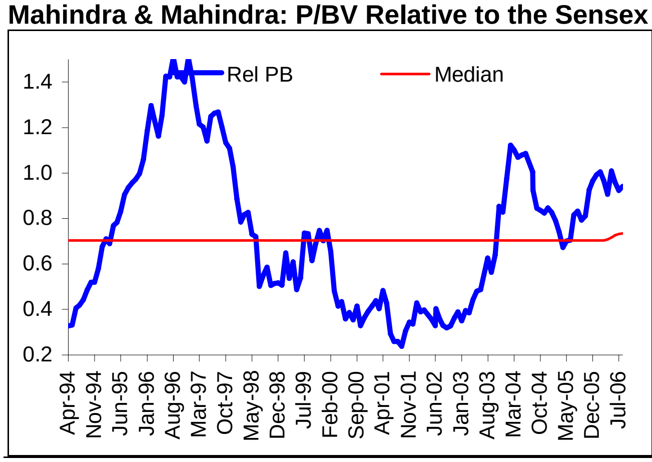
Mahindra & Mahindra: P/E Relative to the Sensex



Source: Bloomberg, Morgan Stanley Research

Exhibit 13

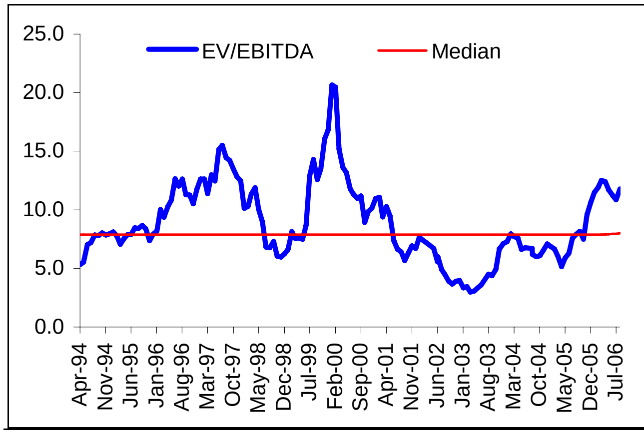
Mahindra & Mahindra: P/BV Relative to the Sensex



Source: Bloomberg, Morgan Stanley Research

Exhibit 14

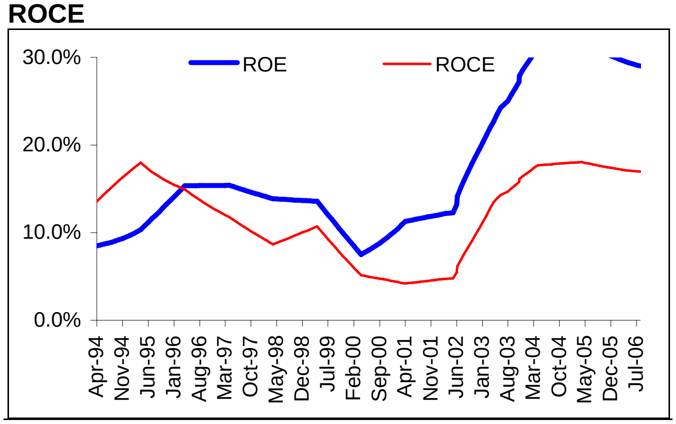
Mahindra & Mahindra: One-Year Forward EV/EBITDA



Source: Company data, Morgan Stanley Research

Exhibit 15

Mahindra & Mahindra: One-Year Forward ROE & ROCE



Source: Bloomberg, Morgan Stanley Research

Exhibit 22

Auto Valuations, 6 Sept 2006

	Price	MS	P/E			P/B			EV/EBITDA		
	(Rs)	Rating	F2006	F2007E	F2008E	F2006	F2007E	F2008E	F2006	F2007E	F2008E
Mahindra & Mahindra	645	OW	15.0	12.4	10.0	4.8	3.7	2.8	15.7	12.7	10.0
Maruti	893	EW	20.8	17.8	16.2	4.7	3.8	3.2	12.1	10.3	8.9
Tata Motors	884	**EW**	22.1	19.2	17.0	5.9	5.0	4.0	13.6	11.4	10.0
Ashok Leyland	44	OW	18.8	15.6	12.1	4.1	3.6	3.2	10.4	8.6	6.5
4 Wheeler Industry		**Attractive**	**19.2**	**16.1**	**13.9**	**5.0**	**4.0**	**3.3**	**13.2**	**11.0**	**9.3**

	Price Target	Market	EBITDA Margin			ROE (%)			ROCE (%)		
	(Rs)	Cap ($mn)	F2006	F2007E	F2008E	F2006	F2007E	F2008E	F2006	F2007E	F2008E
Mahindra & Mahindra	800	3,440	12.0%	12.3%	12.8%	23.6	20.7	19.5	17.2	16.8	16.8
Maruti	760	5,601	15.8%	15.8%	16.0%	24.5	23.1	20.9	22.8	22.0	20.3
Tata Motors	770	6,941	12.5%	12.5%	12.4%	26.7	23.7	20.2	18.0	17.0	15.5
Ashok Leyland	50	1,272	10.1%	11.1%	12.2%	24.2	24.8	28.0	14.3	16.6	19.9
4 Wheeler Industry		**17,253**	**13.0%**	**13.2%**	**13.4%**	**25.9**	**24.9**	**23.5**			

Source: Company data, Morgan Stanley Research. E= Morgan Stanley Research estimates

Indian Tractor Industry – A Snapshot

We forecast India tractor unit sales will post 10-12% CAGR through F2009, driven by the rural programs recently initiated by the government, higher minimum support prices, an increase in irrigated land, and easy availability of credit (farm holdings required to buy tractors have been reduced from 8 acres to 4 acres). We also believe that the recent favorable monsoon and the growing trend toward contract farming (e.g., Pepsi purchasing potatoes for its wafer snack unit) support our demand outlook.

Exhibit 23

Minimum Support Prices

Sl. No.	Commodity	2002-03	2003-04	2004-05	2005-06	CAGR
	Kharif crops					
1	Paddy	530	550	560	570	2.5%
2	Jowar	485	505	515	525	2.7%
3	Bajra	485	505	515	525	2.7%
4	Maize	485	505	525	540	3.6%
5	Ragi	485	505	515	525	2.7%
6	Arhar(tur)	1320	1360	1390	1400	2.0%
7	Moong	1330	1370	1410	1520	4.6%
8	Urad	1330	1370	1410	1520	4.6%
9	Cotton	1675	1725	1760	1760	1.7%
10	Groundnut in shell	1355	1400	1500	1520	3.9%
11	Sunflower seed	1195	1250	1340	1500	7.9%
12	Soyabean	795	840	900	900	4.2%
13	Sesamum	1450	1485	1500	1550	2.2%
14	Nigerseed	1120	1155	1180	1200	2.3%
	Rabi crops					
15	Wheat	620	630	640	NA	1.6%
16	Barley	500	525	540	NA	3.9%
17	Gram	1220	1400	1425	NA	8.1%
18	Masur (lentil)	1320	1500	1525	NA	7.5%
19	Rapeseed/mustard	1330	1600	1700	NA	13.1%
20	Safflower	1300	1500	1550	NA	9.2%
21	Toria	1295	1565	1665	NA	13.4%
	Other crops					
22	Copra	3300	3320	3500	3570	2.7%
23	Jute	850	860	890	910	2.3%
24	Sugarcane@	69.5	73	74.5	79.5	4.6%
25	Tobacco(vfc)	28	31	32	NA	6.9%

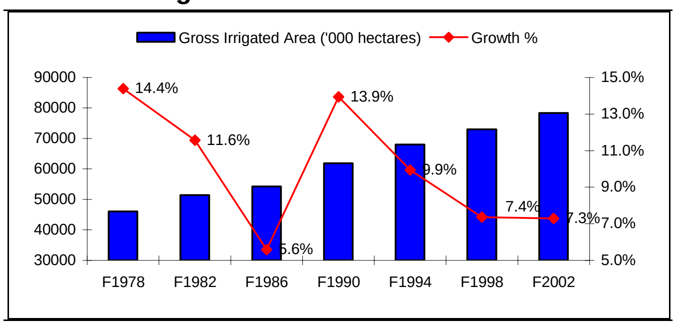
Source: Department of Agriculture and Cooperation, Morgan Stanley Research

Exhibit 24
Budget 2006 Highlights in Agriculture Sector

Irrigation	A) Outlay for 2006-07 increased to Rs71.2 billion ; B) Command Area Development Programme to be revamped to allow participatory irrigation management through water users' associations; C) 20,000 water bodies with a command area of 1.47 million hectares identified in the first phase for repair, renovation and restoration;
Credit	A) Farm credit expected to cross target of Rs1415 billion for 2005-06; to increase to Rs1,750 billion in 2006-07 B) One-time relief to be granted to farmers who have availed of crop loans from SCBs, RRBs and PACS for Kharif and Rabi 2005-06, and amount equal to 2% of the borrower's interest liability on the principal amount up to Rs100,000. C) From F2006-07 farmers to receive short-term credit at 7%, with an upper limit of Rs300,000 on the principal amount; subvention for this to be given to NABARD. D) Sanctions under Rural Infrastructure Development Fund to increase to Rs100 billion; separate window for rural roads with a corpus of Rs40 billion during 2006-07.

Source: India Budget 2006, Morgan Stanley Research

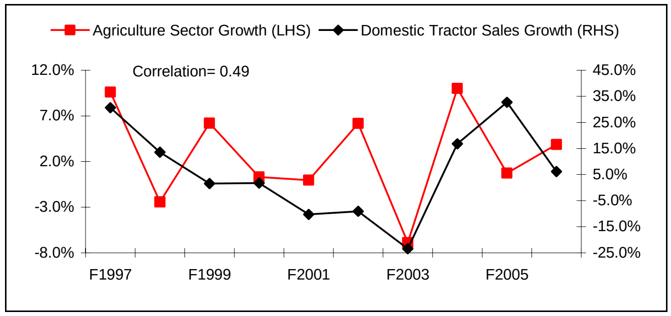
Exhibit 25
Growth in Irrigated Land



Source: CEIC, Morgan Stanley Research

Further supporting our demand outlook, Morgan Stanley economist Chetan Ahya expects India's agricultural sector to grow at nearly 2% in F2007 and 3.5% in F2008.

Exhibit 26
Agricultural Growth Correlates with Domestic Tractor Sales Growth



Source: CEIC, Tractors Manufacturers Association, Morgan Stanley Research

Key risks to our demand outlook are unfavorable monsoon conditions, a slowdown in rural credit off-take and/or reduced availability of credit to farmers and higher interest rates.

Appendix: M&M Subsidiaries

Mahindra System and Technologies (MSAT): MSAT's three divisions, **a**uto components, strategic sourcing and engineering services, have completed a string of acquisitions in the past 12-18 months, which include acquisitions of SAR Auto Transmissions, a gear manufacturing company, the Chakan unit of Amforge India, Strokes Forging in UK and the engineering services company, Plexion Technologies. The subsidiary has a target of US$1 billion for revenues by F2010 and is looking at both organic and inorganic routes to expand. In F2006, the subsidiary posted 16% YoY growth in revenues to Rs6.7 billion and 17% YoY growth in profits to Rs737 million. The auto components business could have revenues of nearly Rs10-15 billion over the next three to four years, in our view, with nearly 50% of revenues coming from M&M and its JVs with Renault and ITEC. M&M views this business as having significant potential for catering to global OEM's sourcing requirements. M&M has stated that it will continue to seek inorganic growth opportunities in the domestic and international markets.

Mahindra Finance: M&M reduced its stake in Mahindra Financial Services Limited (MMFSL) from 95% to 68% by listing the company on the primary market in March 2006. MMFSL finances M&M vehicle domestic sales. The company has an extensive distribution network with a presence in 25 states and two union territories through 356 branches with over 266 branches in rural areas. MMFL's asset book comprises nearly 35% of M&M's automotive segment sales and roughly 25-30% of tractor sales and as a guiding principal has set a benchmark not to exceed over 40% of M&M sales. The size of MMFS' asset book is Rs49.5 billion with an average tenor of 24 months with most of its funding coming from the issue of bonds and bank loans. The growth potential for MMFS is considerable, in our view, given that only NBFC provides rural tractor financing with almost all tractors purchased on credit. In F2006, the gross spread yield for MMFS was 9.5% with a net spread at 4.2%. MMFS posted YoY growth of 47% and 32% in net income and profits for the year, and we estimate MMFS will post 25% CAGR growth over F2006-09 and contribute nearly 7% of consolidated profits for M&M. MMFS has also tied up with Maruti Udyog for the financing of passenger cars and has also begun financing the two-wheeler business on a pilot basis.

Tech Mahindra: Mahindra Tech is the telecom software joint venture with British Telecom in which M&M had a 45% stake until it reduced it to 12% by taking the company public in the primary market in August 2006. In F2006, Mahindra Tech posted revenues of Rs12.4 billion (31% YoY growth) and net profit of Rs2.4 billion (130% YoY growth). We expect Tech Mahindra to post 16% growth in profits over F2006-09 and contribute nearly 9% of consolidated PAT by F2008.

Morgan Stanley
ModelWare[SM]

ModelWare is Morgan Stanley's new system for helping investors and analysts to uncover value, free from the distortions and ambiguities created by accounting data. Morgan Stanley has dissected and fundamentally redefined the components of corporate valuation, giving clients more consistent definitions, more comparable data, and more flexible analytic tools. ModelWare makes investment insights easier by making value more visible.

Past inconsistencies in financial reporting made it difficult to compare performance among companies and across sectors and regions. Even within US GAAP, flexibility complicates comparisons. And accounting standards were developed to analyze historical data, not to facilitate projections. In response, Morgan Stanley analysts spent two years reviewing our entire coverage universe of company metrics. They defined more than 2,000 general and industry-specific metrics that eliminated inconsistencies stemming from regional differences, historical precedents and accounting conventions. The team applied these metrics across also all 1900+ companies we cover, and created flexible tools and services that let analysts redefine and use the data with maximum creativity. Because ModelWare provides complete transparency, users see every component of every calculation, to choose elements or recombine them as they wish.

ModelWare EPS illustrates the approach. It represents ModelWare EPS as ModelWare net income divided by average fully diluted shares outstanding. ModelWare net income sums net operating profit after tax (NOPAT), net financial income or expense (NFE) and other income or expense. ModelWare adjusts reported net income to improve comparability across companies, sectors and regions. Among these adjustments: We exclude goodwill amortization and items deemed by analysts to be "one-time" events; we capitalize operating leases where their use is significant (e.g., in transportation and retail); and we convert inventory to FIFO accounting when LIFO costing is used. For more information on these adjustments and others, as well as additional background, please see *Morgan Stanley ModelWare (ver. 1.0): A Road Map for Investors*, by Trevor Harris and team, August 2, 2004.

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(as of August 31, 2006)

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	Coverage Universe		Investment Banking Clients (IBC)		
Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	**784**	**39%**	**294**	**44%**	**38%**
Equal-weight/Hold	**888**	**44%**	**297**	**45%**	**33%**
Underweight/Sell	**332**	**17%**	**74**	**11%**	**22%**
Total	**2,004**		**665**		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

Analyst Stock Ratings

Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Equal-weight (E or Equal) - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Underweight (U or Under) - The stock's total return is expected to be below the total return of the relevant country MSCI Index, on a risk-adjusted basis, over the next 12-18 months.

More volatile (V) - We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst's view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Unless otherwise specified, the time frame for price targets included in this report is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

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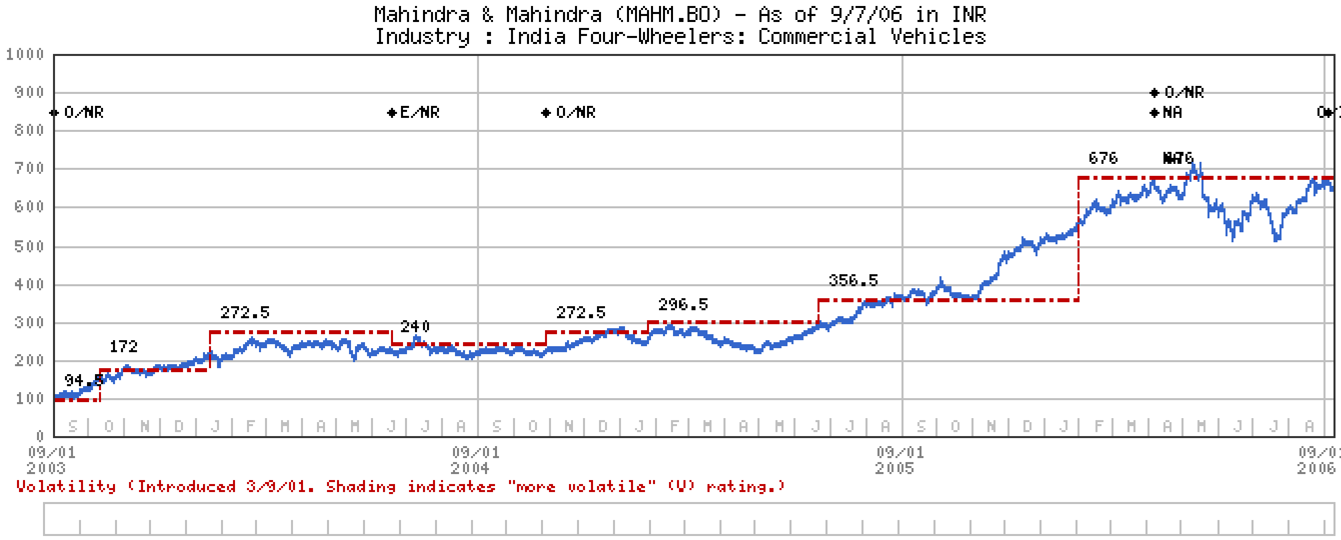
Stock Price, Price Target and Rating History (See Rating Definitions)



Stock Rating History: 6/30/03 : O/NR; 6/18/04 : E/NR; 10/29/04 : O/NR; 4/6/06 : NA; 4/7/06 : O/NR; 9/4/06 : O/I

Price Target History: 6/30/03 : 94.5; 10/10/03 : 172; 1/14/04 : 272.5; 6/18/04 : 240; 10/29/04 : 272.5;
1/25/05 : 296.5; 6/21/05 : 356.5; 2/1/06 : 676; 4/6/06 : NA; 4/7/06 : 676

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) Stock Price (Covered by Current Analyst)
Stock Ratings abbreviated as below (Effective 3/18/02, ratings appear as Stock Ratings/Industry View)
Stock Ratings as of 3/18/02: Overweight (O) Equal-weight (E) Underweight (U) More Volatile (V) No Rating Available (NAV)
Stock Ratings prior to 3/18/02: Strong Buy (SB) Outperform (OP) Neutral (N) Underperform (UP) No Rating Available (NAV)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Industry Coverage:India Four-Wheelers: Commercial Vehicles

Company (Ticker)	Rating (as of)	Price (09/07/2006)
Balaji Jayaraman		
Ashok Leyland Ltd. (ASOK.BO)	O (09/08/2006)	Rs43.30
Mahindra & Mahindra (MAHM.BO)	O (09/08/2006)	Rs644.70
Tata Motors (TAMO.BO)	E (09/08/2006)	Rs897.35

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