

In line with expectations

28th April 2008

BUY

| | |
|--------|--------------|
| Price | Target Price |
| Rs 737 | Rs 1,000 |

Sensex - 17126

Price Performance

| (%) | 1M | 3M | 6M | 12M |
|----------------|------|-----|------|------|
| Absolute | (13) | (8) | (38) | (7) |
| Reel. to Sense | (18) | (7) | (30) | (23) |

Source: Bloomberg

Stock Details

| | |
|-------------------------------|-------------|
| Sector | Automobiles |
| Reuters | MRTI.BO |
| Bloomberg | MSIL@IN |
| Equity Capital (Rs mn) | 1445 |
| Face Value (Rs) | 5 |
| No of shares o/s (mn) | 289 |
| 52 Week H/L (Rs) | 1252/700 |
| Market Cap (Rs bn) | 213 |
| Daily Avg Volt (No of shares) | 840903 |
| Daily Avg Turnover (US\$ mn) | 17.4 |

Shareholding Pattern (%)

(31st Dec'07)

| | |
|---------------|------|
| Promoters | 54.2 |
| FII/NRI | 15.8 |
| Institutions | 23.1 |
| Private Corp. | 3.9 |
| Public | 3.0 |

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Maruti's 4QFY08 operating performance was in line with our estimates, adjusting for MTM loss provision on its forex derivatives and the one time expense of Rs 545 mn, representing compensation to dealer. The MTM provision is with respect to forward cover for its European exports (commencing in 4QFY09) and ECB borrowings. The company has charged higher depreciation in 4QFY08 as the company shortened the life of certain assets, in line with changing dynamics of the industry. This coupled with extraordinary items resulted reported net profits of the company registered a decline of 33.6% to Rs 3 bn. Adjusting for extraordinary items, the company has reported a net profit of 4.8 bn, which is in line with our estimates.

With the change in depreciation policy, the company is now more or less par with the Suzuki Motor Co, except for difference in the method of depreciation. Maruti follows SLM method where as Suzuki follows WDV method. *What surprised us was the sudden change in depreciation policy and also the timing of the same. The change in policy has come immediately after the change in top management (which has raised concerns during the transition phase). In our view, the surprises of the 4QFY08 are likely to create an overhang on the performance of the stock in the short term. The key triggers to the stock are good set of volume numbers and 1QFY09 results.*

We have downgraded our earnings estimates to factor in the change in depreciation policy and the cautious stance of the management on the industry growth. As a result, there is a sharp deceleration in our EPS estimates and the stock appears expensive on PE basis. At current price of Rs 737, the stock trades at a PE of 11 times and 9.6 times our FY09 and FY10 EPS estimates of Rs 67.9 and Rs 77.5 and EV/EBIDTA of 6.4 times and 5.2 times respectively. We are lowering our price target to Rs 1,000 to factor in lower volume growth and rising pressure on profitability. At our target price the stock trades at PE of 14.7 and 12.9 times for FY09 and FY10 respectively and EV/EBIDTA of 9.2 times and 7.5 times for FY09 and FY10 respectively. We maintain our BUY on the stock.

Realizations drive the performance

Maruti registered a 1.2% YoY growth in volumes to 202435 units in 4QFY08. However, net sales grew by 8% YoY to Rs 47.8 bn on account of significant improvement in average realizations. Average realizations registered an improvement of 7% YoY to Rs 236,321 per vehicle sold.

Better Product mix aiding realizations growth

Improving product mix has aided the realization growth. The company had taken a pricing action of around 1% to 1.5% in 4QFY08. Apart from rising sales of new launches, there is higher demand for Via and Six models. But for the capacity constraints at its Manesar plant, the mix could have been more favorable.

| Product mix % | 4QFY08 | 4QFY07 | 3QFY08 |
|----------------------------|--------|--------|--------|
| M-800 | 8.8 | 9.6 | 8.6 |
| Omni, versa | 11.9 | 12.2 | 11.6 |
| Alto, Wagon -R, Zen, Swift | 65.1 | 67.3 | 66.6 |
| SX4, DZire, Esteem | 6.1 | 3.4 | 5.8 |
| Gypsy, Viagra | 0.6 | 0.5 | 0.5 |
| Exports | 7.4 | 7.1 | 6.8 |

Source: Company, Emkay research

Extraordinary items dent EBIDTA growth

EBIDTA declined by 13.5% YoY to Rs 4.8 bn in 4QFY08, against our estimate of Rs 5.8 bn. MTM losses of Rs 505 mn and Dealer compensation of Rs 545 mn affected EBIDTA. The MTM losses pertain to forward cover that company has taken for its European exports (likely to commence in 4QFY09) and ECB borrowings. Adjusting for the two items, the EBIDTA stood at 5.8 bn (in line with our estimates). The compensation to dealers pertains to reduction in the retail prices post the excise duty cut announced in the budget for the inventory held by them on 29th February 2008. Company claims that MTM losses are book entries and pure hedge transaction rather than speculation. The provision is made to company with the accounting standard - 30 on Financial Instruments.

Net Profits nose dives due to accelerated depreciation

In 4QFY08, the company resorted to accelerated depreciation on some of its assets. It revised the estimated useful life of certain plant and machinery from 13 Years to 8-11 Years. dies and digs from 5 Years to 4 Years and electronic data processing Equipment from 6 Years to 3 Years. As a result an additional charge of Rs 2123 for FY08 which was accounted in 4QFY08.

As per the management, with the change in depreciation policy, the company is more or less in line with the policy of Suzuki Motor Co., except for the methods of depreciation. Suzuki follows WDV method, where as Maruti follows, SLM method.

Based on a comparison of the depreciation policy of Maruti, Tata Motors, Ashok Leyland and M&M, it appears that Maruti follows an aggressive. Infact, the move of the company will raise question for other players with respect to their depreciation policy. Given below is the depreciation rate for plant and machinery and schedule XIV of companies act and the policies followed by the companies.

| Schedule XIV rates (%) | SLM | WDV |
|------------------------|------|------|
| Single Shift | 4.8 | 13.9 |
| Double Shift | 7.4 | 20.9 |
| Triple Shift | 10.3 | 27.8 |

Depreciation policy for plant and machinery (based on AR 2006-07)

- Maruti –Plant and Machinery at 7.31% and 11.88% on single shift and double shift respectively. We believe that company has further increased the depreciation rates for the plant and machinery.
- Tata Motors – Depreciation at schedule XIV rates i.e. 4.8% and 7.4% for single and double shift respectively.
- M&M – Certain items of plant and machinery (individually costing more than Rs 5000) over the useful life (2 years, 3 years, 5 years, 7 years as the case may be).
- Ashok Leyland – Over the estimated life of the assets or Schedule XIV, whichever ever is higher.

What surprised us was the sudden change in the depreciation policy as well as the timing of the same. The change in policy has come after a change in the management. Also, recently, Maruti has created a new management structure, dividing the organization into six verticals head by a Japanese expatriate (also being a board member) and a local professional.

Revision in estimates

Considering the cautious stance of the company at the industry level due to rising inflationary concerns, we have lowered our volume estimates which are summarized below. Also, we have factored in the change in the depreciation policy in our numbers. We have downgraded our industry growth estimates by 130 and 110 bps for FY09 and FY10 respectively. For Maruti we have revised our volumes growth estimates by 250 and 100 bps for FY09 and FY10 respectively. Also, we have factored in higher pressure on profitability in FY09 due to higher raw material prices and the lower probability of the pass on of the same due to inflationary pressure in the economy (thereby affecting demand) and competition.

Volume Summary

| | FY07 | FY08E | FY09E | FY10E |
|-----------------|-----------|-----------|-----------|-----------|
| Maruti | | | | |
| Domestic | 635,629 | 711,824 | 791,951 | 849,786 |
| % growth | 20.6 | 12.0 | 11.3 | 7.3 |
| Exports | 38,853 | 51,999 | 73,037 | 168,895 |
| % growth | 11.7 | 33.8 | 40.5 | 131.2 |
| Total | | | | |
| Industry | | | | |
| Domestic | 1,159,499 | 1,293,260 | 1,460,664 | 1,643,057 |
| % growth | 22.3 | 11.5 | 12.9 | 12.5 |

Valuation and View

Adjusting for the extraordinary items and change in depreciation policy, the company has performed in line with our estimates. We believe that there is no change in the operating matrix of the company (EBIDTA and cash flow generation). However, higher depreciation charge has suppressed the EPS estimates by Rs 6.4 mad Rs 7.7 for FY09 and FY10 respectively.

As a result of aggressive depreciation charging policy, the stock appears expensive on PE basis. However, there is not any significant change in the valuation based on EV/EBIDTA and Cash PE basis. At current price of Rs 737, the stock trades at FY09 and FY10 EV/EBIDTA multiple of 6.4 times and 5.2 times respectively. We maintain our buy rating on the stock. However, we have revised our price target to factor in lower growth and rising pressure on profitability. Also, we are downgrading our FY 10 target valuation EV/EBIDTA multiple by 12% to 7.5 times. We recommend a BUY on the stock with a target price of Rs 1000.

Quarterly and annual results summary

| <i>Rs mn</i> | 3QFY07 | 3QFY08 | % change | 9MFY07 | 9MFY08 | % change |
|---------------------------|--------|--------|----------|---------|---------|----------|
| Net Sales | 36,794 | 46,741 | 27.0 | 102,241 | 131,523 | 28.6 |
| Operating Expenses | | | | | | |
| Raw Materials | 27,662 | 35,762 | 29.3 | 76,827 | 100,053 | 30.2 |
| <i>% of Sales</i> | 75.2 | 76.5 | | 75.1 | 76.1 | |
| Staff Costs | 738 | 968 | 31.0 | 2,078 | 2,681 | 29.1 |
| <i>% of Sales</i> | 2.0 | 2.1 | | 2.0 | 2.0 | |
| Other Expenses | 3,323 | 3,879 | 16.7 | 8,943 | 10,930 | 22.2 |
| <i>% of Sales</i> | 9.0 | 8.3 | | 8.7 | 8.3 | |
| EBIDTA | 5,071 | 6,133 | 20.9 | 14,393 | 17,859 | 24.1 |
| EBIDTA % | 13.8 | 13.1 | | 14.1 | 13.6 | |
| Depreciation | 759 | 867 | 14.3 | 1,995 | 2,571 | 28.8 |
| EBIT | 4,312 | 5,266 | 22.1 | 12,398 | 15,289 | 23.3 |
| Other Income | 1,284 | 1,707 | 32.9 | 3,934 | 5,824 | 48.0 |
| Interest | 157 | 144 | -8.8 | 221 | 435 | 97.1 |
| PBT | 5,439 | 6,829 | 25.6 | 16,111 | 20,678 | 28.3 |
| Extraordinary inc/(exp)* | 0.0 | 0.0 | | 0.0 | 0.0 | |
| Tax | 1,676 | 2,158 | 28.8 | 4,978 | 6,345 | 27.5 |
| Net Profit | 3,764 | 4,671 | 24.1 | 11,134 | 14,332 | 28.7 |
| <i>Net Margin %</i> | 10.2 | 10.0 | | 10.9 | 10.9 | |
| EPS | 13.0 | 16.2 | 24.1 | 38.5 | 49.6 | 28.7 |
| CEPS | 15.7 | 19.2 | 22.5 | 45.4 | 58.5 | 28.7 |

* see table annexed below

Adjustment Summary

| <i>Rs mn</i> | 4QFY07 | 4QFY08 | % change | FY07 | FY08 | % change |
|-------------------------------|--------------|--------------|----------|---------------|---------------|----------|
| EBIDTA | | | | | | |
| Reported EBIDTA | 5,510 | 4,766 | -13.5 | 19,904 | 22,624 | 13.7 |
| <i>EBIDTA margins (%)</i> | 12.4 | 10.0 | | 13.6 | 12.6 | |
| Adjustments | | | | | | |
| Dealer compensation | 0 | 545 | | 0 | 545 | |
| MTM losses on export cover | 0 | 505 | | 0 | 505 | |
| Adjusted EBIDTA | 5,510 | 5,816 | 5.5 | 19,904 | 23,674 | 18.9 |
| <i>EBIDTA margins (%)</i> | 12.4 | 12.0 | | 13.6 | 13.2 | |
| Net Profits | | | | | | |
| Reported Net Profits | 4,486 | 2,977 | -33.6 | 15,619 | 17,308 | 10.8 |
| Adjustments (Post tax) | | | | | | |
| Dealer compensation | 0 | 345 | | 0 | 345 | |
| MTM losses on export cover | 0 | 373 | | 0 | 373 | |
| Accelerated Depreciation | 0 | 1,512 | | 0 | 1,512 | |
| Forex gain | 0 | -424 | | 0 | -561 | |
| Adj Net Profits | 4,486 | 4,782 | 6.6 | 15,619 | 18,977 | 21.5 |
| <i>Net Profit margins (%)</i> | 10.1 | 10.0 | | 10.7 | 10.6 | |
| Reported EPS | 15.5 | 10.3 | -33.6 | 54.1 | 59.9 | 10.8 |
| Adj EPS* | 15.5 | 16.6 | 6.6 | 54.1 | 65.7 | 21.5 |

* before factoring in the change in the depreciation policy

Profit & Loss Account

| Mar ending (Rs mn) | FY07 | FY08E | FY09E | FY10E |
|------------------------------|----------------|----------------|----------------|----------------|
| Net Sales | 145,922 | 179,908 | 214,125 | 255,873 |
| Growth YoY % | 21.6 | 23.3 | 19.0 | 19.5 |
| Operating Expenses | | | | |
| Raw Materials | 110,637 | 136,468 | 163,578 | 195,661 |
| % of sales | 75.8 | 75.9 | 76.4 | 76.5 |
| Staff Costs | 2,884 | 3,562 | 4,246 | 5,030 |
| % of sales | 2.0 | 2.0 | 2.0 | 2.0 |
| Other Expenses | 13,198 | 16,395 | 19,914 | 23,540 |
| % of sales | 9.0 | 9.1 | 9.3 | 9.2 |
| EBIDTA | 19,203 | 23,484 | 26,388 | 31,641 |
| Growth % | 21.7 | 22.3 | 12.4 | 19.9 |
| EBIDTA % | 13 | 13 | 12 | 12 |
| Depreciation | 2,714 | 5,682 | 6,928 | 8,589 |
| EBIT | 16,489 | 17,802 | 19,460 | 23,053 |
| Other Income | 6,684 | 9,158 | 9,721 | 10,240 |
| Interest | 376 | 880 | 760 | 860 |
| PBT | 22,797 | 26,080 | 28,421 | 32,433 |
| Tax | 7,178 | 7,722 | 8,790 | 10,030 |
| Extraordinary (income) / exp | | 1,050 | | |
| Net Profit | 15,619 | 17,308 | 19,631 | 22,402 |
| NPM % | 10.7 | 9.6 | 9.2 | 8.8 |
| EPS | 54.1 | 59.9 | 67.9 | 77.5 |
| Adj EPS | 54.1 | 60.5 | 67.9 | 77.5 |
| CEPS | 63.5 | 79.6 | 91.9 | 107.3 |

Cash Flow

| Mar ending (Rs mn) | FY07 | FY08P | FY09E | FY10E |
|---|-----------------|-----------------|-----------------|-----------------|
| Net Profit before tax | 22,797 | 26,080 | 28,421 | 32,433 |
| Add: Depreciation | 2,714 | 5,682 | 6,928 | 8,589 |
| Add: Interest | 376 | 880 | 760 | 860 |
| Less: Other income | 6,684 | 9,158 | 9,721 | 10,240 |
| Working capital chgs Other non operating items | 4,292 | (6,093) | 328 | (1,376) |
| Less: Tax paid | 6,352 | 7,722 | 8,790 | 10,030 |
| Cash from operations | 20280 | 9,669 | 17,926 | 20,235 |
| Capex | (13,832) | (18,993) | (17,130) | (23,029) |
| Investments and Others | (13,191) | (9,708) | (4,000) | (4,000) |
| Other income | 2,655 | 9,158 | 9,721 | 10,240 |
| Cash from Investing | (24,368) | (19,543) | (11,409) | (16,789) |
| Borrowings | 5,591 | 2,692 | 1,000 | 1,500 |
| Interest paid | (280) | (880) | (760) | (860) |
| Dividend paid | (1,011) | (1,713) | (1,835) | (2,094) |
| Cash from financing | 4,300 | 99 | (1,595) | (1,454) |
| Cash generation | 212 | (9,775) | 4,923 | 1,992 |
| Opening Balance | 14,016 | 14,228 | 3,342 | 8,265 |
| Closing Balance | 14,228 | 3,342 | 8,265 | 10,257 |

Balance Sheet

| Mar ending (Rs mn) | FY07 | FY08P | FY09E | FY10E |
|-------------------------------|---------------|---------------|----------------|----------------|
| Share Capital | 1,445 | 1,445 | 1,445 | 1,445 |
| Reserves | 67,094 | 82,628 | 100,424 | 120,732 |
| Owned Funds | 68,539 | 84,073 | 101,869 | 122,177 |
| Secured Loans | 635 | 4,035 | 5,035 | 6,535 |
| Unsecured Loans | 5,673 | 4,965 | 4,965 | 4,965 |
| Loan Funds | 6,308 | 9,000 | 10,000 | 11,500 |
| Deffered Tax Liability | 1,675 | 1,675 | 1,675 | 1,675 |
| Total | 76,522 | 94,748 | 113,544 | 135,352 |
| Gross Fixed Assets | 61,468 | 72,850 | 89,980 | 113,009 |
| Acc. Depreciation | 34,871 | 40,553 | 47,481 | 56,070 |
| Net Fixed Assets | 26,597 | 32,297 | 42,499 | 56,939 |
| Capital WIP | 2,389 | 10,000 | 10,000 | 10,000 |
| Net Block | 28,986 | 42,297 | 52,499 | 66,939 |
| Investments | 34,092 | 43,800 | 47,800 | 51,800 |
| Sundry Debtors | 7,474 | 9,800 | 12,383 | 14,682 |
| Inventory | 7,132 | 12,106 | 11,695 | 14,682 |
| Cash & Bank | 14,228 | 3,342 | 8,265 | 10,257 |
| Advances | 9,241 | 11,362 | 14,312 | 16,970 |
| Other Current Assets | 384 | 384 | 384 | 384 |
| Current Assets | 38,459 | 36,995 | 47,038 | 56,975 |
| Liabilities | 20,110 | 20,471 | 24,406 | 29,150 |
| Provisions | 4,905 | 7,873 | 9,387 | 11,212 |
| Current Liabilities | 25,015 | 28,344 | 33,793 | 40,362 |
| Net Current Assets | 13,444 | 8,651 | 13,245 | 16,614 |
| Total | 76,522 | 94,748 | 113,544 | 135,352 |

Valuation Summary

| Mar ending (Rs mn) | FY07 | FY08P | FY09E | FY10E |
|-------------------------|-------|-------|-------|-------|
| Per Share Data | | | | |
| EPS | 54.1 | 59.9 | 67.9 | 77.5 |
| Cash EPS | 63.5 | 79.6 | 91.9 | 107.3 |
| BVPS | 237.2 | 291.0 | 352.6 | 422.9 |
| Net cash per share | 140.4 | 127.1 | 154.5 | 170.0 |
| Valuation ratio | | | | |
| P/E | 18.5 | 16.7 | 14.7 | 12.9 |
| Cash P/E | 15.8 | 12.6 | 10.9 | 9.3 |
| P/BV | 4.2 | 3.4 | 2.8 | 2.4 |
| EV/EBIDTA | 12.9 | 10.7 | 9.2 | 7.5 |
| Retun Ratios (%) | | | | |
| AROE | 25.4 | 22.7 | 21.1 | 20.0 |
| AROCE | 66.4 | 47.0 | 37.0 | 35.3 |
| Dupont | | | | |
| NPM (%) | 10.7 | 9.6 | 9.2 | 8.8 |
| Sales/TA | 1.4 | 1.5 | 1.5 | 1.5 |
| TA/Equity | 1.5 | 1.5 | 1.4 | 1.4 |
| Other key ratios | | | | |
| D/E | 0.1 | 0.1 | 0.1 | 0.1 |
| NCA/Sales (%) | 9.2 | 4.8 | 6.2 | 6.5 |

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