Flashnote

HSBC Global Research

Industrials
Autos
Equity – India

Overweight (V)

Target price (INR)			**990.00**
Share price (INR)			**788.85**
Potential total return (%)			**25.5**
Performance	**1M**	**3M**	**12M**
Absolute (%)	-13.7	-13.3	-10.0
Relative^ (%)	-1.7	-8.2	-22.7
Index^			BOMBAY SE IDX
RIC			MRTI.BO
Bloomberg			MUL IN
Market cap (USDm)			5,170
Market cap (INRm)			227,907
Enterprise value (INRm)			190802
Free float (%)			27.5

Note: (V) = volatile (please see disclosure appendix)

21 March 2007

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Maruti Udyog

On top

- **We forecast car sales to grow 14% in FY08 and 13% in FY09 compared to 22% in FY07, affected by rising interest rates**
- **Maruti likely to gain 200bp in market share in FY08e and maintain this in FY09e on the back of new products**
- **Upgrade Maruti to Overweight (V) from Neutral due to correction in share price, but cut target price from INR1,080 to INR990 as we cut FY08e and FY09e EPS by 2.1% and 3.4% respectively**

Return to trend line growth

Domestic demand has grown at a CAGR of 12% in the decade ending FY97 to FY07, nearly 1.8 times the average GDP growth. We expect total car demand to grow at 14% in FY08 and 13% in FY09 which is almost in line with the trend line growth of the last decade. Our expectation of a decline in the growth rate to 13% from 22% in FY07 is due to the following changes to key drivers:

- Slower sales growth: Reduction in excise duty in February 2006 will, we expect, increase sales by 22% in FY 07 vs 8.7% in FY 06, thus leading to a high base for comparison in FY08. We do not expect any further excise reductions for FY07 and FY08, and hence expect car sales growth to slow down slightly in FY08 and FY09 vis-à-vis FY07.
- Higher interest rates: Interest rates on car loans has gone up by over 250bp over the past year, and our economist, Robert Prior-Wandesforde, in his report *India Watch: Has inflation peaked?* dated 9 March 2007, expects rates to rise further. This could impact sales growth as affordability could decline.
- Slower GDP growth: According to Robert, the average GDP growth in FY08 and FY09 could be lower at 7.3% compared to an average of 9.1% in the last two years.

We, however, believe that new product launches have the most significant influence in driving growth in this segment. We expect to see significant sales growth for Maruti, driven by a number of new product launches in FY08 and FY09, compared to the past two to three years. This is likely to mitigate the impact of an adverse macro environment in our view.

We believe that affordability of a car in terms of overall ownership cost is likely to be the key driver of a product's success in India over the next five years. Maruti scores very high in terms of affordability criteria, including the upfront cost of buying the car, operating cost in terms of fuel efficiency and type of fuel, and maintenance cost. We therefore expect Maruti to gain market share in the car segment.

India – Car sales trend and expectations, vis-à-vis macro environment

YE Mar	Borrowing rate at the end of year	Change in borrowing rate (bp)	GDP growth	Excise duty*	Domestic car sales (no.)	y-o-y car sales growth
FY 98	15.50	(50)	5.0%	40%	388,015	3.7%
FY 99	14.50	(100)	6.6%	40%	384,483	-0.9%
FY 00	13.75	(75)	6.1%	40%	615,544	60.1%
FY 01	12.75	(100)	4.4%	40%	567,734	-7.8%
FY 02	12.25	(50)	5.8%	32%	570,473	0.5%
FY 03	10.75	(150)	4.0%	32%	591,870	3.8%
FY 04	9.75	(100)	8.5%	24%	755,335	27.6%
FY 05	10.00	25	7.5%	24%	872,795	15.6%
FY 06	10.50	50	9.0%	16%*	948,460	8.7%
FY 07e	13.00	250	9.2%	16%*	1,157,121	22.0%
FY 08e	13.75	75	8.2%	16%*	1,307,547	14.0%
FY 09e	14.75	100	6.3%	16%*	1,477,528	13.0%

* On small cars
Source: CMIE, SIAM, HDFC, HSBC estimates

Maruti on top

We expect Maruti to maintain its H2 FY07 market share of 53%, driven by new product launches. We expect Maruti's market share in FY08 to be 200bp higher than its average market share of 51% in FY07. Maruti has launched three new products, including a modified *WagonR* in Q2FY07, *Zen Estilo* in Q3FY07 and *Swift Diesel* in Q4FY07 (year end Mar 2007) – averaging one new product per quarter. We expect the trend to continue into Q1 FY08, when the company is likely to introduce a new sedan in the place of *Baleno*, whose production it stopped recently. Essentially, we expect Maruti to maintain its leadership despite increasing competition, with the following strategies:

- It plans to introduce two to three new products per annum, a higher rate than its competitors.
- Maruti is likely to gain market share in the cheaper fuel car segment - diesel, CNG and LPG as the company is increasing its presence in these categories much faster than its competition.
- It plans to expand presence in premium car and utility vehicles, where its current market share is relatively low. Maruti's market share in big cars is only 11%. Maruti's market share in utility vehicles and van segment is 29%, significantly lower than its share in the compact car segment.

Upgrade rating to Overweight (V), lower target price to INR990

We upgrade Maruti to Overweight (V) from Neutral as our target price now shows 27% potential total return compared to the current price due to the the recent sharp correction in the stock price (down 13% over the past 3 months). Note that the stock is now considered volatile under the HSBC rating system. However, we cut our DCF-based target price to INR990 per share from INR1,080 for two reasons. Firstly, because of the 2.1% and 3.4% cut in our estimated FY07 and FY08 EPS due to our lower volume growth assumptions for FY08 and FY09, following the increase in borrowing costs for buying cars. Secondly, we have also increased our assumption of capex for Maruti during FY11 to FY20 to reflect the growing capital intensity of the car business. This has pulled down ROIC and has affected our DCF valuation.

We continue to assume the cost of equity to be 13.5% for our DCF valuation. We have explicit estimates until FY10. In our semi-explicit forecast period of 10 years starting FY11, we have assumed the NOPLAT to grow at 14.7% CAGR compared to FY10 NOPLAT. We have assumed the fade period to start in FY21. During the fade period, we have assumed ROIC to decline to the level of cost of capital. We have assumed the fade period to start in FY21 and last for 17 years.

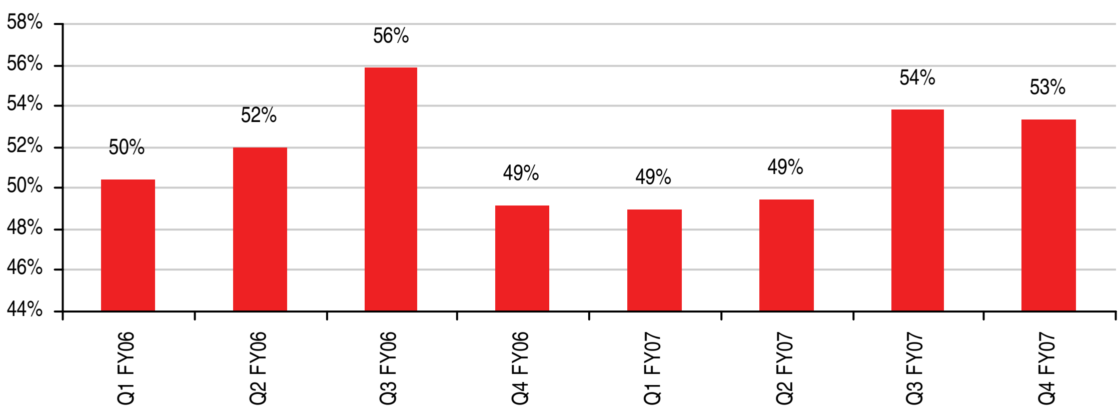
At our one-year target price of INR990, we expect the stock to trade at a PE of 15.5x FY08e EPS of INR63.97 and 13.9x FY09e EPS of INR71.2.

Maruti – HSBC segmental volume growth and market share assumptions

y-o-y growth (%)	FY 06	FY 07e	FY 08e	FY 09e
Small & Compact (a)	9.5%	22.3%	18.6%	12.6%
Premium (b)	7.8%	-14.7%	9.4%	27.1%
Total domestic car (a) + (b)	9.4%	19.7%	18.2%	13.3%
Domestic UV and Van	0.7%	22.8%	12.8%	11.2%
Exports	-28.9%	4.0%	15.0%	50.0%
Total sales	**4.8%**	**19.1%**	**17.3%**	**15.0%**
Market Share (%)				
Small & Compact	64.1%	62.7%	65.6%	65.0%
Premium	14.5%	11.1%	10.6%	12.0%
Total domestic car	**51.7%**	**50.9%**	**52.9%**	**52.9%**

Source: SIAM, Company, HSBC estimates

Maruti's market share in cars is inching up



SIAM's Q4FY07 data assumes same market share in Mar07 as in Jan and Feb07
Source: SIAM]

Key risks

The key downside risk to Maruti is increase in competition. A host of new entrants and capacity expansion by existing competition are likely to put pressure on Maruti's market share and margin. We expect industry capacity to double by FY10 compared to FY07, while Maruti's capacity is likely to grow by 70%, in our view. However, most of the new capacity should come in a phased manner from early 2008e and capacity utilisation of the industry is unlikely to drop below 67%, in our view.

Maruti – FY08 and FY09 earnings downgrade and assumptions

	FY08e			FY09e			FY09 vs. FY08 (New)
	Old	New	Difference	Old	New	Difference	
Sales Volume (No. of units)	794,776	785,136	-1.2%	939,936	902,889	-3.9%	15.0%
EBITDA (INRm)	28,692	28,127	-2.0%	32,430	31,413	-3.1%	11.7%
PAT (INRm)	18,871	18,482	-2.1%	21,292	20,571	-3.4%	11.3%
EPS (INR)	65.3	64.0	-2.1%	73.7	71.2	-3.4%	11.3%

Source: HSBC estimates

Financials

Financial statements

Year to	03/2006a	03/2007e	03/2008e	03/2009e
Profit & loss summary (INRm)				
Revenue	124,954	149,650	180,543	209,505
EBITDA	19,207	24,439	28,127	31,413
Depreciation & amortisation	-2,891	-2,721	-3,300	-4,064
Operating profit/EBIT	16,316	21,718	24,827	27,349
Net interest	1,590	1,500	1,673	2,038
PBT	17,906	23,217	26,501	29,387
HSBC PBT	17,906	23,217	26,501	29,387
Taxation	-5,740	-7,197	-7,950	-8,816
Net profit	12,191	16,000	18,482	20,571
HSBC net profit	12,191	16,000	18,482	20,571
Cash flow summary (INRm)				
Cash flow from operations	16,672	19,330	21,596	24,396
Capex	-3,945	-15,229	-8,830	-15,000
Cash flow from investment	-9,259	-24,687	-18,662	-22,312
Dividends	-1,153	-1,443	-1,764	-2,084
Change in net debt	-11,080	-3,087	-9,832	-7,312
FCF equity	12,727	4,101	12,766	9,396
Balance sheet summary (INRm)				
Intangible fixed assets	0	0	0	0
Tangible fixed assets	20,491	32,877	39,577	50,513
Current assets	61,908	66,705	81,615	93,688
Cash & others	39,214	42,105	51,937	59,249
Total assets	84,206	101,081	122,693	145,701
Operating liabilities	20,875	23,370	28,194	32,717
Gross debt	6,696	6,500	6,500	6,500
Net debt	-32,518	-35,605	-45,437	-52,749
Shareholders funds	55,730	70,287	87,005	105,491
Invested capital	22,310	34,107	41,061	52,235

Ratio, growth and per share analysis

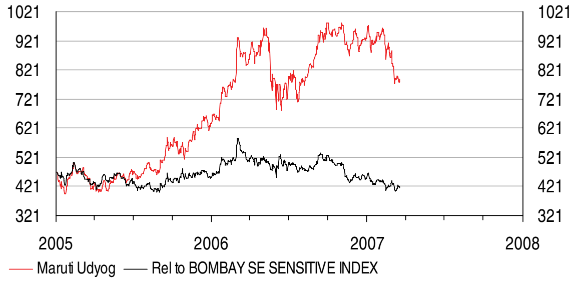
Year to	03/2006a	03/2007e	03/2008e	03/2009e
Y-o-y % change				
Revenue	10.1	19.8	20.6	16.0
EBITDA	12.3	27.2	15.1	11.7
Operating profit	30.7	33.1	14.3	10.2
PBT	33.8	29.7	14.1	10.9
HSBC EPS	38.5	31.2	15.5	11.3
Ratios (%)				
Revenue/IC (x)	5.5	5.3	4.8	4.5
ROIC	49.0	53.1	46.2	41.0
ROE	24.3	25.4	23.5	21.4
ROA	16.5	17.5	16.8	15.5
EBITDA margin	15.4	16.3	15.6	15.0
Operating profit margin	13.1	14.5	13.8	13.1
EBITDA/net interest (x)				
Net debt/equity	-58.2	-50.6	-52.1	-49.9
Net debt/EBITDA (x)	-1.7	-1.5	-1.6	-1.7
CF from operations/net debt				
Per share data (INR)				
EPS reported (fully diluted)	42.20	55.38	63.97	71.20
HSBC EPS (fully diluted)	42.20	55.38	63.97	71.20
DPS	3.99	5.00	6.11	7.21
NAV	192.90	243.28	301.15	365.13

Valuation data

Year to	03/2006a	03/2007e	03/2008e	03/2009e
EV/sales	1.5	1.3	1.0	0.8
EV/EBITDA	10.1	7.8	6.4	5.5
EV/IC	8.7	5.6	4.4	3.3
PE*	18.7	14.2	12.3	11.1
P/NAV	4.1	3.2	2.6	2.2
FCF yield (%)	5.6	1.8	5.6	4.2
Dividend yield (%)	0.5	0.6	0.8	0.9

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 19 Mar 2007

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Disclosure appendix

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Rating definitions for long-term investment opportunities

Stock ratings

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For each stock we set a required rate of return calculated from the risk free rate for that stock's domestic, or as appropriate, regional market and the relevant equity risk premium established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the implied return must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

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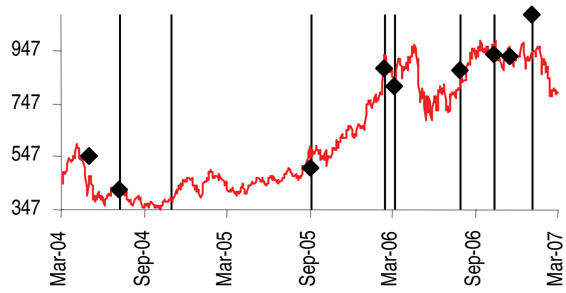
Underweight (Sell)	20%	(11% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Maruti Udyog Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Buy	Hold	27 July 2004
Hold	N/R	15 November 2004
N/R	Underweight	21 September 2005
Underweight	Neutral	01 March 2006
Neutral	Underweight	24 March 2006
Underweight	Neutral	18 August 2006
Neutral	Underweight	31 October 2006
Underweight	Neutral	23 January 2007
Target Price	**Value**	**Date**
Price 1	550.00	18 May 2004
Price 2	423.00	27 July 2004
Price 3	N/R	15 November 2004
Price 4	506.00	21 September 2005
Price 5	877.00	01 March 2006
Price 6	807.00	24 March 2006
Price 7	869.70	18 August 2006
Price 8	931.00	31 October 2006
Price 9	925.00	05 December 2006
Price 10	1080.00	23 January 2007

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
MARUTI UDYOG	MRTI.NS	788.85	19-Mar-2007	4

Source: HSBC

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