

Mahindra & Mahindra

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,742	MM IN
	REUTERS CODE
S&P CNX: 3,156	MAHM.BO

27 July 2006

Buy
Previous Recommendation: Buy
Rs577

Equity Shares (m)	232.0
52-Week Range	719/310
1,6,12 Rel.Perf.(%)	-5/-1/36
M.Cap. (Rs b)	122.5
M.Cap. (US\$ b)	2.6

YEAR	NET SALES	PAT	ADJ.EPS	CONS.	P/E	CONS,	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	EPS (Rs)	(X)	P/E (X)	(%)	(%)	SALES	EBITDA
3/06E	82,227	6,471	26.5	39.6	19.9	13.3	23.3	21.7	1.3	10.8
3/07E	90,443	7,609	31.2	49.7	17.0	10.6	23.9	23.5	1.1	9.1
3/08E	99,708	8,592	35.2	60.0	15.0	8.8	23.3	23.9	1.0	7.9

M&M's 1QFY07 results were ahead of expectations due to strong performance in the farm equipment segment, backed by improved margins therein. PAT (after adjusting for extraordinary items) grew 27.2% YoY to Rs1.87b, v/s our expectation of Rs1.55b. Consolidated PAT (after minority) registered a growth of 53% YoY to Rs2.9b.

- Net sales grew 22.4% YoY, ahead of volume growth of 19%, reflecting 2.5% growth in average realizations. We have reduced the net sales, EBITDA and PAT by Rs190m, to adjust for an octroi received by the company for the earlier years.
- PAT (after extraordinary items), which grew 27.2% YoY to Rs1.87b, was ahead of our estimate at Rs1.55b.
- EBITDA margin at 11.3% (up 68bp YoY but down 134bp QoQ) was inline with expectation. Improvement in EBITDA margins on YoY basis was on account of lower other expenses (11.7% in 1QFY07 v/s 12.4% in 1QFY06) and lower staff costs (7.3% in FY07 v/s 7.9% in 1QFY06). These gains were offset to some extent by higher RM/sales in the quarter (69.6% in 1QFY07 v/s 69% in 1QFY06).
- Other income more than doubled to Rs454m, buoyed by higher dividends from group companies (Rs 276m).

Though M&M offers a relatively low risk exposure to India's automotive industry, it trades at a discount to most of its peers. The stock trades at 11.6x FY07E and 9.6x FY08E consolidated earnings. Our SOTP valuation of Rs803 indicates a 39.2% upside from current levels. We recommend **Buy**.

QUARTERLY PERFORMANCE

Y/E MARCH	FY06				FY07E				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Total Volumes (nos)	52,421	53,746	62,845	65,587	62,426	59,590	70,000	73,079	234,599	265,095
Total Income	18,119	19,148	21,867	23,093	22,172	20,699	23,625	23,945	82,227	90,443
Change (%)	27.3	23.2	23.4	20.9	22.4	8.1	8.0	3.7	23.5	10.0
Total Cost	16,190	16,966	19,231	20,168	19,660	18,257	20,625	20,828	72,555	79,370
EBITDA	1,929	2,182	2,636	2,926	2,512	2,443	3,000	3,117	9,672	11,072
As % of Sales	10.6	11.4	12.1	12.7	11.3	11.8	12.7	13.0	11.8	12.2
Change (%)	19.9	16.4	24.5	38.8	30.2	11.9	13.8	6.5	25.5	14.5
Non-Operating Income	204	294	403	138	454	400	350	257	1,039	1,462
Interest	-54	-48	-21	-61	-147	-60	-50	187	-184	-70
Gross Profit	2,171	2,509	3,734	4,785	3,288	2,903	3,400	3,188	13,200	12,604
Less: Depreciation	466	466	558	509	463	500	535	611	2,000	2,109
Amortisation										
PBT	1,705	2,043	3,175	4,276	2,825	2,403	2,865	2,577	11,200	10,495
Tax	253	472	841	859	784	630	725	748	2,424	2,886
Effective Tax Rate (%)	14.8	23.1	26.5	20.1	27.7	26.2	25.3	29.0	21.6	27.5
PAT	1,453	1,572	2,334	3,417	2,042	1,773	2,140	1,829	8,775	7,609
Change (%)	39.8	27.8	75.3	124.1	40.6	22.0	36.2	-21.6	47	-13
Adj PAT	1,468	1,587	1,790	1,626	1,867	1,773	2,140	1,829	6,471	7,609
Change (%)	61.5	27.9	33.0	4.0	27.2	11.7	19.6	12.5	28.4	17.6

E: M0St Estimates

Net revenues up 22.4% YoY...

M&M's net revenues grew 22.4% YoY to Rs22.2b in 1QFY07, on the back of 19% volume growth and 2.5% increase in average realizations. Tractors and 3-wheelers, which grew 29.1% and 75.3% YoY, respectively, led overall volume growth, while UVs registered 3.3% growth. Average realizations improved as a result of better sales mix.

...driven by 19% volume growth

Overall volumes grew 19% YoY, led by tractors and three wheelers. As against industry growth of 34%, M&M's tractor volumes in the domestic market grew 32% YoY. The company's market share increased from 25.9% in 1QFY06 to 31.7% in 1QFY07. EBIT margins for the tractor division expanded 380bp to 13.5% due to strong volume growth and richer product mix.

UVs showed moderate growth in 1QFY07. The Scorpio, which accounts for 30% of UV volumes, grew 17.2% YoY. The semi-urban and rural portfolio declined by 4.5% YoY, resulting in overall UV volumes growing 3.3% YoY. M&M's UVs are facing competition from GM Tavera and Toyota Innova. Nevertheless, M&M continues to be the leader in the segment, with share of 43.7% (down 190bp YoY)

VOLUME BREAK-UP (UNITS NOS)

	1QFY07	1QFY06	%CH	4QFY06	%CH
Utility Vehicle	26,547	25,701	3.3	35,072	-24.3
-Scorpio	8,093	6,906	17.2	8,552	-5.4
-Uvs w/o Scorpio	17,123	17,939	-4.5	25,096	-31.8
LCVs	1,930	1,808	6.7	1,545	24.9
Three Wheelers	6,582	3,754	75.3	7,136	-7.8
Total Automotive	35,059	31,263	12.1	43,753	-19.9
Tractors	27,367	21,200	29.1	21,640	26.5
Total	62,426	52,463	19.0	65,393	-4.5
Exports - UVs	1,331	856	55.5	1,424	-6.5
Exports - Tractors	2,325	3,877	-40.0	2,266	2.6
Total Exports	3,656	4,733	-22.8	3,690	-0.9

Source: Company/ Motilal Oswal Securities

RESIDUAL GROWTH REQUIRE

	FY07	FY06	GR. (%)
YTD FY07	62,426	52,463	19.0
FY07 estimate	265,095	234,447	13.1
Residual Growth Req.(%)	11.0		
YTD FY07	26,547	25,701	3.3
UV's - FY07 Estimate	135,227	120,222	12.5
Residual Growth Req.(%)	15.0		
YTD FY07	27,367	21,200	29.1
Tractors -FY07 est.	97,758	85,007	15.0
Residual Growth Req.(%)	10.0		

Source: Company/ Motilal Oswal Securities

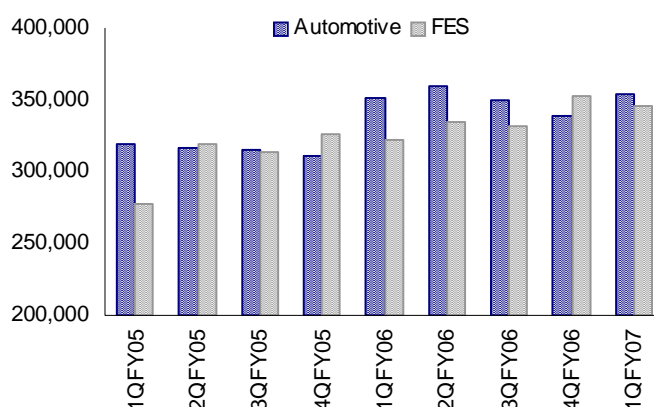
Exports decline YoY

In 1QFY07, M&M's automotive segment exports grew 55.5% YoY to 1,331 units. The company exported 2,323 tractors as against 3,877 in 1QFY06, a decline of 40% YoY.

2.5% increase in average realization

Average realization increased 2.5% YoY on account of a richer product mix in the automotive division. The Scorpio and Hardtops continued their higher proportion of sales. As a result, EBIT margins for the automotive division (adjusted for octroi refund) decreased 30bp to 8.5%. Similarly, EBIT margins for the tractor division expanded 380bp to 13.5% due to strong volume growth and richer product mix. Also, higher spare part and engine sales could have contributed. M&M's engine sales increased 70% to 4,731 units.

REALISATION/UNIT (RS)



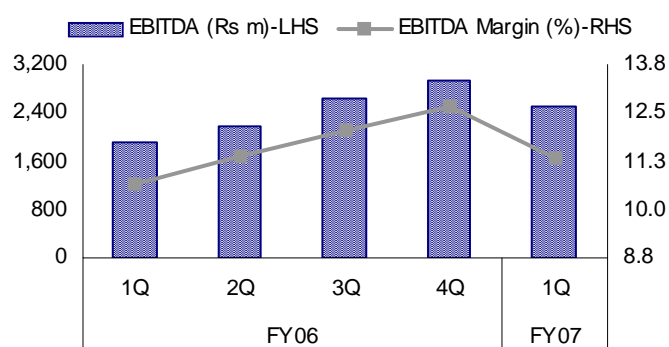
Source: Company/ Motilal Oswal Securities

EBITDA margins expand 68bp, despite higher input costs

M&M's EBITDA margins for 1QFY07 expanded 68bp YoY but decline 134bp QoQ to 11.3%. EBITDA grew 30.2% YoY to Rs2.5b, aided by declining other expenses (11.7% in 1QFY07 v/s 12.4% in 1QFY06) and lower staff costs (7.3% in FY07 v/s 7.9% in 1QFY06). These gains were offset to some extent by higher RM/sales in the quarter (69.6% in 1QFY07 v/s 69% in 1QFY06).

M&M has also started sourcing material for both the divisions for some time – automotive and farm equipment together and synergies in sourcing may help M&M maintain margins at current levels, going forward. MSAT will act as the sourcing partner.

EBITDA MARGIN IMPROVING DESPITE INPUT PRESSURE



Source: Company/ Motilal Oswal Securities

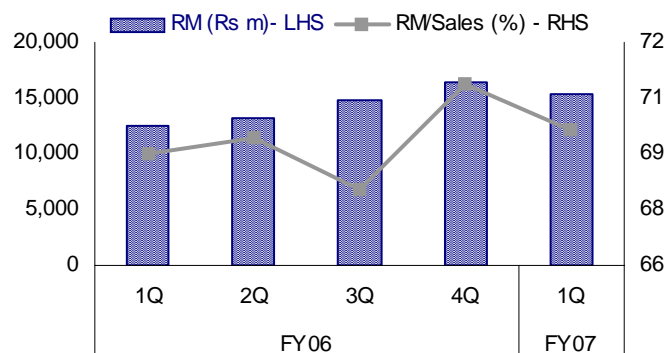
SEGMENT-WISE DETAILS (RS M)

	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07
Revenue from Operations					
Automotive Segment	10,991	12,793	13,566	14,848	12,248
Farm Equipment Segment	6,823	6,088	7,988	7,641	9,463
Other Segments	634	745	801	891	926
Total *	18,448	19,625	22,354	23,380	22,637
Profit/Loss Before Interest and Tax					
Automotive Segment	963	1,308	1,887	1,455	1,040
Farm Equipment Segment	663	716	985	802	1,274
Other Segments	29	29	31	35	35
Total *	1,655	2,054	2,904	2,292	2,350
Margins (%)					
Automotive Segment	8.8	10.2	13.9	9.8	8.5
Farm Equipment Segment	9.7	11.8	12.3	10.5	13.5
Other Segments	4.6	3.9	3.9	3.9	3.8
ROCE (%)					
Automotive Segment	10.2	12.2	17.8	12.7	9.5
Farm Equipment Segment	11.6	10.9	15.7	13.4	20.4
Total	10.8	11.8	17.1	12.9	13.5

* Includes inter-segmental revenues

Source: Company/ Motilal Oswal Securities

RAW MATERIAL COSTS



Source: Company/ Motilal Oswal Securities

Adjusted PAT up 27.2% YoY

Reported PAT grew 40.6% YoY to Rs2b. However, 1QFY07 figures include an octroi refund of Rs190m received by the company for earlier years. We have reduced the same from net sales, EBITDA and PAT. As a result, adjusted for extraordinaries, PAT grew 27.2% YoY to Rs1.9b.

Consolidated results: Robust performance

Consolidated income (including other income) increased by 43% to Rs41.8b, due to all round strong performance of all the group companies. PBT (before exceptional items) grew 83% to Rs4.8b resulting in PAT growth (after minority interest and share of associates) of 53% to Rs2.9b.

SUBSIDIARY PERFORMANCE (RS M)

	1QFY07	1QFY06	YOY GR. (%)
MMFSL			
NI	919	646	42.2
EBITDA	559	483	15.8
EBITDA Margins (%)	61	75	
Net Profit	192	170	13.2
Mahindra Gesco Limited			
Net Sales	343	246	39.3
EBITDA	65	51	27.7
EBITDA Margins (%)	19	21	
Net Profit	34	23	47.6
Tech Mahindra			
Net Sales	5,871	2,419	142.7
EBITDA	1,278	423	202.1
EBITDA Margins (%)	22	17	
Net Profit	1,066	338	215.4
MUSCO			
Net Sales	1,514	1,426	6.2
EBITDA	215	169	27.2
EBITDA Margins (%)	14	12	
Net Profit	105	84	25.0

Source: Company/ Motilal Oswal Securities

STANDALONE V/S CONSOLIDATED RESULT

	1Q FY07	1Q FY06	YOY GR (%)
Dividend Income (S)	276	106	160.9
Standalone adj. PAT excl div	1,590	1,362	16.8
Consol PAT	2,900	1,895	53.0
S/a PAT excl div as % of consol	54.8	71.9	

Source: Company/ Motilal Oswal Securities

Conference call highlights

- M&M is to undertake capex of Rs6.5b, however, due to sufficient cash availability, will not need any further fund-raising activity.
- SEBI's approval has been received for the listing of MASL, and the company will now work with the stock exchanges to carry forward the process.
- Although Safari has announced a price cut last quarter, M&M won't enter into a price war by cutting Scorpio's prices, since the management feels that Scorpio is a more recent product. However, in the short-term, Safari has been able to increase its share in the UV segment.
- The management expects a long-term growth of 8-10% in the tractor segment.

Investment arguments

Core business – growing in strength: M&M enjoys market leadership in both utility vehicles (UVs) and tractors. Given the rural bias in its product mix, we expect the company to benefit significantly from government's thrust on the development of the rural economy. We believe that the company would witness robust volume growth and maintain its market share in both UVs and tractors for the next two years.

UVs – expect 12% CAGR over FY06-08: Driven by rising UV penetration and improvement in road infrastructure, we expect UVs to outperform the passenger vehicle segment. In our opinion, M&M is best positioned in the UV segment. It provides the full range of UVs across user segment – taxi, semi urban, rural and urban.

Tractors estimates 12% CAGR over FY06-08: The current UPA government is highly committed to improving the terms of trade for rural economy. Being the industry leader, with market share of 30%, we expect M&M's tractor volumes to grow at least in line with the industry.

Exports to contribute significantly to growth: M&M has recorded strong growth in exports (both tractors and UVs) over the last four years. Exports contributed 5% to M&M's volumes in FY06. We believe that exports would contribute significantly to volume growth going forward.

Subsidiaries and associates – adding substantial value: M&M has invested in other Mahindra group companies. We believe that its non automotive subsidiaries like Tech Mahindra, the recently listed Mahindra Financial Services (MMFSL), and Mahindra Gesco would not only add significantly to M&M's consolidated financials but also valuations. We estimate the value of its non automotive subsidiaries at Rs183/share – almost half of its core business.

New initiatives in passenger cars and commercial vehicles and MSAT, potential blockbusters in our opinion: M&M's entry into the auto-parts business (MSAT) is a value proposition. In FY05, MSAT posted revenues of

Rs11b, which it aims to increase to Rs45b over the next five years. It's recently proposed JVs to manufacture passenger cars and commercial vehicles would start contributing post 2008.

Valuation and view

Though M&M offers a relatively low risk exposure to India's automotive industry, it trades at a discount to most of its peers. The stock trades at 11.6x FY07E and 9.6x FY08E consolidated earnings. Our SOTP valuation of Rs803 indicates a 39.2% upside from current levels. We recommend **Buy**.

Mahindra & Mahindra: an investment profile

Company description

Mahindra & Mahindra, the leading UV and Tractor manufacturer in the country, has gone from strength to strength during the quarter. Its market share in overall tractor sales stands at 31.7%, which is a marginal improvement of 10bp on a YoY basis. It is also expected to benefit from the Government's thrust on the development of the rural economy. In the UV segment, it is expected to maintain its market share in even in the face of competition.

Key investment arguments

- M&M has been able to increase its tractor volumes at 29.1% YoY in 1Q FY07, which is slightly higher than the industry growth.
- The company's increased focus on exports and the well acceptance of the Scorpio despite strong competition is a big positive. We expect UV's to outperform the passenger vehicle market, with M&M being best positioned in this segment.

Key investments risks

- Numerous launches in the UV has lead to an increase in the competitive scenario
- Susceptibility to monsoons remains a key threat in the tractors segment.

COMPARATIVE VALUATIONS

		M&M	TATA MOTORS	MARUTI
P/E (x)	FY07E	11.6	13.9	14.8
	FY08E	9.6	11.7	12.6
EPS Gr (%)	FY07E	25.5	24.3	26.1
	FY08E	20.9	18.9	17.4
RoE (%)	FY07E	23.9	26.8	22.4
	FY08E	23.3	25.9	21.4
EV/EBITDA (x)	FY07E	10.2	8.3	7.7
	FY08E	8.8	7.0	6.1

SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	22.8	23.6	24.0
Domestic Institutions	21.5	23.4	27.1
FII's/FDIs	41.9	38.7	34.7
Others	13.8	14.3	14.3

Recent developments

- Mahindra – Renault's first product launch – the Logan, will be in the fast growing 'C' segment. The JV would start contributing positively to M&M's consolidated earnings post FY08.
- After the successful IPO of M&M Financial Services, Tech Mahindra has lined up its maiden public offering.

Valuation and view

- We are maintaining our FY07 and FY08 standalone earnings estimates of Rs31.2 and Rs35.2 respectively. Consolidated earnings estimates for FY07 and FY08 are Rs49.7 and Rs60.0 respectively.
- On a consolidated basis, the stock trades at 11.6x FY07E EPS of Rs49.7 and 9.6x FY08E EPS of Rs60.0. We maintain our **Buy** recommendation with a SOTP based price target of Rs803.

Sector view

- We remain bullish on the macro growth picture for passenger cars in India
- We also believe that within passenger cars, UVs will increase their market share consistently over the next few years
- We maintain an overweight stance on the sector.

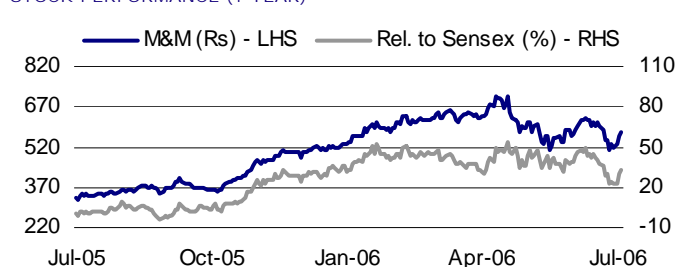
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	49.7	32.5	52.7
FY08	60.0	35.5	69.1

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
577	803	39.2	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Net Sales	48,855	65,307	82,227	89,631	98,996	
Change (%)	33.2	33.7	25.9	9.0	10.4	
Operating Other Income	542	1,299	0	812	712	
Total Income	49,397	66,606	82,227	90,443	99,708	
Total Expenditure	44,285	58,897	72,555	79,370	87,299	
EBITDA	5,111	7,709	9,672	11,072	12,409	
Change (%)	97.5	50.8	25.5	14.5	12.1	
% of Net Sales	10.3	11.6	11.8	12.2	12.4	
Depreciation	1,652	1,840	2,000	2,109	2,306	
EBIT	3,459	5,869	7,672	8,963	10,103	
Interest & Finance Charges	516	-56	-184	-70	-70	
Other Income	1,178	1,084	1,039	1,462	1,678	
Non-recurring Expense	34	3	45	0	0	
Non-recurring Income	295	136	2,350	0	0	
Profit before Tax	4,381	7,141	11,200	10,495	11,851	
Tax	897	2,015	2,424	2,886	3,259	
Effective Rate (%)	20.5	28.2	21.6	27.5	27.5	
Profit after Tax	3,485	5,126	8,776	7,609	8,592	
% of Net Sales	7.1	7.7	10.7	8.4	8.6	
Adj. Profit after Tax	3,316	5,040	6,471	7,609	8,592	
Change (%)	187.8	52.0	28.4	17.6	12.9	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Share Capital	2,320	2,320	2,320	2,320	2,320	
Reserves	16,590	18,962	25,442	29,528	34,574	
Networth	18,910	21,283	27,762	31,848	36,894	
Deferred tax	2,033	1,898	1,898	1,898	1,898	
Loans	7,298	10,526	10,526	10,526	10,526	
Capital Employed	28,241	33,706	40,186	44,272	49,317	
Gross Fixed Assets	25,209	26,997	31,497	35,997	40,497	
Less: Depreciation	11,677	13,356	15,356	17,465	19,771	
Net Fixed Assets	13,532	13,642	16,141	18,532	20,726	
Capital WIP	384	1,107	501	502	503	
Investments	11,112	11,898	12,398	12,898	13,398	
Curr.Assets, L & Adv.	15,984	24,334	34,720	38,730	43,348	
Inventory	4,997	7,294	8,945	9,815	11,035	
Sundry Debtors	4,005	5,115	6,422	6,942	7,673	
Cash & Bank Balances	2,333	6,240	16,516	19,125	21,780	
Loans & Advances	2,885	4,197	2,500	2,501	2,502	
Others	1,764	1,488	338	348	358	
Current Liab. & Prov.	13,069	17,518	23,574	26,390	28,657	
Sundry Creditors	9,902	10,948	17,179	18,307	20,128	
Other Liabilities	197	1,572	1,622	1,672	1,722	
Provisions	2,970	4,997	4,773	6,410	6,806	
Net Current Assets	2,915	6,816	11,146	12,340	14,691	
Misc. Expenditures	96	244	0	0	0	
Application of Funds	28,241	33,706	40,186	44,272	49,317	

E: M O S t Estimates

RATIOS						
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Basic (Rs)						
Adjusted EPS	14.3	21.0	26.5	31.2	35.2	
Consolidated EPS	17.4	25.4	39.6	49.7	60.0	
Cash EPS	214	297	365	419	470	
Book Value per Share	815	917	119.7	137.3	159.0	
DPS	4.5	6.5	5.0	7.5	7.6	
Payout (Incl. Div. Tax) %	60.7	59.6	26.8	46.3	413	
Valuation (x)						
P/E	37.0	25.2	19.9	17.0	15.0	
Consolidated P/E	30.3	20.8	13.3	10.6	8.8	
Cash P/E	24.7	17.8	14.5	12.6	11.2	
EV/EBITDA	22.8	14.9	10.8	9.1	7.9	
EV/Sales	2.4	1.8	1.3	1.1	1.0	
Price to Book Value	6.5	5.8	4.4	3.8	3.3	
Dividend Yield (%)	0.9	12	0.9	14	14	
Profitability Ratios (%)						
RoE	17.5	23.7	23.3	23.9	23.3	
RoCE	16.4	20.6	21.7	23.5	23.9	
Turnover Ratios						
Debtors (Days)	25	25	25	25	25	
Asset Turnover (x)	1.7	1.9	2.0	2.0	2.0	
Leverage Ratio						
Debt/Equity (x)	0.4	0.5	0.4	0.3	0.3	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
OP/(Loss) before Tax	3,459	5,869	7,672	8,963	10,103	
Int./Dividends Received	1,178	1,084	1,039	1,462	1,678	
Depreciation & Amort.	1,652	1,840	2,000	2,109	2,306	
Direct Taxes Paid	-635	-2,150	-2,424	-2,886	-3,259	
(Inc)/Dec in Wkg. Capital	3,356	6	5,946	1,415	305	
CF from Oper. Activity	9,011	6,649	14,233	11,063	11,133	
Extra-ordinary Items	261	132	2,305	0	0	
Other Items	301	-147	244	0	0	
CF after EO Items	9,572	6,634	16,782	11,063	11,133	
(Inc)/Dec in FA +CWIP	-1,109	-2,471	-3,894	-4,501	-4,501	
(Pur)/Sale of Invest.	-2,489	-786	-500	-500	-500	
CF from Inv. Activity	-3,598	-3,257	-4,393	-5,001	-5,001	
Change in Networth	681	300	53	2	3	
Inc/(Dec) in Debt	-4,100	3,228	0	0	0	
Interest Paid	-516	56	184	70	70	
Dividends Paid	-2,114	-3,054	-2,349	-3,524	-3,547	
CF from Fin. Activity	-6,050	530	-2,112	-3,452	-3,474	
Inc/(Dec) in Cash	-76	3,907	10,276	2,610	2,658	
Add: Beginning Balance	2,409	2,333	6,240	16,516	19,125	
Closing Balance	2,333	6,240	16,516	19,126	21,782	

E: M O S t Estimates



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Disclosure of Interest Statement

Mahindra & Mahindra

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
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