

October 31, 2011

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	Accumulate
Rating	
Price	Rs1,126
Target Price	Rs1,200
Implied Upside	6.6%
Sensex	17,705

(Prices as on October 31, 2011)

Trading data

Market Cap. (Rs bn)	325.3
Shares o/s (m)	288.9
3M Avg. Daily value (Rs m)	876.6

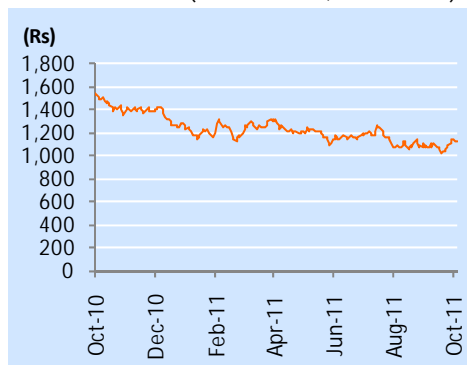
Major shareholders

Promoters	54.21%
Foreign	18.71%
Domestic Inst.	18.01%
Public & Other	9.07%

Stock Performance

(%)	1M	6M	12M
Absolute	4.0	(14.5)	(27.4)
Relative	(3.6)	(7.1)	(15.8)

Price Performance (RIC: MRTI.BO, BB: MSIL IN)



Source: Bloomberg

■ **Results disappoint on account of higher other expenditure:** Q2FY12 top-line declined by 14.4% YoY to Rs78.3bn (our estimate Rs77.1bn) on account of 19.6% YoY decline in volumes. Adverse impact of Yen appreciation was to the extent of Rs1bn (impact of ~120bps on EBITDA margins). Selling and promotion expenses increased by 100bps YoY, leading to a 160bps increase in SGA expenses. Royalty for the quarter was higher by Rs500m pertaining to Q1FY12, whereas MTM on commodity hedges stood at Rs260m. Adjusted for the same, EBITDA declined by 40.6% to Rs5.7bn on account on lower volumes, increased discounts on vehicles and adverse currency impact. As a result, EBITDA margins declined by 320bps YoY to 7.3%. On account of higher depreciation and lower other income, the adj. PAT de-grew by 47% YoY to Rs3.2bn (our estimate Rs3.9bn).

■ **Conference call highlights:** Diesel engine capacity will be enhanced to 25k/month by January 2012 compared to 20k/month to cater to the increasing demand for diesel cars. The new 'Swift' has received a good response and MSIL already has an order backlog of ~1 lac units, out of which ~88% is diesel. Average discount has been increased to Rs13,500/vehicle in the quarter compared to Rs9,500/vehicle. However, with diesel vehicles accounting for ~26% of overall volumes in FY13E compared to ~21% currently, discounts are likely to come down. MSIL has hedged its direct imports at ₹79/\$. However, its indirect imports remain unhedged.

■ **Revise earnings downwards by 13% for FY12E and 7% for FY13E:** We estimate 11% decline in volumes for FY12E at 1.1m and a strong 14.8% volume growth for FY13E at 1.3m units. Taking into account the strike at Manesar in October 2011 and the lower operating profit for the quarter, we revise our earnings estimate downwards by 13% and 7% for FY12E and FY13E, respectively. As a result, our target price is revised downwards to Rs1,200 (Rs1,265 earlier).

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Key financials (Y/e March)	2010	2011	2012E	2013E
Revenues (Rs m)	296,229	370,402	349,310	410,676
Growth (%)	42.1	25.0	(5.7)	17.6
EBITDA (Rs m)	39,761	36,439	29,316	38,948
PAT (Rs m)	25,194	23,181	18,139	24,767
EPS (Rs)	87.2	80.2	62.8	85.7
Growth (%)	106.7	(8.0)	(21.7)	36.5
Net DPS (Rs)	6.0	7.5	8.5	9.5

Source: Company Data; PL Research

Profitability & Valuation	2010	2011	2012E	2013E
EBITDA margin (%)	13.4	9.8	8.4	9.5
RoE (%)	23.8	18.1	12.5	15.1
RoCE (%)	22.4	17.4	12.3	15.0
EV / sales (x)	1.1	0.8	0.9	0.7
EV / EBITDA (x)	8.4	8.3	10.3	7.8
PE (x)	12.9	14.0	17.9	13.1
P / BV (x)	2.7	2.4	2.1	1.9
Net dividend yield (%)	0.5	0.7	0.8	0.8

Source: Company Data; PL Research

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- Outlook & Valuation:** With interest rate cycle nearing its peak, we believe the four-wheeler space will be the most likely beneficiary of the same. We expect the FY13E top-line to grow by 17.6% YoY, driven by 14.8% volume growth. We expect the margins to improve by ~100bps in FY13E, mainly on account of operating leverage due to higher volumes and lower discounts. The stock is currently trading at 13.1x FY13E EPS, which in our view is fair, given the 35%+ growth in FY13E earnings. Maintain **'Accumulate'** on expected improvement in volumes and margins from Q4FY12E onwards.

Exhibit 1: Q2FY12 Result Overview (Rs m)

Y/e March	Q2FY12	Q2FY11	YoY gr. (%)	Q1FY12	H1FY12	H1FY11	YoY gr. (%)
Net Revenues	78,316	91,473	(14.4)	85,293	163,609	174,565	(6.3)
Raw Materials	61,566	70,756	(13.0)	66,917	128,483	134,859	(4.7)
<i>% of Net Sales</i>	<i>78.6</i>	<i>77.4</i>		<i>78.5</i>	<i>78.5</i>	<i>77.3</i>	
Personnel	1,995	1,568	27.2	1,794	3,788	3,177	19.2
<i>% of Net Sales</i>	<i>2.5</i>	<i>1.7</i>		<i>2.1</i>	<i>2.3</i>	<i>1.8</i>	
Manufacturing & Other Expenses	9,054	9,556	(5.2)	8,938	17,992	18,361	(2.0)
<i>% of Net Sales</i>	<i>11.6</i>	<i>9.9</i>		<i>10.5</i>	<i>11.0</i>	<i>10.5</i>	
Total Expenditure	72,614	81,880	(11.3)	77,649	150,263	156,397	(3.9)
EBITDA	5,702	9,593	(40.6)	7,644	13,346	18,167	(26.5)
<i>EBITDA Margin (%)</i>	<i>7.3</i>	<i>10.5</i>		<i>9.0</i>	<i>8.2</i>	<i>10.4</i>	
Depreciation	2,664	2,382	11.8	2,425	5,088	4,799	6.0
EBIT	3,038	7,211	(57.9)	5,219	8,258	13,369	(38.2)
Interest Expenses	109	97	12.3	58	167	177	(5.8)
Non-operating income	1,177	1,340	(12.1)	1,800	2,977	2,344	27.0
PBT	4,106	8,453	(51.4)	6,962	11,068	15,535	(28.8)
Extraordinary Expenses	760	-		(500)	260	652	
PBT after extra-ordinary items	3,346	8,453	(60.4)	7,462	10,808	14,883	(27.4)
Tax-Total	942	2,481	(62.0)	1,970	2,912	4,258	(31.6)
<i>Tax Rate (%) - Total</i>	<i>28.2</i>	<i>29.4</i>		<i>26.4</i>	<i>26.9</i>	<i>28.6</i>	
Reported PAT	2,404	5,972	(59.7)	5,492	7,896	10,625	(25.7)
Extraordinary Expenses	760	-		(500)	260	652	
Adj. PAT	3,164	5,972	(47.0)	4,992	8,156	11,277	(27.7)

Source: Company Data, PL Research

Exhibit 2: Operating Metrics (Rs m)

Y/e March	Q2FY12	Q2FY11	YoY gr. (%)	Q1FY12	H1FY12	H1FY11	YoY gr. (%)
Car Sales Volume (nos)	252,307	313,654	(19.6)	281,526	533,833	596,978	(10.6)
Other expenses / vehicle	35,886	30,465	17.8	31,749	33,704	30,757	9.6
Net Realisation/Vehicle	310,400	291,636	6.4	302,967	306,480	292,414	4.8
Material cost / vehicle	244,010	225,587	8.2	237,695	240,680	225,902	6.5
Contribution/vehicle	66,390	66,049	0.5	65,272	65,800	66,511	(1.1)
EBITDA/vehicle	22,599	30,583	(26.1)	27,152	25,000	30,432	(17.8)
Net Profit/vehicle	12,540	19,039	(34.1)	17,731	15,277	18,889	(19.1)

Source: Company Data, PL Research

Key takeaways of the Conference Call

- Diesel engine capacity to be enhanced to 25k/month: Diesel engine capacity will be enhanced to 25k /month by January 2012 compared to 20k/month to cater to the increasing demand for diesel cars.
- Diesel vehicle proportion likely to increase: We expect diesel vehicles to account for ~26% of overall volumes in FY13E compared to ~21% currently, thereby, enhancing the product mix.
- Discounts likely to come down: Average discount increased to Rs13,500/vehicle in the quarter compared to Rs9,500/vehicle. With higher proportion of diesel vehicles in its portfolio, the average blended discount would be lower for the company in the coming quarters.
- New Swift order backlog at ~1 lac units : New Swift has received a good response and MSIL already has an order backlog of ~1 lac units, out of which ~88% is diesel. We expect the deliveries of Swift to commence from January 2012.
- Margins and volumes to improve from Q4FY12E: With Manesar strike being resolved, MSIL is likely to start deliveries of the new 'Swift'. On account of lower discounts and better product mix, the company would report better margins compared to the current quarter, thereby, enhancing profitability.
- Direct exposure of Yen hedged at ¥79/\$: MSIL has hedged its direct imports at ¥79/\$. However, its indirect imports remain unhedged.



Income Statement (Rs m)

Y/e March	2010	2011	2012E	2013E
Net Revenue	296,229	370,402	349,310	410,676
Raw Material Expenses	224,134	288,801	274,441	321,252
Gross Profit	72,095	81,601	74,869	89,424
Employee Cost	5,456	7,035	7,389	7,957
Other Expenses	26,878	38,127	38,163	42,519
EBITDA	39,761	36,439	29,316	38,948
Depr. & Amortization	8,250	9,635	10,387	11,429
Net Interest	335	244	250	250
Other Income	4,749	4,170	5,240	6,200
Profit before Tax	35,925	30,730	23,919	33,469
Total Tax	10,949	8,201	6,540	8,702
Profit after Tax	24,976	22,529	17,379	24,767
Ex-Od items / Min. Int.	(218)	(652)	(760)	—
Adj. PAT	25,194	23,181	18,139	24,767
Avg. Shares O/S (m)	289.0	289.0	289.0	289.0
EPS (Rs.)	87.2	80.2	62.8	85.7

Cash Flow Abstract (Rs m)

Y/e March	2010	2011	2012E	2013E
C/F from Operations	28,874	32,856	33,687	31,260
C/F from Investing	(47,833)	(1,655)	(29,558)	(29,472)
C/F from Financing	551	(7,098)	(2,418)	(2,707)
Inc. / Dec. in Cash	(18,408)	24,103	1,711	(918)
Opening Cash	19,390	982	25,085	26,796
Closing Cash	982	25,085	26,796	25,878
FCFF	17,064	11,064	3,045	2,909
FCFE	18,289	5,943	3,045	2,909

Key Financial Metrics

Y/e March	2010	2011	2012E	2013E
Growth				
Revenue (%)	42.1	25.0	(5.7)	17.6
EBITDA (%)	102.3	(8.4)	(19.5)	32.9
PAT (%)	106.7	(8.0)	(21.7)	36.5
EPS (%)	106.7	(8.0)	(21.7)	36.5
Profitability				
EBITDA Margin (%)	13.4	9.8	8.4	9.5
PAT Margin (%)	8.5	6.3	5.2	6.0
RoCE (%)	22.4	17.4	12.3	15.0
RoE (%)	23.8	18.1	12.5	15.1

Balance Sheet

Net Debt : Equity	0.1	(0.2)	(0.2)	(0.1)
Net Wrkng Cap. (days)	(18)	(18)	(26)	(18)

Valuation

PER (x)	12.9	14.0	17.9	13.1
P / B (x)	2.7	2.4	2.1	1.9
EV / EBITDA (x)	8.4	8.3	10.3	7.8
EV / Sales (x)	1.1	0.8	0.9	0.7

Earnings Quality

Eff. Tax Rate	30.5	26.7	27.3	26.0
Other Inc / PBT	13.7	15.4	24.3	18.5
Eff. Depr. Rate (%)	7.9	7.5	6.5	6.1
FCFE / PAT	72.6	25.6	16.8	11.7

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2010	2011	2012E	2013E
Shareholder's Funds	118,351	138,328	152,817	174,352
Total Debt	8,214	3,093	3,093	3,093
Other Liabilities	1,370	1,644	1,644	1,644
Total Liabilities	127,935	143,065	157,554	179,089
Net Fixed Assets	54,123	69,580	91,069	106,516
Goodwill	—	—	—	—
Investments	71,766	50,677	48,359	49,954
Net Current Assets	2,046	22,809	18,125	22,618
<i>Cash & Equivalents</i>	982	25,085	26,796	25,878
<i>Other Current Assets</i>	36,742	38,522	42,912	46,933
<i>Current Liabilities</i>	35,678	40,798	51,583	50,193
Other Assets	—	—	—	—
Total Assets	127,935	143,065	157,554	179,089

Quarterly Financials (Rs m)

Y/e March	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Net Revenue	94,945	100,922	85,293	78,316
EBITDA	9,017	9,597	7,644	5,702
% of revenue	9.5	9.5	9.0	7.3
Depr. & Amortization	2,369	2,467	2,425	2,664
Net Interest	4	64	58	109
Other Income	1,283	1,199	1,800	1,178
Profit before Tax	7,927	8,266	7,462	3,347
Total Tax	2,276	1,667	1,970	942
Profit after Tax	5,651	6,599	5,492	2,405
Adj. PAT	5,651	6,599	4,992	3,165

Key Operating Metrics

Y/e March	2010	2011	2012E	2013E
A2 Seg. Vol. (nos)	633,190	808,552	698,302	792,573
Total Domestic Vol. (nos)	870,790	1,132,739	1,009,489	1,158,676
Export Vol. (nos)	147,575	138,266	116,744	140,000
Total Vol. (nos)	1,018,365	1,271,005	1,126,233	1,298,676
Net Realization/Unit (Rs)	290,887	291,424	310,158	316,227
RM Cost/Unit (Rs)	220,092	227,223	243,681	247,369
Other Exp./Unit (Rs)	26,393	29,997	33,886	32,740
EBITDA/Unit (Rs)	39,044	28,669	26,030	29,990
Net Profit/Unit (Rs)	24,526	17,725	15,431	19,071

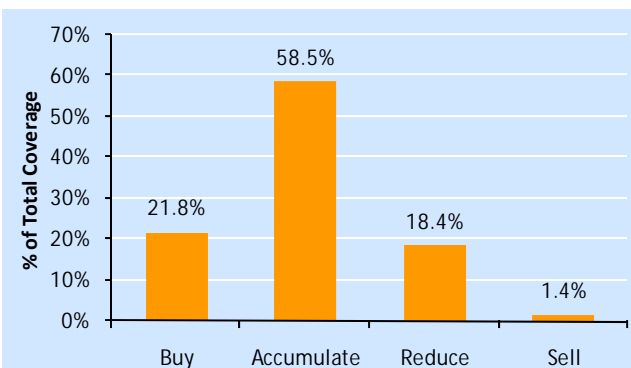
Source: Company Data, PL Research.

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Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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