

May 29, 2006

Stock Rating
Overweight

Industry View
Attractive

Mahindra & Mahindra Capital Gains Spruce up Otherwise In-line Results

Overall results in line with our estimates: Buoyed by a 11% YoY increase in sales volumes, M&M posted 20%, 29% and 21% YoY growth in revenues, EBITDA and PBT before extraordinary items respectively in F4Q06, slightly below our estimates. EBITDA margins expanded for the quarter by approx. 80 bps to 11.9%. This was on largely due to other expenses, which as a percentage of sales declined by 290 bps to 10.5% as M&M embarked on cost re-engineering and greater focus on minimizing manufacturing cost. Raw materials as % of sales increased by 210 bps to 71.5% for the quarter due to higher inventory levels maintained in the quarter. On the other hand, depreciation and other income declined by nearly 2% and 66% YoY for the quarter. In addition, M&M booked capital gains of Rs1.7 Bn (Rs1.5 Bn net of tax) as capital gains from sale of a part stake in Mahindra Finance, which went public this quarter. Effective tax rate for the quarter was at 27%. M&M has ended F2006 with revenues, EBITDA and PBT before extraordinary increasing by 23%, 23% and 24% respectively. EBITDA margins for F2006 remained flattish at 11.5% and we expect margins to expand to 12.6% in F07E and 12.8% in F08E.

Consolidated Results Impressive: On a consolidated basis M&M posted 31%, 46% and 94% YoY growth in revenues, EBITDA and net earnings respectively for F2006 (excluding exceptional items, PAT grew by 61% YoY). Consolidated EBITDA margins were at 14%, a YoY increase of 140 bps. M&M standalone formed nearly 67% of consolidated net revenues and nearly half of consolidated EBIT. The key subsidiaries contributing to growth included Mahindra Tech, Mahindra Financial Services and, Mahindra Holidays.

Key Ratios and Statistics

Reuters: MAHM.BO Bloomberg: MM IN

India Four-Wheelers

Price target	Rs676.00
Shr price, close (May 29, 2006)	Rs591.50
Mkt cap, curr (mn)	Rs145,278
52-Week Range	Rs719.00-244.00
Sh out, basic, curr (mn)	246
EV, curr (mn)	Rs136,185

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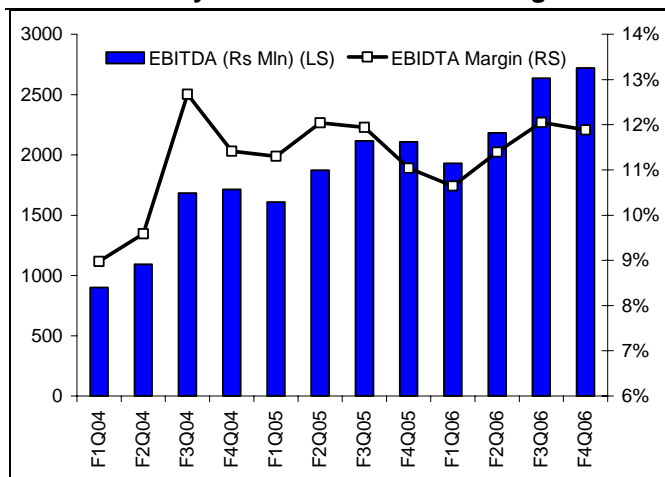
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Improved Realizations Aided Margin Expansion

Average realizations in the automotive and tractor segments improved by nearly 7.5% and 8.1% respectively in F4Q06. This was primarily driven by a change in product mix (higher proportion of Scorpio sales, higher export sales and also some price increases taken to cushion the impact of changed emission norms). Scorpio sales volumes comprised nearly 25% of total UV sales in F4Q06 as compared to 22% in F4Q05. On a full year basis, Scorpio sales have grown by 18% YoY and formed nearly 28% of UV sales in F2006. M&M spent nearly Rs300 Mn in upgrading the Scorpio with added features including new suspension and styling elements. M&M is looking at increasing price of the Scorpio by Rs10,000-20,000 over the next few weeks which will help margins to expand in F1Q07.

Exhibit 1
M&M: Quarterly EBITDA and EBITDA Margin Trend



Source: Company data, Morgan Stanley Research

Modest Volume Growth in Automotive Segment

Despite Scorpio volumes growing by nearly 22% in F4Q06, automotive volumes grew by a modest 5% YoY growth. UVs (excluding Scorpio) grew by 3% YoY in the quarter. LCVs declined by 19% YoY due to slower ramping of BS-II compliant LCV production and non-availability of BS-III vehicles. Three-wheelers also posted modest 3% YoY growth for the quarter. For F2006, automotive sales grew by 2% YoY, with Scorpio sales rising by 18% YoY. Excluding Scorpio sales, automotive sales have declined by 2% YoY. Three-wheeler sales have declined by 3% YoY in F2006 with industry growing by nearly 8% for the year. This was on account of no significant new product launches by M&M in F2006 and competition from TAMO's 1 tonner pick up vehicle,

Ace, which was launched in May 2005 and has performed exceedingly well. To combat competition M&M is launching its 0.5 tonner vehicle Champion Alfa in new states like Gujarat and is also preparing CNG engines for the same. Gujarat is the fifth state where Alfa has been launched after AP, Karnataka, Kerala and Maharashtra. M&M's EBIT margins in the automotive business have decreased by 50 bps from 10.3% to 9.8%. For F2006, EBIT margin for automotive business was at 10.3%, a YoY decline of 20 bps and ROCE was 46.6% (up 40 bps YoY)

Tractor Business Continues to Witness Strong Growth

With good monsoons, reduction in inventories over past two years and rural credit support, tractor volumes rose by 23% YoY in F4Q06, ending F2006 with a 30% YoY growth. Tractor export sales have grown by 30% YoY and M&M expects to improve the growth with new outfits set up in Australia and China in F2006. In the domestic market, M&M has gained 320 bps market share to 29.7%. EBIT margins for the tractor business improved by 210 bps to 10.5% in the quarter while for F2006 EBIT margins improved by 180 bps to 11.2% with ROCE of 53.3% up 19.2%.

Focus on Export Markets

In F2006, M&M posted a 30% and 82% growth in exports in the tractors and automotive segments respectively. Exports accounted for 8% and 4% of sales from these segments and M&M is looking at increasing the contribution from exports significantly going forward, tapping various new markets such as Spain, Portugal, Egypt and Turkey. M&M has appointed Sino Motors to be its importer and distributor in Spain, which is one of the large markets in Europe for sports utility vehicles (SUVs) and has launched Mahindra Goa, Mahindra Pik-up and Bolero Pik-Up over there. M&M has a presence in the US, China, Malaysia, West Asia, Australia, Latin America and the Middle East. M&M targets assembling pick-up trucks in Malaysia from F2007.

Significant Contribution from Subsidiaries

Subsidiaries and associate companies contribution (net of dividend and minority interest) was approx. 36% for F2006 and we expect the contribution to continue at these levels over next few years. M&M's key subsidiary Mahindra Finance (MFL) was listed on the exchange in March 2006 with M&M diluting its stake to 68% in the process. Therefore M&M managed to post capital gains of nearly Rs1.7 Bn (Rs1.5 Bn net of tax) from the sale of its part stake in MFL. MFL posted 47% and 32% YoY growth in revenues and net earnings to Rs5.8 Bn and Rs1 Bn respectively for F2006. Other key M&M subsidiaries like

MBT posted 31% and 130% YoY growth in revenues and net earnings respectively

and 11.4x, 8.6x and 2.9x on our F2008E. The key risks to our earnings are far higher increase in competitive pressures in the UV business, potential rise in interest rates and continued strength in oil and steel prices.

Valuations

At Rs592, M&M trades at a P/E, EV/EBITDA and P/B of 13.6x, 10.8x and 3.6x, respectively on our F2007 estimates

Exhibit 2

M&M: F4Q06 Results

	F4Q05	F3Q06	F4Q06	YoY	QoQ	F2005	F2006	YoY
Volumes								
Tractors	17,578	24,018	21,640	23.1%	-9.9%	65,400	85,029	30.0%
MUVs	32,183	29,594	34,465	7.1%	16.5%	111,138	115,744	4.1%
LCVs	1,910	1,541	1,545	-19.1%	0.3%	7,887	6,777	-14.1%
3-W	6,951	6,260	7,136	2.7%	14.0%	22,943	22,419	-2.3%
Total automotives	41,044	37,395	43,146	5.1%	15.4%	141,968	144,940	2.1%
Total Sales	58,622	61,413	64,786	10.5%	5.5%	207,368	229,969	10.9%
Sales	19,107	21,867	22,888	19.8%	4.7%	66,606	82,021	23.1%
Total Expenditure	16,998	19,231	20,168	18.6%	4.9%	58,899	72,554	23.2%
EBITDA	2,109	2,636	2,720	29.0%	3.2%	7,707	9,467	22.8%
Depreciation	518	558	509	-1.7%	-8.8%	1,841	2,000	8.7%
EBIT	1,591	2,077	2,211	39.0%	6.4%	5,866	7,467	27.3%
Other income	406	403	138	-66.1%	-65.8%	1,085	1,039	-4.3%
Net Interest	1	(21)	(61)	-4817.1%	188.5%	(53)	(184)	246.0%
PBT	1,996	2,501	2,410	20.7%	-3.7%	7,004	8,690	24.1%
Extraord inc	0	689	1,676	NA	143.2%	204	2,365	1061.8%
Extraord exp	39	15	15	-61.5%	0%	68	60	-11.9%
PBT	1,957	3,175	4,070	108.0%	28.2%	7,140	10,995	54.0%
Tax	432	841	859	98.8%	2.1%	2,015	2,424	20.3%
PAT	1,525	2,334	3,211	110.6%	37.6%	5,125	8,571	67.2%
EBIDTA Margin	11.0%	12.1%	11.9%	0.8%	-0.2%	11.6%	11.5%	0.0%
PBT Margin	10.2%	14.5%	17.8%	7.5%	3.3%	10.7%	13.4%	25.0%
Net Margin	8.0%	10.7%	14.0%	6.1%	3.4%	7.7%	10.4%	2.8%
Tax Rate	22.1%	26.5%	21.1%	-1.0%	-5.4%	28.2%	22.0%	-6.2%
% of Sales								
Raw Materials	69.5%	68.0%	71.5%	2.1%	3.5%	69.0%	69.5%	0.5%
Staff Cost	6.1%	6.5%	6.1%	0.0%	-0.3%	7.0%	6.7%	-0.2%
Other Expenses	13.4%	13.5%	10.5%	-2.9%	-3.0%	12.5%	12.2%	-0.3%

Source: Company data, Morgan Stanley Research



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(as of April 30, 2006)

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Total	1,963		640		

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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.

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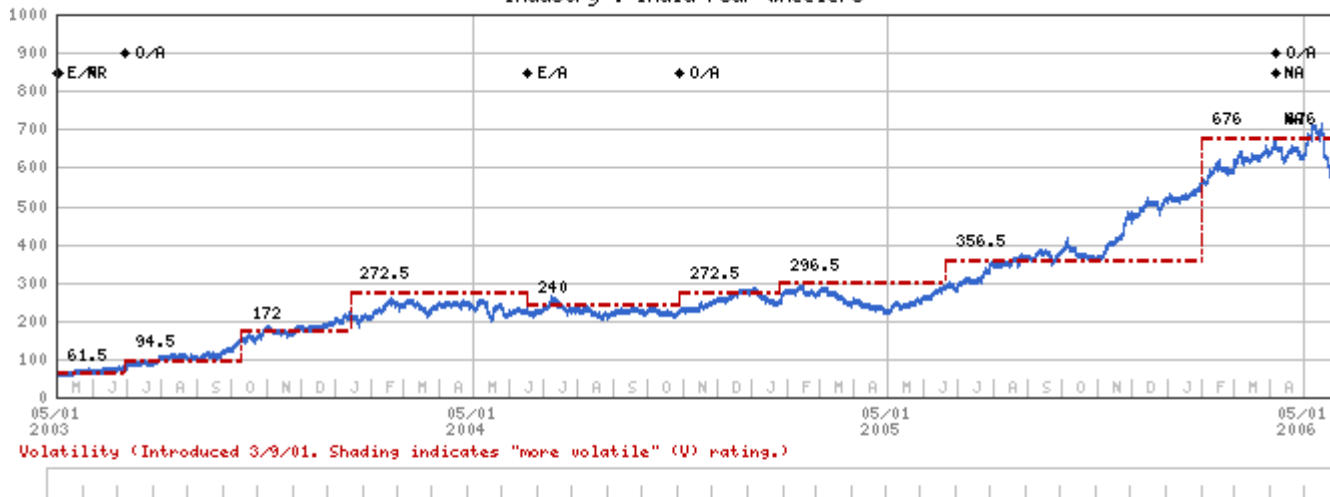
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Stock Price, Price Target and Rating History (See Rating Definitions)

Mahindra & Mahindra (MAHM.BO) - As of 5/29/06 in INR
 Industry : India Four-Wheelers



Stock Rating History: 7/30/02 : E/NR; 5/2/03 : E/A; 6/30/03 : O/A; 6/18/04 : E/A; 10/29/04 : O/A; 4/6/06 : NA;
 4/7/06 : O/A
 Price Target History: 1/7/03 : 61.5; 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

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 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) ■
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Industry Coverage: India Four-Wheelers

Company (Ticker)	Rating (as of)	Price (05/29/2006)
Satish Jain		
Ashok Leyland Ltd. (ASOK.BO)	O (01/14/2004)	Rs40.90
Mahindra & Mahindra (MAHM.BO)	Overweight (04/07/2006)	Rs591.50
Maruti Udyog Ltd. (MRTI.BO)	O (10/20/2005)	Rs791.05
Tata Motors (TAMO.BO)	O (07/11/2005)	Rs825.00

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