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IDBI capital

MANAGEMENT VISIT NOTE

Maruti Suzuki India Ltd.

Some time before dawn!

REDUCE

Analyst
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Nifty: 4,652; Sensex: 15,491

CMP	**Rs930**
Target Price	**Rs1,009**
Potential Upside/Downside	**+9%**

Key Stock Data

Sector	Automobile
Bloomberg / Reuters	MSIL IN / MRTI.BO
Shares o/s (mn)	6,316.4
Market cap. (Rs mn)	5,872,956
Market cap. (US$ mn)	110,899
3-m daily average vol.	98,881

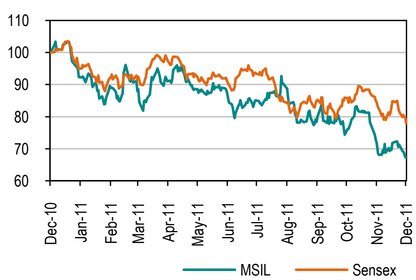
Price Performance

52-week high/low		Rs1,455/906	
	-1m	-3m	-12m
Absolute (%)	(6)	(16)	(33)
Rel to Sensex (%)	(5)	(16)	(13)

Shareholding Pattern (%)

Promoters	54.2
FIIs/NRIs/OCBs/GDR	19.3
MFs/Banks/FIs	17.7
Non Promoter Corporate	6.2
Public & Others	2.6

Relative to Sensex



Source: Capitaline

Summary

We met the management of Maruti Suzuki (MSIL). Management tone remained subdued on demand expectations in the car industry in the near term; evident from its downward revision in FY12 volume growth forecast to 10% decline from earlier expectations of marginal decline. This is led by worsening consumer sentiment, rising discounts (partially seasonal as December month has highest discounts in most years), rising inventory levels and stringent financing.

It expects Q3 results to be worse than Q2, led by continued Yen appreciation (direct + indirect imports including royalty constitute ~27% of net sales – the company has hedged direct imports for H2FY12 for JPY/USD but is open for USD/INR; it is also open for indirect imports), impact of Q2 MTM loss on indirect imports being accounted for in Q3 (with a quarter lag and hence will impact Q4 margin as well as Q3 forex movement has been unfavourable too), higher discounts (it expects discounts to remain at elevated levels on weak demand, though higher proportion of Swift/D'zire will moderate pressure on margin) and limited pricing power.

Management expects demand to improve towards the end of Q4FY12 led by new launches (RIII – Ertiga and compact D'zire), production at Manesar recovering to normalised levels and interest rates peaking. This will aid margin, though uncertainty prevails with regards to INR/USD/JPY equation. However, it is hopeful of margin improvement in FY13 and expects to clock 30% growth in FY13E (IDBIe 1.34 mn units, up 20%).

- **Reiterate REDUCE; risk reward likely to turn favourable post Q3**

  We cut FY12/13 volume estimates by 11%/8% to 1.12 mn/1.34 mn units, down 12%/up 20% YoY. We cut FY12 EBITDA margin estimate by 120bps to 7.5% to factor in higher discounts and Yen appreciation, in addition to continued weak demand environment. We maintain our FY13 EBITDA margin estimate at 9.4% on expectation of improved demand, increased localisation and relatively stable forex movement. Our EPS stands revised downwards by 24%/3% to Rs51/84 (we are 22%/3% below consensus and expect street to downgrade their FY12 estimates in the coming weeks). Though MSIL has corrected ~18% post Q2FY12 results, we feel there is still some pain left, which will get reflected around Q3 results. We believe the risk reward would turn favourable once weak Q3 results are priced in. However, we would keep a close eye on the demand environment post December (our channel checks indicate weakness to continue till Mar'12), as that will determine the outlook on discounts and pricing power, and response to new launches in RIII and compact D'zire. **Reiterate REDUCE**.

Key monitorables: forex movement, demand environment, production ramp up at Manesar.

Table: Financial snapshot **(Rs mn)**

Year	Revenue	EBITDA	EBITDA (%)	Adj. PAT	EPS (Rs)	P/E (x)	EV/EBITDA (x)	RoE (%)	RoCE (%)
FY10	296,231	39,786	13.4	24,976	86.4	10.8	5.1	23.6	27.2
FY11	369,199	35,580	9.6	22,886	79.2	11.7	5.5	17.8	18.6
FY12E	340,917	25,635	7.5	14,664	50.8	18.3	7.2	10.1	9.9
FY13E	424,669	39,828	9.4	24,287	84.1	11.1	4.5	15.0	16.3

Source: Company; IDBI Capital Research

Key takeaways from MSIL management meet

Volume guidance of 10% decline in FY12; FY13 to see 30% growth

Management indicated that demand remains weak in petrol led by high interest rates, stringent financing, weak sentiment and rising fuel prices. Consequently, discounts have gone up post festive season (contrary to expectation of discount being constant as indicated during Q2 concall) – vindicated by our dealer interactions in Maharashtra, Gujarat and Delhi, where discounts are up 1.5-2% post festive season. We believe part of these higher discounts pertains to year-end phenomenon, when discounts go up to attract buyers, who prefer to wait for the new model year. Our channel checks indicate inventory levels for petrol vehicles to have gone up by 1-2 weeks to 7-8 weeks, while NPAs for financiers have also rose in the past 4-5 months (financiers have become much more stringent in lending), indicating weak demand. On the other hand, demand for diesel vehicles remains strong with most models commanding 3-4 months waiting period. Also the proportion of diesel remains high at 75-80% in the models where MSIL has both petrol and diesel variants.

MSIL has guided for 10% volume decline in FY12, followed by 30% growth in FY13 led by normalised production levels at Manesar Plant A and B (normal production from Jan'12; production shutdown from Dec-25 to Jan-3), improved consumer sentiment and new launches of RIII-Ertiga MPV (to be launched by FY12 end and will be positioned between Mahindra Xylo and Toyota Innova) and compact D'zire (Feb'12; <4 metre).

Q3 to be a wash out led by forex and production issues; things to improve in FY13

Management expects Q3 to be even worse than Q2 (EBITDA margin of 6.3%), led by continued demand pressures, higher discounts and more importantly continued Yen appreciation (direct + indirect imports including royalty constitute ~27% of net sales – the company has hedged direct imports for H2FY12 for JPY/USD @ JPY79/USD, but is open for USD/INR; it is also open for indirect imports). In addition, impact of Q2 MTM loss on indirect imports will be accounted for in Q3 (with a quarter lag and hence will impact Q4 margin as well as forex movement has been unfavourable in Q3 too). Nonetheless, it expects volumes and margin to improve from Q4 onwards led by new launches, improved consumer sentiment, increased localisation (it is working on reducing import content by 5-6% over next 3 years, leading to cost savings of 25-30%) and stabilising exchange rate.

Dealer feedback on new launches indicated limited impact on MSIL volumes

Though MSIL has lost some market share (adjusting for production loss), dealers believe that new launches, along with wide reach and cost effective after sales will enable the company to maintain ~40% share, once production issues are sorted out and consumer sentiment improves, despite slew of new launches by competition in the form of Eon/Etios/Liva/Brio/Beat Diesel. Also, they were positive on MSIL entering the MUV segment with RIII, where it does not have any presence currently and the segment is relatively less crowded as compared to the compact segment.

Other highlights

- Diesel vehicles form 22% of total volumes (petrol demand declined by 11%, while diesel demand grew by 24% in H1FY12), while 20% of its volumes comes from rural markets. CNG contributes 5% of volumes.
- Slowdown in petrol demand is visible across regions. Currently, top 10 cities contribute 60% of volumes, while rest 40% comes from smaller cities/towns/villages. Management has seen strong growth in rural markets and expects the ratio to reverse with smaller cities contributing 60% of volumes over the medium term.
- During H1FY12, 44% volumes came from first time buyers, with 36% coming from additional car buyers and 20% from replacement demand.
- Though the company has not taken any pricing call for Jan'12 (as reported in the media), any price hike to counter unfavourable forex movement will depend on competitor's actions. It has taken price hike of Rs2k-10k on diesel vehicles in Nov'11. Our channel checks indicate price hike across car OEMs in Jan'12.

- MSIL will spend Rs25 bn on capex in FY12 vs. earlier estimate of Rs40 bn, with Rs5-6 bn deviation coming from cost savings on capex and balance being deferred to FY13. FY13 capex stands at Rs30 bn. The company has resumed normal production at Manesar; however, full month production will return to normal only in Jan'12 as Dec'11 will have plant shutdown from 25th Dec to 3rd Jan. From Jan'12, production capacity will stand at 1.6 mn units (Gurgaon – 1 mn, Manesar A – 0.3 mn, Manesar B – 0.3 mn). Manesar plant C is expected to come up by Q4FY13 with 0.25 mn capacity, taking total capacity to 1.8-1.9 mn units. Capacity addition at Gujarat will take time as the company is in the process of finalising the location.
- Diesel engine supply from SPIL will go up to 25k/month from Jan'12 (20k at present). Fiat engine supply will also start from Q1CY12 with engine supply capacity of up to 100k p.a. However, the company is in the process of finalising details with Fiat and indicated that Tata Motors could have an issue with pricing/supply of these engines (TTMT has JV with Fiat for diesel engine supply from its Ranjangaon facility).
- 36% of exports came from Euro region during YTDFY12. Part of exports is hedged at Rs48-49/USD. Direct imports contribute 8% of sales, while indirect imports ~13%.
- Swift order book stands at >100k units (largely diesel) and has seen 9% cancellations. Petrol Swift is largely available on demand. D'zire diesel has >6 months waiting period.
- On new launches, apart from RIII and compact D'zire, it is working on upgraded 800cc car (M800 replacement); however it is too early to comment. It added that it has no plans to come out with a Nano competitor.
- Currently it is not facing any supply side issues (except diesel engine supply). However, it sounded cautious on the ability of tier II vendors to align their capacities with demand (especially in times of swift changes in demand pattern), especially in cases where it has single source. It is also working on having multiple sources, wherever possible.
- 70% of cars are financed currently, with HDFC being the most aggressive with 25% share in MSIL volumes, followed by Mahindra Finance (15% share) and SBI (10% share; SBI has slowed down in the past few months).
- Cash on books stood at Rs60 bn post capex at Manesar plant B.
- There are 2,400/1,600 permanent/casual employees at Manesar A & B and 6,500/3,000 permanent/ casual employees at Gurgaon.

Reiterate REDUCE; risk reward likely to turn favourable around Q3 results

We cut our FY12/13 volume estimates by 11%/8% to 1.12 mn/1.34 mn units. We cut our FY12 EBITDA margin estimates by 120bps to 7.5% to factor in higher discounts and Yen appreciation, in addition to continued weak demand environment. We maintain our FY13 EBITDA margin estimate at 9.4% on improved demand and relatively stable forex movement. Our EPS stands revised downwards by 24%/3% to Rs51/84 (we are 22%/3% below consensus and expect street to downgrade their FY12 estimates in the coming weeks). Though MSIL has corrected 18% post Q2FY12 results, we feel there is still some pain left, which will get reflected around Q3 results. We believe the risk reward would turn favourable once weak Q3 results are priced in. However, we would keep a close eye on the demand environment post December (our channel checks indicate weakness to continue till March), as that will determine the outlook on discounts and pricing power, and response to new launches in RIII and compact D'zire. **Reiterate REDUCE**.

Financial summary

Profit & Loss Account (Rs mn)

Year-end: March	FY10	FY11	FY12E	FY13E
Net sales	**296,231**	**369,199**	**340,917**	**424,669**
Growth (%)	*42.1*	*24.6*	*(7.7)*	*24.6*
Operating expenses	(256,445)	(333,619)	(315,283)	(384,841)
EBITDA	**39,786**	**35,580**	**25,635**	**39,828**
Growth (%)	*96.1*	*(10.6)*	*(28.0)*	*55.4*
Depreciation	(8,250)	(10,135)	(10,862)	(12,839)
EBIT	**31,536**	**25,445**	**14,773**	**26,989**
Interest paid	(335)	(244)	(235)	(227)
Other income	4,724	5,887	5,550	6,281
Pre-tax profit	**35,925**	**31,088**	**20,088**	**33,043**
Tax	(10,949)	(8,202)	(5,424)	(8,756)
Effective tax rate (%)	*30.5*	*26.4*	*27.0*	*26.5*
Net profit	**24,976**	**22,886**	**14,664**	**24,287**
Adjusted net profit	**24,976**	**22,886**	**14,664**	**24,287**
Growth (%)	*104.9*	*(8.4)*	*(35.9)*	*65.6*
Shares o/s (mn nos)	*289*	*289*	*289*	*289*

Cash Flow Statement (Rs mn)

Year-end: March	FY10	FY11	FY12E	FY13E
Pre-tax profit	35,925	31,088	20,088	33,043
Depreciation	7,322	8,263	10,862	12,839
Tax paid	(10,007)	(9,779)	(4,989)	(8,423)
Chg in working capital	(1,480)	4,738	(224)	1,894
Other operating activities	-	-	-	-
Cash flow from operations (a)	**31,760**	**34,310**	**25,736**	**39,353**
Capital expenditure	(12,124)	(23,720)	(13,214)	(32,500)
Chg in investments	-	(5)	-	-
Other investing activities	-	-	-	-
Cash flow from investing (b)	**(52,157)**	**(3,021)**	**(8,214)**	**(32,500)**
Equity raised/(repaid)	-	-	-	-
Debt raised/(repaid)	1,225	(5,121)	(1,390)	(1,391)
Dividend (incl. tax)	(1,183)	(2,021)	(2,518)	(2,028)
Chg in minorities	-	-	-	-
Other financing activities	1,947	(44)	(0)	-
Cash flow from financing (c)	**1,989**	**(7,186)**	**(3,908)**	**(3,419)**
Net chg in cash (a+b+c)	**(18,408)**	**24,103**	**13,614**	**3,434**

Balance Sheet (Rs mn)

Year-end: March	FY10	FY11	FY12E	FY13E
Net fixed assets	54,123	69,580	71,932	91,593
Investments	120	125	125	125
Other non-curr assets	836	868	868	868
Current assets	**109,370**	**114,505**	**123,204**	**131,893**
Inventories	12,088	14,150	13,006	16,227
Sundry Debtors	8,099	8,933	8,211	10,244
Cash and Bank	982	25,085	38,699	42,133
Loans and advances	16,555	15,395	17,347	17,347
Total assets	**164,449**	**185,078**	**196,130**	**224,480**
Shareholders' funds	**118,351**	**138,675**	**151,311**	**172,894**
Share capital	1,445	1,445	1,445	1,445
Reserves & surplus	116,906	137,230	149,867	171,449
Total Debt	**8,214**	**3,093**	**1,703**	**312**
Secured loans	265	312	312	312
Unsecured loans	7,949	2,781	1,391	-
Other liabilities	10,420	5,605	4,215	2,824
Curr Liab & prov	**37,982**	**43,430**	**43,413**	**51,572**
Current liabilities	35,678	40,798	40,603	48,762
Provisions	2,304	2,632	2,810	2,810
Total liabilities	**46,098**	**46,403**	**44,818**	**51,586**
Total equity & liabilities	**164,449**	**185,078**	**196,130**	**224,480**
Book Value (Rs)	**410**	**480**	**524**	**598**

Financial Ratios

Year-end: March	FY10	FY11	FY12E	FY13E
Adj. EPS (Rs)	86.4	79.2	50.8	84.1
Adj. EPS growth (%)	104.9	(8.4)	(35.9)	65.6
EBITDA margin (%)	13.4	9.6	7.5	9.4
Pre-tax margin (%)	12.1	8.4	5.9	7.8
ROE (%)	23.6	17.8	10.1	15.0
ROCE (%)	27.2	18.6	9.9	16.3
Turnover & Leverage ratios (x)				
Asset turnover (x)	2.0	2.1	1.8	2.0
Leverage factor (x)	1.4	1.4	1.3	1.3
Net margin (%)	8.4	6.2	4.3	5.7
Net Debt/Equity (x)	(0.5)	(0.5)	(0.5)	(0.5)
Working Capital & Liquidity ratio				
Inventory days	15	14	14	14
Receivable days	10	9	9	9
Payable days	33	32	32	32

Valuation

Year-end: March	FY10	FY11	FY12E	FY13E
P/E (x)	10.8	11.7	18.3	11.1
Price / Book value (x)	2.3	1.9	1.8	1.6
PCE (x)	8.1	8.1	10.5	7.2
EV / Net sales (x)	0.7	0.5	0.5	0.4
EV / EBITDA (x)	5.1	5.5	7.2	4.5
Dividend Yield (%)	0.6	0.8	0.6	0.9

Source: Company; IDBI Capital Research

Notes

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Key to Ratings

Stocks:

BUY: Absolute return of 15% and above; **ACCUMULATE:** 5% to 15%; **HOLD:** Upto ±5%; **REDUCE:** -5% to -15%; **SELL:** -15% and below.

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