Result Update

April 28, 2010

MSIL recently came out with its Q4FY10 results. It net sales stood at Rs.8,234.9 cr, which was sharply up by 30.5% y-o-y and up 12.3% q-o-q. Operating Profit for the quarter grew from Rs.449.3 cr in Q4FY09 to Rs.1,111.1 cr in Q4FY10. The Net Profit for the quarter stood at Rs.656.6 cr, up by 170% q-o-q.

Quarterly Financials

Rs.Cr.

Particulars	Q4FY10	Q4FY09	% Chg	Q3FY10	% Chg	FY10	FY09	% Chg
Net Sales	8234.9	6308.4	30.5%	7333.8	12.3%	28958.5	20358.3	42.2%
Income from services	46.0	24.4	88.3%	38.9	18.2%	140.4	95.4	47.1%
Other Operating Income	143.7	100.1	43.5%	130.2	10.4%	524.2	398.8	31.4%
Total Income	**8424.6**	**6432.9**	31.0%	**7502.9**	12.3%	**29623.0**	**20852.5**	42.1%
Expenditure	7313.5	5983.6	22.2%	6368.9	14.8%	25668.7	19018.5	35.0%
Raw Materials	6412.7	5080.9	26.2%	5590.1	14.7%	22413.4	16240.7	38.0%
Other Expenditure	747.4	769.6	-2.9%	646.4	15.6%	2709.7	2306.7	17.5%
Employees Cost	153.4	133.1	15.2%	132.5	15.8%	545.6	471.1	15.8%
Operating Profit	**1111.1**	**449.3**	147.3%	**1133.9**	-2.0%	**3954.3**	**1834.1**	115.6%
OPM %	*13.5%*	*7.1%*		*15.5%*		*13.7%*	*9.0%*	
Other Income	79.0	105.4	-25.1%	91.3	-13.5%	496.8	601.3	-17.4%
Interest	12.9	8.9	44.9%	8.4	53.5%	33.5	51.0	-34.3%
Depreciation	223.0	197.1	13.1%	202.8	10.0%	825.0	706.5	16.8%
Profit before Tax	954.2	348.7	173.6%	1014.0	-5.9%	3592.5	1677.9	114.1%
PBTM %	*11.6%*	*5.5%*		*13.8%*		*12.4%*	*8.2%*	
Tax	297.6	105.6	181.8%	326.5	-8.8%	1094.9	457.1	139.5%
Effective Tax Rate %	*31.2%*	*30.3%*		*32.2%*	-3.1%	*30.5%*	*27.2%*	
Net Profit	**656.6**	**243.1**	170.0%	**687.5**	-4.5%	**2497.6**	**1220.7**	104.6%
NPM %	*8.0%*	*3.9%*		*9.4%*		*8.6%*	*6.0%*	
Equity Capital	144.5	144.5	0.0%	144.5	0.0%	144.5	144.5	0.0%
EPS	**22.7**	**8.4**	170.0%	**23.8**	-4.5%	**86.4**	**42.3**	104.6%

(Source: Company Press Release)

Volumes	Q4FY10	Q4FY09	% Chg	Q3FY10	% Chg	FY10	FY09	% Chg
A1	8,434	12,076	-30.2%	8,738	-3.5%	33,028	49,383	-33.1%
A2	173,683	152,645	13.8%	159,678	8.8%	633,190	511,396	23.8%
A3	29,702	23,228	27.9%	25,388	17.0%	99,315	75,928	30.8%
C	32,466	21,421	51.6%	24,426	32.9%	101,325	77,948	30.0%
MUV	1,097	2,115	-48.1%	680	61.3%	3,932	7,489	-47.5%
Total Domestic Sales	**245,382**	**211,485**	16.0%	**218,910**	12.1%	**870,790**	**722,144**	20.6%
Exports	42,040	25,153	67.1%	39,116	7.5%	147,575	70,023	110.8%
Total Volumes (Nos.)	**287,422**	**236,638**	21.5%	**258,026**	11.4%	**1,018,365**	**792,167**	28.6%
Realisation (Rs/vehicle)	**286,508**	**266,582**	7.5%	**284,226**	0.8%	**284,362**	**256,995**	10.6%

(Source: Company Press Release)

Some of the key highlights of the results are as follows:

- On the back of robust volume growth and higher realisations, MSIL's net sales rose by 30.5% y-o-y and 12.3% q-o-q to Rs.8,234.9 cr in Q4FY10.

- Domestic sales in volume terms have grown by 16% y-o-y and up by 12.1% q-o-q. This was led by a strong performance from the A2, A3 and C segments. However, the volumes of MUVs have witnessed degrowth y-o-y of 48.1%. in the big car segment, the market share rose from 31.4% in Q4FY09 to 36% in Q4FY10.

- Export volumes have witnessed a sharp growth of 67.1% y-o-y and 7.5% q-o-q on the back of growth in demand from the European markets despite withdrawal of scrappage scheme and good volumes witnessed in sales of A-Star. To cater to the strong demand, MSIL has debottlenecked its production facilities at Manesar. This will enable it to increase production of Swift and Dzire. Increase in sales of higher value models i.e. Ritz, diesel variants and higher realisations on exports led to improved realisations. Exports revenues for Q4FY10 were Rs.1,283 cr and that for the year was Rs.4,862 cr. The management has indicated that exports could be a challenge in FY11 due to the end of scrappage incentives in Europe.

- Average realisations in Q4FY10 have improved by 7.5% y-o-y to Rs.286,508/vehicle which also aided topline growth. Higher domestic product mix and increase in exports of A-Star in Western Europe led to realisations rising by 10.6% in FY10.

- Sales to government employees is down from 15.5% in Q3FY10 to 13% while sales from rural areas was around 18%, lower from 17% in Q3FY10.

- Other operating income was higher by 43.5% y-o-y on account of higher sale of scrap during the quarter.

- MSIL's operating margins have expanded by 5750 bps y-o-y to 13.5% on the back of lower raw material costs, manufacturing and admin costs and selling and distribution costs. Raw material costs were lower by 260 bps at 77.9% as a percentage of sales in Q4FY10 vs. 80.5% in Q4FY09 on account of material cost reduction and favourable price variance. Manufacturing costs were lower by 370 bps y-o-y on the back of positive forex variation and fuel cost and economies of scale. However, selling and distribution cost rose by 50 bps y-o-y due to large amount spent for advertising in the Auto Expo.

- On a q-o-q basis, raw materials to net sales percentage has increased by 170 bps on the back of depreciating euro, initial cost incurred for new models and higher raw material prices due to upgradation to BS-IV (Bharat Stage IV) norms. Manufacturing costs were lower by 50 bps q-o-q on the back of forex translational gains, mainly on euro contracts. Selling and distribution cost rose by 70 bps q-o-q due to large amount spent for advertising in the Auto Expo. This led to OPMs contracting by 200 bps q-o-q in Q4FY10.

- Other income fell by 25.1% y-o-y and 13.5% q-o-q to Rs.79 cr on the back of declining yields. Interest costs were higher by 44.9% y-o-y and 53.5% q-o-q on account of export loans taken. Depreciation cost grew from Rs.197.1 cr in Q4FY09 to Rs.223 cr in Q4FY10 and was higher by 10% q-o-q as it includes amortisation of tooling (tooling is amortised over 4 years). Tax rate was marginally higher y-o-y at 31.2%. Strong volume growth, higher realisations and improved operating efficiencies helped boost PAT margins by 410 bps y-o-y to 8% in Q4FY10. PAT margins however contracted q-o-q by 140 bps.

- In Q4FY10, many companies have launched new models, which have led to MSIL witnessing a fall in its market share by 400 bps from 51% in Q3FY10 to 47% in Q4FY10.

- MSIL undertook three price hikes in the last three months of which the last one of 1.6% was taken in April 2010 and the effect of the same could be witnessed in Q1FY11 numbers.

- As of March 2010, MSIL has 802 sales outlets (up by ~18%) in 565 cities and 2740 service centers in 1345 cities. The management has indicated strong growth in rural sales in FY11.

- MSIL has also announced expansion of capacity at its Manesar plant by 2.5 lakh units p.a. to cater to the growing demand expected going ahead. The current capacity is 3 lakh units p.a. With this expansion, the total capacity would increase from 11 lakh units to 13.5 lakh units p.a. As per the management, the capex for the same would be Rs.1,700 cr and it plans to commence production on the expanded capacity from Q4FY12.

- MSIL plans to expand its production capacities and invest more in its research and development activities to develop small cars. The company will deploy Rs.1,000-Rs.1,500 cr for the R&D unit in Rohtak. The company can fund this expansion through its internal accruals. It has purchased 780 acres of land for the same.

- MSIL's current diesel engine capacity stands at 200,000 units. There are no capacity constraints currently but MSIL plans to increase it to 300,000 units by end of FY11. The K-Series engine plant has a current capacity of 250,000 units and going forward would be expanded to 500,000 units.

- The management has guided for capex of Rs.2,800 cr for FY11 and Rs.3,000 cr for FY12 for expansion of product and facility development. In FY10, the capex incurred was Rs.1,300 cr.

- The MSIL management has indicated strong trends in the domestic market given the launch of new models, despite hike in fuel prices and possible increase in interest rates. It expects both urban and rural markets to grow, going into FY11.

- The lower priced raw material contracts signed in Q1FY10 were executed in Q3FY10 and the negotiations with vendors for renewal of contracts could be on the higher side, which are due to get completed by May 2010. However, with respect to tyres it indicates that the prices negotiated will be lower than the previous half as in H2FY10 it took an increase of 7%. The change in emission norms from BS-III to BS-IV (Bharat Stage III & IV) and limited pricing power in the wake of aggressive launches by new entrants could also dent the margins going forward.

Concerns

- Intensifying competition could pose a threat to MSIL in terms of sales and profit growth.

- Adverse currency movement (depreciation of INR vs USD, depreciation of Euro vs USD and appreciation of yen vs USD) could lead to higher input costs and higher other expenses (on account of forex loss) and in turn hurt margins. However, appreciation of Euro vs USD could bring in higher export revenues and offset part of the loss incurred due to above.

- With a rise in commodity prices, MSIL could face pressure on its margins.

- Hardening interest rates could have an impact on volumes as this could impact demand for cars.

Conclusion:

MSIL reported below-expected margins in Q4FY10 on account of higher raw materials cost. Higher input costs, change in emission norms and rising competition were the reasons for margins getting affected in Q4FY10. For FY10, the actual PAT was a little ahead of our estimates.

MSIL posted highest ever jump in volumes and realizations in Q4FY10. However, this situation may not continue going forward, as the commodity prices are moving upwards and there could be stiff competition in the A2 segment by domestic and global peers. A2 generates a major chunk of revenue for MSIL. It has lost its market share by 410 bps q-o-q in Q4FY10 to 47%. Increased competition could lower MSIL's pricing power and this combined with rising commodity prices could lead to pressure on profit margins. However, the management believes that with the launch of new models in the domestic markets, its market share could improve. Its depreciation policies are more aggressive than its peers.

We are revising our FY11 estimates downwards (but revising our topline upwards on account of higher volumes expected) as we believe FY11 could be a challenging year for MSIL given the higher base. It would have to take several measures so as to improve volumes and maintain its margins. At the CMP of Rs.1,283.15, MSIL quotes at 13.8x FY11(RE) EPS of Rs.93.

In our earlier report dated February 1, 2010, we had stated that the stock could be bought at Rs.1,226 for a target of Rs.1,453. Post the issue of the report, the stock touched a high of Rs.1,519.9 on March 10, 2010. It touched a low of Rs.1,310 on February 24, 2010.

MSIL could fetch lower valuation multiples going forward due to risk of margin hit, rising competition, moderate early growth and slower growth due to various factors. Though the valuations of MSIL are benign at 13.8x FY11(RE) EPS, a lot more depends on whether it is able to grow its market share, at what rate India's GDP grows in FY11, what kind of volume surprises it is able to record in Q1FY11 and Q2FY11and how soon the cost pressures ease. **We think that MSIL could trade in the Rs.1,230 to Rs.1,411 band for the next quarter.**

Particulars (Rs in Crs)	FY08	FY09	FY10 (E)*	FY10 (A)*	FY11 (OE)*	FY11 (RE)*
Operating income	18104.1	20413.3	27402.3	29623.0	31238.3	33345.9
PBIDT	2195.6	2020.9	3671.9	3954.3	4312.4	4201.9
PBIDTM (%)	12.1%	9.9%	13.4%	13.3%	13.8%	12.6%
Profit after Tax	1769.9	1482.5	2440.6	2497.6	2913.6	2687.7
PATM (%)	9.8%	7.3%	8.9%	8.4%	9.3%	8.1%
EPS	61.2	42.2	84.4	86.4	100.8	93.0
P/E (x)	21.8	31.6	15.2	14.8	12.7	13.8

*OE = Original Estimates, RE = Revised Estimates (Source: Company, HDFC Sec Estimates)

Analyst: Sneha Venkatraman (sneha.venkatraman@hdfcsec.com)

RETAIL RESEARCH Tel: (022) 30753400 Fax: (022) 30753435 Corporate Office
HDFC Securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Tel: (022) 30753400 Fax: (022) 30753435 Website: www.hdfcsec.com
Email: hdfcsecretailresearch@hdfcsec.com