

Mahindra & Mahindra

STOCK INFO.	BLOOMBERG
BSE Sensex: 14,091	MM IN
	REUTERS CODE
S&P CNX: 4,083	MAHM.BO

31 January 2007

Buy

Previous Recommendation: Buy

Rs900

Equity Shares (m)	255.9
52-Week Range	1,002/488
1,6,12 Rel.Perf.(%)	-7/21/19
M.Cap. (Rs b)	230.4
M.Cap. (US\$ b)	5.2

YEAR	NET SALES	S/A 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
3/06A	81,412	6,479	25.3	37.8	35.6	23.8	22.3	22.1	2.4	22.0
3/07E	98,269	9,158	35.8	55.1	25.2	16.3	25.2	25.5	1.9	15.1
3/08E	106,530	9,839	38.4	65.2	23.4	13.8	23.1	23.9	1.7	13.7

Standalone results

- ✦ M&M's 3QFY07 results were below expectations, as margins declined in the automotive segment. Adj. PAT grew 35.3% YoY to Rs2.4b, against our estimate of Rs2.6b.
- ✦ Net sales grew 17.8% to Rs24.8b (unlike previous quarters, there was no octroi refund adjustment), in line with volume growth of 17.7%, reflecting flattish average realization on a YoY basis.
- ✦ EBITDA margins at 12% (down 10bp YoY and 140bp QoQ) were lower than our estimate of 13.2%. Farm equipment margins continued to expand, while automotive segment margins declined 390bp YoY and 260bp QoQ. We believe that promotional schemes and competitive pressures in the festive season could have contributed to lower margins in the automotive segment.

Consolidated results

- ✦ Total income (including other income) increased by 30.7% to Rs47.6b due to all-round strong performance of group companies as well as the parent company, while adj. PAT was Rs3.3b, an increase of 27% YoY (as per our calculations).

Valuation and view: We have adjusted our consolidated estimates for the strong earnings growth being displayed by Tech Mahindra. As a result, our EPS estimates for FY07 and FY08 have been upgraded by 2.4% and 0.2%, respectively. The stock trades at 16.3x FY07E consolidated EPS of Rs55.1 and 13.8x FY08E consolidated EPS of Rs65.2. We reiterate our **Buy** recommendation.

QUARTERLY PERFORMANCE

Y/E MARCH	(Rs Million)									
	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Total Volumes (nos)	52,421	53,746	62,845	65,587	62,426	66,708	73,971	73,332	234,599	276,437
Total Income	18,119	19,148	21,867	22,278	22,172	24,501	25,761	25,835	81,412	98,269
Change (%)	27.3	23.2	23.4	16.6	22.4	28.0	17.8	16.0	22.2	20.7
Total Cost	16,190	16,966	19,231	20,159	19,660	21,209	22,664	22,699	72,546	86,233
EBITDA	1,929	2,182	2,636	2,119	2,512	3,292	3,096	3,136	8,865	12,036
As % of Sales	10.6	11.4	12.1	9.5	11.3	13.4	12.0	12.1	10.9	12.2
Change (%)	19.9	16.4	24.5	0.5	30.2	50.9	17.5	48.0	15.0	35.8
Non-Operating Income	204	294	403	953	454	478	412	551	1,854	1,895
Extraordinary Income	0	0	689	1,411	190	1,393	0	0	2,100	1,583
Extraordinary Expense	15	15	15	-37	15	0	6	-6	8	15
Interest	-54	-48	-21	-61	-147	-155	-168	-180	-184	-650
Gross Profit	2,171	2,509	3,734	4,581	3,288	5,318	3,670	3,873	12,995	16,150
Less: Depreciation	466	466	558	509	463	501	522	550	2,000	2,037
PBT	1,705	2,043	3,175	4,071	2,825	4,817	3,148	3,323	10,995	14,113
Tax	253	472	841	859	784	952	731	920	2,424	3,387
Effective Tax Rate (%)	14.8	23.1	26.5	21.1	27.7	19.8	23.2	27.7	22.0	24.0
PAT	1,453	1,572	2,334	3,212	2,042	3,865	2,417	2,402	8,570	10,726
Change (%)	39.8	27.8	75.3	110.7	40.6	145.9	3.5	-25.2	47.1	25.2
Adj PAT	1,468	1,587	1,790	1,634	1,867	2,472	2,423	2,396	6,479	9,158
Change (%)	61.5	27.9	33.0	4.6	27.2	55.8	35.3	46.6	28.6	41.3

E: MOST Estimates

Net revenues up 28% YoY...

M&M's net revenues grew 17.8% YoY to Rs25.8b in 3QFY07, on the back of 17.7% volume growth and flat realizations. Unlike previous quarters, there was no octroi refund adjustment. LCVs and 3-wheelers, which grew 40.6% and 34.3% YoY, respectively, led overall volume growth. UV volumes grew 13.7% and tractors registered 17.1% growth.

...driven by 17.7% volume growth

Overall volumes grew 17.7% YoY, led by 3-wheelers and LCVs. As against the industry growth of 15%, M&M's tractor volumes in the domestic market grew 18% YoY in 3QFY07. M&M remains the market leader in tractors, with a share of 31.2%, up from 30.3% in 1HFY07. EBIT margins for the tractor division expanded 270bp YoY to 15% due to strong volume growth and richer product mix.

UVs showed average growth, as *Scorpio* sales increased by a mere 9.4% YoY. Better growth momentum in other UVs helped overall UV sales to increase by 13.7% YoY. M&M's UVs are facing competition from GM's *Tavera* and Toyota *Innova*. Nevertheless, M&M continues to be the leader in the segment, with a domestic market share of 40.8% (down 190bp YoY).

In 3QFY07, M&M's automotive segment exports grew 36.5% YoY to 1,954 units. The company exported 1,486 tractors as against 1,453 in 3QFY06, an increase of 2.3% YoY.

VOLUME BREAK-UP (UNITS NOS)

	3QFY07	3QFY06	% CH	2QFY07	% CH
Utility Vehicle	35,267	31,026	13.7	32,266	9.3
Scorpio	8,702	7,955	9.4	9,893	-12.0
Uvs w/o Scorpio	24,611	21,639	13.7	19,612	25.5
LCVs	2,166	1,541	40.6	1,991	8.8
Three Wheelers	8,408	6,260	34.3	8,887	-5.4
Total Automotive	45,841	38,827	18.1	43,144	6.3
Tractors	28,130	24,018	17.1	23,564	19.4
Total	73,971	62,845	17.7	66,708	10.9
Exports - UVs	1,954	1,432	36.5	2,761	-29.2
Exports - Tractors	1,486	1,453	2.3	1,764	-15.8
Total Exports	3,440	2,885	19.2	4,525	-24.0

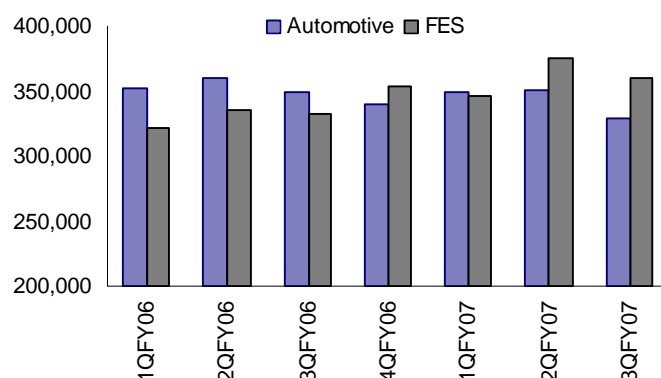
Source: Company/ Motilal Oswal Securities

RESIDUAL GROWTH REQUIRED

MAHINDRA	FY07	FY06	GR. (%)
YTD FY07 Sales (units)	203,105	169,054	20.1
FY07 estimate (units)	276,437	234,447	17.9
Residual Growth Req.(%)			12.1
YTD FY07 Sales (units)	94,080	85,150	10.5
UV's - FY07 estimate (units)	132,845	120,222	10.5
Residual Growth Req.(%)			10.5
YTD FY07 sales (units)	79,061	63,389	24.7
Tractors -FY07 estimate (units)	102,884	85,028	21.0
Residual Growth Req.(%)			10.1

Source: Company/ Motilal Oswal Securities

REALIZATION REMAINS FLAT (RS/UNIT)



Source: Company/ Motilal Oswal Securities

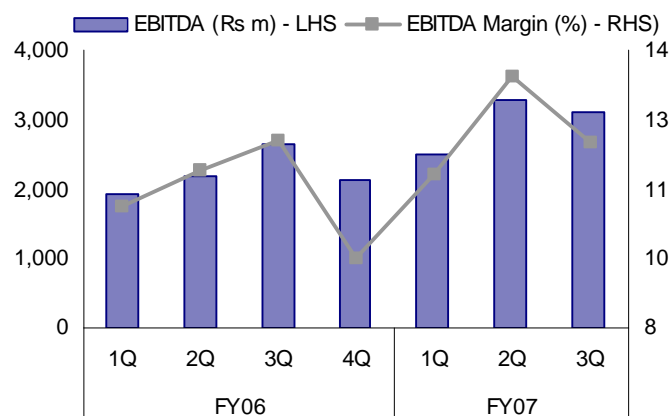
EBITDA margins flat

EBITDA margins at 12% (down 10bp YoY and 140bp QoQ) were lower than our estimate of 13.2%. EBITDA margins were lower on a QoQ basis partially due to the Rs2.3b increase in inventory seen in 2QFY07, which resulted in lower RM/sales at 66.2%. RM/sales increased to 68.3% in 3QFY07 in the absence of a similar build-up in inventory.

Margins in the farm equipment segment improved significantly by 270bp YoY and 80bp QoQ. However, automotive segment margins declined to 10% in 3QFY07, from 13.9% in 3QFY06 and 12.6% in 2QFY07, despite price increases. We believe that promotional schemes and competitive pressures in the festive season could have contributed to lower margins in the automotive segment.

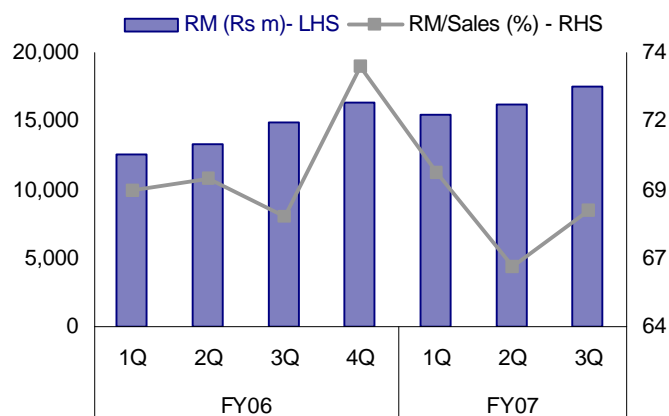
M&M has also been jointly sourcing material for both divisions for quite some time –synergies in sourcing may help M&M maintain margins at current levels, going forward. Mahindra Systech will act as the sourcing partner.

EBITDA MARGINS FLAT...



Source: Company / Motilal Oswal Securities

... AS RAW MATERIAL COSTS INCREASE



Source: Company / Motilal Oswal Securities

SEGMENT-WISE DETAILS (INCLUDES INTER-SEGMENTAL REVENUES)

(RS MILLION)

	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07
Revenue from Operations							
Automotive Segment	10,991	12,793	13,566	14,848	12,248	15,161	15,103
Farm Equipment Segment	6,823	6,088	7,988	7,641	9,463	8,833	10,145
Other Segments	634	745	801	891	926	1,151	1,215
Total *	18,448	19,625	22,354	23,380	22,637	25,145	26,463
Profit/Loss before Interest and Tax							
Automotive Segment	963	1,308	1,887	1,455	1,040	1,914	1,513
Farm Equipment Segment	663	716	985	802	1,274	1,255	1,522
Other Segments	29	29	31	35	35	39	68
Total *	1,655	2,054	2,904	2,292	2,350	3,208	3,102
Margins (%)							
Automotive Segment	8.8	10.2	13.9	9.8	8.5	12.6	10.0
Farm Equipment Segment	9.7	11.8	12.3	10.5	13.5	14.2	15.0
Capital Employed							
Automotive Segment	9,481	10,742	10,610	11,490	10,909	11,645	12,934
Farm Equipment Segment	5,737	6,587	6,264	5,991	6,250	7,456	7,686
Other Segments	160	120	126	219	198	79	207
Total	15,378	17,449	17,000	17,701	17,357	19,180	20,828
RoCE (%)							
Automotive Segment	10.2	12.2	17.8	12.7	9.5	16.4	11.7
Farm Equipment Segment	11.6	10.9	15.7	13.4	20.4	16.8	19.8
Total	10.8	11.8	17.1	12.9	13.5	16.7	14.9

Source: Company / Motilal Oswal Securities

Adjusted PAT up 35.3% YoY

Depreciation was lower than expectations, while interest income exceeded expectations. This led to 35.3% increase in adj. PAT to Rs2.4b.

Consolidated results: robust performance

Total income (including other income) increased by 30.7% to Rs47.6b, due to all-round strong performance of group companies as well as the parent company. PBT (before exceptional items) grew 40.6% to Rs5.5b. It reported PAT of Rs5.3b (+102.1% YoY), while adj. PAT was Rs3.3b, an increase of 27% YoY (as per our calculations).

SUBSIDIARY PERFORMANCE (RS M)

	3QFY07	3QFY06	YOY GR. (%)
MMFSL			
Nil	1,281	829	54.6
EBITDA	786	435	80.5
EBITDA Margins (%)	61.3	52.5	
Net Profit	256	161	59.1
Mahindra Gesco			
Net Sales	418	311	34.2
EBITDA	93	51	83.1
EBITDA Margins (%)	22.3	16.4	
Net Profit	95	25	275.5
Tech Mahindra			
Net Sales	7,698	3,326	131.4
EBITDA	2,072	860	140.9
EBITDA Margins (%)	26.9	25.9	
Net Profit	1,668	751	122.1
MUSCO			
Net Sales	1,763	1,451	21.5
EBITDA	200	174	14.6
EBITDA Margins (%)	11.3	12.0	
Net Profit	96	105	-8.6

Source: Company/ Motilal Oswal Securities

Investment arguments

Core business – from strength to 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 the government's thrust on the development of the rural economy. We believe the company would witness robust volume growth in tractors (14.8% CAGR over FY06-08) and UVs (10.7% CAGR over FY06-08) over the next two years.

UVs – expect 10.7% 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 14.8% 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.

Subsidiaries and associates – adding substantial value: M&M has invested in other Mahindra group companies. M&M's non-automotive subsidiaries like the recently listed Tech Mahindra and Mahindra Financial Services (MMFSL) would continue to add significantly to M&M's consolidated financials and along with Mahindra Gesco also add to its valuations. We estimate the value of its non-automotive subsidiaries at Rs412/share of M&M.

Recent JVs – potential blockbusters: Its recent JVs with Renault and ITEC, which would enable it to enter the passenger car and commercial vehicle segment, are potential blockbusters in our opinion. Besides, the company's acquisition led strategy is fuelling growth of its automotive parts division, Mahindra Systech (MS). MS, which has made a host of acquisitions in the past 12 months, including Stokes, Amforge's Chakan plant Jeco Holdings, is targeting revenues of US\$1b by 2010.

Valuation and view

We remain positive on the growth prospects of M&M's core business. While volume growth would remain strong, margins should remain stable. With several growth drivers for the company over the next 3-4 years, M&M remains one of our top bets in auto sector. We have adjusted our consolidated estimates for the strong growth in earnings being displayed by Tech Mahindra. As a result, our EPS estimates for FY07 and FY08 have been upgraded by 2.4% and 0.2%, respectively. The stock trades at 16.3x FY07E consolidated EPS of Rs55.1 and 13.8x FY08E consolidated EPS of Rs65.2. We reiterate **Buy** with a target price of Rs1,083.

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 30.3%. 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 29.7% YoY in 2QFY07, 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	16.3	15.6	17.8
	FY08E	13.8	13.6	15.1
EPS Gr (%)	FY07E	45.8	34.8	25.7
	FY08E	18.4	14.6	17.5
RoE (%)	FY07E	25.2	29.1	22.4
	FY08E	23.1	26.7	21.4
EV/EBITDA (x)	FY07E	15.1	9.8	10.2
	FY08E	13.7	8.5	8.4

SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	23.1	23.1	23.6
Domestic Inst	21.2	21.6	23.4
Foreign	41.9	41.9	38.7
Others	13.9	13.5	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.
- ✍ Tech Mahindra made a successful maiden public offering.

Valuation and view

- ✍ We have adjusted our consolidated estimates for the strong growth in earnings being displayed by Tech Mahindra. As a result, our EPS estimates for FY07 and FY08 have been upgraded by 2.4% and 0.2%, respectively.
- ✍ The stock trades at 16.3x FY07E consolidated EPS of Rs55.1 and 13.8x FY08E consolidated EPS of Rs65.2. We reiterate **Buy** with a target price of Rs1,083.

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.

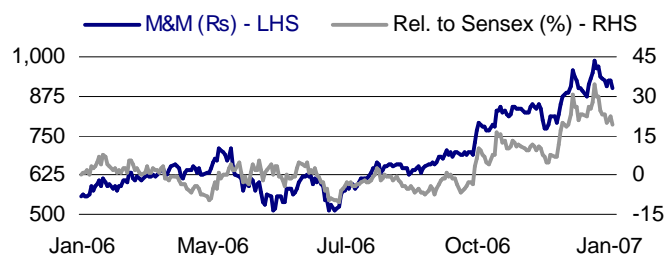
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	55.1	50.8	8.5
FY08	65.2	61.9	5.4

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
900	1,083	20.3	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Gross Sales	75,658	91,137	108,254	119,930	133,012	
Less: Excise	10,350	11,249	12,547	14,112	15,878	
Net Sales	65,307	79,888	95,707	105,818	117,133	
Change (%)	33.7	22.3	19.8	10.6	10.7	
Operating Other Income	1,299	1,524	2,562	712	712	
Total Income	66,606	81,412	98,269	106,530	117,845	
Total Expenditure	58,897	72,546	86,233	93,521	103,642	
EBITDA	7,709	8,865	12,036	13,008	14,204	
Change (%)	50.8	15.0	35.8	8.1	9.2	
% of Net Sales	11.6	10.9	12.2	12.2	12.1	
Depreciation	1,840	2,000	2,022	2,314	2,607	
EBIT	5,869	6,865	10,015	10,694	11,597	
Deferred Revenue Exp.	0	0	15	0	0	
Interest & Finance Charges	-56	-184	-650	-488	-366	
Other Income	1,084	1,854	1,895	1,938	2,062	
Non-recurring Expense	3	8	15	0	0	
Non-recurring Income	136	2,100	1,583	0	0	
Profit before Tax	7,141	10,995	14,113	13,119	14,024	
Tax	2,015	2,424	3,387	3,280	3,506	
Effective Rate (%)	28.2	22.0	24.0	25.0	25.0	
Profit after Tax	5,126	8,571	10,726	9,839	10,518	
% of Net Sales	7.7	10.5	10.9	9.2	8.9	
Adj. Profit after Tax	5,040	6,479	9,158	9,839	10,518	
Change (%)	52.0	28.6	41.3	7.4	6.9	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Share Capital	2,320	2,334	2,334	2,334	2,334	
Reserves	18,962	26,755	34,014	40,286	47,236	
Net Worth	21,283	29,089	36,348	42,620	49,570	
Deferred tax	1,898	1,468	1,468	1,468	1,468	
Loans	10,526	8,834	8,834	8,834	8,834	
Capital Employed	33,706	39,390	46,650	52,922	59,871	
Gross Fixed Assets	26,997	28,855	33,355	37,855	42,355	
Less: Depreciation	13,356	15,103	17,125	19,439	22,046	
Net Fixed Assets	13,642	13,753	16,231	18,416	20,310	
Capital WIP	1,107	1,792	502	503	503	
Investments	11,898	16,691	12,898	13,398	13,898	
Curr.Assets, L & Adv.	24,334	27,614	45,268	50,334	57,575	
Inventory	7,294	8,419	10,663	11,822	13,101	
Sundry Debtors	5,115	6,380	7,437	8,239	9,138	
Cash & Bank Balances	6,240	7,303	24,257	27,351	32,404	
Loans & Advances	4,197	5,112	2,501	2,502	2,502	
Others	1,488	400	410	420	430	
Current Liab. & Prov.	17,518	20,640	28,249	29,729	32,413	
Sundry Creditors	10,948	13,707	19,765	21,279	23,687	
Other Liabilities	1,572	1,502	1,552	1,602	1,652	
Provisions	4,997	5,431	6,932	6,848	7,074	
Net Current Assets	6,816	6,974	17,020	20,605	25,161	
Misc. Expenditures	244	181	0	0	0	
Application of Funds	33,706	39,390	46,650	52,922	59,871	

E: MOST Estimates

RATIOS		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Basic (Rs)						
Adjusted EPS	19.7	25.3	35.8	38.4	41.1	
Consolidated EPS	24.2	37.8	55.1	65.2	76.5	
Cash EPS	29.7	36.3	47.9	52.1	56.2	
Book Value per Share	91.7	124.6	155.7	182.6	212.4	
DPS	6.5	5.0	7.5	7.6	7.6	
Payout (Incl. Div. Tax) %	59.6	27.6	33.0	36.3	33.9	
Valuation (x)						
P/E		35.6	25.2	23.4	21.9	
Consolidated P/E		23.8	16.3	13.8	11.8	
Cash P/E		24.8	18.8	17.3	16.0	
EV/EBITDA		22.0	15.1	13.7	12.2	
EV/Sales		2.4	1.9	1.7	1.5	
Price to Book Value		7.2	5.8	4.9	4.2	
Dividend Yield (%)		0.6	0.8	0.8	0.8	
Profitability Ratios (%)						
RoE	23.7	22.3	25.2	23.1	21.2	
RoCE	20.6	22.1	25.5	23.9	22.8	
Turnover Ratios						
Debtors (Days)	25	26	25	25	25	
Asset Turnover (x)	1.9	2.0	2.1	2.0	2.0	
Leverage Ratio						
Debt/Equity (x)	0.5	0.3	0.2	0.2	0.2	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
OP/(Loss) before Tax	5,869	6,865	10,000	10,694	11,597	
Int./Dividends Received	1,084	1,854	1,895	1,938	2,062	
Depreciation & Amort.	1,840	2,000	2,022	2,314	2,607	
Direct Taxes Paid	-2,150	-2,854	-3,387	-3,280	-3,506	
(Inc)/Dec in Wkg. Capital	6	905	6,908	-491	496	
CF from Oper. Activity	6,649	8,770	17,438	11,175	13,256	
Extra-ordinary Items	132	2,092	1,568	0	0	
Other Items	-147	63	181	0	0	
CF after EO Items	6,634	10,926	19,187	11,175	13,256	
(Inc)/Dec in FA+CWIP	-2,471	-2,796	-3,210	-4,501	-4,500	
(Pur)/Sale of Invest.	-786	-4,793	3,793	-500	-500	
CF from Inv. Activity	-3,257	-7,589	583	-5,001	-5,000	
Change in Net Worth	300	1,598	79	3	2	
Inc/(Dec) in Debt	3,228	-1,692	0	0	0	
Interest Paid	56	184	650	488	366	
Dividends Paid	-3,054	-2,363	-3,545	-3,568	-3,568	
CF from Fin. Activity	530	-2,274	-2,816	-3,078	-3,201	
Inc/(Dec) in Cash	3,907	1,063	16,954	3,094	5,055	
Add: Beginning Balance	2,333	6,240	7,303	24,257	27,351	
Closing Balance	6,240	7,303	24,257	27,351	32,406	

E: MOST Estimates

N O T E S



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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 |
| 4. Investment Banking relationship with company covered | No |

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