



Maruti Suzuki

STOCK INFO.	BLOOMBERG
BSE Sensex: 18,020	MSIL IN
	REUTERS CODE
S&P CNX: 5,419	MRTL.BO

26 July 2010

Buy

Previous Recommendation: Buy

Rs1,191

Diluted Equity Shares	289.0
52-Week Range	1,740/1,171
1,6,12 Rel.Perf.(%)	-17/-24/-31
M.Cap. (Rs b)	344.2
M.Cap. (US\$ b)	7.3

YEAR	TOTAL INC.	PAT	ADJ. EPS	EPS	P/E	P/C	P/B	EVI	ROE	ROCE
END	(RS M)	(RS M)	(RS)	GR. (%)	(X)	(X)	(X)	EBITDA	(%)	(%)
3/09A	209,075	13,334	46.1	-22.0	25.8	16.9	3.7	14.6	13.0	18.7
3/10A	296,230	24,976	86.4	87.3	13.8	10.3	3.0	7.5	21.5	29.5
3/11E	345,937	23,229	80.4	-7.0	14.8	10.3	2.5	7.6	16.7	23.4
3/12E	408,765	28,205	97.6	21.4	12.2	8.4	2.1	6.2	17.4	23.9

Maruti-Suzuki's operating performance for 1QFY11 disappointed us. EBITDA margin was 10.4% (v/s our estimate of 12.1%), impacted by higher raw material cost and increase in royalty. Further, lower other income further impacted recurring PAT, which was Rs5.12b (v/s our estimate of Rs7.06b).

Highlights

- Volumes grew 25% YoY (down ~1.4% QoQ) to 283,324 units. Realizations improved by 1.6% YoY (down ~0.8% QoQ). Export realizations declined 17% YoY and 8.4% QoQ.
- EBITDA margin declined 280bp QoQ (~180bp YoY) to 10.4%, driven by 180bp QoQ (~160bp YoY) increase in raw material cost and 90bp QoQ (~40bp YoY) increase in other expenditure due to 180bp QoQ increase in royalty.
- PAT grew 12.2% YoY to Rs5.12b, restricted by higher depreciation and lower other income.
- The impact of higher raw material cost is likely to taper off in 2HFY11, as the benefit of currently soft commodity prices is realized.

Downgrading estimates: We are downgrading our EPS estimates by 13% to Rs80.4 for FY11 and by 11% to Rs97.6 for FY12 to factor in higher royalty. It would result in structural downward shift in profitability and return ratios. The stock trades at 12.2x FY12E standalone EPS and 11.3x FY12E consolidated EPS. We maintain **Buy**, with a target price of Rs1,417 (~10x FY12E cash EPS – median cash P/E since listing).

QUARTERLY PERFORMANCE

Y/E MARCH	FY10				FY11				FY10	FY11E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Total Volumes (nos)	226,729	246,188	258,026	287,422	283,324	300,000	295,500	315,028	1,018,365	1,193,852
Change (%)	17.7	29.9	48.7	21.5	25.0	21.9	14.5	9.6	28.6	17.2
Realizations (Rs/car)	279,640	286,349	284,226	286,508	284,151	284,300	280,038	284,141	284,362	283,168
Change (%)	13.8	12.9	8.0	7.5	1.6	-0.7	-1.5	-0.8	10.4	-0.4
Net Op. Revenues	64,930	72,026	75,029	84,246	82,315	87,150	84,731	91,741	296,230	345,937
Change (%)	33.6	44.2	60.3	31.0	26.8	21.0	12.9	8.9	41.7	16.8
RM Cost (% of Sales)	76.3	75.7	74.5	76.1	77.9	77.7	76.8	76.6	75.7	77.1
Staff Cost (% of Sales)	2.1	1.8	1.8	1.8	2.0	1.9	2.0	2.0	1.8	2.0
Other exp. (% of Sales)	9.4	9.8	8.6	8.9	9.8	9.7	9.9	9.8	9.1	9.8
EBITDA	7,932	9,161	11,339	11,111	8,577	9,323	9,569	10,670	39,543	38,689
As % of Sales	12.2	12.7	15.1	13.2	10.4	10.7	11.3	11.6	13.3	11.2
Non-Operating Income	2,165	1,100	913	790	1,002	1,250	1,100	1,373	4,968	4,725
Extraordinary Expense	0	0	0	0	652	0	0	0	0	652
Interest	63	60	84	129	80	90	95	103	335	368
Depreciation	1,961	2,031	2,028	2,230	2,417	2,460	2,550	2,620	8,250	10,047
PBT	8,073	8,171	10,140	9,542	6,430	8,023	8,024	9,320	35,925	32,348
Tax	2,238	2,471	3,265	2,976	1,777	2,407	2,488	2,871	10,949	9,543
Effective Tax Rate (%)	27.7	30.2	32.2	31.2	27.6	30.0	31.0	30.8	30.5	29.5
PAT	5,835	5,700	6,875	6,566	4,654	5,616	5,537	6,449	24,976	22,805
Adjusted PAT	5,835	5,700	6,875	6,566	5,125	5,616	5,537	6,449	24,976	23,264
Change (%)	25.3	92.5	221.6	170.0	-12.2	-1.5	-19.5	-1.8	105.9	-6.9

E:MOSL Estimates

Robust volumes boost revenues

Net revenues grew 26.8% YoY to Rs82.3b (v/s our estimate of Rs82.6b), driven by 25% YoY growth (~1.4% QoQ decline) in volumes and 1.6% YoY increase (~0.8% QoQ decline) in realizations. Volume growth was driven by 23% YoY growth (~1% QoQ decline) in domestic volumes and 38% YoY growth (~3.8% QoQ decline) in export volumes. Export realizations declined 17% YoY and 8.4% QoQ, impacted by depreciation of the Euro against the Rupee and change in market mix in favor of non-Euro region.

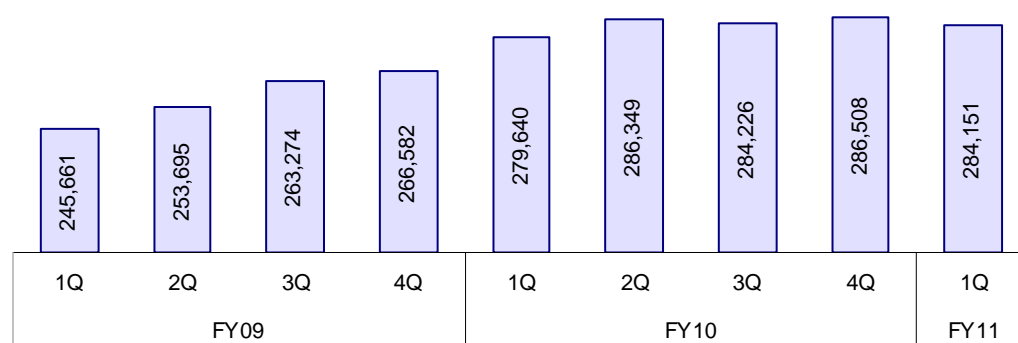
Product mix is stabilizing, with higher share of the A2 and A3 segment (to 84.5% v/s 86.4% in 1QFY10 and 85.4% in 4QFY10). The share of the MPV segment has also increased (to 12.0% v/s 9.8% in 1QFY10 and 11.3% in 4QFY10), led by robust demand for the recently-launched *Eco* model.

SALES MIX STABILIZING WITH HIGHER CONTRIBUTION FROM A2 AND A3 SEGMENT (UNITS)

	1QFY11	1QFY10	YOY (%)	4QFY10	QOQ (%)
A1	6,906	7,119	-3.0	8,434	-18.1
<i>% of Total</i>	2.5	3.1		2.9	
MPV	33,521	22,233	50.8	32,466	3.2
<i>% of Total</i>	12.0	9.8		11.3	
A2	170,513	146,733	16.2	173,683	-1.8
<i>% of Total</i>	61.0	64.7		60.4	
A3	28,958	19,947	45.2	29,702	-2.5
<i>% of Total</i>	10.4	8.8		10.3	
UV	2,989	1,383	116.1	1,097	172.5
<i>% of Total</i>	1.1	0.6		0.4	
Exports	36,658	29,314	25.1	42,040	-12.8
<i>% of Total</i>	13.1	12.9		14.6	
Total Sales	279,545	226,729	23.3	287,422	-2.7
Total PV (Incl Exports) MS (%)	42.2	44.0	-180	41.2	90
Total Dom. Cars MS (%)	47.6	53.5	-590	46.5	110
Total Dom. Small Cars. MS (%)	42.2	44.0	-180	41.2	90

Source: Company/SIAM/MOSL

REALIZATIONS (RS/UNIT) - REFLECTION OF CHANGING SALES MIX



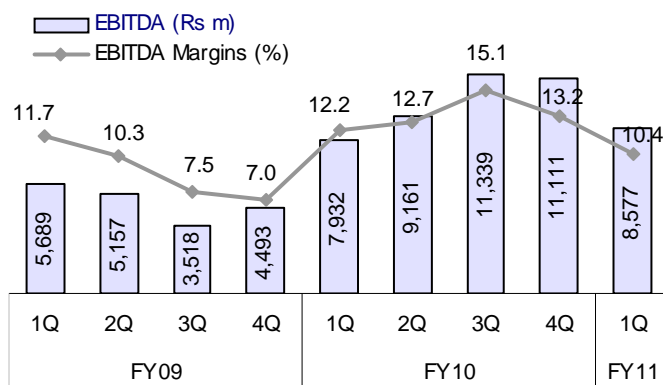
Source: Company/MOSL

RM cost inflation, increase in royalty impacts margins

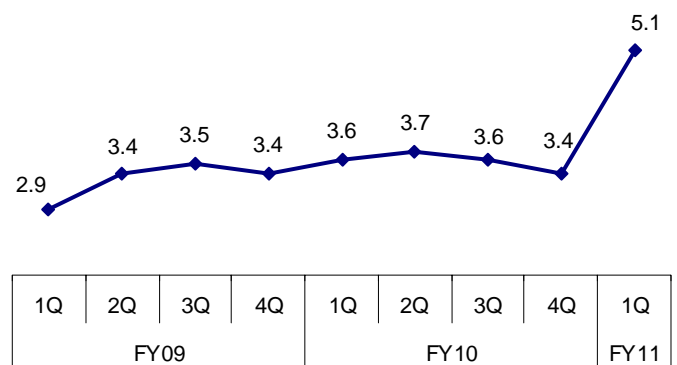
EBITDA margin declined 280bp QoQ (~180bp YoY) to 10.4% (v/s our estimate of 12.1%), impacted by increase in raw material cost and higher royalty. Adjusting for change in royalty, EBITDA margin would have been 12.2% (in-line).

Raw material cost increased by 180bp QoQ (~160bp YoY), which fully reflects cost push based on contracted steel prices for 1HFY11. Increase in raw material cost is not only a reflection of higher commodity cost, but also of adverse product mix (higher contribution of low margin products like *Eeco*) and faster product refreshes. The impact of higher raw material cost is likely to taper off in 2HFY11, as the benefit of currently soft commodity prices is realized.

TREND IN EBITDA



TREND IN ROYALTY (% OF NET SALES)



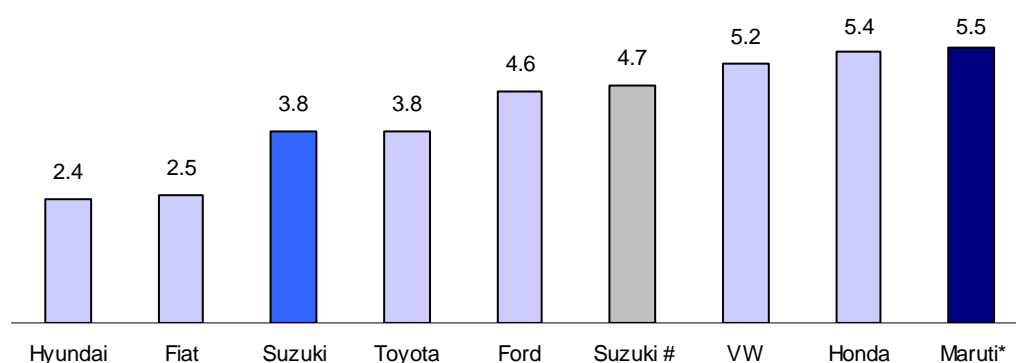
Source: Company/MOSL

Royalty payment to the parent has increased by 180bp QoQ to 5.1% (excluding prior-period royalty). This increase is pursuant to removal of cap on royalty by the government. The management has guided average royalty of 5.1% of net sales, as it is ‘true cost of technology’. This coupled with higher depreciation and lower other income resulted in recurring PAT decline of 12.2% to Rs5.12b.

Royalty increase to reflect ‘true cost of technology’; now at higher end of peers

The management has cited higher royalty as ‘true cost of technology’, which was underrecovered earlier due to regulatory cap. Following the increase in royalty to ~5.1% coupled with Maruti’s own R&D spend of 0.4% (4QFY10), its total cost of technology increases to ~5.5%, which is at the higher end of its global peers. Interestingly, Suzuki’s own R&D spend is ~3.8% (including motorcycles and marine products). Further, there is increase in royalty coverage to 89% of the product basket, driven by new product launches (*A-Star*, *Ritz*, etc) and product upgrades (*Wagon-R*, *Eeco*, etc). Increase in royalty to ~5.1% has resulted in 11-13% downgrade in our EPS estimates.

COST OF TECHNOLOGY FOR GLOBAL MAJORS (% OF SALES)



* Including R&D incurred by Maruti on its own (~0.4%); # Assuming Suzuki's R&D is only for cars

Source: Companies/MOSL

Volumes not constrained by capacity

The management is confident of meeting demand growth from its current capacity of 1.2m (with the ability to scale up with a third shift). Further, it is focusing on preponing commissioning of brownfield expansion of 0.25m cars at Manesar by end CY11. While there would be constraints in the form of product mix requirement and paint shop/press shop, which already operate three shifts, the management intends to work around these constraints. They are confident of increasing capacity by 25-30%, subject to product mix considerations.

Other highlights of results / call with the management

- Increasing share of new models resulted in decrease in discounts to Rs8,000/unit v/s Rs9,300/unit in 4QFY10 and Rs9,500/unit in 1QFY11.
- Its direct forex exposure is fully hedged for 1HFY11. 2HFY11 forex exposure as well as vendor imports are unhedged and exposes it to vagaries of volatility in forex.
- Impact of adverse product mix was Rs1b in 1QFY11 or 120bp on EBITDA margins.
- 70bp QoQ savings in SG&A, as 4QFY10 had Auto Expo related expenses.
- Financing (% of volumes) has reduced to 65.6% in 1QFY11 v/s 70% in 4QFY10.

Downgrading EPS to factor in increase in royalty

We are downgrading our EPS estimates by 13% to Rs80.4 for FY11 and by 11% to Rs97.6 for FY12 to factor in the following:

- Increase in royalty; we model in royalty of 5% in FY11 (from 3.7% earlier)
- Increase in depreciation due to impending new product launches/upgrades
- Reduction in other income to reflect change in investments from FMPs to MFs/FDs

REVISED FORECAST

	FY11E			FY12E		
	REV	OLD	CHG (%)	REV	OLD	CHG (%)
Domestic Volumes	1,053,656	1,053,656	0.0	1,211,704	1,211,704	0.0
Export Volumes	140,196	140,196	0.0	161,226	161,226	0.0
Total Volumes	1,193,852	1,193,852	0.0	1,372,930	1,372,930	0.0
Net Sales (Rs m)	345,937	337,025	2.6	408,765	399,470	2.3
EBITDA (%)	11.2	12.2	-97	11.3	12.2	-91
Net Profit (Rs m)	23,229	26,710	-13.0	28,205	31,842	-11.3
EPS (Rs)	80.4	92.4	-13.0	97.6	110.2	-11.4
CEPS (Rs)	115.9	125.4	-7.6	141.7	151.7	-6.6

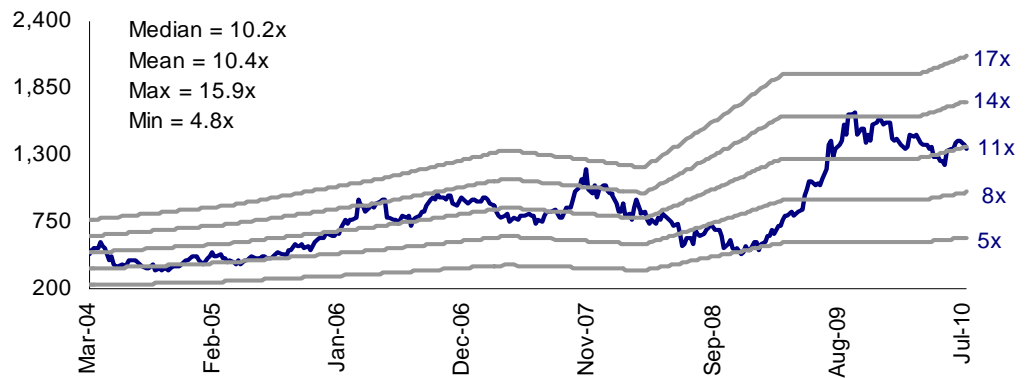
Source: Company/MOSL

Valuation and view

Maruti has underperformed (17% relative underperformance) since January 2010 on account of concerns of increasing competition in small cars. While new models from the competition are doing well, we believe it will take 4-5 years for new players to seriously impact Maruti's market share due to lack of distribution network. Further, strong market growth would also absorb supply from new players.

Increase in royalty payment has resulted in 11-13% downgrade in our EPS estimates. Further, it would result in structural downward shift in profitability and return ratios. The stock trades at 12.2x FY12E standalone EPS and 11.3x FY12E consolidated EPS. We maintain **Buy**, with a target price of Rs1,417 (~10x FY12E cash EPS – median cash P/E since listing).

MARUTI'S CASH P/E (X) BAND



Maruti Suzuki: an investment profile

Company description

Maruti Suzuki is the largest passenger vehicle manufacturer in India, with 1.2m units. It dominates the small cars segment with ~48% market share. It is also emerging as the global export hub of small cars for Suzuki, with world strategic model *A-Star* exclusively produced in India.

Key investment arguments

- Strong volume momentum to continue in FY11, driven by estimated 21% growth in domestic volumes.
- Volume growth in domestic market, driven by focus on tier-II cities and rural market.
- Improving product mix, with increasing share of A2 & A3 segment, driven by newer products.

Key investments risks

- Intense competition in the key A2 segment.
- Adverse forex movement may impact margins negatively.
- Higher royalty, forex volatility and higher share of diesel vehicles could impact margins.

Recent developments

- Increased royalty payout to the parent to ~5.1%

Valuation and view

- The stock trades at 12.2x FY12E standalone EPS and 11.3x FY12E consolidated EPS.
- We maintain **Buy**, with a target price of Rs1,417 (~10x FY12E cash EPS – median cash P/E since listing).

Sector view

- Passenger vehicle segment is expected to continue its growth momentum.
- With low car penetration levels in India, the upside potential for growth is tremendous.
- However, increasing competition poses threat in long term.

COMPARATIVE VALUATIONS

		MARUTI	M&M	TATA MOTORS
P/E (x)	FY11E	14.8	14.8	10.7
	FY12E	12.2	12.3	8.3
EPS Gr (%)	FY11E	-7.0	17.8	213.8
	FY12E	21.4	19.5	29.5
RoE (%)	FY11E	16.7	22.9	41.0
	FY12E	17.4	22.5	37.5
EV/EBITDA (x)	FY11E	7.6	8.3	6.1
	FY12E	6.2	6.6	5.5

SHAREHOLDING PATTERN (%)

	JUN-10	MAR-10	JUN-09
Promoter	54.2	54.2	54.2
Domestic Inst	17.0	16.7	18.6
Foreign	20.2	21.2	20.8
Others	8.6	8.0	6.4

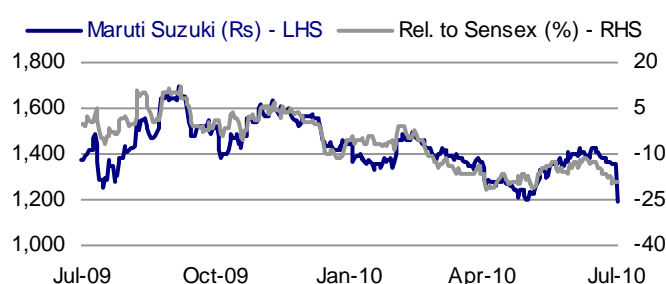
EPS: MOST FORECAST V/S CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY11	80.4	90.0	-9.0
FY12	97.6	102.4	-9.5

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,191	1,417	19.0	Buy

STOCK PERFORMANCE (1 YEAR)



Financials and Valuation

INCOME STATEMENT						RATIOS					
(Rs Million)											
Y/E MARCH	2008	2009	2010	2011E	2012E	Y/E MARCH	2008	2009	2010	2011E	2012E
Net Sales	178,603	204,132	289,585	338,060	400,913	Basic (Rs)					
<i>Change (%)</i>	22.4	14.3	41.9	16.7	18.6	Adjusted EPS	59.2	46.1	86.4	80.4	97.6
Operating Other Income	4,851	4,943	6,645	7,877	7,852	EPS Growth (%)	9.1	-22.0	87.3	(7.0)	21.4
Total Income	183,454	209,075	296,230	345,937	408,765	Consol EPS	61.9	42.5	90.8	88.3	105.5
Total Cost	156,623	188,586	256,687	307,249	362,542	Cash EPS	78.8	70.6	115.7	115.9	141.7
EBITDA	26,832	20,489	39,543	38,689	46,223	Book Value per Share	291.2	323.4	401.0	472.1	560.4
<i>% of Net Sales</i>	14.6	9.8	13.3	11.2	11.3	DPS	5.0	3.5	6.0	6.7	7.9
Depreciation	5,682	7,065	8,473	10,270	12,735	Payout (Incl. Div. Tax) %	9.8	9.7	10.1	10.0	8.1
EBIT	21,150	13,424	31,070	28,419	33,489	Valuation (x)					11.3
Def Revenue Exp. / Others	-198	-223	-223	-223	-223	P/E		25.8	13.8	14.8	12.2
Interest & Finance Charges	596	510	335	368	312	Cash P/E		16.9	10.3	10.3	8.4
Other Income	3,974	5,386	4,968	4,725	6,325	EWEBITDA		14.6	7.5	7.6	6.2
Non-recurring Expense	-305	1,765	0	652	0	EV/Sales		1.5	1.0	0.9	0.7
PBT	25,030	16,758	35,925	32,348	39,725	Price to Book Value		3.7	3.0	2.5	2.1
Tax	7,722	4,571	10,949	9,543	11,520	Dividend Yield (%)		0.3	0.5	0.6	0.7
<i>Effective Rate (%)</i>	30.9	27.3	30.5	29.5	29.0	Profitability Ratios (%)					
PAT	17,308	12,187	24,976	22,805	28,205	RoE	20.6	13.0	21.5	16.7	17.4
<i>Change (%)</i>	10.8	-29.6	104.9	-8.7	23.7	RoCE	26.7	18.7	29.5	23.4	23.9
Adj. PAT	17,100	13,334	24,976	23,229	28,205	Leverage Ratio					
<i>Change (%)</i>	9.1	-22.0	87.3	-7.0	21.4	Debt/Equity (x)	0.1	0.1	0.0	0.0	0.0
BALANCE SHEET	(Rs Million)					CASH FLOW STATEMENT	(Rs Million)				
Y/E MARCH	2008	2009	2010	2011E	2012E	Y/E MARCH	2008	2009	2010	2011E	2012E
Share Capital	1,445	1,445	1,445	1,445	1,445	OP/(Loss) before Tax	21,264	10,391	31,293	28,642	33,712
Reserves	82,709	92,004	114,458	134,982	160,508	Int./Dividends Received	3,158	3,469	4,968	4,725	6,325
Net Worth	84,154	93,449	115,903	136,427	161,953	Depreciation & Amort.	5,682	7,065	8,473	10,270	12,735
Loans	9,002	6,989	5,406	4,406	3,906	Direct Taxes Paid	-8,647	-4,524	-10,949	-9,543	-11,520
Deferred Tax Liability	1,701	1,551	1,551	1,551	1,551	(Inc)/Dec in W/kg. Capital	-71	-999	-7,159	-621	671
Capital Employed	94,857	101,989	122,860	142,384	167,410	CF from Oper. Activity	21,386	15,402	26,626	33,473	41,923
Gross Fixed Assets	72,853	87,206	111,819	129,819	169,819	Extra-ordinary Items	0	0	0	-652	0
Less: Depreciation	39,888	46,498	54,971	65,241	77,975	Other Items	0	0	0	0	0
Net Fixed Assets	32,965	40,708	56,848	64,578	91,844	CF after EO Items	21,386	15,402	26,626	32,822	41,923
Capital WIP	7,363	8,613	5,000	15,000	5,000	(Inc)/Dec in FA+C/WIP	-16,789	-16,136	-21,000	-28,000	-30,000
Investments	51,807	31,733	31,733	31,733	31,733	(Pur)/Sale of Invest.	-16,843	22,181	0	0	0
Curr.Assets, Loans	30,979	54,911	65,478	71,282	85,566	CF from Inv. Activity	-33,632	6,045	-21,000	-28,000	-30,000
Inventory	10,380	9,023	14,609	17,060	20,158	Change in Networth	0	0	-789	-332	-390
Sundry Debtors	6,555	9,189	12,985	15,164	17,918	Inc/(Dec) in Debt	3,365	-3,339	-1,583	-1,000	-500
Cash & Bank Balances	3,305	19,390	20,575	21,748	30,180	Interest Paid	-743	-579	-335	-368	-312
Loans & Advances	10,408	16,328	16,328	16,328	16,328	Dividends Paid	-1,299	-1,444	-1,734	-1,949	-2,290
Others	331	981	981	981	981	CF from Fin. Activity	1,323	-5,362	-4,441	-3,648	-3,491
Current Liab. & Prov.	28,257	33,976	36,199	40,209	46,733	Inc/(Dec) in Cash	-10,923	16,085	1,185	1,173	8,431
Sundry Creditors	24,562	30,169	28,821	32,906	38,070	Add: Beginning Balance	14,228	3,305	19,390	20,575	21,748
Provisions	3,695	3,807	7,378	7,302	8,662	Closing Balance	3,305	19,390	20,575	21,748	30,180
Net Current Assets	2,722	20,935	29,279	31,073	38,833						
Appl. of Funds	94,857	101,989	122,860	142,384	167,410						

E: MOSL Estimates



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Institutional: Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: reports@motiloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

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Maruti Suzuki

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