Maruti Suzuki India

Apple Green

Stock Update

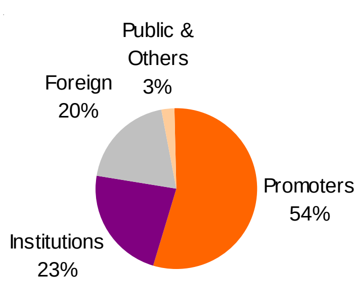
Upgraded to Hold, price target revised to Rs1,600

Hold; CMP: Rs1,460

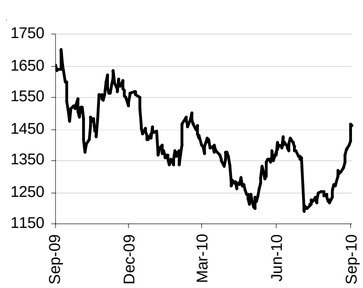
Company details

Price target:	Rs1,600
Market cap:	Rs42,194 cr
52 week high/low:	Rs1740/1171
NSE volume: (No of shares)	6.1 lakh
BSE code:	532500
NSE code:	MARUTI
Sharekhan code:	MARUTI
Free float: (No of shares)	13.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	18.7	7.4	5.3	-11.3
Relative to Sensex	9.4	-4.8	-9.1	-25.9

What has changed?: We are positively surprised by Maruti Suzuki India Ltd (MSIL)'s response to competition which has helped it to maintain its market share. We expect MSIL to operate at peak utilisation rate during FY2010-14 on the back of robust domestic demand. Its association with Volkswagen strengthens our case of sustained volume visibility through outsourcing contracts. Any move by the government to introduce a mileage related rating system would also favour MSIL. We are upgrading MSIL from "Reduce" to "Hold" with a revised price target of Rs1,600 per share.

High volume growth supported by lower penetration and consumerism: We estimate that 18-20% growth would surprisingly not increase car penetration in India as masses shift upwards from Deprived and Aspirer segments to the high-income segments. We expect MSIL to achieve volumes of 1.24 million units and 1.36 million units in FY2011 and FY2012 respectively.

Competitive "Beat" failed to erode MSIL's market share: Contrary to popular perception, MSIL's domestic market share has sustained the competitive onslaught. In the key compact car segment, it even improved its share over the last few months. General Motors happens to be the major loser.

Maruti likely to be the key beneficiary of stricter emission norms: The recent talks by the Indian government to grade passenger cars on mileage are pro-MSIL as the company is the mileage leader across product segments. The Indian government's taxation structure is strongly skewed towards small cars. This may get additional strength with stricter emissions weighted heavily on mileage.

Risks largely related to royalty and yen-based imports: The parent, Suzuki Motor Corporation, Japan dramatically increased royalty charges on MSIL to 4.5-6.5% of sales after the government removed the upper cap on royalties. We believe that MSIL's yen-denominated expenses—royalty, component imports from Japan—would remain a major overhang on the stock. We estimate a 10% impact on the earnings per share (EPS) if the royalty on MSIL increases by 1% on our base assumption of 5%.

Valuation: In view of the strong visibility of MSIL's volumes and market share, we are raising our FY2012 EPS estimate for the company to Rs100.9. We recommend a Hold on the stock with a revised price target of Rs1,600.

Valuation table

Particular	FY2009	FY2010	FY2011E	FY2012E	FY2013E
Net sales (Rs cr)	20358	28959	35867	41884	50262
EBITDA (Rs cr)	1892	3979	3845	4699	5618
OPM (%)	9.0	13.4	10.5	11.0	10.9
PAT (Rs cr)	1219	2498	2418	2916	3510
EPS (Rs)	42.2	86.5	83.7	100.9	121.5
Growth (%)	-29.9	104.9	-3.2	20.6	20.4
P/E 1-year forward (x)	16.9	17.5	14.5	12.0	10.3
P/B (x)	4.8	4.0	3.3	2.8	2.4
EV/EBITDA (x)	21.7	10.8	10.4	8.3	6.4
RoE (%)	13.7	23.6	18.8	19.4	19.9
RoCE (%)	12.0	27.4	20.8	23.4	24.8

Higher income migration to keep car penetration lower

India's income demographics have changed dramatically on the back of country's gross domestic product (GDP) growth. To understand it better, we have divided Indian GDP into four cycles of ten years each: 1985-1995, 1995-2005, 2005-2015 and 2015-2025. (We have used National Council of Applied Economic Research [NCAER] and McKinsey Global Institute [MGI] 2006 reports for estimates).

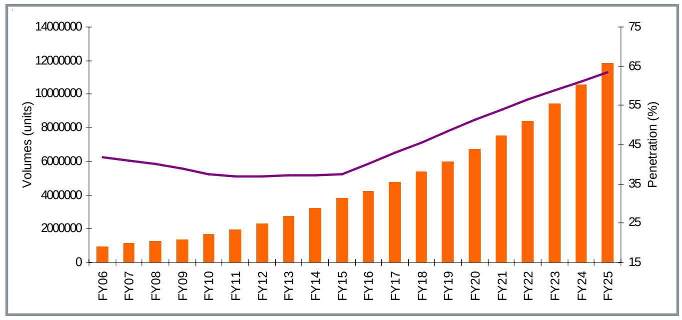
The high-income groups, ie Seekers, Strivers and Globals, constituted a mere 7% of the total Indian households in 2005. By 2015, their composition is expected to touch 26%, reflecting a 16% compounded annual growth rate (CAGR) between 2005 and 2015. However, these groups would form 56% of the consumption basket, thereby driving the consumer discretionary spending.

With an 18% growth in passenger cars and a 16% growth in the addressable market (the top three income groups), the penetration curve would flatten till 2015 before rising upwards.

Indian household income distribution

Key parameters	CAGR (%)			
	1985-95	1995-05	2005-15	2015-25
GDP	5.5	6.5	7.5	7.5
Domestic car volume	12.5	13.7	15.2	12.5
Personal disposable income	15.0	11.5	10.0	10.0
Household size income-wise				
Deprived < 90k	0.9	-2.8	-3.1	-3.9
Aspirers (90-200k)	14.3	11.6	1.5	-1.3
Seekers (200-500k) - A	9.8	12.4	17.6	5.6
Strivers (500-1000k) - B			8.6	19.7
Globals >1000k - C			10.6	11.2
Addressable housholds (A+B+C)		15.7	16.0	8.0
Total	**2.4**	**2.1**	**1.7**	**1.4**
Household consumption growth				
Deprived < 90k	0.0	-2.2	-2.8	-4.0
Aspirers (90-200k)	11.6	11.6	2.9	0.0
Seekers (200-500k) - D	0.0	7.2	19.6	7.6
Strivers (500-1000k) - E			11.6	18.2
Globals >1000k - F			14.9	13.3
Addressable housholds (D+E+F)		7.2	16.9	11.2
Total	**3.6**	**5.4**	**7.2**	**7.3**

Domestic car volumes and penetration



Maruti's response to competition—playing the value card

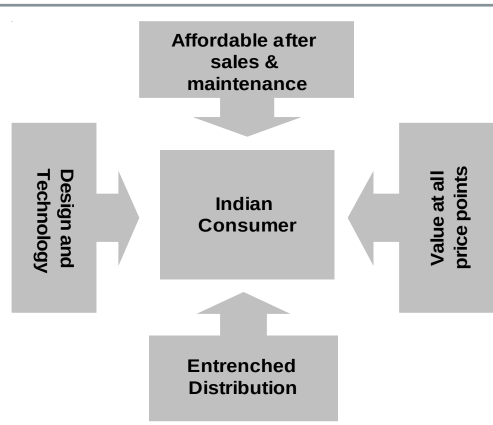
"Buy it, run it or sell it at unmatched value" forms the core ethos of MSIL. The ownership cost right from buying a car to running it, maintaining it and deriving the maximum resale value out of it is the unmatched package offering.

The new Alto K10's positioning is the classic example of value creation. The basic product has been face lifted, installed with nextgen K-series engine and priced aggressively. The product combines the best in class mileage and performance. On the one hand, the strategy rejuvenated the ageing brand and on the other, it brought incremental volumes.

The company further strengthened its value card by launching factory fitted compressed natural gas (CNG) variants across five models. Getting aggressive on alternative fuels with wide offerings would also create a strong competitive barrier.

In spite of running a waiting list across products, MSIL is maintaining its relevance in the market by offering festive discounts.

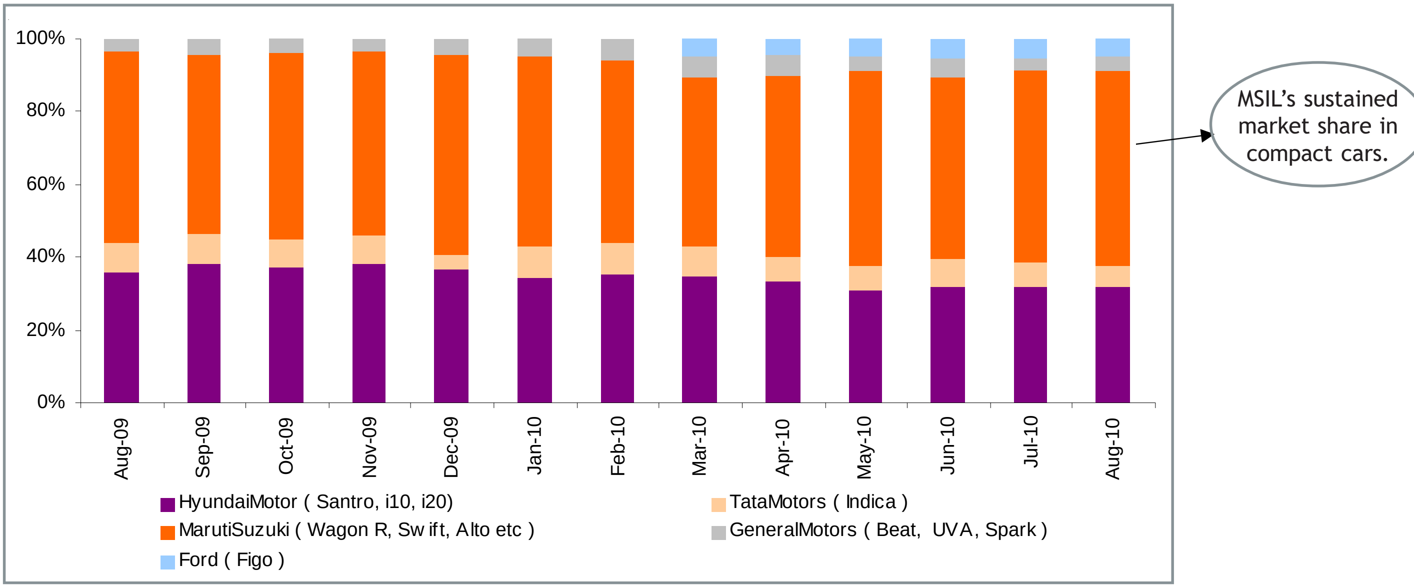
MSIL's core ethos



Sustains domestic market share in compact car segment

The company has outplayed the threat of competitive onslaught by playing the value card. We have observed a sharp revival in its market share in the domestic compact car segment and a moderation in the competitive threats. We expect the maximum competitive offerings to come in the premium hatchback categories (the Swift segment) while MSIL's base would be shielded.

Market share in compact cars



We estimate the mini car segment dominated by Tata Nano to grow the most at 45% CAGR between FY2010-2014E. However, MSIL would retain its lead in compact and mid-size car segments.

Indian car industry growth and market share trend

Segments	CAGR (%) FY10-14E	Mix (%) FY10	Mix (%) FY14E	Top players	Market share (%) FY2002	Market share (%) FY2006	Market share (%) FY2010	Market share (%) FY2014E
Mini	45.0	3.8	8.1	MSIL	100.0	100.0	52.1	5.1
				TAMO	0.0	0.0	47.9	94.9
Compact	15.4	67.6	60.4	MSIL	42.3	58.5	56.2	**54.6**
				Hyundai	24.7	21.7	25.3	21.4
				TAMO	23.3	19.5	10.2	7.0
Mid	20.0	16.4	17.0	MSIL	15.4	17.1	36.1	**37.2**
				TAMO	0.0	21.1	20.6	24.7
				Honda	11.4	20.2	16.4	14.3
Executive	18.0	2.7	2.7	Fiat	0.0	0.0	24.7	19.3
				Toyota	0.0	32.2	21.6	21.1
				Skoda	0.0	34.7	15.7	14.0
Premium	18.0	0.7	0.7	Skoda	0.0	8.4	25.0	26.5
				Honda	29.7	53.2	24.8	14.7
				BMW	0.0	0.0	13.5	17.5
Luxury	18.0	0.1	0.1	Mercedes	100.0	100.0	39.4	39.2
				BMW	0.0	0.0	30.8	37.6
				Audi	0.0	0.0	37.6	23.2
MPV	12.0	9.1	8.8	MSIL	99.6	100.0	67.4	73.8
				TAMO	0.0	0.0	32.6	26.2
Total	**18.0**	**100.0**	**100.0**					

Capacity de-bottlenecking can surprise

The new Manesar line is expected to be commissioned from Q4FY2012. However, the company has positively surprised in the past after it shifted the production of the petrol version of Swift to Gurgaon which spared 40,000 units from Manesar thereby yielding incremental volumes.

To take on the festive season's challenges, a temporary line has been installed at Manesar to increase production. We expect de-bottlenecking to yield approximately 4-5% of the incremental capacity.

Product mix to improve post expansion

Currently, *Swift* and *Dzire* have occupied most of the capacity at Manessar. The two products have a large waiting period and market acceptance. We see a significant deployment of the new Manessar line towards these products thereby increasing their contribution from 20% to 25%.

Particulars	Kerb weight	Price (Rs)	Price/Kg	Volume contribution (%)
M800	682	230000	337	3.0
Alto	728	300000	412	22.4
Zen Estilo	855	395000	462	2.4
Wagon R	863	400000	464	15.0
A-Star	870	430000	494	20.4
Swift	1028	530000	516	12.4
Ritz	1058	510000	482	4.7
Dzire	1063	600000	565	8.0
SX4	1190	850000	714	1.3
Gypsy	1018	590000	580	0.3
Grand Vitara	1594	2100000	1317	0.5
Omni	793	250000	315	9.6

Maruti likely to be the key beneficiary of stricter emission norms

MSIL has aligned all products on BSIV standards that would be applicable from October 1, 2010. The recent talks by the Indian government to grade passenger cars on mileage are pro-MSIL as the company is the mileage leader across product segments.

In order to promote small cars and cut emissions by 2% a year, the government follows a differential excise policy whereby cars under 4 meters and engines under 1.4 litres are charged lower duty. The new proposed rating system assigns standard mileage in a particular class and rates cars which are higher than the base standards. This scheme is followed in Europe and is incentive linked. Any such reforms would be incrementally positive for MSIL.

Suzuki-Volkswagen association to be positive for MSIL

After Volkswagen's 20% stake in Suzuki Motor Corporation, the focus has shifted to the Indian subsidiary of the Japanese car major (ie MSIL). One of the key considerations for Volkswagen was to play a strong role in India. Such kind of Euro-Japanese arrangements have worked successfully in the past, eg Nissan-Renault. We see MSIL starting off with component supplies and then moving on to jointly developing a global small car.

Capturing "value-migration" critical; market becoming product centric

We have observed that MSIL's approach to the Indian market place has clear Japanese flavour, where fireball car brands are created (cars profitable even at low price levels) followed by subsequent product introductions at the higher end where maximum profitability exists. Classic global examples are Toyota, Honda and Nissan, which introduced lower priced cars, sold them profitably and later introduced *Lexus*, *Acura* and *Infinity* respectively at the upper end.

Today's customer is spoilt for choice whereby low-cost ownership is not the sole criteria for buying a car. The consumer is increasingly becoming receptive towards exciting products with dynamic designs and high technology features even if he has to compromise on services and higher after-sales costs. We observe the traditional value flag would not yield any pricing premium to MSIL's products.

Royalty and currency: Key risks

The parent Suzuki Motor Corporation, Japan dramatically increased the royalty charges on its Indian subsidiary, taking investors by surprise. This had a huge negative impact on the MSIL stock. A lack of clarity on the same resulted in downward revisions of estimates.

We estimate that the company's yen-denominated expenses—royalty (5.1%) and component imports (13%) from Japan—would remain a major overhang on the stock. As the company scales up investments at Manessar; bulk imports from Japan are likely to go up; hence aggravating the currency impact.

We estimate a 10% impact on the EPS if the royalty increases by 1% on our base assumption of 5%.

Sensitivity: Royalty impact

Particulars	FY2011E	FY2012E
Sales (Rs cr)	35866.7	41883.9
Royalty increase 1%	358.7	418.8
Less 30% tax	251.1	293.2
EPS (Rs)	83.7	100.9
New EPS (Rs)	75.0	90.8
Impact (%)	-10.4	-10.0

Valuation

In view of the higher than expected volume growth, the strong Alto K10 launch and MSIL's strength in the Indian small car market, we are upgrading MSIL from Reduce to Hold.

Maruti model assumptions

Particulars	FY09	FY10	FY11E	FY12E	FY13E
Volume	792166	1018358	1247539	1361524	1526992
% yoy chg	*3.6*	*28.6*	*22.5*	*9.1*	*12.2*
Realisation/ Vehicle (Rs)	256995	284365	287500	307625	329159
Growth (%)	10.1	10.6	1.1	7.0	7.0
Raw material/ vehicle (Rs)	205042	217705	226604	242466	259439
% yoy chg	*14.9*	*6.2*	*4.1*	*7.0*	*7.0*
Operating profit (Rs cr)	1892	3979	3845	4699	5618
Growth (%)	-29.1	110.3	-3.4	22.2	19.6
OPM (%)	9.0	13.4	10.5	11.0	10.9
Tax rate (%)	27.3	30.5	27.9	29.0	29.0

MSIL CAGR (%)

Particulars	FY02-06	FY06-10	FY10-14E
Volume	12.4	16.0	13.4
Revenue	14.3	25.2	19.6
Operating profit	55.6	25.1	13.2
PBT	110.2	24.2	12.6
PAT	96.6	27.4	13.2
Average RoE (%)	11.3	20.0	20.3
Average RoCE (%)	12.5	23.1	24.4
Average P/E (x)	NA	15.7	15.7
Average P/B (x)	NA	3.0	3.0
Average EV/EBIDTA (x)	NA	10.1	10.1

Valuation parameter

Particulars	FY2012E
5 year average P/E	1,583
5 year average P/B	1,570
5 year average EV/Ebidta	1,646
5 year average price target (Rs)	**1,600**
Upside (%)	10

The author doesn't hold any investment in any of the companies mentioned in the article.

Evergreen

Housing Development Finance Corporation
HDFC Bank
Infosys Technologies
Larsen & Toubro
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
Apollo Tyres
Bajaj Auto
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