Indian Autos -- Maintain UNDERWEIGHT

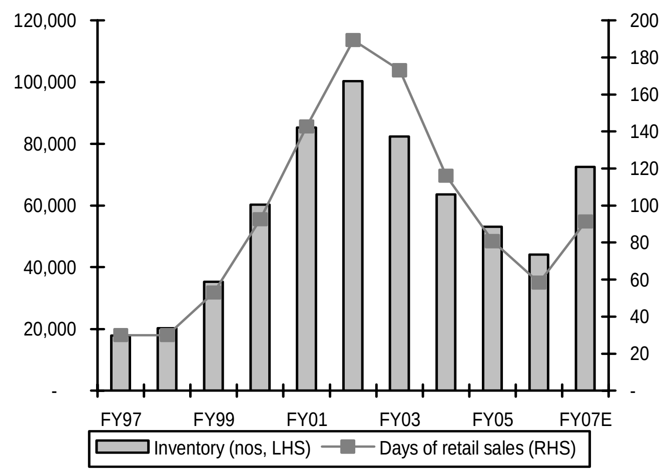
Tractor industry: headed for another sharp correction?

Govindarajan Chellappa / Research Analyst / 91 22 6777 3715 / govindarajan.chellappa@credit-suisse.com

- Feedback from leading tractor financing companies suggests a sharp slowdown in retail sales in FY07. Top 4 players (50% of market) financed roughly 130k tractors in FY07, same as in FY06
- Reported primary sales (manufacturers to dealers) increased 19% to 318k tractors in FY07, suggesting considerable increase (by 25-30k units) in inventory with dealers. Our estimate suggests dealer inventory at 70-75k units, translating to 90 days of retail sales
- North & Central India seem to be most affected by the inventory build up. Banks have cut down exposure to these regions owing to delinquency issues. Amongst manufacturers, Mahindra and TAFE (unlisted) reportedly have the least inventory in the system.
- The scenario seems scarily similar to that in FY99-00, when inventory was high and manufacturers dumped stocks regardless. Industry sales declined 38% in FY00-03. Fundamentals are far better now, government focus on rural lending being the foremost. However, at least a temporary slowdown is round the corner.

Inventory with dealers has gone up (by about 25-30k units) in FY07, for the first time in the last 5 years. While there is a geographical divergence (North and Central India being the worst affected) and manufacturer wise differences (Mahindra seems to have the least inventory) in the trend, deterioration in industry fundamentals is bound to flow through the system affecting all. The slowdown in the retail sales started with banks tightening lending norms on account of high NPAs (in mid-teens for a few players). While the inventory levels are still lower than what it was in FY02, the absolute numbers are very high compared to the optimal levels.

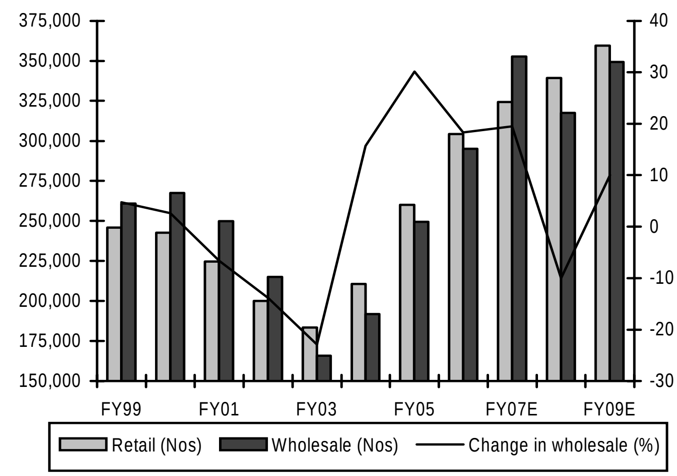
Figure 1: Dealer inventory increasing once again



Source: Credit Suisse estimates.

We expect the top manufacturers to start correcting the situation sooner than later, in an attempt to prevent the repeat of previous downturn (FY00-03) which resulted in a 38% drop in sales and high write-offs. Moreover, with lenders tightening norms, there is little scope for huge growth in retail sales. Assuming a 5% growth in retail sales in FY08E, industry primary sales will have to fall 10% to bring inventory levels down to 60 days of retail sales. However, if retail sales fall 5% in FY08E (due to tight lending norms/bad monsoons), primary sales will have to fall 20% to bring inventory down to 60 days. Growth in exports could prop up sales for a few manufacturers.

Figure 2: Primary sales will likely fall 10% in FY08E

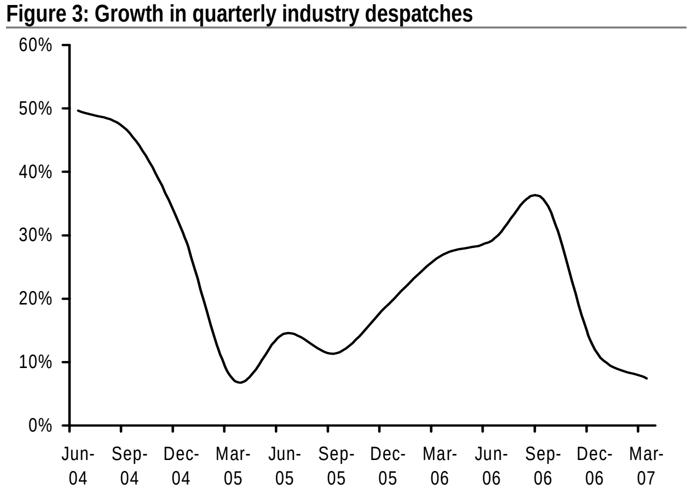


Source: TMA, Credit Suisse estimates; Note: Retail includes exports.

The impact of high dealer inventory is already visible in recent despatch numbers. Mahindra's domestic sales fell 11% in April 2007 (and industry despatches by an estimated 5%). Owing the fragmentation in manufacturing and distribution, correction in inventory will likely get delayed by a few months (or a few years as was the case in previous downturn). That will likely lead to a sharper and more painful correction at a later stage (much like the previous downturn).

We forecast a 5% growth in tractor sales for Mahindra in FY08E.

Figure 3: Growth in quarterly industry despatches



Source: Company data, Credit Suisse estimates.

Companies Mentioned *(Price as of 09 May 07)*
Mahindra & Mahindra (MAHM.BO, Rs761.05, NEUTRAL, TP Rs811.63)
Tractor & Farm Equipment (TAFE, not listed)

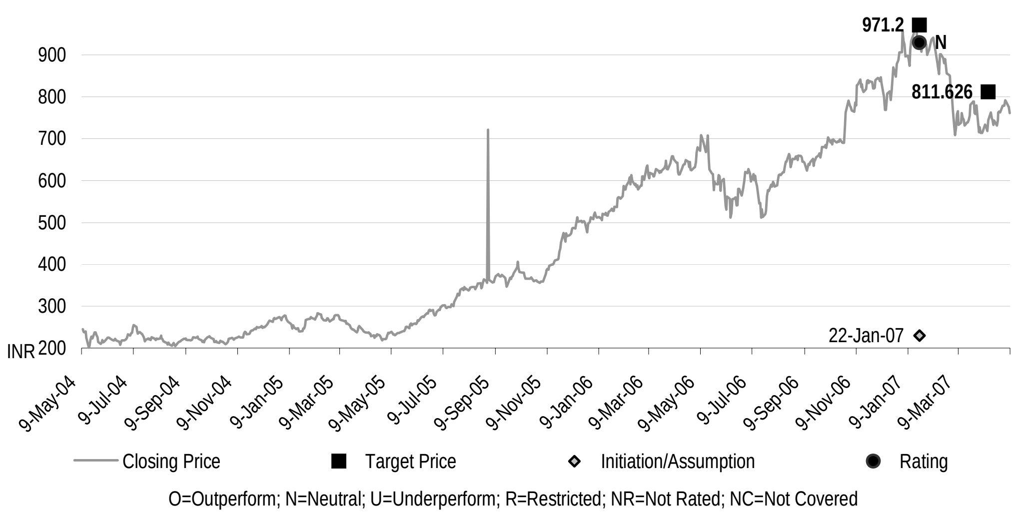
Disclosure Appendix

Important Global Disclosures

I, Govindarajan Chellappa, certify that (1) the views expressed in this report accurately reflect my personal views about all of the subject companies and securities and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

See the Companies Mentioned section for full company names.

3-Year Price, Target Price and Rating Change History Chart for MAHM.BO



MAHM.BO Date	Closing Price Price (INR)	Target Price Price (INR)	Rating	Initiation/ Assumption
22-Jan-07	929.2	971.2	NEUTRAL	X
13-Apr-07	744.6	811.626		

The analyst(s) responsible for preparing this research report received compensation that is based upon various factors including Credit Suisse's total revenues, a portion of which are generated by Credit Suisse's investment banking activities.

Analysts' stock ratings are defined as follows***:

Outperform: The stock's total return is expected to exceed the industry average* by at least 10-15% (or more, depending on perceived risk) over the next 12 months.

Neutral: The stock's total return is expected to be in line with the industry average* (range of ±10%) over the next 12 months.

Underperform:** The stock's total return is expected to underperform the industry average* by 10-15% or more over the next 12 months.

**The industry average refers to the average total return of the analyst's industry coverage universe (except with respect to Asia/Pacific, Latin America and Emerging Markets, where stock ratings are relative to the relevant country index, and Credit Suisse Small and Mid-Cap Advisor stocks, where stock ratings are relative to the regional Credit Suisse Small and Mid-Cap Advisor investment universe.*

***In an effort to achieve a more balanced distribution of stock ratings, the Firm has requested that analysts maintain at least 15% of their rated coverage universe as Underperform. This guideline is subject to change depending on several factors, including general market conditions.*

****For Australian and New Zealand stocks a 7.5% threshold replaces the 10% level in all three rating definitions, with a required equity return overlay applied.*

Restricted: In certain circumstances, Credit Suisse policy and/or applicable law and regulations preclude certain types of communications, including an investment recommendation, during the course of Credit Suisse's engagement in an investment banking transaction and in certain other circumstances.

Volatility Indicator [V]: A stock is defined as volatile if the stock price has moved up or down by 20% or more in a month in at least 8 of the past 24 months or the analyst expects significant volatility going forward. All Credit Suisse Small and Mid-Cap Advisor stocks are automatically rated volatile. All IPO stocks are automatically rated volatile within the first 12 months of trading.

Analysts' coverage universe weightings* are distinct from analysts' stock ratings and are based on the expected performance of an analyst's coverage universe versus the relevant broad market benchmark***:**

Overweight: Industry expected to outperform the relevant broad market benchmark over the next 12 months.

Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.
Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.
Credit Suisse Small and Mid-Cap Advisor stocks do not have coverage universe weightings.
***An analyst's coverage universe consists of all companies covered by the analyst within the relevant sector.*
****The broad market benchmark is based on the expected return of the local market index (e.g., the S&P 500 in the U.S.) over the next 12 months.*

Credit Suisse's distribution of stock ratings (and banking clients) is:

	Global Ratings Distribution	
Outperform/Buy*	40%	(62% banking clients)
Neutral/Hold*	41%	(57% banking clients)
Underperform/Sell*	16%	(47% banking clients)
Restricted	4%	

**For purposes of the NYSE and NASD ratings distribution disclosure requirements, our stock ratings of Outperform, Neutral, and Underperform most closely correspond to Buy, Hold, and Sell, respectively; however, the meanings are not the same, as our stock ratings are determined on a relative basis. (Please refer to definitions above.) An investor's decision to buy or sell a security should be based on investment objectives, current holdings, and other individual factors.*

Credit Suisse's policy is to update research reports as it deems appropriate, based on developments with the subject company, the sector or the market that may have a material impact on the research views or opinions stated herein.

Credit Suisse's policy is only to publish investment research that is impartial, independent, clear, fair and not misleading. For more detail please refer to Credit Suisse's Policies for Managing Conflicts of Interest in connection with Investment Research: http://www.csfb.com/research-and-analytics/disclaimer/managing_conflicts_disclaimer.html

Credit Suisse does not provide any tax advice. Any statement herein regarding any US federal tax is not intended or written to be used, and cannot be used, by any taxpayer for the purposes of avoiding any penalties.

See the Companies Mentioned section for full company names.
Price Target: (12 months) for (MAHM.BO)
Method: We set a sum-of-the-parts-based target price of Rs812 for Mahindra & Mahindra. We value the core business on a discounted cash flow (DCF) basis at Rs447 per share (WACC of 11%, terminal growth of 6%, and terminal RoIC of 15%), which translates into 12.2x FY09E, in line with Maruti's target multiple. We value the core business on a DCF basis, as cash flows are becoming increasingly relevant to profitability analysis. We value subsidiaries at Mahindra's share of the market value (for listed subsidiaries) or at the book value of investments. The value of Mahindra's holding in its subsidiaries accounts for over 50% of the company's current market value.
Risks: The key downside risk to Rs812 target price for Mahindra & Mahindar is the possible deterioration of the trade practices in tractors, as was witnessed in the previous downturn. However, in the current cycle, most of the liabilities of advance sales and dealer inventories have been funded by the banks and not by the manufacturers. Moreover, our interaction with dealers suggests than Mahindra has amongst the best trade practices and the lowest inventory in the system and thus will be the least affected. Key upside risks to our target price include the possible excise duty cut on large cars and utility vehicles (at 24% now). Mahindra would be the single largest beneficiary amongst the listed companies, given its exposure to utility vehicles and the recent launch of the Logan.

See the Companies Mentioned section for full company names.
Credit Suisse expects to receive or intends to seek investment banking related compensation from the subject company (MAHM.BO) within the next 3 months.

Important Regional Disclosures

The analyst(s) involved in the preparation of this report have not visited the material operations of the subject company (MAHM.BO) within the past 12 months.

Restrictions on certain Canadian securities are indicated by the following abbreviations: NVS--Non-Voting shares; RVS--Restricted Voting Shares; SVS--Subordinate Voting Shares.
Individuals receiving this report from a Canadian investment dealer that is not affiliated with Credit Suisse should be advised that this report may not contain regulatory disclosures the non-affiliated Canadian investment dealer would be required to make if this were its own report.
For Credit Suisse Securities (Canada), Inc.'s policies and procedures regarding the dissemination of equity research, please visit http://www.csfb.com/legal_terms/canada_research_policy.shtml.

As of the date of this report, Credit Suisse acts as a market maker or liquidity provider in the equities securities that are the subject of this report.

For disclosure information on other companies mentioned in this report, please visit the website at www.credit-suisse.com/researchdisclosures or call +1 (877) 291-2683.
Disclaimers continue on next page.

Disclaimers

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject Credit Suisse, the Swiss bank, or its subsidiaries or its affiliates ("CS") to any registration or licensing requirement within such jurisdiction. All material presented in this report, unless specifically indicated otherwise, is under copyright to CS. None of the material, nor its content, nor any copy of it, may be altered in any way, transmitted to, copied or distributed to any other party, without the prior express written permission of CS. All trademarks, service marks and logos used in this report are trademarks or service marks or registered trademarks or service marks of CS or its affiliates.
The information, tools and material presented in this report are provided to you for information purposes only and are not to be used or considered as an offer or the solicitation of an offer to sell or to buy or subscribe for securities or other financial instruments. CS may not have taken any steps to ensure that the securities referred to in this report are suitable for any particular investor. CS will not treat recipients as its customers by virtue of their receiving the report. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about such investments or investment services. Nothing in this report constitutes investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable or appropriate to your individual circumstances or otherwise constitutes a personal recommendation to you. CS does not offer advice on the tax consequences of investment and you are advised to contact an independent tax adviser. Please note in particular that the bases and levels of taxation may change.
CS believes the information and opinions in the Disclosure Appendix of this report are accurate and complete. Information and opinions presented in the other sections of the report were obtained or derived from sources CS believes are reliable, but CS makes no representations as to their accuracy or completeness. Additional information is available upon request. CS accepts no liability for loss arising from the use of the material presented in this report, except that this exclusion of liability does not apply to the extent that liability arises under specific statutes or regulations applicable to CS. This report is not to be relied upon in substitution for the exercise of independent judgment. CS may have issued, and may in the future issue, a trading call regarding this security. Trading calls are short term trading opportunities based on market events and catalysts, while stock ratings reflect investment recommendations based on expected total return over a 12-month period relative to the relevant coverage universe. Because trading calls and stock ratings reflect different assumptions and analytical methods, trading calls may differ directionally from the stock rating. In addition, CS may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and CS is under no obligation to ensure that such other reports are brought to the attention of any recipient of this report. CS is involved in many businesses that relate to companies mentioned in this report. These businesses include specialized trading, risk arbitrage, market making, and other proprietary trading.
Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information, opinions and estimates contained in this report reflect a judgement at its original date of publication by CS and are subject to change without notice. The price, value of and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. The value of securities and financial instruments is subject to exchange rate fluctuation that may have a positive or adverse effect on the price or income of such securities or financial instruments. Investors in securities such as ADR's, the values of which are influenced by currency volatility, effectively assume this risk.
Structured securities are complex instruments, typically involve a high degree of risk and are intended for sale only to sophisticated investors who are capable of understanding and assuming the risks involved. The market value of any structured security may be affected by changes in economic, financial and political factors (including, but not limited to, spot and forward interest and exchange rates), time to maturity, market conditions and volatility, and the credit quality of any issuer or reference issuer. Any investor interested in purchasing a structured product should conduct their own investigation and analysis of the product and consult with their own professional advisers as to the risks involved in making such a purchase.
Some investments discussed in this report have a high level of volatility. High volatility investments may experience sudden and large falls in their value causing losses when that investment is realised. Those losses may equal your original investment. Indeed, in the case of some investments the potential losses may exceed the amount of initial investment, in such circumstances you may be required to pay more money to support those losses. Income yields from investments may fluctuate and, in consequence, initial capital paid to make the investment may be used as part of that income yield. Some investments may not be readily realisable and it may be difficult to sell or realise those investments, similarly it may prove difficult for you to obtain reliable information about the value, or risks, to which such an investment is exposed.
This report may provide the addresses of, or contain hyperlinks to, websites. Except to the extent to which the report refers to website material of CS, CS has not reviewed the linked site and takes no responsibility for the content contained therein. Such address or hyperlink (including addresses or hyperlinks to CS's own website material) is provided solely for your convenience and information and the content of the linked site does not in any way form part of this document. Accessing such website or following such link through this report or CS's website shall be at your own risk.
This report is issued and distributed in Europe (except Switzerland) by Credit Suisse Securities (Europe) Limited, One Cabot Square, London E14 4QJ, England, which is regulated in the United Kingdom by The Financial Services Authority ("FSA"). This report is being distributed in Germany by Credit Suisse Securities (Europe) Limited Niederlassung Frankfurt am Main regulated by the Bundesanstalt fuer Finanzdienstleistungsaufsicht ("BaFin"). This report is being distributed in the United States by Credit Suisse Securities (USA) LLC ; in Switzerland by Credit Suisse; in Canada by Credit Suisse Securities (Canada), Inc..; in Brazil by Banco de Investimentos Credit Suisse (Brasil) S.A.; in Japan by Credit Suisse Securities (Japan) Limited; elsewhere in Asia/Pacific by whichever of the following is the appropriately authorised entity in the relevant jurisdiction: Credit Suisse (Hong Kong) Limited, Credit Suisse Equities (Australia) Limited , Credit Suisse Securities (Thailand) Limited, Credit Suisse Securities (Malaysia) Sdn Bhd, Credit Suisse Singapore Branch and elsewhere in the world by the relevant authorised affiliate of the above. Research on Taiwanese securities produced by Credit Suisse Taipei Branch has been prepared by a registered Senior Business Person. Research provided to residents of Malaysia is authorised by the Head of Research for Credit Suisse Securities (Malaysia) Sdn. Bhd., to whom they should direct any queries on +603 2723 2020.
In jurisdictions where CS is not already registered or licensed to trade in securities, transactions will only be effected in accordance with applicable securities legislation, which will vary from jurisdiction to jurisdiction and may require that the trade be made in accordance with applicable exemptions from registration or licensing requirements. Non-U.S. customers wishing to effect a transaction should contact a CS entity in their local jurisdiction unless governing law permits otherwise. U.S. customers wishing to effect a transaction should do so only by contacting a representative at Credit Suisse Securities (USA) LLC in the U.S.
Please note that this report was originally prepared and issued by CS for distribution to their market professional and institutional investor customers. Recipients who are not market professional or institutional investor customers of CS should seek the advice of their independent financial advisor prior to taking any investment decision based on this report or for any necessary explanation of its contents. This research may relate to investments or services of a person outside of the UK or to other matters which are not regulated by the FSA or in respect of which the protections of the FSA for private customers and/or the UK compensation scheme may not be available, and further details as to where this may be the case are available upon request in respect of this report.
Any Nielsen Media Research material contained in this report represents Nielsen Media Research's estimates and does not represent facts. NMR has neither reviewed nor approved this report and/or any of the statements made herein.