

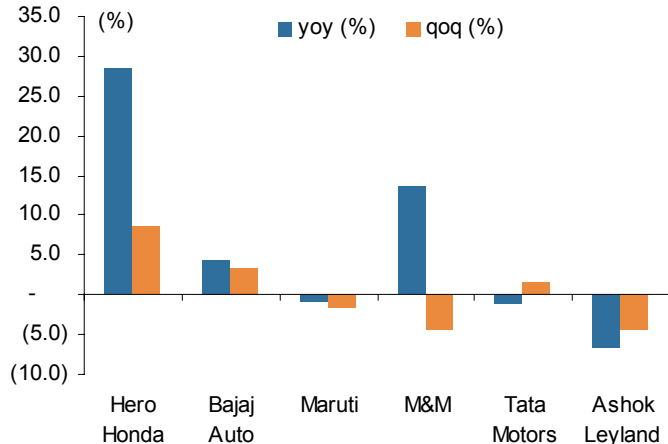
The impact of economic headwinds on the Indian Auto Industry was evident in the Q2 FY09 results. Domestic volumes declined for all companies except for Hero Honda Motors Ltd (HHML) and Mahindra and Mahindra (M&M). Realizations were up for most of the companies, due to price hikes implemented in the last one year and changes in product mix towards higher priced products. Despite higher realizations, expectantly, operating margins remained under pressure primarily on account of higher raw material prices and forex losses (included in other expenditure). With most of the companies undergoing capacity expansions, depreciation and interest expenses have also been higher. Consequently, only HHML reported an increase in APAT on a yoy basis.

## Q2 FY09 performance snapshot

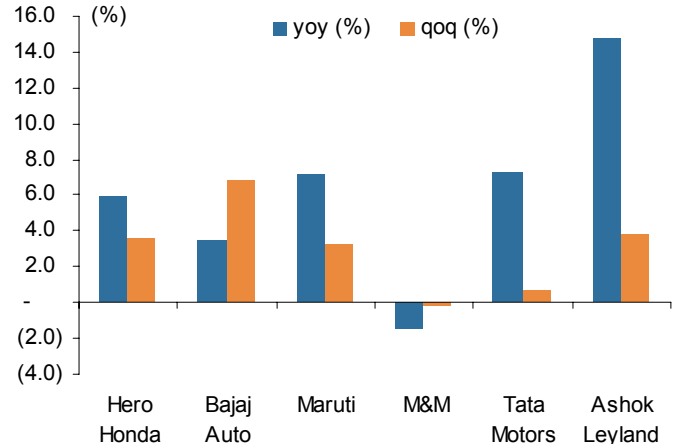
	Sales (Rs mn)			OPM (%)			APAT (Rs mn)		
	Q2 FY09	Yoy (%)	qoq (%)	Q2 FY09	yoy (bps)	qoq (bps)	Q2 FY09	yoy (%)	qoq (%)
Hero Honda	32,021	36.1	12.6	13.6	119	159	3,063	49.9	12.3
Bajaj Auto	24,507	9.2	9.8	13.5	(271)	195	1,849	(22.5)	5.6
<b>Two-wheelers</b>	<b>56,528</b>	<b>23.0</b>	<b>11.4</b>	<b>13.5</b>	<b>63</b>	<b>175</b>	<b>4,912</b>	<b>10.9</b>	<b>9.6</b>
Maruti	48,063	6.1	1.6	10.7	(489)	(132)	2,961	(36.5)	(36.4)
M&M	31,380	11.6	(4.7)	9.3	(462)	(53)	2,268	(20.7)	42.4
Tata Motors	70,789	6.1	2.2	8.0	(411)	44	3,470	(34.1)	6.4
Ashok Leyland	18,664	6.9	(0.9)	8.2	(140)	23	672	(16.3)	33.0
<b>Four-wheelers</b>	<b>168,895</b>	<b>7.2</b>	<b>0.3</b>	<b>9.0</b>	<b>(328)</b>	<b>(27)</b>	<b>9,371</b>	<b>(31.1)</b>	<b>(6.5)</b>
<b>Total</b>	<b>225,422</b>	<b>10.7</b>	<b>2.9</b>	<b>10.2</b>	<b>(229)</b>	<b>28</b>	<b>14,283</b>	<b>(20.8)</b>	<b>(1.5)</b>

Source: Company, India Infoline Research

## Change in volumes



## Change in realizations



Source: Company, India Infoline Research

## Two wheelers: Hero Honda posts a stellar performance across the industry

Q2 FY09 saw return of momentum in volume growth for the two wheeler industry. HHML stood out with a 28.5% yoy growth in volumes. The growth was driven by marked increase in rural sales driven by bumper Rabi crop season and improved affordability on account of farm loan waiver. However, Bajaj Auto Ltd (BAL), which has a major presence in urban and semi-urban regions, witnessed a steep decline in domestic sales. Growth of 4.2% yoy in BAL's volume was on account of robust growth in exports. On realization front, both the companies witnessed an increase driven by price hikes implemented in the quarter. Across the sector, only HHML reported an expansion in margins. For BAL, margins were depressed on account of high raw material cost and Rs300mn foreign exchange fluctuation loss. At the net level, higher other income helped HHML report strong growth but for BAL it was lower tax rate that helped the company report a growth in PAT (decline in PBT).

## Four wheelers: margins under severe pressure

Amongst the four-wheeler companies only M&M reported a yoy increase in volumes driven primarily on account of higher UV sales and robust growth in 3-wheeler volumes. Considering realizations, Ashok Leyland was the most impressive with a 14.7% yoy increase driven by price hikes taken. With contribution of low-value products such as three-wheelers increasing in M&M's portfolio, realizations for the company declined on a yoy basis. Operating margins for all the companies were on a declining mode as the companies were not able to pass on higher raw material costs. Additional pressure on profitability was witnessed on account of foreign exchange fluctuation losses reported by most of the companies.

## Key positives and negatives of company results in Q2 FY09

	Key positives	Key negatives
Hero Honda	Strong volume growth, higher realizations	Shift towards lower priced entry level segment, higher tax rate on account of lower than expected production at Haridwar plant
Bajaj Auto	Robust 3-wheeler volume and export growth, higher production at tax-free Uttarakhand plant	Declining margins, VRS expenses at Akrudi plant
Maruti	Change in mix of volumes towards high priced A3 category	Declining volumes across other segments, higher royalty and S&D expenses, higher fuel cost at Manesar plant
M&M	Strong volume growth, higher other income	Flat realizations, lower octroi refund, MTM loss, one time expenses
Tata Motors	Higher realizations	Lower volumes, margin pressures, lower other incomes, forex loss
Ashok Leyland	Higher realization for CV segment, increase in revenues from engines and spare parts business, higher other income	Lower volumes, higher other expenditure causing decline in margins, MTM loss and higher interest expense

Source: India Infoline Research

## Outlook: rural demand to remain strong

Q2 FY09 was reflective of a strong demand emerging from the rural India. We expect rural demand to remain strong driven by a bumper Rabi crop season and farm loan waiver. With a spate of measures from RBI to improve liquidity in the Indian financial system, credit scenario in the country is expected to ease considerably. Banks have initiated cuts in their PLR. However, we expect the benefits to flow in to the auto sector with a lag of six to eight months. With commodity prices on a constant decline, margins would also improve in a couple of quarters. Our top pick in the sector is HHML.

## Valuation summary

	CMP (RS)	EPS (Rs)		P/E (x)	
		FY09E	FY10E	FY09E	FY10E
Hero Honda	745	62.6	70.2	11.9	10.6
Bajaj Auto	445	53.2	59.8	8.4	7.4
Maruti	616	58.5	66.8	10.5	9.2
M&M	375	36.6	40.3	10.3	9.3
Tata Motors	181	35.0	43.2	5.2	4.2

Source: India Infoline Research

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