COMPANY REPORT

Indsec Securities & Finance Ltd.

Maruti Udyog Ltd.

Recommendation: Buy **June 14, 2007**

Share Price : Rs 720

BSE Sensex : 14003

Nifty : 4113

Sector : Auto

High / Low : 991/670

Year end : March

Listed on : BSE, NSE

Market Lot : 1

BSE Scrip Code : 532500

NSE Scrip Code : MARUTI

Shares in issue : 28.9 Cr

Shareholding : March 2007

Foreign Promoters : 54.2%
Govt of India : 10.3%
Institutions : 17.2%
Public & Others : 5.6%
Foreign : 12.7%

All currency in INR unless otherwise stated

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We are initiating coverage on Maruti Udyog Ltd (MUL), India's largest passenger vehicle manufacturer commanding 51% market share *(as on 31st Mar 2007: source SIAM)*. The Company's strong brand equity and pre-emptive innovation of product portfolio has helped MUL to stay ahead of its peers. We believe capacity expansion, export orders kicking in from FY09 and new launches planned will augur well for the company.

We recommend Buy on MUL for the following reasons:

- With macro trends indicating **industry growth of 12 – 15 % in the coming years**, MUL being the market leader is well positioned to benefit from the growth in the domestic automobile industry.
- The story of small car hub & exports is seen unfolding with **Suzuki and Nissan to source cars from MUL's new plant** set up at Manesar for the European markets.
- In line with the growth opportunities, MUL has chalked out a **capex plan of Rs 9000 cr., to enhance the company's capability to manufacture 1 mn cars annually** by 2010. A part of this capex will be used for ramping up the production of **Suzuki's only diesel engine plant at Manesar** to 3 lakh engines p.a. by 2010.
- Infrastructure bottlenecks calls for **demand of compact cars despite the availability of aggressively priced sedans**. MUL being the leader in compact car segment with 58% share, stands to gain from this.
- **In line with the trend of increasing preference for Alternate Fuel cars, MUL marked its entry in the diesel segment with the launch of Swift Diesel.** This has strengthened its position further.
- **After sale service** through its huge network of authorized service stations, **value added services** like insurance etc and affordable range of genuine spares & accessories have led to **unmatched customer convenience, lower maintenance and better residual value for MUL cars. These inimitable factors have contributed significantly to Brand Equity of MUL.**
- **Over 90% of the total pre owned cars that MUL bought during the year under its True Value business, led to the sale of a new car.**
- Focus on **Indianisation will further help in cutting cost** and sustaining margins.

At CMP of Rs.720 the stock trades at PER of 12.2 of its FY08E earnings and 10.1 of its FY09E earnings. We recommend a Buy on MUL.

Earnings Table	Income (Rs Cr)	Op. Profit (Rs Cr)	PBT (Rs Cr)	PAT (Rs Cr)	EPS (Rs)	CEPS (Rs)	P/E (x)
FY2006	12481.4	2055.8	1750.0	1189.1	41.2	51.0	17.5
FY2007	15252.3	2588.8	2279.8	1561.9	54.1	63.5	13.3
FY2008 (P)	17201.0	2910.3	2489.5	1705.3	59.0	72.3	12.2
FY2009 (P)	20891.2	3523.9	2993.4	2050.5	71.0	88.2	10.1

Company Background:

Maruti Udyog Ltd (MUL), India's largest player in the domestic passenger vehicle market commanding 51% market share, is turning out to be the jewel in the crown of its Japanese parent, Suzuki Motor Corporation (SMC). It contributed over 29 % of the Latter's net profit in April-December 2006, though it accounted for less than 7 % of its turnover. MUL's rising share in SMC's profitability has prompted the Japanese company to invest Rs 9,000 crore in India over the next three years to increase its local production capacity to 1 mn cars and make India a hub for its global requirements for small and compact cars. MUL will continue to gain preference in SMC's global operations owing to good volume growth and higher profit margins. We believe that the proportion of profit will further increase, as SMC will source its global requirement of small and compact cars from MUL.

The company enjoys a fleet of 11 models spread across the small, compact and mid size sedan segments. Maruti800 is the only small/mini car in the industry, which forms 7.36% of domestic market. Further the company plans to launch 5 models in next five years, with the aim of sustaining its leadership position. MUL also boasts of SMC's only diesel engine plant at Manesar. The company is yet to make a mark in the booming upper end car market, which indicates an avenue of growth for the company. MUL will help in achieving the Govt's dream of making India a small car hub by meeting the requirement of Suzuki Motor Corp. and Nissan for exporting to European markets.

MUL has an endeavour of staying ahead of its competitors. It has done this successfully by launching new models and variants. Backed by Suzuki's technology it has recently unveiled its new anti theft system, known as iCATS (Intelligent Computerized Anti-Theft System) which is no longer a privilege of luxury cars as MUL has introduced it even in compact cars. MUL has already planned to roll out the new series of engines, which will meet the stringent emission norms. The strategy is to cover both Euro4 and Euro5 compatibility. MUL plans to use the new series of engines in all its models.

Industry Outlook:

- The Indian automobile industry, led by low penetration levels, increasing income & aspiration level, availability of finance and inadequate public transport facilities, is likely to witness impressive growth. However, it might not be able to keep up the tempo of 18.7% CAGR witnessed in last five years considering the rising interest rate scenario. In last five years, over 25 mn motorcycles and almost 4.5 mn scooters have been sold, which triggers the upgradation demand from these two wheeler users. Further, globally, supply chain is shifting to high skill & low cost countries like India, which is fast emerging as a small-car hub. Thus growth prospect remain intact and we expect the industry to grow by 12 – 15 % in coming years.

- Increasing interest rates has taken its toll on two wheeler industry, whereas it had a marginal impact on domestic sales of passenger cars.

Industry	Growth in the industry on Y-O-Y basis.			
	First Half FY07	**Second Half FY07**	**FY07**	**FY06**
Two wheelers	18.50%	7.80%	12.80%	17.13%
Passenger cars	22.80%	21.30%	22%	7.55%

We believe that the rising aspiration for upgrading to a four wheeler coupled with 12–15% average hike in salaries has taken care of the threat from rising interest rates.

- ***Advantage India:*** With high skilled work force, engineering capabilities, cheap labour and strong ancillary network coupled with a slash in excise duty on small cars from 24% to 16%, India offers a low cost (with high quality) destination for sourcing cars to the rest of the world. It is estimated that the manufacturing cost is lower in India by 30% compared to that in the developed nations. Thus the recent trend of strengthening Rupee against USD by ~9-10% still offers a sizeable cost differential and as such we believe that stronger Rupee might not hamper the export potential of the industry.

Investment Arguments:

Capitalizing growth opportunities:
Macro trends are indicating industry growth of 12 – 15 % in coming years. Being the market leader, MUL is well poised to benefit from the growth in the domestic automobile market as well as from the booming export markets. In line with the growth opportunities, MUL has already chalked out a capex plan of Rs 9000 cr. to be invested by the year 2010, which will enhance the company's capability to manufacture 1 mn cars annually. A part of the capex is set aside for ramping up the production of Suzuki's only diesel engine plant to 3 lakh engines p.a. at Manesar by 2010. Thus the timely expansion plans will help in meeting the demand for domestic as well as global markets.

Export boom foreseen:
In order to make India a small car hub, Government's initiatives like reducing excise duty on small cars and investing in port infrastructure to support automobile exports, is now paying off as Suzuki Motor Corp has initiated to make India as its hub for sourcing small and compact cars for its global markets. Exports are expected to boost from FY09 with Nissan sourcing 50,000 cars and MUL also setting aggressive export targets. Thus, the story of India being a small-car hub is seen to be materializing. Export is likely to contribute 11.1% of total volumes in FY09, up from 5.8% in FY07.

Product portfolio in line with industry's trend has led to improved volume mix:
Owing to the infrastructure bottlenecks there will be a huge demand for small and compact cars and is expected to remain intact regardless of aggressive pricing of mid size sedans. Considering this trend of more liking for compact cars, MUL continued its focus on the compact car segment, which is evident from the fact that it enjoys 58% market share in this segment. Four models of compact cars in its product portfolio has helped MUL to consistently improve its volume mix in favour of compact cars from the low margin small/mini car i.e. M800. The share of M800 in its total sales volumes has decreased from 23.85% to 12.47% during last three years, while the share of compact cars has increased from 55.66% to 69.28% during the same period. We believe that the leadership position in the booming compact car segment will ensure sustained volume growth whereas continuous improvement in volume mix in favour of compact cars has helped in sustaining better margins.

Shift towards Diesel engines:
The launch of Swift Diesel has marked MUL's entry in the diesel car segment, which has further strengthened its position. MUL will no longer remain aloof from the diesel car market, which currently forms 27% of the car market and is expected to increase to 35% by 2010. With the petrol prices on an upmove, globally there has been an increasing preference for diesel cars. The diesel engine plant established at Manesar will take care of the growing requirement of diesel engines as well. We believe that timely entry in the alternate fuel car segment will help MUL in consolidating its position and benefit from the potential growth in this segment.

Moving up in the mid size sedan segment (A3) by rolling out SX4:

With the launch of *SX4*, a mid size sedan, MUL has manifested its presence in this segment which currently forms just 4.67% of its volumes. The strategy of moving up in the mid size segment is in line with the rising aspiration for sedans and also to maintain a balanced product portfolio which otherwise is skewed towards small & compact cars. The *SX4* is launched to replace the ailing *Baleno*. It also provides an opportunity for its customers to upgrade from compact cars to sedan.

Value added services strengthening its brand equity:

MUL has developed a service network of 2096 outlets, covering 1092 cities offering unmatched customer convenience. An affordable range of genuine accessories and spare parts are made available through its huge network of service centers. Thus, the maintenance cost is lower compared to others while at the same time, the resale value of MUL models are unbeatable. This has been the crux of its strong brand equity, which we feel is difficult to emulate.

Indianisation bolstering margins:

The localization content in production has already increased from 72% in FY02 to 81% in FY06. It is further expected to move up leading to enhanced margins.

Emerging trends in the industry	**Proactive step taken**
Fuel efficiency – a marketing tool.	MUL's cars ranks first in its respective segments on fuel efficiency grounds.
Intense price competition leading to aggressive pricing.	Already practicing penetration pricing strategy by launching new model at introductory prices, which later on are revised upwards.
Rising income – rising aspiration for mid size sedans, however in near term compact cars will continue to dominate the industry.	The focus is currently on compact cars with 4 models in this segment. However the launch of *SX4*, the mid size sedan will help in catering to the rising aspiration for sedans in coming years. MUL expects to cover the entire range of the mid-size car market between *Esteem* and *SX4*.
With the rising petrol cost there is a slow shift towards diesel cars, which offers lower running cost to the car owner.	MUL has already launched the dual fuel version of WagonR and Diesel Swift. Both the models are well received by the market. MUL further plans to roll out more of such non petrol version of other models.
The impact of a Rs. 1 lakh car is not yet known and it could take the demand to a different level. It will act as a bridge between two wheelers and cars.	MUL's sales mix has been moving in favour of compact cars.

MUL's rising share in Suzuki's profitability has prompted the Japanese company to invest Rs 9,000 crore in India, which is divided among the new car plant, diesel engine plant and modernization of the existing facilities.

Details of capex plans (to be invested in phases until 2010):

Capex Amount	Purpose	Investment by MUL
Rs 2500 cr	4th Car Plant at Manesar	Rs 2500 cr
Rs 4000 cr	Modernization of existing facility	Rs 4000 cr
Rs 2500 cr	Diesel engine plant (30:70 JV)	Rs 750 cr (30%)
Rs 9000 cr	---Total---	Rs 7250 cr

The 4th car plant at Manesar: This plant would entail an investment of Rs 2,500 crore, in phases until 2010. Currently this plant is rolling out 1 lakh units p.a. Further, the capacity is expected to reach 3 lakh units p.a. by 2010. Besides manufacturing the premium hatchback Swift, the new plant will also manufacture a new export model expected to be launched in 2008-09. As per the company's strategy, the new platform will also tie in new engine series to cover both Euro4 and Euro5 compatibility in order to realize unhindered export boom.

Suzuki's only Diesel engine Plant at Manesar: This plant would entail an investment of Rs 2,500 crore, in phases until 2010. The diesel engine plant has been set up by Suzuki Powertrain India Ltd, a 30:70 JV between MUL and its parent Suzuki Motor Corp. The total capacity will be 3,00,000 diesel engines per annum to be developed in phases. The initial annual capacity will be 1,00,000 diesel engines, 20,000 petrol engines and 1,40,000 transmission assemblies. The diesel engines manufactured at this plant will be used captively for its diesel models and will also be exported to Suzuki's group companies across the world.

Modernization of existing facilities: The balance capex of Rs 4000 cr would mainly be utilized for upgrading the existing facilities coupled with marginal expansion of capacities. This will include investment towards R&D facilities, designing facilities, building a test track, etc.

Of the proposed capex of Rs 9000 cr, MUL will be investing Rs 7250 cr and Suzuki Motors will invest the balance of Rs 1750 cr. Of the total planned capex of Rs 7250 cr, an estimated Rs 1316 cr has already been invested and MUL has earmarked a capex of Rs. 2000 cr each for FY08 and FY09.

Investment Concerns:

Restricted volume growth:

- Rising interest rates may lead to slow down in demand for cars.
- Sharp rise in fuel price can have an adverse impact on car sales as running costs increases.
- Ramping up of Diesel Engine production will go to Suzuki for their global requirement thus the constraint over availability of diesel engines from the JV Company will impede the growth in sales of Swift diesel, which is already a run away success.

Market share may slide:

- All major players are rolling out new models in the compact car segment to increase their market share. Thus, the intense competition brewing up in this segment can hurt the volume growth of MUL leading to slide in market share.

Margin pressure:

- Subvention by way of cheaper auto loans @ 7.99% will impact margins.
- Price competition brewing up in the compact car segment may lead to aggressive discounts.
- Rising raw material prices will restrict margin improvement.
- High localization at launch reduces the scope for further cost reduction in the future.

Performance Highlights:

Q4 FY07:

In Q4FY07 Sales increased to Rs 4413.4 cr. from Rs 3260.3 cr. registering growth of 35%. This growth was supported by 29.6% growth in volumes, which stood at 200112 vehicles from 154400 vehicles during the same Qtr in the previous year; the balance growth was supported by better realization, which grew by 4.5%. OPM (excluding other income) decreased by 240 bps to 12.44% from 14.84% on YoY basis. The fall in OPM is attributed to the merger of MSAIL, which incurred a loss of Rs 58.5 cr. during the Qtr. MSAIL was a JV between MUL and Suzuki and the fourth plant was developed through this JV, which is now completely acquired by MUL. Net profits increased to Rs. 448.6 cr. from Rs. 360.9 cr. a year ago registering a growth of 24.3% on YoY basis. Net margins for the Qtr stood at 9.68% compared to 10.64% a year ago.

FY07:

In FY07 Sales increased to Rs 14592.2 cr. from Rs 12003.4 cr. registering growth of 21.6%. This growth was supported by 20.1% growth in volumes, which stood at 674924 vehicles from 561819 vehicles a year ago; the balance growth was supported by better realization, which grew by 1.2%. OPM (excluding other income) marginally increased by 8 bps to 13.58% from 13.5%. Despite rising prices of input MUL has done well to maintain its OPM. Net profits increased to Rs. 1562 cr. from Rs. 1189 cr. a year ago registering a growth of 31%. Net margins for the year stood at 10.66% compared to 9.87% a year ago. Higher net margins are supported by spurt in other income.

Earning Summary for MUL					(Rs in Cr)
	Mar 07 12 mths	Mar 06 12 mths	YoY %	FY 2008 (P) 12 mths	FY 2009 (P) 12 mths
Income from operations	14653.9	12052.2	21.6	16542.8	20160.5
Other Income	598.4	429.2		658.3	730.7
Op. Profit	2588.8	2055.8	25.9	2910.3	3523.9
Interest	37.6	20.4		36.8	34.1
Gross Profit	2551.2	2035.4	25.3	2873.4	3489.8
Depreciation	271.4	285.4		383.9	496.4
PBT	2279.8	1750.0	30.3	2489.5	2993.4
Tax	717.9	560.9		784.2	942.9
Profit	1561.9	1189.1	31.4	1705.3	2050.5
Equity capital	144.5	144.5		144.5	144.5
OPM (%)	17.7	17.1		17.6	17.5
GPM (%)	17.4	16.9		17.4	17.3
NPM (%)	10.7	9.9		10.3	10.2
EPS (Rs - Ann)	54.1	41.2		59.0	71.0
CEPS (Rs -Ann)	63.5	51.0		72.3	88.2

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