IDFC SSKI

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Sector strategy

Automobiles

Running uphill

The auto industry is not yet out of the woods. While firm interest rates, high input costs and higher fuel prices are hurting volumes, price hikes taken are insufficient to compensate for rising cost pressures. Though Sixth Pay Commission would act as a trigger for sale of small cars and two-wheelers (2Ws), higher duty levied on gas guzzlers would impact mid-size car and UV segment. 2W players could see muted volume growth in 2HFY09 due to high base effect and difficulty in tying up finance. Also, CV fleet operators are putting expansion on hold with operating costs rising ahead of freight rates. While Maruti Suzuki remains our top pick, we are downgrading Hero Honda and Bajaj Auto to Underperformer as the stocks have crossed our price targets. We are Neutral on Tata Motors, which though facing tough times in core business, offers 16% upside from CMP on SOTP basis.

Sustained growth in cars, slowdown in CVs and 2Ws: We expect sustained growth momentum in passenger car segment (22.4% CAGR over FY08-10E) driven by new product launches and rising exports. However, CV sales are likely to be under pressure with deteriorating profitability of fleet operators as freight rates fail to align with fuel prices post the recent hikes. Growth outlook for 2W segment is likely to be muted primarily due to reduced availability of finance.

Soaring input costs, ambitious expansion plans to hurt earnings: Rising input costs have forced the industry to continuously review prices and effect price hikes. However, the quantum of price hikes taken (~5%) is far below the input cost rise (30% increase in steel and 41% rise in rubber costs over Jan-July08). Aggressive capex plans announced by four wheeler (4W) majors would also adversely impact their profitability. We expect only 8.4% PAT CAGR for our auto universe over FY08-10.

Maruti Suzuki – top sector pick: Maruti Suzuki remains our top pick in the sector owing to its sustained leadership, strong growth in exports and attractive valuations. We believe the stock price has reacted too strongly to margin pressure concerns (33% price correction since January 2008). Maintain Outperformer with a price target of Rs835. Hero Honda and Bajaj Auto stocks are trading above our estimated price targets. Downgrade to Underperformer.

Comparative valuations

Company	Price	Mkt Cap	Reco	EPS CAGR (%)	FY10E		Target	Upside
	(Rs)	(Rs bn)		FY08-10E	PE (x)	EV/EBITDA (x)	(Rs)	(%)
Ashok Leyland	33	43.5	Neutral	(0.4)	9.3	5.8	35	7.0
Bajaj Auto	607	87.8	Underperformer	3.2	9.5	6.0	545	(10.1)
Hero Honda	860	171.7	Underperformer	16.3	13.1	8.6	797	(7.3)
Mahindra & Mahindra	582	150.9	Neutral	(2.4)	8.6	6.3	591	1.5
Maruti Udyog	680	196.4	Outperformer	6.7	9.8	5.2	835	22.9
Tata Motors	420	161.9	Neutral	13.3	7.0	4.7	485	15.5
TVS Motor	34	8.1	Underperformer	248.8	13.5	8.6	25	(26.5)

** Based on fully diluted EPS*

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Despite high interest rates, rising raw material (especially steel) prices and higher fuel prices impacting demand, we expect sustained growth momentum in passenger cars (22.4% CAGR over FY08-10E) backed by new product launches and rising exports. However, we expect the slowdown in CV segment to persist (10% CAGR over FY08-10E) with freight rates lagging the rise in operating costs of operators, and forcing them to put expansion plans on hold. Tractor off-take also is likely to be muted due to hardening interest rates. The 2W segment continues to bear the brunt of stringent financing norms and rising interest rates. Nevertheless, implementation of Sixth Pay Commission proposals could provide a trigger to 2W sales (7.9% CAGR over FY08-10E). We expect PAT CAGR of only 8.4% for our automobile universe over FY08-10 (11.6% for 2W companies) with contraction in return ratios due to lower profitability and aggressive expansion plans. We had recently upgraded Hero Honda and Bajaj Auto to Outperformer on the premise of attractive valuations, but both the stocks have met our price targets. Maruti Suzuki (Maruti) remains our top pick in the sector on the back of its domestic market leadership and rising exports.

PVS: SUSTAINING MOMENTUM IN CHALLENGING TIMES

Despite a challenging macro-economic environment, the passenger vehicle (PV) industry has posted 11.8% yoy growth in FY08, driven by new product launches and forays into new export markets. The momentum has sustained for the period Apr-July08 with 14.9%yoy growth. However, rising interest rates, surging input costs and the recent fuel price hike pose a significant challenge for the industry in the current fiscal. The government's recent decision to raise excise duty on gas guzzling vehicles would aggravate the slowdown in UVs and mid-size cars.

Exhibit 1: PVs – sustained growth momentum

	Domestic			Exports			Total		
Segment	YTD* FY09	YTD* FY08	% change	YTD *FY09	YTD* FY08	% change	YTD* FY09	YTD* FY08	% change
Passenger Cars	364,458	396,945	8.9	64,439	93,483	45.1	428,897	490,428	14.3
UVs	71,363	82,803	16.0	2,137	1,622	(24.1)	73,500	84,425	14.8
MPVs	28,543	35,569	24.6	298	296	(0.7)	28,841	35,865	24.3
Total PVs	**464,364**	**515,317**	**10.9**	**66,874**	**95,401**	**42.6**	**531,238**	**610,718**	**14.9**

*Source: SIAM; * -YTD numbers are for April-July08*

Nevertheless, favorable demographics, low penetration and rising disposable incomes indicate that the industry would continue to grow despite the near-term challenges. Also, many global auto majors are developing India as an export base (Hyundai; *i-10* and Maruti Suzuki; *A Star*). Domestic companies are also aggressively expanding their global footprint. While volumes are likely to be muted in the domestic market in FY09, exports would compensate for the lower offtake. We expect 22.4% CAGR in passenger car volumes and 11.2% CAGR in UV volumes over FY08-10.

New models sustaining the buzz in the cars segment; sales declining for existing models

❑ New launches, exports propping up car sales

New product launches have fuelled demand for cars despite a steep rise in interest rates. Recent launches like *WagonR Duo*, *SX4*, *Dzire*, *Swift* Diesel, *Logan*, *Spark* and *Fabia* have helped the segment post 8.9% volume growth in the domestic market in the Apr-July08 period. However, most of the existing models have witnessed a decline, which indicates the underlying slowdown in the sector. Tata Motors has witnessed a decline in volumes primarily due to an aging product portfolio.

Exhibit 2: New model launches driving growth

(nos.)	YTDFY08	YTDFY09	Growth (%)
Maruti Suzuki India	**184,564**	**203,773**	**10.4**
Existing models	**104,256**	**99,748**	**(4.3)**
800	23,964	21,602	(9.9)
Alto	66,862	65,211	(2.5)
Estilo	13,430	12,935	(3.7)
New / variants launched	**80,308**	**104,025**	**29.5**
Wagon R	39,944	46,216	15.7
Swift	24,914	35,860	43.9
Esteem, Dzire, SX4	15,450.0	21,949	42.1
Hyundai Motors India	**63,609**	**82,936**	**30.4**
Existing models	**55,956**	**37,980**	**(32.1)**
Santro	46,204	29,067	(37.1)
Verna	9,302	8,729	(6.2)
Elantra + Sonata	450	184	(59.1)
New models / Variants launched	**7,653**	**44,956**	**487.4**
Getz + i10	6,012	41,199	585.3
Accent	1,641	3,757	128.9
Tata Motors	**55,488**	**50,740**	**(8.6)**
Existing models: Indica	45,696	33,201	(27.3)
New / variants launched: Indigo	9,792	17,539	79.1
General Motors India	**12,627**	**14,697**	**16.4**
Existing models	**6,542**	**5,294**	**(19.1)**
Aveo, Aveo - UVA	5,065	3,717	(26.6)
Optra	1,477	1,577	6.8
New models / Variants launched: Spark	**6,085**	**9,403**	**54.5**
Total	**316,288**	**352,146**	**11.3**
Existing models	212,450	176,223	(17.1)
New models / Variants launched	**103,838**	**175,923**	**69.4**

Source: Crisinfac, IDFC-SSKI Research

Domestic slowdown being offset by higher exports

Focus on exports has also helped car majors tide over the lull in the domestic car segment. Exports for the period Apr-July08 have increased by 45.1% to 93,483 units, driving a 14.3% rise in overall passenger car sales to 490,000 units.

Exhibit 3: Exports boost volumes in the car segment

	Domestic sales			Exports			Total		
	YTDFY08	YTDFY09	Growth (%)	YTDFY08	YTDFY09	Growth(%)	YTDFY08	YTDFY09	Growth(%)
Maruti Suzuki	184,564	203,773	10.4	13,823	17,828	29.0	198,387	221,601	11.7
Tata Motors	54,981	50,740	(7.7)	4,736	1,995	(57.9)	59,717	52,735	(11.7)
Hyundai Motor India	63,609	82,936	30.4	45,865	73,638	60.6	109,474	156,574	43.0
General Motors	12,627	14,697	16.4	0	0	-	12,627	14,697	16.4
Others	48,677	44,799	(8.0)	15	22	46.7	48,692	44,821	(7.9)
Total	**364,458**	**396,945**	**8.9**	**64,439**	**93,483**	**45.1**	**428,897**	**490,428**	**14.3**

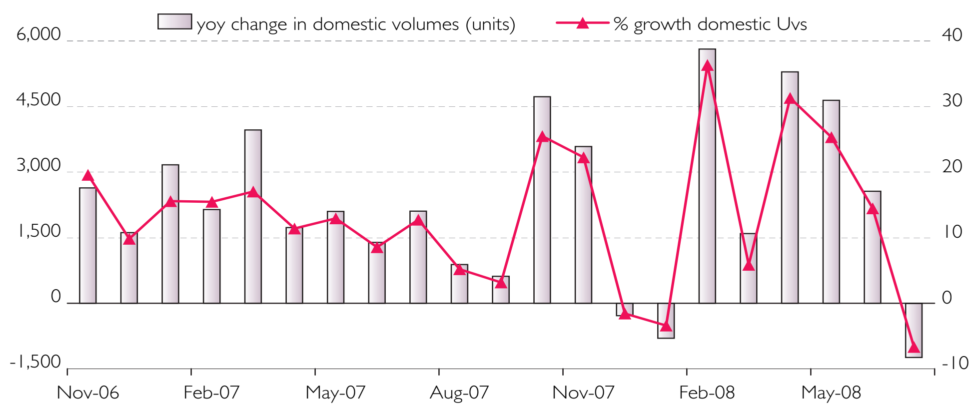
Source: SIAM, IDFC- SSKI Research

❑ UVs – growth momentum arrested by duty hike

UV momentum may slow down as government discouraging sales of fuel guzzlers

The utility vehicles segment has posted a healthy 23.6% growth in Q1FY09 in the domestic market on the back of old warhorses like *Bolero*, *Safari* and *Innova* as also the recently launched *Sumo Grande*. However, a recent government notification to discourage sales of gas guzzling vehicles has levied an additional duty of Rs15,000-20,000, which seems to have arrested the robust momentum. Domestic sales were down 5.8%yoy in July, leading to lower 16%yoy growth for the period Apr-July08.

Exhibit 4: UV momentum halted



Source: SIAM, IDFC-SSKI Research

❑ Car majors luring customers with discounts

Discounts offered vary between Rs30,000-55,000 on different models

With slowing demand in the domestic market, auto majors are doling out huge rebates to lure customers to showrooms. Maruti Suzuki is offering discounts of up to Rs47,000 across models while its closest competitor Hyundai is offering customized packages of up to Rs30,000 in rebates. Tata Motors' dealers are also offering discounts of up to Rs30,000 on *Indica* and *Indigo*. The Rs55,000 discount on *Spark* is also expected to continue till August 2008.

❑ Car majors go on a rural drive

Car majors focusing on rural markets given the vast latent potential

Car majors in India have realised that the next leg of growth would come from rural areas. Thus, they are now looking to expand their network in rural areas to tap the vast potential of these markets. After securing foothold in urban and semi-urban markets, Maruti has already launched a pan-India campaign - *Mera Sapna Meri Maruti*. To increase reach of finance for rural customers and offer flexible loans linked to the harvesting season, Maruti has roped in numerous regional rural banks as its partners. General Motors is investing heavily to set up a massive dealer network to push its popular models – *Tavera*, *Spark* and *UV-A*. The company is launching mobile service centres/ showrooms in C and D-class towns, and is working with zilla parishads and gram panchayats to launch special packages for buyers. Existing GM dealers are being roped in to open up showrooms in smaller markets. Hyundai Motors has launched a promotional scheme *'Ghar Ghar Ki Pehchaan'* for panchayat functionaries and government employees in villages.

❑ Sixth Pay Commission recommendations to prop disposable incomes

Higher disposable incomes expected to trigger 2W and car sale

The raising of income-tax slabs, policy focus on rural economy and recent pay hike for government employees will increase disposable income in the hands of end consumers. An average 21% increase in salary of government employees post implementation of the Sixth Pay Commission recommendations is expected to pump an additional Rs80bn liquidity into the system. Thus, higher aspirations and changing lifestyles would trigger demand for cars and 2Ws. Car market leader Maruti Suzuki has made special efforts to reach out to government employees (the *Wheels of India* scheme targeted at central and state government employees) and is banking on this relationship to reap further benefits.

❑ Exports to give fillip to a waning domestic market

Exports – key growth driver as domestic market turns dull

Global car manufacturers are making India their manufacturing hub as it is a cost-effective (in terms of labour, infrastructure and component sourcing) location. Suzuki's latest offering for global markets (*A-Star*) would be manufactured in India. Maruti Suzuki too has been focusing on exports and is targeting newer markets (export growth of 31.4%yoy to 51,669 units in FY08). The company has set an ambitious export target of 200,000 units by 2010-11. Similarly, Hyundai (already the largest exporter of cars from India) has made Chennai its global manufacturing hub. The company has also set an export target of 240,000 units by CY2008 (exports of 116,000 units in CY2007).

❑ Competitive intensity set to increase in the small car segment

New launches to heat up competition in the domestic small car segment

The small car segment, which currently accounts for ~76% of the car market, is set to witness fierce competition as all the domestic auto majors try to grab a bigger slice of the pie. While Maruti has been the undisputed market leader in this segment, it is expected to face stiff competition from global majors in the coming years. The company has seen its market share in the compact segment come down to ~60%.

Exhibit 5: Maruti losing share to Hyundai, General Motors

(% share)	FY06	FY07	FY08	YTDFY09
Maruti Suzuki	64.1	62.4	61.3	60.1
Hyundai	18.8	19.7	19.7	23.2
Tata Motors	16.9	17.4	14.6	11.0
General Motors	0.1	0.3	3.6	3.9

Source: SIAM, IDFC-SSKI Research

The global launch of *A-Star* followed by *Splash* will help Maruti maintain its share in this segment. Hyundai, riding high on the success of its newly launched compact *i-10* has already increased its market share to 23.2% YTD (19.7% in FY08) in the small car segment. The company is expected to launch *i-20* in India by the end of the current fiscal. General Motors has started a nation-wide aggressive marketing campaign for its entry level compact car *Spark* by slashing its prices by as much as Rs55,000. At this price point, *Spark* has generated considerable interest among consumers. Tata Motors has recently launched a refurbished and more stylish *Indica Vista* in the domestic market.

❑ Expect 22.4% CAGR in cars, 11.2% CAGR in UVs over FY08-FY10

New launches, exports to drive growth in the car segment; UVs may witness a slowdown

We expect CAGR of 22.4% in passenger car sales over FY08-10 backed by new launches including Tata Motors' *Nano* and the revamped *Indica Vista*, Maruti Suzuki's *Splash*, *Dzire* and *A-Star*, and Hyundai Motors *i10* and *i20*. In case of UVs, we expect a slower 11.2% CAGR over FY08-10 as the government's decision to discourage the sale of gas guzzling vehicles is likely to impact UV sales.

Exhibit 6: New launches to aid strong growth momentum in car sales

Sales in '000s	FY06	FY07	FY08	FY09E	FY10E	CAGR FY07-10E	CAGR FY08-10E
Car sales	1,052	1,269	1,413	1,659	2,117	18.6%	22.4%
% growth	7.3	20.6	11.3	17.4	27.6		
UV sales	269	309	355	376	438	12.4%	11.2%
% growth	8.9	14.8	14.8	6.1	16.5		
Total PV sales	**1,321**	**1,578**	**1,768**	**2,036**	**2,556**	**17.4%**	**20.2%**
% growth	7.6	19.4	12.0	15.1	25.5		

Source: SIAM, IDFC-SSKI Research

CVS: SLOWDOWN TO PERSIST

Domestic CV sales were up only 8%yoy over Apr-July 2008. While passenger carrier sales increased 6.8%yoy, goods carrier sales rose 8.2%yoy over the same period. Though the Indian economy is still growing at ~8% a year, small truck operators are feeling the pinch of higher interest rates and rising operating costs. As freight rates have failed to keep pace with rising operating costs, freight operators have resumed overloading and postponed their expansion plans. This has led to a slowdown in CV sales. While the slowdown persists at least for the next few months, we expect the CV industry to post only 9.3% growth in FY09 (10% CAGR over FY08-10E).

Exhibit 7: CV volumes up only 6.7% yoy YTD* FY09

	Domestic			Exports			Total		
	YTDFY08	YTDFY09	Growth (%)	YTDFY08	YTDFY09	Growth (%)	YTDFY08	YTDFY09	Growth (%)
M&HCVs									
Buses	11,696	12,549	7.2	2,972	2,534	(14.7)	14,668	15,083	2.8
Trucks	61,875	65,029	5.1	3,711	3,170	(14.5)	65,586	68,199	3.9
Total M&HCVs	**73,571**	**77,578**	**5.4**	**6,683**	**5,704**	**(14.6)**	**80254**	**83282**	**3.8**
LCVs									
Buses	10,526	11,187	6.3	1,520	1,973	29.8	12,046	13,160	9.2
Trucks	49,513	55,534	12.2	9,097	8,910	(-2.1)	58,610	64,444	9.9
Total LCVs	**60,039**	**66,721**	**11.1**	**10,617**	**10,883**	**2.5**	**70,656**	**77,604**	**9.8**
Total CVs	**133,610**	**144,299**	**8.0**	**17,300**	**16,587**	**(4.1)**	**150,910**	**160,886**	**6.7**

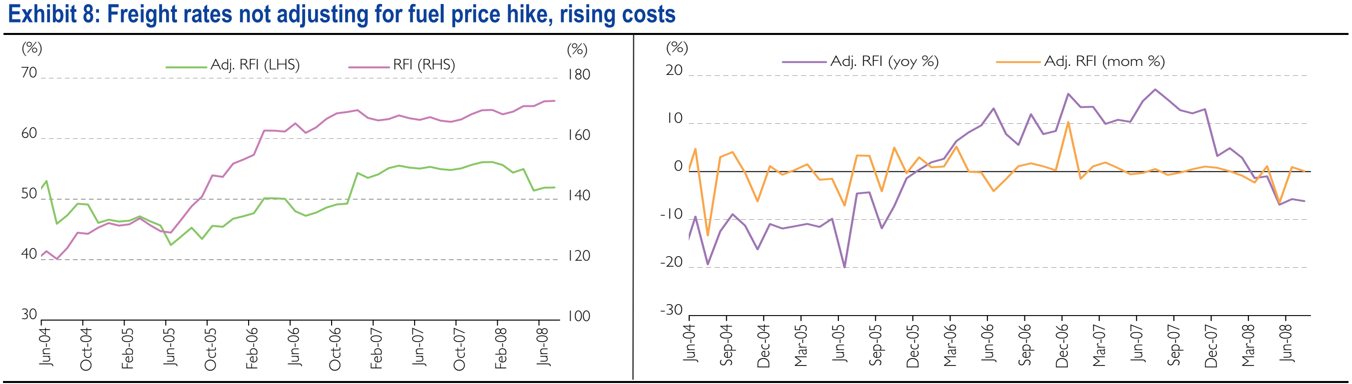
*Source: SIAM *; Note: Numbers for April-July08*

❑ Rising operating costs to impact operator viability, hence CV sales

Freight rates fail to adjust with rising fuel costs

In addition to inflation woes, the recent fuel price hike (besides higher tyre prices) would further dent profitability of fleet operators. With the railways (the biggest competitor) not increasing freight rates in tandem, fleet operators are unable to pass on the cost increase to end consumers. As a result, freight rates have not adjusted in proportion to the recent fuel price increase.

Exhibit 8: Freight rates not adjusting for fuel price hike, rising costs



Source: TCI, IDFC- SSKI Research

Subsequently, an added burden of rising interest costs has forced most fleet operators to postpone their expansion plans. As a result, we feel offtake of CVs would remain subdued, at least over the next 6-8 months.

❑ Ban on overloading takes backseat – to further impact CV demand

Re-enforcement of overloading ban seems unlikely, to impact CV demand

The Supreme Court ruling pertaining to ban on overloading of vehicles drove a 33.3% volume increase for the domestic CV industry in FY07. However, operators have postponed their fleet expansion plans in view of rising costs. Channel checks suggest that operators are once again resorting to overloading to survive in the tough economic environment. With inflation nearing 13%, re-enforcement of the overloading ban seems unlikley as it will force freight operators to expand fleet and increase freight rates to compensate for the higher operating costs. This, in turn, will put upward presuure on commodity prices. Hence, despite overloading being illegal, many state governments allow CVs to carry excess load after payment of a penalty.

❑ Competition set to increase going forward

Competition in the domestic CV market is set to flare up as a host of JVs are being announced with foreign players to set up production facilities in India. The recent CV alliances include the JV between German truckmaker MAN and Pune-based Force Motors for heavy and light commercial vehicles, Tata Motors' tie-up with Iveco and Mahindra & Mahindra's (M&M) JV with US-based International Engine and Truck Corporation for making heavy trucks. Further, three more JVs have been announced in the current fiscal so far:

Ashok Leyland (ALL) - Nissan

Increasing alliances with foreign counterparts would lead to competition heating up in the sector

ALL has announced three JVs with Nissan for production of LCVs, power train manufacturing and technology development at an aggregate investment of about Rs23bn. All these JVs are expected to commence operations by 2010.

Eicher Motors & Volvo

Volvo Eicher Commercial Vehicles (a JV between Eicher Motors and Volvo) would house all Eicher Motor's CVs, components and engineering business. Through this JV, Eicher Motors will get access to Volvo's technology and network across 180 countries while Volvo will be able to leverage Eicher's dealer network in India.

Hero Group & Daimler AG

Daimler AG and the Hero group have formed a 60:40 JV to manufacture light and medium commercial vehicles at an investment of Rs44bn. The JV will have an initial capacity of about 70,000 units and is expected to commence production by 2010. Subsequently, it would also foray into heavy CVs by 2012.

❑ LCVs continue to grow at the expense of 3-wheelers

Better economics and higher load capacity over goods 3Ws driving demand for LCVs

The LCV (goods) segment has witnessed a 2-year CAGR of ~24.5% over FY06-08. LCVs are finding preference over goods three wheelers (3Ws), primarily owing to better cost economics and higher load carrying capacity. Thus, while the 3W goods segment has seen volume decline of ~21.7%yoy in the Apr-July08 period, LCVs (goods) have posted 12.2%yoy growth. We expect LCVs to relatively outperform MHCVs and post a 2-year CAGR of 13% over FY08-10.

Exhibit 9: LCVs – growth unabated

	FY06	FY07	FY08	CAGR(%)	YTDFY09
LCVs - Goods	121,213	168,467	188,140	24.5	55,534
yoy change (%)	*21.3*	*38.9*	*11.7*		*12.2*
3 wheelers - Goods	147,221	166,735	132,571	5.1	34,717
yoy change (%)	*7.9*	*13.3*	*(20.5)*		*(21.7)*

Source: SIAM, IDFC-SSKI Research

❑ Expect 10% CAGR in CV sales over FY08-10

CV slowdown expected to continue

We feel that the prevalent slowdown in the CV industry would continue at least for the next 6-8 months. Rising operating costs for fleet operators and resumption of overloading in many states has been the key growth deterrent for the industry. With the added burden of rising interest rates and stringent financing norms, volume offtake would continue to be muted. We believe the CV industry would post only 10% CAGR over FY08-10. Potential upside to our estimates could arise from strict implementation of the overloading ban and softening of lending rates.

Exhibit 10: CV slowdown expected to continue

Sales in '000s	FY06	FY07	FY08	FY09E	FY10E	CAGR FY07-10E	CAGR FY08-10E
MHCVs	221	294	293	312	337	4.6%	7.3%
% growth	4.0	33.5	(0.5)	6.4	8.2		
LCVs	170	223	266	304	339	15.0%	13.0%
% growth	25.0	31.5	19.1	14.5	11.5		
Total CV sales	**390**	**518**	**559**	**616**	**677**	**9.3%**	**10.0%**
% growth	12.2	32.6	8.0	10.2	9.8		

Source: SIAM, IDFC-SSKI Research

2-WHEELERS: TOUGH ROAD AHEAD

2Ws sustain growth in Apr-July08, H2FY09 expected to be muted over a high base

Rising interest rates and stringent financing norms have led to a slowdown in the 2W segment. The lower cc (<125cc) motorcycle segment has been the worst hit and witnessed only a 4% volume increase in the Apr-July 2008 period led by Hero Honda (16.1% yoy growth vis-à-vis a 19% decline for other players). Given the high reliance of these customers on consumer financers, the exit of leading financiers like ICICI Bank and Citibank from the dealers' end is expected to aggravate the slowdown. However, a shift in customer preference towards the higher cc (125cc and above) segment (driven by higher disposable incomes) enabled it to buck the trend, and post 29.6% growth over the period.

While the 2W sector has posted ~10% growth in the Apr-July08 period, we see lower growth in H2FY09, primarily on account of a high base, rising interest rates and reduced availability of finance. In such a backdrop, we expect a marginal 7.9% CAGR in 2W sales over FY08-10.

Exhibit 11: 2W sales up 11.7%yoy, motorcycle sales up 13.6% over April-July 2008

	Domestic			Exports			Total		
Two-Wheelers	YTDFY09*	YTDFY08	Growth (%)	YTDFY09	YTDFY08	Growth (%)	YTDFY09	YTDFY08	Growth (%)
Scooter/ Scooterets	344,006	368,174	7.0	9,633	7,707	(20.0)	353,639	375,881	6.3
Motor cycles/Step-Throughs	1,753,772	1,945,878	11.0	249,114	329,883	32.4	2,002,886	2,275,761	13.6
Mopeds	138,747	143,431	3.4	9,107	2,693	(70.4)	147,854	146,124	(1.2)
Electric Two Wheelers	5,994	7,223	20.5	0.0	0.0	0.0	5,994	7,223	20.5
Total Two wheelers	**2,242,519**	**2,464,706**	**9.9**	**267,854**	**340,283**	**27.0**	**2,510,373**	**2,804,989**	**11.7**

*Source: SIAM * - data for April-July 2008*

Lower cc segment the most sensitive to reduced availability of finance

❑ Lower cc bikes – lending woes

The lower cc segment witnessed a significant fall in sales in FY08 on account of reduced availability of finance (Bajaj Auto and TVS Motors saw a 41% volume decline in entry level bikes in FY08). This declining trend continued in the current fiscal as well with Bajaj Auto reporting a 17.8% and TVS Motors 19.8% fall in volumes in the segment over Apr-July 2008. These players have been more dependent on broker-led financing network, and thus the worst hit in a rising interest rate scenario.

However, over the same period, market leader Hero Honda posted a smart recovery and clocked 16.1% volume increase in this segment backed by strong rural penetration and lesser dependence on financing (only ~25% vehicles sold are through the finance route).

Exhibit 12: Hero Honda bucks the decline trend in lower cc segment

Growth (%)	FY08	YTDFY09
Hero Honda	(2.5)	**16.1**
Bajaj Auto	(41.8)	(17.9)
TVS Motors	(41.0)	(19.8)
Others	(49.6)	(27.2)
Total	**(18.8)**	**4.8**

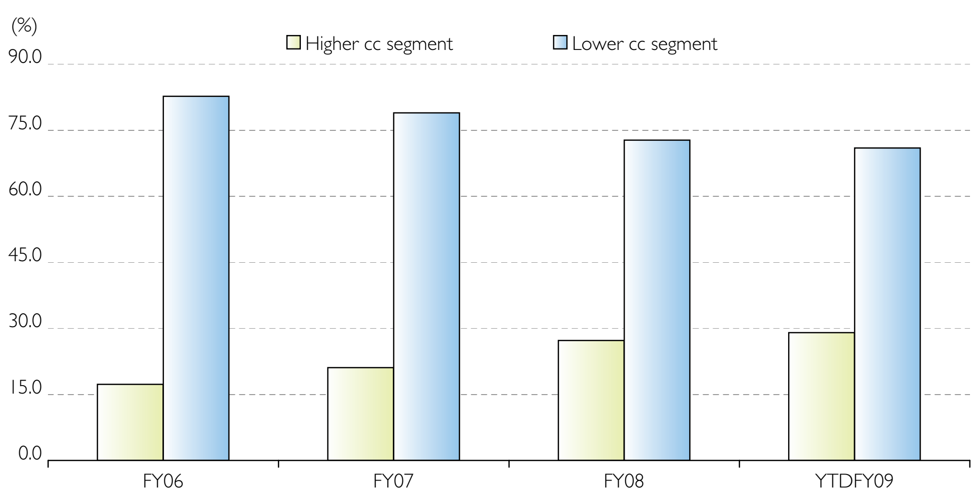
Source: SIAM, IDFC-SSKI Research

❑ Customer preference veering towards high end bikes

Structural shift towards the higher end models clearly evident

Higher disposable incomes and changing lifestyle of Indian consumers have led to a marked shift towards higher cc (125cc and above) models, at least in the urban areas. As a result, players like Bajaj Auto and TVS Motor have actively shifted their focus to this segment in the last couple of years. This segment now constitute about 29% of the overall motorcycle pie from 17.3% in FY06.

Exhibit 13: Customer preference shifts in favor of higher cc category



Source: SIAM, IDFC-SSKI Research

The higher cc segment has witnessed a slew of product launches like the *Hunk*, *TVS Flame*, *CBF Stunner* and *XCD*. New product launches have helped this segment post a robust 29.7%yoy growth over Apr-July08.

Exhibit 14: Higher cc segment posts robust growth

Growth (%)	FY08	YTDFY09
Hero Honda	67.7	32.6
Bajaj Auto	13.2	21.0
HMSI	54.4	22.1
TVS	(37.5)	137.0
Total	**13.9**	**29.7**

Source: SIAM, IDFC-SSKI Research

❑ Competition to abate with diverse focus of majors

Bajaj, TVS, HMSI focusing on higher cc segment…

In the last couple of years, the higher cc segment has seen robust demand in urban areas on account of rising income levels and changing lifestyles. As a result, most of the players (except Hero Honda) have shifted their focus to the more profitable higher end motorcycles. This segment now constitute ~27.2% of the overall motorcycle pie from 17.2% in FY06. After the success of its *XCD*, Bajaj Auto plans to launch four new models by December 2008 to maintain market share in this segment. TVS Motor's recent launches (like *Flame* and *Apache RTR*) in this category have been well accepted in the market. The company plans to launch two new products in this segment, which will tilt its product mix in favor of the executive / premium segment. With no product offerings in the entry level segment, HMSI continues to focus on this segment. HMSI's latest product offering, *CBF Stunner*, would help consolidate its position in this segment.

Exhibit 15: Lower cc segment (market share)

	FY06	FY07	FY08	YTD FY09
Hero Honda	58.6	58.8	70.7	75.2
Bajaj Auto	21.8	24.5	17.5	15.0
TVS Motors	14.0	13.5	9.8	8.3
Others	5.6	3.2	2.0	1.5

Share of higher cc segment (% of total bike sales)

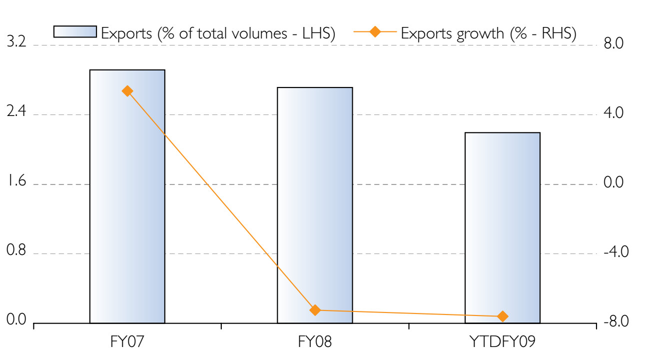
	FY06	FY07	FY08	YTD FY09
Hero Honda	2.7	3.4	5.7	6.6
Bajaj Auto	39.9	39.2	55.6	58.6
TVS Motors	10.6	17.7	18.5	31.7
Others	35.7	64.9	81.8	87.7

Source: SIAM, IDFC-SSKI Research

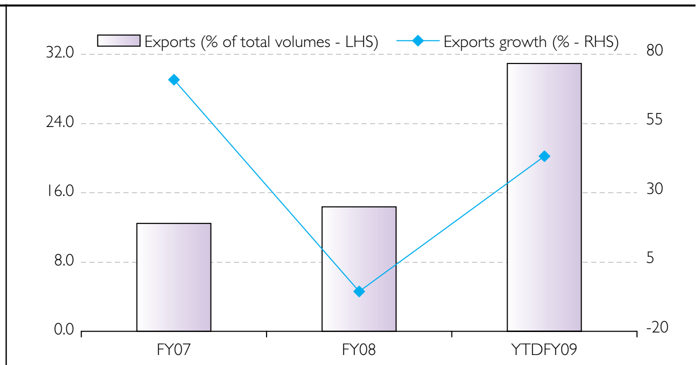
…while Hero Honda maintains dominance in lower cc segment with a higher 75% market share

With limited access to export markets, Hero Honda has retained focus on its 'bread and butter' lower cc segment in the domestic market. With other players focusing on higher end bikes, Hero Honda now commands a dominating 75% market share (~59% in FY07) in the lower cc segment in the domestic market.

Exhibit 16: Hero Honda focuses on the domestic segment



Bajaj Auto's volumes driven by exports



Source: SIAM, IDFC-SSKI Research

While Hero Honda is strengthening its foothold in the domestic market, Bajaj Auto has started focusing on the export markets and witnessed 70.7% CAGR in export volumes over FY06-08. Given that 2W majors are now focusing on diverse segments and geographies, we expect competitive intensity to subside in the space. We do not expect players to resume to irrational pricing strategies in the near term. This would help enhance profitability of players going forward.

❑ Cost push necessitates price hikes; good for players' margins

Price wars seem to be over, at least for the near term

Adverse commodity prices have put an end to the irrational pricing era of FY07 and early FY08, ushered in by price wars between Hero Honda and Bajaj Auto to gain market share. Raw material cost push has forced all 2W majors to raise product prices in three tranches since January 2008. While input costs have gone up by ~30% in Q1FY08, price hikes have been only to the extent of about 5%. The latest across-the-board price hike of Rs500-1,500 effected in July 2008 by 2W players clearly signals that they, for the time being, are done with price wars to gain market share at the cost of profitability. This, in our assessment, is a positive development for the ailing sector as it would help players protect margins going forward.

❑ Exit of leading financial institutions to further impact volumes

Exit of ICICI Bank and Citibank from dealers' end – a severe blow to demand

Consumers are finding it difficult to avail of 2W finance as banks are pulling out retail presence from dealerships. After Citibank, ICICI Bank has now decided to discontinue its financing services at the dealers' end. ICICI Bank is one of the largest 2W financing companies in India with estimated disbursements of Rs1.8bn of 2W loans every month (bulk of this business stemming from dealers' end). The 2W segment is already witnessing a downturn due to stringent lending norms by major financial institutions. In this backdrop, ICICI Bank's exit from dealers' end would put incremental pressure on volumes due to lower offtake.

In such a scenario, we expect Bajaj Auto to leverage its finance arm's (Bajaj Auto Finance) presence in the sector. Hero Honda has already tied up with Fullerton – one of the fastest growing NBFCs in India – to offer financial services at Hero Honda's extensive dealer network. Nevertheless, we feel that demand for 2Ws would remain muted till interest rates cool off and financial institutions increase their exposure to the sector.

❑ Industry expected to post muted growth

Rising interest rates and finance unavailability impacting demand

New model launches may help sustain growth in the motorcycle segment. Higher disposable incomes led by the Sixth Pay Commission recommendations are expected to provide a fillip to the sector. While the 2W sector has posted ~10% growth in the Apr-July08 period, we see muted growth in H2FY09 primarily on account of a high base, rising interest rates and reduced availability of finance. The exit of financial institutions like ICICI Bank and Citibank from the 2W financing space has worsened the situation. In such a backdrop, we expect a marginal 7.9% CAGR in two wheeler sales over FY08-10.

Exhibit 17: Volume estimates for leading two-wheeler players

Sales in '000s	FY06	FY07	FY08E	FY09E	FY10E	CAGR (%) FY07-10E	CAGR (%) FY08-10E
Motorcycles							
Bajaj Auto	1,968	2,377	2,140	2,299	2,498	1.7	8.0
Growth (%)	29.7	20.8	(10.0)	7.5	8.7		
Hero Honda	3,000	3,244	3,232	3,454	3,656	4.1	6.3
Growth (%)	14.5	8.1	(0.4)	6.9	5.8		
TVS Motors	807	925	618	667	720	(8.0)	8.0
Growth (%)	18.8	14.6	(33.2)	8.0	8.0		
Total Industry	**6,269**	**7,093**	**6,544**	**7,018**	**7,570**	**2.2**	**7.5**
Growth (%)	**20.2**	**13.1**	**(7.7)**	**7.2**	**7.9**		
Two-wheelers							
Bajaj Auto	2,085	2,397	2,161	2,311	2,516	1.6	7.9
Growth (%)	24.8	15.0	(9.8)	6.9	8.9		
Hero Honda	3,015	3,337	3,337	3,568	3,782	4.3	6.5
Growth (%)	15.0	10.7	0.0	6.9	6.0		
TVS Motors	1,342	1,529	1,289	1,395	1,510	(0.4)	8.2
Growth (%)	14.9	14.0	(15.7)	8.2	8.3		
Total two-wheeler Industry	**7,637**	**8,462**	**8,052**	**8,658**	**9,373**	**3.5**	**7.9**
Growth (%)	**16.3**	**10.8**	**(5.1)**	**7.5**	**8.3**		

Source: SIAM, Companies, IDFC-SSKI Research

Exhibit 18: Expect 7.9% CAGR in two-wheeler sales over FY08-10

Sales in '000s	FY06	FY07	FY08E	FY09E	FY10E	CAGR (%) FY07-10E	CAGR (%) FY08-10E
Motorcycles	6,269	7,093	6,544	7,018	7,570	2.2	7.5
Growth (%)	20.2	13.1	(7.7)	7.2	7.9		
Scooters	992	976	1,076	1,182	1,301	10.0	10.0
Growth (%)	0.8	(1.6)	10.2	9.9	10.0		
Mopeds	376	393	432	458	503	8.5	7.9
Growth (%)	7.5	4.7	9.8	5.9	9.9		
Two-wheelers	**7,637**	**8,462**	**8,052**	**8,658**	**9,373**	**3.5**	**7.9**
Growth (%)	16.6	10.8	(4.9)	7.5	8.3		

Source: SIAM, IDFC-SSKI Research

FINANCIAL ANALYSIS

We expect revenue CAGR of ~16.7% for our auto universe over FY08-10 on the back of a 9.2% 2-year volume CAGR. However, we expect a much lower PAT CAGR of 8.4% as rising input costs continue to impact margins over our forecast period. Also, aggressive capex plans announced by most of the auto majors would lead to higher interest and depreciation charges, thereby impacting profitability.

❑ 18% volume CAGR, but only 7% PAT CAGR for 4W majors

Strong topline growth unlikely to flow to PAT level for 4W/ CV players due to margin pressure

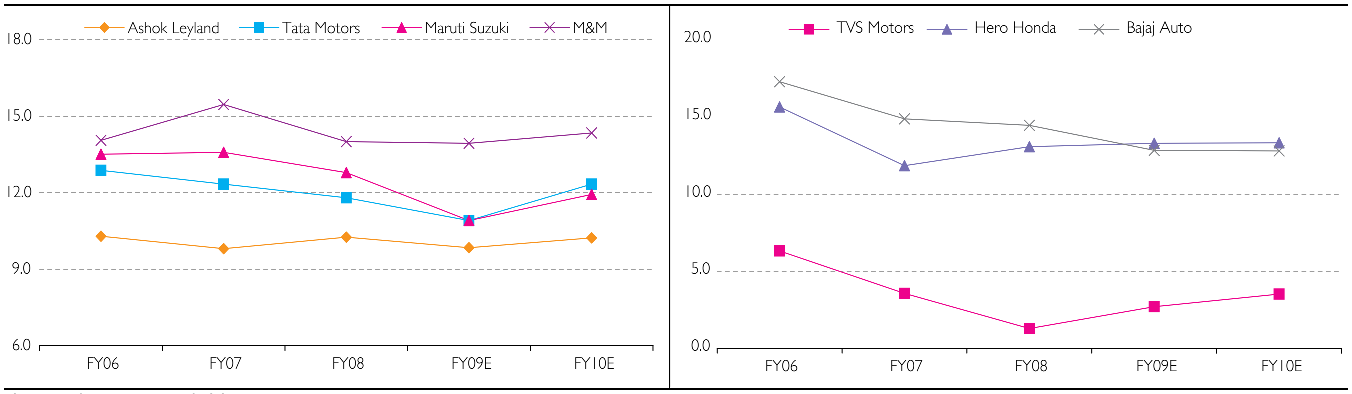
Within our auto universe, 4W majors – Ashok Leyland, Maruti Suzuki, M&M and Tata Motors – are expected to post revenue CAGR of 18.4% on the back of a 17.6% volume CAGR. Volumes would be driven by rising exports and a slew of new model launches including *Dzire*, *A-Star*, *Splash* and *Kizashi* by Maruti Suzuki; *Sumo Grande*, *Nano*, New *Indica Vista,* the world truck and a new UV by Tata Motors; and *Ingenio* and *Scorpio* hybrid by M&M. However, increasing competitive intensity in the 4W space may lead to aggressive pricing. With rising input costs, margins are likely to remain squeezed and aggressive capex plans of 4W majors will also impact profitability. Thus, we expect only 7% PAT CAGR for these players over FY08-10.

2W majors to maintain margins, post a better PAT CAGR at 11.6%

❑ Industry consolidation, richer product mix to support 2W margins

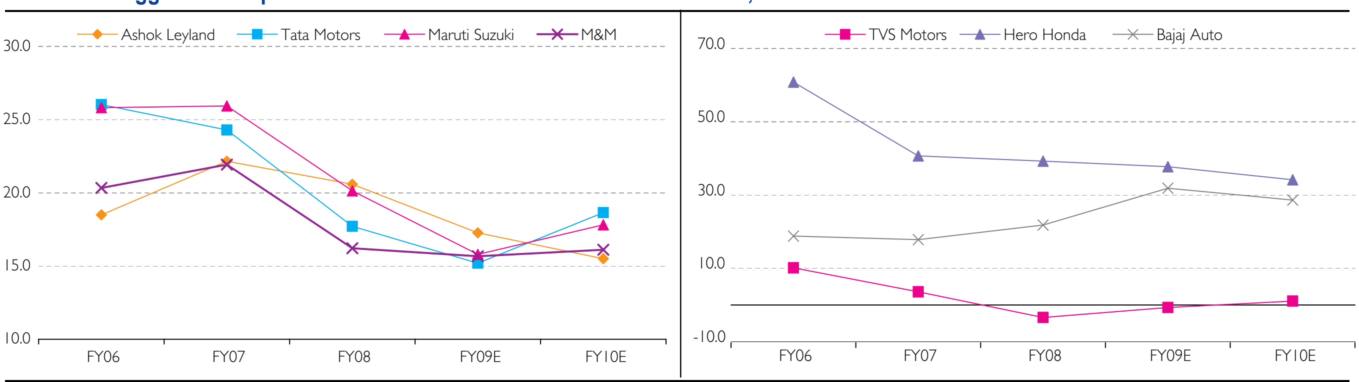
With muted demand outlook for 2Ws, we expect 2W majors within our coverage universe (Bajaj Auto, Hero Honda and TVS Motors) to post a 2-year volume CAGR of only 7.3% and revenue CAGR of 10.3% over FY08-10. The motorcycle segment is witnessing a gradual shift towards the more profitable premium end products. Also, increasing product prices, heraldign the end of pricing wars, would help 2W majors maintain their margins going forward. With all players at the end of their capex cycles, we expect a much better 2-year PAT CAGR of 11.6% for our 2W universe.

Exhibit 19: Expect continued cost pressure on 4W-, margin improvement for 2W-majors



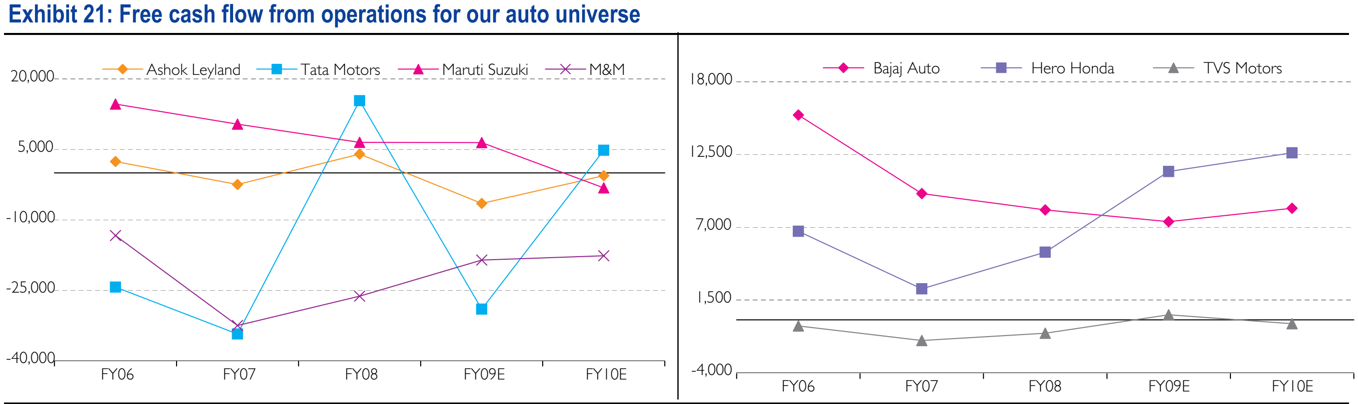
Source: Company, IDFC-SSKI Research

Exhibit 20: Aggressive capex to lead to contraction in return ratios for 4Ws, return ratios stabilize for 2Ws



Source: Company data, IDFC- SSKI Research

Exhibit 21: Free cash flow from operations for our auto universe



Source: Company data, IDFC- SSKI Research

VALUATIONS AND VIEW

We maintain our positive stance on passenger car segment on the back of new product launches and rising exports. However, the government's decision to discourage sale of gas guzzling vehicles may lead to a slowdown in UV sales. Rising interest rates and stringent financing norms would continue to impact off-take of 2Ws though the Sixth Pay Commission recommendations bode well for entry level car and 2W segments. We remain Neutral on the 2W segment. We are Neutral on the CV industry as operator viability continues to be a concern.

Maruti Suzuki remains our top pick in the sector

Maruti Suzuki remains our top pick in the sector. The stock price has witnessed a 33% correction in this calendar year. However, given Maruti's strong inherent fundamentals, we feel the correction has been overdone. The stock is attractively valued at 9.8x FY10E earnings and 5.2x EV/ EBIDTA. Maintain Outperformer.

In the 2W space, we are downgrading Hero Honda and Bajaj Auto, which have returned 35% and 39% respectively since our Outperformer recommendation (dated July08) vis-à-vis Sensex return of 15% over the same period. At 13.1x FY10E earnings and 8.6x EV/ EBIDTA for Hero Honda and 9.5x FY10E earnings and 6x EV/ EBIDTA for Bajaj Auto, valuations appear stretched. Downgrade to Underperformer.

Exhibit 22: Comparative valuations*

Company	Price	Mkt Cap	Reco	EPS CAGR (%)	FY10E		Target	Upside
	(Rs)	(Rs bn)		FY08-10	PER (x)	EV/EBITDA (x)	(Rs)	(%)
Ashok Leyland	33	43.5	Neutral	(0.4)	9.3	5.8	35	7.0
Bajaj Auto	607	87.8	Underperformer	3.2	9.5	6.0	545	(10.1)
Hero Honda	860	171.7	Underperformer	16.3	13.1	8.6	797	(7.3)
Mahindra & Mahindra	582	150.9	Neutral	(2.4)	8.6	6.3	591	1.5
Maruti Udyog	680	196.4	Outperformer	6.7	9.8	5.2	835	22.9
Tata Motors	420	161.9	Neutral	13.3	7.0	4.7	485	15.5
TVS Motor	34	8.1	Underperformer	248.8	13.5	8.6	25	(26.5)

** Based on fully diluted EPS*

COMPANIES

Company update

Maruti Suzuki

Leading from the front

Rs680
OUTPERFORMER

Mkt Cap: Rs196bn; US$4.4bn

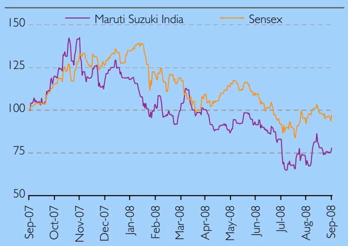
5 September 2008

BSE Sensex: 14484

Stock data

Reuters	MRTI.BO
Bloomberg	MSIL IN
1-yr high/low (Rs)	1252/475
1-yr avg daily volumes (m)	0.99
Free Float (%)	45.8

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
Maruti	(10.7)	(27.7)	(22.2)	34.7
Sensex	(8.2)	(12.4)	(6.2)	82.8

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Maruti Suzuki (Maruti) is expected to maintain its lead in the compact car segment despite launch of numerous competing new models. The company plans to introduce *A-Star* and *Splash* in FY09, and expects to scale up volumes to 1.2m units by FY11 (3-year CAGR of 16.2%; 56% CAGR in exports). Efforts are also on to tap the huge latent potential of rural markets and to reach government employees through promotional schemes. While volumes may decline over the next couple of months due to a high base, launch of A-Star would bring growth back on track in H2FY09. Maintain Outperformer on the stock in view of the inherently strong business model and attractive valuations.

Exports and new launches to drive growth: While the domestic passenger car market is witnessing a slowdown, Maruti is expected to sustain volume growth through higher exports and new product launches (including *A-Star* and *Splash*). The company has set an ambitious target of scaling up volumes to 1.2m vehicles by FY11 (3-year CAGR of 16.2%) – 1m in the domestic (12% CAGR) and 0.2m from exports (56% CAGR). Our estimates factor in a lower volume CAGR of 14.9% over FY08-10.

Gains across segments: While new model launches like *i-10*, *Spark* and *Indica Vista* would beef up competition in the segment, two new launches from Maruti (*A-Star* and *Splash*) will help it maintain its share in the compact segment. After being the undisputed leader in this segment, launch of *SX4* and *Swift Dzire* have helped it achieve leadership position in the midsize (A3) segment as well.

Correction overdone; attractive valuations: Capacity ramp-up and new product launches have led to higher operating costs (royalty, power and fuel) for Maruti. With rising RM costs putting incremental pressure on margins, earnings growth (6.7% CAGR over FY08-10E) would likely lag topline growth (20.2% CAGR). However, we believe the stock price has reacted too strongly to margin pressure concerns (33% price correction since Jan08). At 9.8x FY10E earnings and 5.2x EV/ EBIDTA, we maintain Outperformer with a price target of Rs835.

Key valuation metrics

Year to 31 March	FY06	FY07	FY08	FY09E	FY10E
Net sales (Rs m)	120,522	146,539	179,362	215,363	259,175
Adj. net profit (Rs m)	11,904	15,625	17,663	17,740	20,121
Shares in issue (m)	289	289	289	289	289
Adj. EPS (Rs)	41.2	54.1	61.1	61.4	69.6
% growth	38.7	31.3	13.0	0.4	13.4
PER (x)	16.5	12.6	11.1	11.1	9.8
Price/Book (x)	3.6	2.9	2.3	2.0	1.7
EV/EBITDA (x)	10.2	8.1	7.0	6.6	5.2
RoE (%)	24.2	25.4	23.1	19.3	18.4
RoCE (%)	25.8	25.9	20.1	15.8	17.8

Earnings model

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Net sales	**120,522**	**146,539**	**179,362**	**215,363**	**259,175**
% growth	9.9	21.6	22.4	20.1	20.3
Operating expenses	104,243	126,635	156,425	191,880	228,251
EBITDA	**16,279**	**19,904**	**22,937**	**23,483**	**30,924**
% growth	*15.8*	*22.3*	*15.2*	*2.4*	*31.7*
Other income	4,292	5,984	8,877	8,938	7,530
Net interest	(204)	(371)	(596)	(741)	(855)
Depreciation	2,854	2,714	5,682	7,159	9,259
Pre-tax profit	**17,513**	**22,803**	**25,536**	**24,521**	**28,339**
Deferred Tax	(321)	1,022	115	-	-
Current Tax	5,930	6,156	7,759	6,781	8,218
Profit after tax	11,904	15,625	17,663	17,740	20,121
Preference dividend	-	-	-	-	-
Non-recurring items	-	-	(354)	(125)	-
Net profit after non-recurring items	**11,904**	**15,625**	**17,309**	**17,615**	**20,121**
% growth	*39.4*	*31.3*	*10.8*	*1.8*	*14.2*

Key ratios

Year to Mar 31	FY06	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	13.5	13.6	12.8	10.9	11.9
EBIT margin (%)	11.1	11.7	9.6	7.6	8.4
PAT margin (%)	9.9	10.7	9.8	8.2	7.8
RoE (%)	24.2	25.4	23.1	19.3	18.4
RoCE (%)	25.8	25.9	20.1	15.8	17.8
Gearing (X)	(0.2)	(0.1)	0.1	0.0	0.1

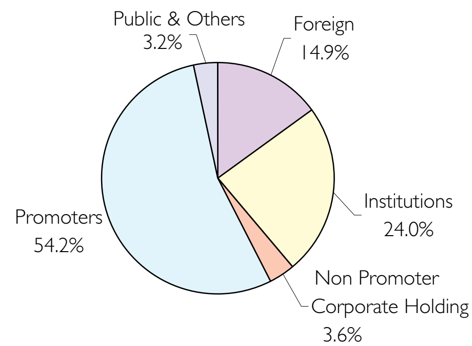
Valuations

Year to Mar 31	FY06	FY07	FY08	FY09E	FY10E
Reported EPS (Rs)	41.2	54.1	59.9	61.0	69.6
Adj. EPS (Rs)	41.2	54.1	61.1	61.4	69.6
PER (x)	16.5	12.6	11.1	11.1	9.8
Price/Book (x)	3.6	2.9	2.3	2.0	1.7
EV/Net sales (x)	1.4	1.1	0.9	0.7	0.6
EV/EBITDA (x)	10.2	8.1	7.0	6.6	5.2
EV/CE (x)	3.0	2.1	1.7	1.4	1.2

Balance sheet

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Paid-up capital	1,445	1,445	1,445	1,445	1,445
Reserves & surplus	53,081	67,094	82,709	98,677	117,151
Total shareholders' equity	54,526	68,539	84,154	100,122	118,596
Total current liabilities	19,771	25,015	28,187	36,289	40,583
Total Debt	717	6,308	9,002	10,002	11,002
Deferred tax liabilities	779	1,675	1,701	1,701	1,701
Total liabilities	21,267	32,998	38,890	47,992	53,286
Total equity & liabilities	75,793	101,537	123,044	148,113	171,881
Net fixed assets	17,872	28,986	40,328	53,169	73,909
Investments	20,512	34,092	51,807	52,307	52,807
Total current assets	37,409	38,459	30,909	42,638	45,165
Working capital	17,638	13,444	2,722	6,349	4,582
Total assets	75,793	101,537	123,044	148,113	171,881

Shareholding pattern



As of June 2008

Cash flow statement

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Pre-tax profit	17,513	22,803	25,536	24,521	28,339
Depreciation	2,854	2,714	5,682	7,159	9,259
chg in Working capital	(276)	4,406	(266)	(1,671)	(2,587)
Total tax paid	(5,930)	(6,156)	(7,759)	(6,781)	(8,218)
Ext ord. Items	-	-	(354)	(125)	-
Operating cash Inflow	14,161	23,767	22,840	26,446	26,793
Capital expenditure	486	(13,391)	(16,359)	(20,000)	(30,000)
Free cash flow (a+b)	14,647	10,376	6,481	6,446	(3,207)
Chg in investments	(5,346)	(13,580)	(17,715)	(500)	(500)
Debt raised/(repaid)	(2,359)	5,591	2,694	1,000	1,000
Capital raised/(repaid)	-	-	-	-	-
Dividend (incl. tax)	(1,153)	(1,520)	(1,693)	(1,647)	(1,647)
Misc	(2,054)	-	-	-	-
Net chg in cash	3,735	867	(10,233)	5,299	(4,354)

Company update

Bajaj Auto

Rs607

UNDERPERFORMER

Advantage 'Diversification'

Mkt Cap: Rs87.7bn; US$1.9bn

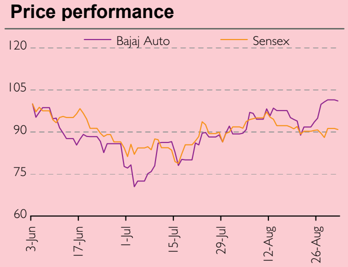
5 September 2008

BSE Sensex: 14484

Stock data

Reuters	BJAT.BO
Bloomberg	BJAUT IN
1-yr high/low (Rs)	945/390
1-yr avg daily volumes (m)	-
Free Float (%)	49.7

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
Bajaj Auto	-	-	-	-
Sensex	(8.2)	(12.4)	(6.2)	82.8

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Bajaj Auto's (BAL) has turned its focus to the executive/ premium motorcycle segment. As BAL plans to launch four products on the *XCD* platform in FY09, its sales mix is expected to be 60:40 in favor of higher cc bikes by FY10. In H2FY09, we expect muted volume growth due to high base effect, rising interest rates and difficulty in securing finance. Nevertheless, diversification across geographies would help BAL maintain overall volume growth over FY08-10 (22% CAGR in exports). We expect 9.4% revenue CAGR and 3.2% earnings CAGR (due to margin pressure) for BAL over FY08-10. Valuations, at 9.5x FY10E earnings and 6x EV/ EBIDTA, appear stretched. The stock has returned 39% vis-à-vis 10% for the Sensex since our Outperformer recommendation in July '08. Downgrade to Underperformer.

Exports to drive volume growth over FY08-10: In domestic 2W business, we expect muted volume growth despite the positive trigger provided by Sixth Pay Commission. In the higher-margin 3W space (11% volume decline over Apr-Aug'08), which is losing out to LCVs, a recovery is unlikely in the near term. While we estimate a meagre 1.6% CAGR in domestic volumes over FY08-10, BAL's diversification across geographies would drive 22% CAGR in exports and thus 7% CAGR in overall volumes, over FY08-10.

Higher proportion of premium bikes in sales to offer margin cushion: New launches in the executive/ premium segment would improve BAL's overall product mix to 60:40 in favor of the premium segment by FY10 (52:48 currently). This, we believe, would lead to higher per unit realization for BAL and provide margin cushion in the wake of rising input costs.

Valuations stretched; Downgrade to Underperfomer: Despite ramp-up at the Pantnagar facility, relentless margin pressure would cap earnings growth (3.2% CAGR over FY08-10). Valuations, at 9.5x FY10E earnings and 6x EV/ EBIDTA, appear stretched. Downgrade to Underperformer with a SOTP based price target of Rs545, wherein we have valued the core business at Rs492 (9x FY10E core EPS of Rs 55) and its cash and investments at Rs53.

Key valuation metrics

Year to 31 March	FY06	FY07	FY08	FY09E	FY10E
Net sales (Rs m)	76,290	95,204	90,461	98,876	108,298
Adj. net profit (Rs m)	11,264	12,870	8,689	8,480	9,254
Shares in issue (m)	101	101	145	145	145
Adj. EPS (Rs)	111.3	127.2	60.1	58.6	64.0
% growth	44.4	14.2	(52.8)	(2.4)	9.1
PER (x)	5.4	4.8	10.1	10.3	9.5
Price/Book (x)	1.3	1.1	5.5	4.1	3.2
EV/EBITDA (x)	1.7	1.3	6.7	6.8	6.0
RoE (%)	25.3	25.0	24.4	45.6	38.1
RoCE (%)	18.8	17.8	21.8	31.9	28.6

Earnings model

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Net sales	**76,290**	**95,204**	**90,461**	**98,876**	**108,298**
% growth	*28.7*	*24.8*	*(5.0)*	*9.3*	*9.5*
Operating expenses	63,095	81,035	77,377	86,179	94,433
EBITDA	**13,195**	**14,169**	**13,084**	**12,697**	**13,865**
% growth	*44.5*	*7.4*	*(7.7)*	*(3.0)*	*9.2*
Other income	4,774	5,556	1,228	1,350	1,593
Net interest	(3)	(53)	(52)	(55)	(60)
Depreciation	1,910	1,902	1,740	1,878	2,178
Pre-tax profit	**16,056**	**17,770**	**12,520**	**12,114**	**13,220**
Deferred Tax	(394)	(134)	213	182	198
Current Tax	5,186	5,035	3,618	3,452	3,768
Profit after tax	11,264	12,870	8,689	8,480	9,254
Preference dividend	-	-	-	-	-
Non-recurring items	(248)	(490)	(1,131)	-	-
Net profit after non-recurring items	**11,016**	**12,380**	**7,558**	**8,480**	**9,254**
% growth	*51.1*	*12.4*	*(39.0)*	*12.2*	*9.1*

Key ratios

Year to Mar 31	FY06	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	17.3	14.9	14.5	12.8	12.8
EBIT margin (%)	14.8	12.9	12.5	10.9	10.8
PAT margin (%)	14.8	13.5	9.6	8.6	8.5
RoE (%)	25.3	25.0	24.4	45.6	38.1
RoCE (%)	18.8	17.8	21.8	31.9	28.6
Gearing (x)	0.3	0.3	0.8	0.7	0.6

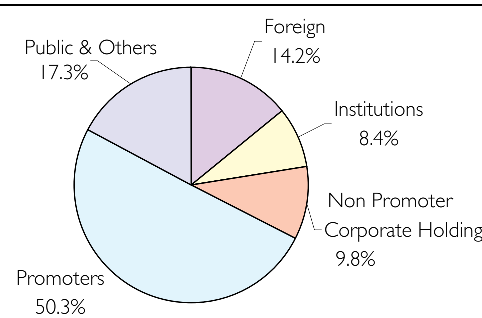
Valuations

Year to Mar 31	FY06	FY07	FY08	FY09E	FY10E
Reported EPS (Rs)	108.9	122.4	52.2	58.6	64.0
Adj. EPS (Rs)	111.3	127.2	60.1	58.6	64.0
PER (x)	5.4	4.8	10.1	10.3	9.5
Price/Book (x)	1.3	1.1	5.5	4.1	3.2
EV/Net sales (x)	0.3	0.2	1.0	0.9	0.8
EV/EBITDA (x)	1.7	1.3	6.7	6.8	6.0
EV/CE (x)	0.4	0.3	2.9	2.3	1.9

Balance sheet

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Paid-up capital	1,012	1,012	1,447	1,447	1,447
Reserves & surplus	46,696	54,331	14,429	19,888	25,785
Total shareholders' equity	47,708	55,343	15,876	21,335	27,232
Total current liabilities	35,448	43,328	18,773	19,425	21,272
Total Debt	14,672	16,254	13,343	14,343	15,343
Deferred tax liabilities	1,902	1,845	1,419	1,601	1,799
Other non-current liabilities	-	-	-	-	-
Total liabilities	52,021	61,427	33,536	35,370	38,415
Total equity & liabilities	**99,729**	**116,770**	**49,412**	**56,704**	**65,647**
Net fixed assets	11,383	12,789	12,928	14,550	15,872
Investments	58,570	64,475	6,259	8,259	10,259
Total current assets	28,749	38,403	28,915	32,586	38,206
Deferred tax assets	1,026	1,103	1,310	1,310	1,310
Other non-current assets	-	-	-	-	-
Working capital	(6,699)	(4,925)	10,142	13,160	16,934
Total assets	**99,729**	**116,770**	**49,412**	**56,704**	**65,647**

Shareholding pattern



As of June 2008

Cash flow statement

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Pre-tax profit	16,056	17,770	12,520	12,114	13,220
Depreciation	1,910	1,902	1,740	1,878	2,178
chg in Working capital	4,606	(1,760)	(3,029)	385	306
Total tax paid	(5,186)	(5,035)	(3,618)	(3,452)	(3,768)
Ext ord. Items	(248)	(490)	(1,131)	-	-
Operating cash Inflow	17,138	12,388	6,482	10,924	11,937
Capital expenditure	(1,651)	(2,843)	1,824	(3,500)	(3,500)
Free cash flow (a+b)	15,487	9,546	8,306	7,424	8,437
Chg in investments	(12,964)	(5,906)	45,904	(5,000)	(6,000)
Debt raised/(repaid)	2,402	1,583	(2,911)	1,000	1,000
Capital raised/(repaid)	-	-	435	-	-
Dividend (incl. tax)	(4,615)	(4,735)	(3,357)	(3,021)	(3,357)
Misc	(576)	(474)	-	-	-
Net chg in cash	(266)	14	48,377	403	80

Hero Honda

'Hero' of the masses

Rs860
UNDERPERFORMER

Mkt Cap: Rs172bn; US$3.8bn

Company update

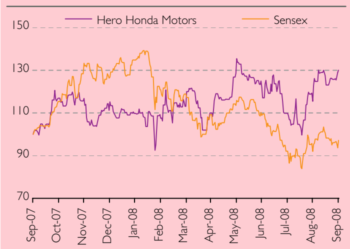
5 September 2008

BSE Sensex: 14484

Stock data

Reuters	HROH.BO
Bloomberg	HH IN
1-yr high/low (Rs)	880/550
1-yr avg daily volumes (m)	0.33
Free Float (%)	45.0

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
Hero Honda	11.9	11.2	35.4	23.7
Sensex	(8.2)	(12.4)	(6.2)	82.8

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Hero Honda is set to maintain its dominance in the entry/ executive segment while striving to gain market share in premium bikes. We have raised our FY09 volume growth estimates by 180 bp for Hero Honda to 6.9%yoy to factor in a stronger 18.9%yoy increase over Apr-Aug'08. However, we see flat volume growth in H2FY09 primarily on account of a higher base. In the face of rising input costs, Hero Honda strives to maintain margins with higher realizations from a richer product mix, price hikes and cost control. We expect 11% revenue CAGR and a much higher 16% earnings CAGR for Hero Honda over FY08-10 aided by a lower effective tax rate. The stock has returned 35% vis-à-vis 18.5% Sensex since our rating upgrade in July'08. As valuations of 13.1x FY10E earnings and 8.6x EV/EBIDTA more than adequately capture the growth potential, downgrade to Underperformer.

Focus on rural markets to deepen penetration: Hero Honda has outperformed the 2W industry on account of its strong distribution reach and lesser dependence on financing. In order to further increase penetration, the company plans to cover 100,000 of the 600,000 Indian villages by end-FY09. Higher penetration in rural markets will help Hero Honda strengthen its foothold in the domestic 2W space.

Tie-up with Fullerton to overcome financing issues: Hero Honda has recently tied up with Fullerton India to offer financial services at its extensive dealer network. Fullerton is India's fastest growing retail financial services company with a network of more than 800 branches across 380 locations in the country. Besides consolidating its position in the traditional markets, the tie-up will also help Hero Honda expand in newer markets in smaller towns.

Valuations stretched, downgrade to Underperformer: We expect revenue CAGR of 11% for Hero Honda over FY08-10 on the back of higher realizations on a better product mix. We expect faster 16% CAGR in earnings over FY08-10 driven by a lower effective tax rate with ramp-up at Haridwar plant. However, the stock appears fully priced at 13.1x FY10E earnings and 8.6x EV/EBIDTA.

Key valuation metrics

Year to 31 March	FY06	FY07	FY08	FY09E	FY10E
Net sales (Rs m)	87,140	99,000	103,344	117,130	126,564
Adj. net profit (Rs m)	9,713	8,579	9,696	12,072	13,121
Shares in issue (m)	200	200	200	200	200
Adj. EPS (Rs)	48.6	43.0	48.6	60.5	65.7
% growth	19.8	(11.7)	13.0	24.5	8.7
PER (x)	17.7	20.0	17.7	14.2	13.1
Price/Book (x)	8.5	7.0	5.7	4.7	3.9
EV/EBITDA (x)	11.4	13.4	11.6	9.7	8.6
RoE (%)	55.5	38.3	35.4	36.2	32.7
RoCE (%)	60.8	40.7	39.3	37.7	34.2

Earnings model

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Net sales	**87,140**	**99,000**	**103,344**	**117,130**	**126,564**
% growth	*17.4*	*13.6*	*4.4*	*13.3*	*8.1*
Operating expenses	73,495	87,269	89,826	101,553	109,691
EBITDA	**13,645**	**11,730**	**13,519**	**15,577**	**16,873**
% growth	*17.2*	*(14.0)*	*15.2*	*15.2*	*8.3*
Other income	1,563	1,899	1,854	1,947	2,200
Net interest	61	230	358	400	450
Depreciation	1,146	1,398	1,603	1,828	2,028
Pre-tax profit	**14,122**	**12,461**	**14,128**	**16,096**	**17,495**
Deferred Tax	179	94	106	161	175
Current Tax	4,230	3,788	4,326	3,863	4,199
Profit after tax	9,713	8,579	9,696	12,072	13,121
Preference dividend	-	-	-	-	-
Non-recurring items	-	-	-	-	-
Net profit after non-recurring items	**9,713**	**8,579**	**9,696**	**12,072**	**13,121**
% growth	*19.8*	*(11.7)*	*13.0*	*24.5*	*8.7*

Balance sheet

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Paid-up capital	399	399	399	399	399
Reserves & surplus	19,694	24,301	29,634	36,194	43,344
Total shareholders' equity	20,093	24,701	30,033	36,594	43,744
Total current liabilities	15,628	14,792	12,401	14,056	15,188
Total Debt	1,858	1,652	1,652	1,652	1,652
Deferred tax liabilities	1,188	1,282	1,388	1,549	1,724
Total liabilities	18,674	17,725	15,441	17,256	18,563
Total equity & liabilities	**38,767**	**42,426**	**45,474**	**53,850**	**62,307**
Net fixed assets	9,936	13,555	14,452	15,124	15,596
Investments	20,619	19,739	19,739	22,739	25,239
Total current assets	8,212	9,133	11,284	15,987	21,472
Working capital	(7,416)	(5,659)	(1,118)	1,931	6,285
Total assets	**38,767**	**42,426**	**45,474**	**53,850**	**62,307**

Cash flow statement

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Pre-tax profit	14,122	12,461	14,128	16,096	17,495
Depreciation	1,146	1,398	1,603	1,828	2,028
chg in Working capital	(633)	(2,986)	(3,794)	(345)	(196)
Total tax paid	(4,230)	(3,788)	(4,326)	(3,863)	(4,199)
Operating cash Inflow	10,406	7,085	7,611	13,715	15,129
Capital expenditure	(3,711)	(4,744)	(2,500)	(2,500)	(2,500)
Free cash flow (a+b)	6,695	2,341	5,111	11,215	12,629
Chg in investments	(352)	880	-	(3,000)	(2,500)
Debt raised/(repaid)	(160)	(206)	-	-	-
Dividend (incl. tax)	(4,554)	(3,972)	(4,363)	(5,512)	(5,971)
Misc	(217)	(273)	0	-	-
Net chg in cash	1,411	(1,230)	748	2,704	4,158

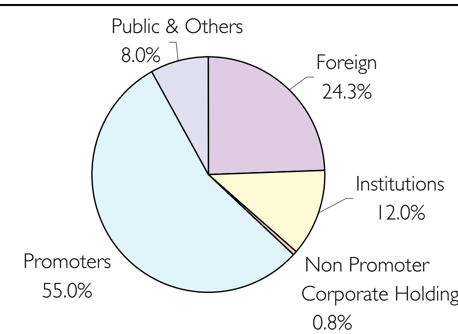
Key ratios

Year to Mar 31	FY06	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	15.7	11.8	13.1	13.3	13.3
EBIT margin (%)	14.3	10.4	11.5	11.7	11.7
PAT margin (%)	11.1	8.7	9.4	10.3	10.4
RoE (%)	55.5	38.3	35.4	36.2	32.7
RoCE (%)	60.8	40.7	39.3	37.7	34.2
Gearing (X)	0.0	0.1	0.0	(0.1)	(0.1)

Valuations

Year to Mar 31	FY06	FY07	FY08	FY09E	FY10E
Reported EPS (Rs)	48.6	43.0	48.6	60.5	65.7
Adj. EPS (Rs)	48.6	43.0	48.6	60.5	65.7
PER (x)	17.7	20.0	17.7	14.2	13.1
Price/Book (x)	8.5	7.0	5.7	4.7	3.9
EV/Net sales (x)	1.8	1.6	1.5	1.3	1.1
EV/EBITDA (x)	11.4	13.4	11.6	9.7	8.6
EV/CE (x)	6.7	5.7	4.7	3.8	3.1

Shareholding pattern



As of June 2008

M&M

Rs582
NEUTRAL

Hard pressed

Mkt Cap: Rs151bn; US$3.4bn

Company update

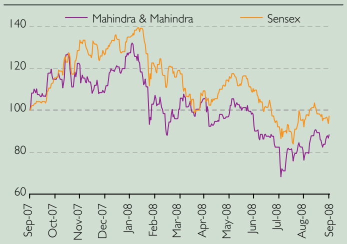
5 September 2008

BSE Sensex: 14484

Stock data

Reurters	MAHM.BO
Bloomberg	MM IN
1-yr high/low (Rs)	874/420
1-yr avg daily volumes (m)	0.63
Free Float (%)	77.4

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
M&M	3.5	(16.2)	(18.1)	63.5
Sensex	(8.2)	(12.4)	(6.2)	82.8

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Mahindra & Mahindra (M&M) is likley to post only 11% CAGR in overall volumes over FY08-10 due to subdued UV sales (additional duty levied on these vehicles) and continued slowdown in tractor segment. While launch of five new products in the next three years would rejuvenate M&M's product portfolio, aggressive inorganic initiatives (acquisitions and JVs) across segments would likely dampen return ratios. Unrelenting margin pressure due to rising input costs and an estimated capex of Rs90bn would restrict earnings (3% CAGR over FY08-10). Maintain Neutral with SOTP based target price of Rs591.

UV growth slows down, bleak tractor outlook: The government's recent proposal to hike excise duty on gas guzzling vehicles is likely to halt growth momentum for the UV segment in the near term. The tractor business has also failed to pick up so far in the current fiscal and is likely to post only single digit growth in FY09. We expect 14% volume CAGR in M&M's UV business and a measly 6% CAGR in tractor volumes over FY08-10.

Aggressive capex to cap earnings growth: M&M has earmarked about Rs90bn as capex over the next three years towards the launch of new products including *Ingenio* and *Logan* variants, a low tonnage vehicle, M&HCVs (JV with Mahindra International Ltd), an SUV and a vehicle for the global markets. This, we believe, would impact earnings growth going forward (1% CAGR over FY08-10E in core standalone earnings).

Subsidiaries expected to outperform the core business: We expect 19% CAGR in M&M's consolidated revenues over FY08-10 driven by new product launches but much slower 3% CAGR in consolidated earnings over the period. M&M's core standalone earnings are likely to register a marginal 1% CAGR over FY08-10 due to margin pressure and aggressive capex plans. Mahindra Holidays & Resorts' listing (a potential trigger for the stock) is expected to be further delayed due to the uncertain market conditions. We have set an SOTP based price target of Rs591 for M&M. Maintain Neutral.

Key valuation metrics

Year to 31 March	FY06	FY07	FY08	FY09E	FY10E
Net sales (Rs m)	123,354	176,207	237,897	283,395	337,240
Adj. net profit (Rs m)	10,391	16,162	18,158	16,567	19,325
Shares in issue (m)	233	238	239	259	259
Adj. EPS (Rs)	44.5	67.9	76.0	63.9	74.5
% growth	54.3	52.5	11.9	(15.9)	16.7
Fully Diluted EPS (Rs)	42.3	63.3	71.1	58.1	67.8
PER (x)	13.8	9.2	8.2	10.0	8.6
Price/Book (x)	3.0	2.1	1.6	1.4	1.1
EV/EBITDA (x)	10.0	7.4	7.0	6.9	6.3
RoE (%)	28.5	29.3	23.6	16.8	16.0
RoCE (%)	20.3	21.9	16.2	15.7	16.1

Earnings model

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Net sales	**123,354**	**176,207**	**237,897**	**283,395**	**337,240**
% growth	*39.3*	*42.8*	*35.0*	*19.1*	*19.0*
Operating expenses	106,022	148,966	204,589	243,894	288,880
EBITDA	**17,332**	**27,241**	**33,308**	**39,501**	**48,360**
% growth	*170.0*	*57.2*	*22.3*	*18.6*	*22.4*
Other income	3,130	2,916	6,556	4,628	4,674
Net interest	(2,194)	(2,992)	(5,895)	(7,337)	(8,547)
Depreciation	2,833	3,799	5,822	6,917	8,695
Pre-tax profit	**15,482**	**23,530**	**28,247**	**29,989**	**35,924**
Deferred Tax	(362)	(286)	(346)	299	358
Current Tax	4,391	6,243	6,918	6,871	8,232
Profit after tax	11,453	17,573	21,675	22,819	27,334
Non-recurring items	2,587	(1,190)	(3,129)	-	-
Net profit after non-recurring items	**12,978**	**14,971**	**15,029**	**16,567**	**19,325**
% growth	*89.7*	*15.4*	*0.4*	*10.2*	*16.7*

Balance sheet

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Paid-up capital	2,334	2,380	2,391	2,593	2,593
Reserves & surplus	34,882	46,181	59,257	72,752	88,989
Total shareholders' equity	45,497	64,966	88,851	108,801	133,047
Total current liabilities	33,712	51,992	66,823	78,296	93,329
Total Debt	52,713	78,290	98,810	108,810	128,810
Deferred tax liabilities	1,157	-	-	299	657
Other non-current liabilities	2,221	3,195	4,780	5,496	6,321
Total liabilities	89,803	133,478	170,412	192,901	229,117
Total equity & liabilities	**135,300**	**198,444**	**259,263**	**301,702**	**362,164**
Net fixed assets	26,055	47,867	76,255	94,338	119,643
Investments	11,803	10,033	13,547	13,547	13,547
Total current assets	97,442	140,396	169,285	193,641	228,797
Deferred tax assets	-	147	176	176	176
Other non-current assets	-	-	-	-	-
Working capital	63,729	88,404	102,463	115,346	135,468
Total assets	**135,300**	**198,444**	**259,263**	**301,702**	**362,164**

Cash flow statement

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Pre-tax profit	15,482	23,530	28,247	29,989	35,924
Depreciation	2,833	3,799	5,822	6,917	8,695
chg in Working capital	(19,229)	(15,121)	(15,646)	(23,598)	(20,038)
Total tax paid	(4,391)	(6,243)	(6,918)	(6,871)	(8,232)
Ext ord. Items	2,676	(1,136)	(3,081)	-	-
Operating cash Inflow	(2,629)	4,828	8,424	6,437	16,349
Capital expenditure	(10,728)	(37,322)	(34,665)	(25,000)	(34,000)
Free cash flow (a+b)	(13,356)	(32,494)	(26,241)	(18,563)	(17,651)
Chg in investments	(5,803)	1,934	(3,414)	115	132
Debt raised/(repaid)	14,768	25,577	20,520	10,000	20,000
Capital raised/(repaid)	4,438	(205)	277	203	-
Dividend (incl. tax)	(2,633)	(3,121)	(3,134)	(2,956)	(2,956)
Misc	4,334	16,888	2,857	567	502
Net chg in cash	1,748	8,579	(9,136)	(10,635)	27

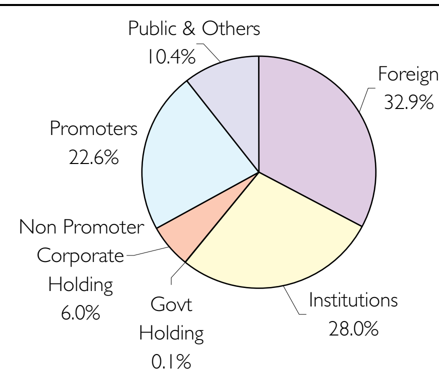
Key ratios

Year to Mar 31	FY06	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	14.1	15.5	14.0	13.9	14.3
EBIT margin (%)	11.8	13.3	11.6	11.5	11.8
PAT margin (%)	8.4	9.2	7.6	5.8	5.7
RoE (%)	28.5	29.3	23.6	16.8	16.0
RoCE (%)	20.3	21.9	16.2	15.7	16.1
Gearing (x)	0.9	0.9	0.9	0.9	0.9

Valuations

Year to Mar 31	FY06	FY07	FY08	FY09E	FY10E
Reported EPS (Rs)	55.6	62.9	62.9	63.9	74.5
Adj. EPS (Rs)	44.5	67.9	76.0	63.9	74.5
PER (x)	13.8	9.2	8.2	10.0	8.6
Price/Book (x)	3.0	2.1	1.6	1.4	1.1
EV/Net sales (x)	1.4	1.2	1.0	1.0	0.9
EV/EBITDA (x)	10.0	7.4	7.0	6.9	6.3
EV/CE (x)	1.7	1.4	1.2	1.2	1.1

Shareholding pattern



As of June 2008

Tata Motors

Rs420
NEUTRAL

Woes abound

Mkt Cap: Rs162bn; US$3.8bn

Company update

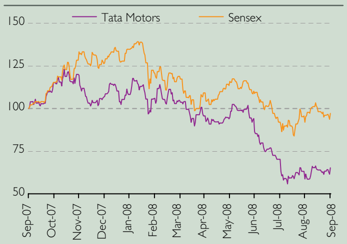
5 September 2008

BSE Sensex: 14484

Stock data

Reurters	TELC.BO
Bloomberg	TTMT IN
1-yr high/low (Rs)	842/374
1-yr avg daily volumes (m)	1.02
Free Float (%)	66.6

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
Tata Motors	(21.2)	(40.4)	(39.9)	(15.2)
Sensex	(8.2)	(12.4)	(6.2)	82.8

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Tata Motors would continue to witness muted volume growth (9.6% CAGR over FY08-10E) in its CV business as the prevailing cyclical downturn persists due to rising interest rates and freight rates unable to make up for incremental fuel cost. However, *ACE* and its variants are expected to continue outperforming the M&HCV business in the domestic market. In the PV segment, new model launches would prop sagging volumes. However, higher input costs as also operating expenses on new product launches would hit margins. An aggressive capex plan of ~Rs120bn (excluding JLR acquisition) would further dampen PAT growth. Maintain Neutral with an SOTP-based price target of Rs485.

New product launches to drive topline growth: Tata Motors plans to launch a range of new products in FY09 including *Nano* and World Truck besides *Indica Vista*, *Indigo*, *Sumo Grande* and the new *Milo* range of buses launched earlier this fiscal. These new products would provide the much-needed volume boost (46.5% CAGR over FY08-10E for PVs) in a tough macro-enviroment.

Jaguar-Land Rover (JLR) woes: Europe Sales of Land Rover have slumped 17.5%yoy in H1CY08 as demand for gas guzzling vehicles is slowing down globally. Any further decline in sales may deteriorate JLR's overall performance. Notably, Tata Motors has pruned its proposed rights issue (from Rs72bn to ~Rs42bn) to be raised for repaying the bridge loan taken for JLR acquisition. The remaining amount (Rs30bn) is planned to be raised by selling investments to group companies in the next 6-8 months. The reworked plan would lower the extent of equity dilution to 43% (earlier estimated 50%).

Expect earnings slowdown; maintain Neutral: Rising input costs and higher operating expenses are exerting pressure on margins in core business, and aggressive capex would further restrict PAT growth. *Nano*'s launch may be delayed due to the ongoing controversy at Singur and relocation of the plant implies additional capex of Rs3bn-4bn. While we have a negative bias on the consolidated operations, maintain Neutral as our SOTP valuation works out to Rs485 (valuing JLR at 0.5x the investment), a 16% upside from CMP.

Key valuation metrics

Year to 31 March	FY06	FY07	FY08	FY09E	FY10E
Net sales (Rs m)	237,182	322,941	355,755	416,541	496,295
Adj. net profit (Rs m)	17,380	20,393	19,885	19,727	25,527
Shares in issue (m)	383	385	386	386	386
Adj. EPS (Rs)	45.4	52.9	51.6	51.2	66.2
% growth	17.2	16.6	(2.5)	(0.8)	29.4
Fully Diluted EPS	42.7	50.1	46.5	46.1	59.7
PER (x)	9.8	8.4	9.0	9.1	7.0
Price/Book (x)	2.6	2.0	1.8	1.5	1.3
EV/EBITDA (x)	6.0	5.7	5.8	6.2	4.7
RoE (%)	32.4	28.6	23.2	19.9	21.7
RoCE (%)	26.0	24.3	17.7	15.2	18.7

Earnings model

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Net sales	**237,182**	**322,941**	**355,755**	**416,541**	**496,295**
% growth	*21.4*	*36.2*	*10.2*	*17.1*	*19.1*
Operating expenses	206,643	283,106	313,782	371,113	435,075
EBITDA	**30,539**	**39,836**	**41,972**	**45,429**	**61,220**
% growth	*22.3*	*30.4*	*5.4*	*8.2*	*34.8*
Other income	2,436	1,532	2,675	3,608	2,258
Net interest	(2,460)	(4,058)	(7,431)	(10,000)	(11,850)
Depreciation	6,951	7,736	8,490	10,489	13,027
Pre-tax profit	**24,003**	**29,967**	**29,379**	**29,330**	**39,501**
Deferred Tax	-	1,612	3,674	1,020	1,213
Current Tax	6,400	7,220	4,498	6,393	9,714
Profit after tax	17,603	21,135	21,207	21,916	28,574
Preference dividend	-	-	-	-	-
Non-recurring items	(99)	1,307	1,792	-	-
Net profit after non-recurring items	**17,281**	**21,700**	**21,677**	**19,727**	**25,527**
% growth	*24.7*	*25.6*	*(0.1)*	*(9.0)*	*29.4*

Key ratios

Year to Mar 31	FY06	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	12.9	12.3	11.8	10.9	12.3
EBIT margin (%)	9.9	9.9	9.4	8.4	9.7
PAT margin (%)	7.3	6.3	5.6	4.7	5.1
RoE (%)	32.4	28.6	23.2	19.9	21.7
RoCE (%)	26.0	24.3	17.7	15.2	18.7
Gearing	0.3	0.8	0.8	1.1	0.9

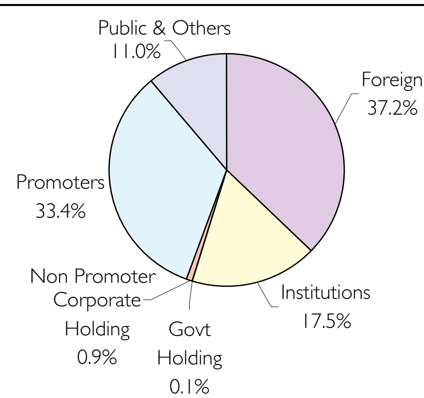
Valuations

Year to Mar 31	FY06	FY07	FY08	FY09E	FY10E
Reported EPS (Rs)	45.1	56.3	56.2	51.2	66.2
Adj. EPS (Rs)	45.4	52.9	51.6	51.2	66.2
PER (x)	9.8	8.4	9.0	9.1	7.0
Price/Book (x)	2.6	2.0	1.8	1.5	1.3
EV/Net sales (x)	0.8	0.7	0.7	0.7	0.6
EV/EBITDA (x)	6.0	5.7	5.8	6.2	4.7
EV/CE (x)	1.8	1.4	1.1	1.2	1.0

Balance sheet

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Paid-up capital	3,829	3,854	3,855	3,855	3,855
Reserves & surplus	57,486	73,363	83,120	96,323	114,675
Total shareholders' equity	62,915	79,597	91,589	106,981	128,380
Total current liabilities	79,924	88,654	136,446	138,908	164,982
Total Debt	33,791	73,019	115,849	124,849	133,849
Deferred tax liabilities	6,768	8,173	9,745	10,765	11,977
Total liabilities	120,483	169,846	262,039	274,521	310,808
Total equity & liabilities	**183,398**	**249,443**	**353,628**	**381,503**	**439,188**
Net fixed assets	54,359	75,142	128,634	151,639	169,359
Investments	12,680	11,746	26,658	25,876	24,976
Total current assets	112,237	158,125	192,674	198,326	239,191
Other non-current assets	4,122	4,430	5,662	5,662	5,662
Working capital	32,313	69,471	56,228	59,418	74,209
Total assets	**183,398**	**249,443**	**353,628**	**381,502**	**439,188**

Shareholding pattern



As of June 2008

Cash flow statement

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Pre-tax profit	24,003	29,967	29,379	29,330	39,501
Depreciation	6,951	7,736	8,490	10,489	13,027
chg in Working capital	(29,285)	(39,480)	40,032	(29,424)	(8,009)
Total tax paid	(6,400)	(7,220)	(4,498)	(6,393)	(9,714)
Ext ord. Items	(99)	1,307	1,792	-	-
Operating cash Inflow	(4,830)	(7,690)	75,195	4,001	34,805
Capital expenditure	(19,497)	(26,613)	(59,831)	(33,000)	(30,000)
Free cash flow (a+b)	(24,327)	(34,303)	15,364	(28,999)	4,805
Chg in investments	9,023	934	(14,912)	782	900
Debt raised/(repaid)	6,649	39,228	42,830	8,999	9,000
Capital raised/(repaid)	3,759	1,102	(3,991)	0	0
Dividend (incl. tax)	(5,676)	(6,764)	(6,597)	(6,523)	(7,176)
Misc	3,462	(2,519)	31	(1,204)	(1,394)
Net chg in cash	(7,109)	(2,322)	32,725	(26,944)	6,135

Ashok Leyland

Rs33
NEUTRAL

Static times

Mkt Cap: Rs43.5bn; US$978mn

Company update

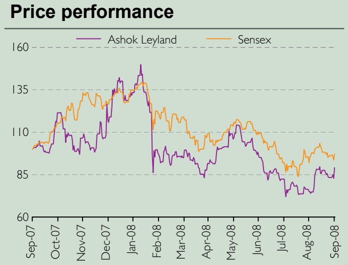
5 September 2008

BSE Sensex: 14484

Stock data

Reurters	ASOK.BO
Bloomberg	AL IN
1-yr high/low (Rs)	58/26
1-yr avg daily volumes (m)	4.23
Free Float (%)	61.4

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
Ashok Leyland	1.1	(10.9)	(15.8)	12.7
Sensex	(8.2)	(12.4)	(6.2)	82.8

Ashok Leyland (ALL) has lined up a slew of new launches in the next two years. We expect ALL to post 12.9% revenue CAGR over FY08-10 driven by the new products and higher contribution from its non-cyclical businesses (bus, exports, spares, engine and defense). Alternate raw material sourcing and aggressive value engineering methods are expected to help the company maintain margins at the targeted level of 10%. The Nissan JV for LCVs is expected to further strengthen ALL's product portfolio. However, aggressive capex plans (Rs33bn over the next three years) would keep earnings flat over FY08-10E. At 9.3x FY10E earnings and 5.8x EV/EBIDTA, we maintain Neutral.

New products and non-cyclical business to drive revenues: ALL plans to launch a number of new products including *4930TT*, *i-bus* and *4018Super* over the next two years. Further, the non-cyclical business is estimated to contribute ~45% to ALL's topline in FY09 (33% in FY08). ALL is targeting a 3-year export volume CAGR of 25% while it expects to sell 10,000 engines in FY09 (1,500 engines in FY08). These initiatives are expected to drive a 12.9% revenue CAGR for ALL over FY08-10. Also, the three JVs signed with Nissan for production of LCVs, power train manufacturing and technology development (a combined investment of Rs24bn) would strengthen ALL's CV product portfolio.

Doubling capacity in three years: ALL is expected to more than double its capacity from84,000 vehicles to 1,84,000 vehicles over the next three years at a capex of Rs33bn. While incremental capacity of 50,000 vehicles would be added to the existing facilities by October 2008, the Uttarakhand facilty (50,000 vehicles) is expected to be operational by FY10.

Expect flat earnings over FY08-10; maintain Neutral: We expect revenue CAGR of 12.9% for ALL over FY08-10 backed by new products and higher contribution from its non-cyclical business. ALL looks to maintain its margins at 10% through alternative raw material sourcing and value engineering methods. However, aggressive capex plans would cap earnings growth over FY08-10E. At 9.3x FY10E earnings and 5.8x EV/EBIDTA, we maintain Neutral.

Key valuation metrics

Year to 31 March	FY06	FY07	FY08	FY09E	FY10E
Net sales (Rs m)	52,477	71,682	77,291	88,562	98,543
Adj. net profit (Rs m)	3,056	4,544	4,712	4,581	4,677
Shares in issue (m)	1,222	1,324	1,330	1,330	1,330
Adj. EPS (Rs)	2.5	3.4	3.5	3.4	3.5
% growth	5.9	37.2	3.2	-2.8	2.1
PER (x)	13.1	9.5	9.2	9.5	9.3
Price/Book (x)	2.8	2.3	2.0	1.9	1.7
EV/EBITDA (x)	7.2	6.3	5.7	6.3	5.8
RoE (%)	25.6	26.9	23.5	19.5	19.4
RoCE (%)	18.5	22.2	20.6	17.3	15.5

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Earnings model

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Net sales	**52,477**	**71,682**	**77,291**	**88,562**	**98,543**
% growth	*25.5*	*36.6*	*7.8*	*14.6*	*11.3*
Operating expenses	(47,076)	(64,655)	(69,365)	(79,848)	(88,466)
EBITDA	**5,401**	**7,027**	**7,927**	**8,714**	**10,077**
% growth	*27.7*	*30.1*	*12.8*	*9.9*	*15.6*
Other income	330	708	740	356	365
Net interest	(165)	(53)	(497)	(579)	(1,211)
Depreciation	(1,260)	(1,506)	(1,774)	(2,214)	(2,912)
Pre-tax profit	**4,306**	**6,176**	**6,396**	**6,276**	**6,320**
Deferred Tax	(72)	(230)	(128)	(157)	(158)
Current Tax	(1,178)	(1,402)	(1,556)	(1,538)	(1,485)
Profit after tax	3,056	4,544	4,712	4,581	4,677
Non-recurring items	(217)	131	18	259	-
Net profit after non-recurring items	**3,273**	**4,413**	**4,693**	**4,322**	**4,677**
% growth	*20.6*	*34.8*	*6.4*	*(7.9)*	*8.2*

Balance sheet

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Paid-up capital	1,222	1,324	1,330	1,330	1,330
Reserves & surplus	12,902	17,622	20,159	21,904	24,002
Total shareholders' equity	14,051	18,702	21,267	23,011	25,110
Deferred tax liabilities	1,797	1,969	2,538	2,695	2,853
ST Debt/Lease financing	5,072	2,802	6,973	14,973	19,973
LT Debt	1,847	3,602	1,902	1,902	1,902
Total equity & liabilities	**36,852**	**44,633**	**55,400**	**66,493**	**76,444**
Net fixed assets	10,846	15,445	20,548	30,334	35,922
Investments	3,682	2,211	6,099	7,599	8,599
Total current assets	22,324	26,977	28,753	28,560	31,923
Total current liabilities	14,085	17,559	22,719	23,912	26,607
Working capital	8,239	9,419	6,033	4,649	5,317
Total assets	**36,852**	**44,633**	**55,400**	**66,493**	**76,444**

Cash flow statement

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Pre-tax profit	4,306	6,176	6,396	6,276	6,320
Depreciation	1,260	1,506	1,774	2,214	2,912
chg in Working capital	(261)	(2,859)	3,550	(1,470)	164
Total tax paid	(1,178)	(1,402)	(1,556)	(1,538)	(1,485)
Ext ord. Items	217	(131)	(18)	-	-
Operating cash Inflow	4,344	3,290	10,145	5,483	7,911
Capital expenditure	(1,925)	(5,778)	(6,140)	(12,000)	(8,500)
Free cash flow (a+b)	2,419	(2,488)	4,005	(6,517)	(589)
Chg in investments	(1,390)	1,471	(3,888)	(1,500)	(1,000)
Debt raised/(repaid)	(1,885)	(515)	2,471	8,000	5,000
Capital raised/(repaid)	1,001	3,171	194	-	-
Dividend (incl. tax)	(1,822)	(2,264)	(2,275)	(2,578)	(2,578)
Misc	(262)	(1,053)	-	-	-
Net chg in cash	(1,938)	(1,679)	507	(2,595)	832

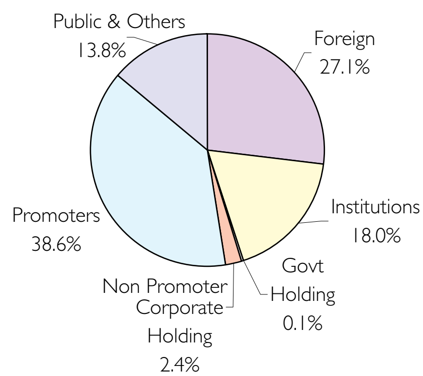
Key ratios

Year to Mar 31	FY06	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	10.3	9.8	10.3	9.8	10.2
EBIT margin (%)	7.9	7.7	8.0	7.3	7.3
PAT margin (%)	5.8	6.3	6.1	5.2	4.7
RoE (%)	25.6	26.9	23.5	19.5	19.4
RoCE (%)	18.5	22.2	20.6	17.3	15.5
Gearing (X)	0.5	0.3	0.4	0.7	0.9

Valuations

Year to Mar 31	FY06	FY07	FY08	FY09E	FY10E
Reported EPS (Rs)	2.7	3.3	3.5	3.2	3.5
Adj. EPS (Rs)	2.5	3.4	3.5	3.4	3.5
PER (x)	13.1	9.5	9.2	9.5	9.3
Price/Book (x)	2.8	2.3	2.0	1.9	1.7
EV/Net sales (x)	0.7	0.6	0.6	0.6	0.6
EV/EBITDA (x)	7.2	6.3	5.7	6.3	5.8
EV/CE (x)	1.7	1.6	1.4	1.3	1.2

Shareholding pattern



As of June 2008

TVS Motors

Rs34

UNDERPERFORMER

In the shadows

Mkt Cap: Rs8.1bn; US$182m

Company update

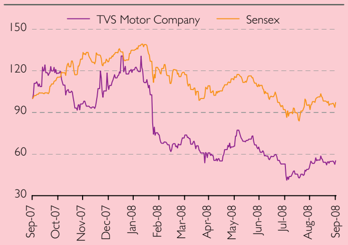
5 September 2008

BSE Sensex: 14484

Stock data

Reuters	TVSM.BO
Bloomberg	TVSL IN
1-yr high/low (Rs)	79/23.1
1-yr avg daily volumes (m)	1.32
Free Float (%)	43.2

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
TVS Motors	(2.0)	(18.7)	(46.8)	(59.4)
Sensex	(8.2)	(12.4)	(6.2)	82.8

TVS Motors (TVS) is gradually reducing its dependence on entry level bikes by launching two new executive segment models in FY09 in addition to the recently launched *TVS Flame* and *Apache RTR*. Also, two new launches in the scooter segment and the recent 3W foray would boost volumes. We expect TVS to post a 2-year topline CAGR of 11.2% over FY08-10. Our estimates factor in a better product mix (higher proportion of >125cc bikes) as well as ramp-up in 3W sales. However, margin pressure is unlikely to relent due to a sustained rise in input cost and stiff competition. The stock, at 13.5x FY10E earnings and 8.6x EV/EBIDTA, appears expensive vis-à-vis peers. Maintain Underperformer on the stock with a price target of Rs25.

New launches to diversify product portfolio: TVS plans to launch two scooters and two motorcycles in the executive segment in FY09 after the recently launched 125cc *TVS Flame* and 160cc *Apache RTR*. The new launches will help diversify TVS's product portfolio away from the entry level segment and boost sales. We expect 8.9% volume CAGR for TVS over FY08-10.

3-wheeler foray – limited scalability: TVS launched its first 3W, the 2-stroke 200cc *TVS King*, in March 2008 in select Indian markets. TVS has set up a dedicated Rs1.2bn facility at Hosur with installed capacity of 100,000 3Ws. TVS intends to launch a diesel powered goods 3W in the sub-one tonne category in FY10. The 3W foray has come at a time when the segment is on a downward trend on account of stiff competition from sub-one tonne LCVs.

Expect earnings recovery over FY08-10; but expensive valuations: We expect TVS to post 11.2% topline CAGR over FY08-10 led by new product launches and higher realizations. Margins would likely expand by 220bp to 3.5% led by an improved product mix (3Ws and higher proportion of premium motorcycles). However, at 13.5x FY10E earnings and 8.6x EV/EBIDTA, the stock appears expensive vis-à-vis peers. Maintain Underperformer.

Key valuation metrics

Year to 31 March	FY06	FY07	FY08	FY09E	FY10E
Net sales (Rs m)	32,350	38,550	32,195	35,863	39,820
Adj. net profit (Rs m)	1,170	666	49	354	599
Shares in issue (m)	238	238	238	238	238
Adj. EPS (Rs)	4.9	2.8	0.2	1.5	2.5
% growth	(15.0)	(43.1)	(92.6)	619.8	69.0
PER (x)	6.9	12.2	25.5	22.9	13.5
Price/Book (x)	1.2	1.1	1.1	1.0	1.0
EV/EBITDA (x)	4.2	7.6	28.3	11.9	8.6
RoE (%)	17.9	9.2	4.2	4.6	7.5
RoCE (%)	10.1	3.6	(3.4)	(0.7)	1.1

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Earnings model

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Net sales	**32,350**	**38,550**	**32,195**	**35,863**	**39,820**
% growth	*12.5*	*19.2*	*(16.5)*	*11.4*	*11.0*
Operating expenses	30,305	37,177	31,782	34,894	38,420
EBITDA	**2,045**	**1,373**	**413**	**969**	**1,400**
% growth	*(3.4)*	*(32.9)*	*(69.9)*	*134.6*	*44.5*
Other income	710	732	909	943	994
Net interest	(131)	(321)	(290)	(354)	(362)
Depreciation	939	876	946	1,079	1,223
Pre-tax profit	**1,685**	**909**	**85**	**479**	**809**
Deferred Tax	5	100	(41)	2	4
Current Tax	510	143	77	122	206
Profit after tax	1,170	666	49	354	599
Preference dividend	-	-	-	-	-
Non-recurring items	-	-	269	-	-
Net profit after non-recurring items	**1,170**	**666**	**318**	**354**	**599**
% growth	*(15.0)*	*(43.1)*	*(52.3)*	*11.5*	*69.0*

Key ratios

Year to Mar 31	FY06	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	6.3	3.6	1.3	2.7	3.5
EBIT margin (%)	3.4	1.3	(1.7)	(0.3)	0.4
PAT margin (%)	3.6	1.7	1.0	1.0	1.5
RoE (%)	17.9	9.2	4.2	4.6	7.5
RoCE (%)	10.1	3.6	(3.4)	(0.7)	1.1
Gearing (X)	0.5	0.8	0.9	0.9	0.9

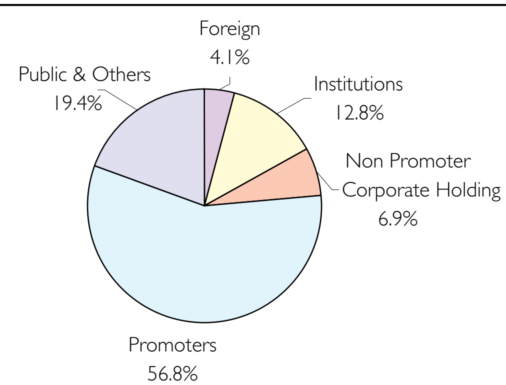
Valuations

Year to Mar 31	FY06	FY07	FY08	FY09E	FY10E
Reported EPS (Rs)	4.9	2.8	0.2	1.5	2.5
Adj. EPS (Rs)	4.9	2.8	1.3	1.5	2.5
PER (x)	6.9	12.2	25.5	22.9	13.5
Price/Book (x)	1.2	1.1	1.1	1.0	1.0
EV/Net sales (x)	0.3	0.3	0.4	0.3	0.3
EV/EBITDA (x)	4.2	7.6	28.3	11.9	8.6
EV/CE (x)	0.7	0.7	0.7	0.7	0.7

Balance sheet

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Paid-up capital	238	238	238	238	238
Reserves & surplus	7,424	7,855	7,978	8,129	8,498
Total shareholders' equity	7,003	7,507	7,688	7,839	8,208
Total current liabilities	5,869	6,268	5,668	5,514	6,123
Total Debt	3,850	6,336	6,663	6,663	7,463
Deferred tax liabilities	1,490	1,590	1,549	1,551	1,555
Total liabilities	11,210	14,193	13,880	13,729	15,142
Total equity & liabilities	**18,213**	**21,701**	**21,568**	**21,568**	**23,349**
Net fixed assets	8,215	10,029	10,431	11,351	12,128
Investments	3,442	3,447	3,390	3,390	3,390
Total current assets	6,556	8,224	7,748	6,828	7,832
Total assets	**18,213**	**21,701**	**21,568**	**21,568**	**23,349**

Shareholding pattern



As of June 2008

Cash flow statement

Year to Mar (Rs m)	FY06	FY07	FY08	FY09E	FY10E
Pre-tax profit	1,685	909	85	479	809
Depreciation	939	876	946	1,079	1,223
chg in Working capital	(1,194)	(647)	(952)	941	(122)
Total tax paid	(510)	(143)	(77)	(122)	(206)
Ext ord. Items	-	-	269	-	-
Operating cash Inflow	920	995	270	2,377	1,705
Capital expenditure	(1,390)	(2,558)	(1,287)	(2,000)	(2,000)
Free cash flow (a+b)	(470)	(1,563)	(1,017)	377	(295)
Chg in investments	(1,688)	(6)	58	-	-
Debt raised/(repaid)	1,982	2,485	328	-	800
Capital raised/(repaid)	-	-	-	-	-
Dividend (incl. tax)	(352)	(231)	(195)	(203)	(230)
Misc	-	-	-	-	-
Net chg in cash	(528)	686	(826)	174	274

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Explanation of Ratings:

1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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