Maruti Suzuki India Ltd.

Rating Change BUY

Equity | India | Autos/Car Manufacturers
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Bank of America Merrill Lynch

RESEARCH

Powering ahead; Raise to Buy

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Strong growth visibility drives rating upgrade

Despite 50% YTD stock rally, we are upgrading Maruti to Buy from Underperform, with PO of Rs 900. This follows sharp revision in EBITDA forecasts by 23.5% in FY10E and 20.2% in FY11E, on (1) increased domestic sales growth estimates of 15% (earlier 5%) and 12% (from 10%) respectively, and (2) higher margin assumptions. We expect stock to re-rate on much better growth visibility, and likely consensus upgrades.

We expect Maruti to lead industry growth

We believe Maruti's Q4 sales momentum (up 12% YoY) will sustain over the next year, driven by (1) demand from government employees benefiting from pay hikes, and (2) phased new launches, mainly in mass-market compact hatchback segment. We also expect Maruti to beat industry trends (15% vs 10% in FY10E), as competition grapples with relatively weaker franchise, and limited launches.

Margin expansion likely to be stronger

Our margin assumptions are raised by ~10% annually on (1) leverage of stronger sales, (2) higher ASPs on select models, and (3) localization benefits. We expect commodity price benefit to be partially passed on through higher sales incentives.

Notwithstanding rally, stock still undervalued

We believe valuations are inexpensive, given our expectations of strong earnings trajectory, similar to historic highs. At our new PO of Rs 900, the shares would trade at 7.0x our FY10E EV/EBITDA, in line with past average.

Estimates (Mar)

(Rs)	2007A	2008A	2009E	2010E	2011E
Net Income (Adjusted - mn)	15,620	17,657	14,003	18,909	22,215
EPS	54.05	61.10	48.45	65.43	76.87
EPS Change (YoY)	31.4%	13.0%	-20.7%	35.0%	17.5%
Dividend / Share	4.50	5.00	4.50	6.00	8.00
Free Cash Flow / Share	30.84	19.72	0.507	32.36	41.95

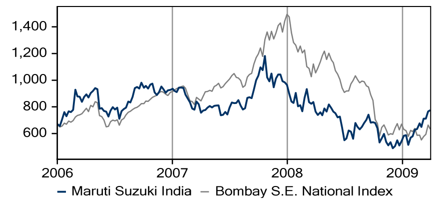
Valuation (Mar)

	2007A	2008A	2009E	2010E	2011E
P/E	14.43x	12.76x	16.09x	11.92x	10.15x
Dividend Yield	0.577%	0.641%	0.577%	0.769%	1.03%
EV / EBITDA*	7.73x	6.41x	8.16x	5.87x	4.85x
Free Cash Flow Yield*	4.07%	2.60%	0.067%	4.27%	5.53%

* For full definitions of *iQmethod* SM measures, see page 16.

Stock Data

Price	Rs779.85
Price Objective	Rs596.00 to Rs900.00
Date Established	1-Apr-2009
Investment Opinion	C-3-7 to C-1-7
Volatility Risk	HIGH
52-Week Range	Rs428.40-Rs855.00
Mrkt Val / Shares Out (mn)	US$4,442 / 289.0
Average Daily Volume	1,797,846
ML Symbol / Exchange	MUDGF / BSE
Bloomberg / Reuters	MSIL IN / MRTI.BO
ROE (2009E)	15.5%
Net Dbt to Eqty (Mar-2008A)	6.8%
Est. 5-Yr EPS / DPS Growth	20.0% / 20.0%
Free Float	27.5%



Refer to important disclosures on page 17 to 19. Analyst Certification on Page 15. Price Objective Basis/Risk on page 15.

iQprofile SM Maruti Suzuki India Ltd.

Key Income Statement Data (Mar)	2007A	2008A	2009E	2010E	2011E
(Rs Millions)					
Sales	149,038	183,409	210,875	269,036	315,698
Gross Profit	30,432	36,248	33,104	43,744	52,397
Sell General & Admin Expense	(8,029)	(9,264)	(11,895)	(14,275)	(16,737)
Operating Profit	19,690	21,302	14,263	21,580	26,431
Net Interest & Other Income	3,109	4,233	5,052	5,241	5,304
Associates	0	0	0	0	0
Pretax Income	22,798	25,535	19,315	26,821	31,736
Tax (expense) / Benefit	(7,179)	(7,878)	(5,312)	(7,912)	(9,521)
Net Income (Adjusted)	15,620	17,657	14,003	18,909	22,215
Average Fully Diluted Shares Outstanding	289	289	289	289	289
Key Cash Flow Statement Data					
Net Income	15,620	17,657	14,003	18,909	22,215
Depreciation & Amortization	2,714	5,682	6,947	7,888	9,228
Change in Working Capital	4,301	944	(2,297)	(445)	(1,320)
Deferred Taxation Charge	897	26	(300)	(500)	(499)
Other Adjustments, Net	(792)	(1,585)	(456)	(500)	0
Cash Flow from Operations	22,739	22,724	17,896	25,352	29,624
Capital Expenditure	(13,828)	(17,024)	(17,750)	(16,000)	(17,500)
(Acquisition) / Disposal of Investments	(13,580)	(17,715)	(2,250)	(2,250)	0
Other Cash Inflow / (Outflow)	0	0	0	0	0
Cash Flow from Investing	(27,408)	(34,739)	(20,000)	(18,250)	(17,500)
Shares Issue / (Repurchase)	0	0	0	0	0
Cost of Dividends Paid	(1,300)	(1,445)	(1,301)	(1,734)	(2,312)
Cash Flow from Financing	4,291	1,249	3,200	(1,234)	(2,312)
Free Cash Flow	8,912	5,700	146	9,352	12,124
Net Debt	(7,920)	5,762	9,166	3,798	(6,014)
Change in Net Debt	5,968	13,460	3,404	(5,368)	(9,812)
Key Balance Sheet Data					
Property, Plant & Equipment	26,597	32,965	43,768	51,880	60,152
Other Non-Current Assets	36,481	59,170	61,420	63,670	63,670
Trade Receivables	7,474	6,555	9,016	11,545	15,273
Cash & Equivalents	14,228	3,240	4,336	10,204	20,016
Other Current Assets	16,757	21,114	24,634	30,453	33,543
Total Assets	101,537	123,044	143,174	167,753	192,654
Long-Term Debt	6,308	9,002	13,502	14,002	14,002
Other Non-Current Liabilities	1,675	1,701	1,401	901	402
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	25,015	28,187	31,676	39,079	44,576
Total Liabilities	32,998	38,890	46,579	53,982	58,980
Total Equity	68,539	84,154	96,595	113,770	133,673
Total Equity & Liabilities	101,537	123,044	143,174	167,753	192,654
iQmethod **SM - Bus Performance***					
Return On Capital Employed	21.5%	18.3%	11.2%	13.6%	14.2%
Return On Equity	25.4%	23.1%	15.5%	18.0%	18.0%
Operating Margin	13.5%	11.9%	6.9%	8.2%	8.5%
EBITDA Margin	15.0%	14.7%	10.1%	11.0%	11.3%
iQmethod **SM - Quality of Earnings***					
Cash Realization Ratio	1.5x	1.3x	1.3x	1.3x	1.3x
Asset Replacement Ratio	5.1x	3.0x	2.6x	2.0x	1.9x
Tax Rate (Reported)	31.5%	30.9%	27.5%	29.5%	30.0%
Net Debt-to-Equity Ratio	-11.6%	6.8%	9.5%	3.3%	-4.5%
Interest Cover	NM	35.7x	28.8x	NM	NM
Key Metrics					

* For full definitions of *iQmethod* SM measures, see page 16.

Company Description

Maruti Suzuki (Maruti) is a subsidiary of Suzuki Motor Corp, Japan. Started in 1983, Maruti is India's largest passenger car company. The company primarily sells minis, compacts (collectively 70% of volumes) and has recently moved up to premium hatchback and mid-size segments. Its key models are Alto, Swift and Sx4. Maruti operates out of three manufacturing plants from two different locations at Gurgaon and Manesar, both in Haryana (near New Delhi).

Investment Thesis

We expect Maruti to deliver strong earnings growth over our forecast period, well above consensus estimates. This will be mainly driven by incremental demand from government emplyees, as well as phased new model launches. Also, we estimate better margins on sales leverage, and improved realisations. We expect stock to re-rate on consensus upgrades.

Stock Data

Price to Book Value	2.3x

Upgraded to Buy, PO at Rs 900

Our upgrade is driven by (1) sharp revision of forecasts, on higher estimates of domestic sales, and (2) expected re-rating, on better growth visibility, and likely consensus upgrades. Our PO of Rs 900 is based on 7.0x FY10E EV/EBITDA, and implies 17% upside potential.

Forecasts raised over FY09-11

We raise EBITDA forecasts by 23.5% in FY10E and 20.2% in FY11E, and EPS estimates by 21.6% and 19.4% respectively, on the back of:

1. Revision in domestic sales growth to 15% in FY10E and 12% in FY11E (earlier 5% and 10% respectively);

2. Higher ASPs (net of rising incentives), also aided by shift to pricier models i.e. *Swift, Dzire, A-star*;

3. Localisation benefits on transmission parts, more than earlier anticipated.

Table 1: Revision in estimates

	Earlier			Revised			Revision		
Rsbn, '000 volume	FY09E	FY10E	FY11E	FY09E	FY10E	FY11E	FY09E	FY10E	FY11E
Domestic volume	722	758	834	726	835	936	0.5%	10.2%	12.1%
Exports volume	64	100.088	150.132	64	100	150	0.0%	0.0%	0.0%
Volumes ('000 nos)	787	859	985	791	936	1,086	0.5%	9.0%	10.3%
Net Sales	203.8	239.8	279.5	205.7	263.4	309.7	0.9%	9.8%	10.8%
EBITDA	*15.6*	*19.3*	*24.8*	*16.0*	*23.8*	*29.7*	*2.5%*	*23.1%*	*19.4%*
EBITDA Margin	7.7%	8.1%	8.9%	7.8%	9.0%	9.6%	12bps	98bps	69bps
PAT	13.7	15.6	18.7	14.0	18.9	22.2	2.3%	21.1%	18.5%
EPS (Rs)	47.4	54.0	64.9	48.5	65.4	76.9	2.3%	21.1%	18.5%

Source: Banc of America Securities-Merrill Lynch Research

Operating performance has conclusively bottomed

We expect sharp rebound in Q4 (QoQ EBITDA up 84%), across key parameters, thanks mainly to reversal in both, sales and cost trends.

Table 2: Earnings trajectory to reverse

(Rs bn. '000s volume)	9M FY09A	YoY	Q4 FY09E	YoY	QoQ
Sales (vol)	556	-1.3%	235	16.2%	35.4%
EBITDA	11.2	-37.5%	4.8	-4.2%	84.3%
Recurring net profit	10.0	-30.1%	4.0	20.0%	87.8%
EPS (Rs)	34.7	-30.1%	13.8	20.0%	87.8%

Source: Banc of America Securities-Merrill Lynch Research

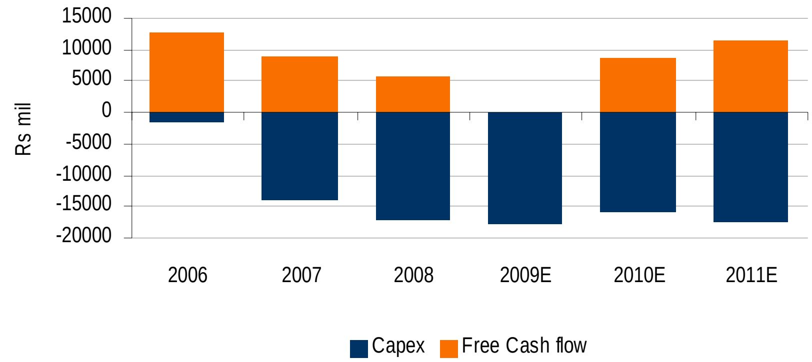
We expect earnings trajectory to revert to historic highs

Following 26.7% YoY decline this fiscal, we estimate Maruti's EBITDA to register 35.6% CAGR over FY09-11, driven by (1) annual sales volume growth of 17%, (2) ASP increase of ~5%, aided by improved sales mix, and (3) margin expansion of ~10% annually. We estimate 25.6% net profit/ EPS CAGR over next 2 years.

Maruti to turn strongly free cash positive

We expect Maruti to generate substantial free cash flows from next fiscal, ahead of our earlier estimates in FY11. This is mainly due to much stronger earnings, and slight deferment of capex related to strengthening of distribution.

Chart 1: We forecast strong free cash flows



Source: Banc of America Securities-Merrill Lynch Research

Valuation: We expect stock to re-rate

Despite stock rising 45% YTD, valuations are inexpensive at 1-year forward P/E of ~11.7x and EV/EBITDA of 5.7x. We expect stock to re-rate on the back of:

- Market share gains, leading volume recovery
- Improved earnings visibility, with trajectory in line with historic averages
- Strong balance sheet, which minimizes financial risk

Chart 2: 1-year forward P/E

Source: Bloomberg, Banc of America Securities-Merrill Lynch Research

Chart 3: 1-year forward EV/EBITDA

Source: Bloomberg, Banc of America Securities-Merrill Lynch Research

PO at Rs900

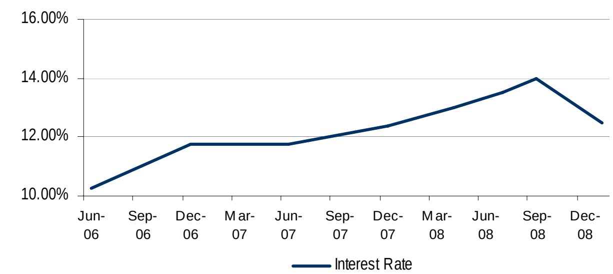
We assign multiple of 7.0x FY10E EV/EBITDA, which is similar to historic average (compared to earlier 5x, near trough multiple). This is on expectation that forecast growth rates will be similar to historical trends (37% EBITDA CAGR over FY03-08). At our new PO, the shares would trade at 13.7x FY10E EPS, in line with historic average.

Demand: High on stimulus

Recent trends have been stronger than expected (Jan-Feb industry car sales up 12% YoY), driven by favorable impact of government-led initiatives such as:

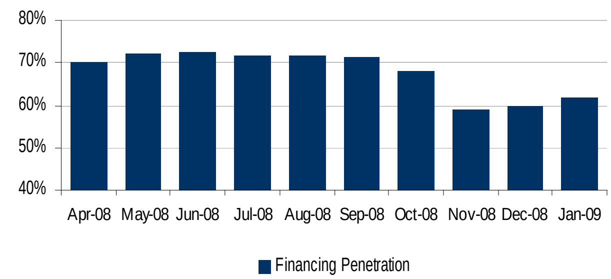
- Reduction in cash reserve ratios/reverse repo rates, driving easier liquidity, and lower auto financing rates, mostly by public sector banks (see Chart 5);
- Successive excise cuts on small cars to 8% (from 16% a year ago), which has lowered price tag and improved affordability;
- Pay commission related salary/auto loan limit hikes, thereby increasing affordability; and
- Fuel price cut aggregating 20%, which has reduced operating cost.

Chart 4: Auto loan rates have started to decline



Source: Banc of America Securities-Merrill Lynch Research

Chart 5: Bank financing penetration has reversed from troughs



Source: Banc of America Securities-Merrill Lynch Research

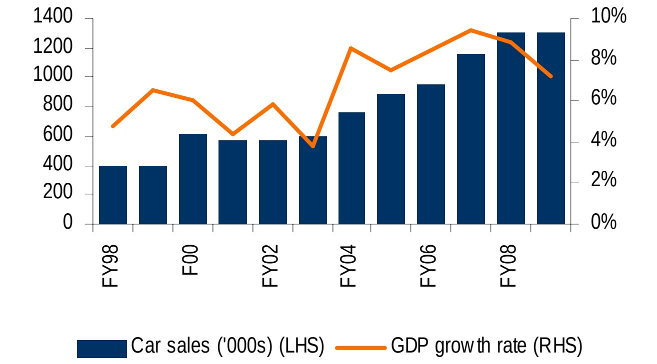
We expect improvement next year

Following disappointing fiscal 2009 (industry expected to grow just 2-3%), we forecast near double-digit increase in car sales next year, despite economic slowdown. We expect improvement mainly due to incremental demand from government sector benefiting from pay revisions, and rural market, where disposable incomes are still on the rise. However, we expect overall growth to be restricted by continuing weak off-take in the urban market, affected by insecurity of salary cuts and job losses.

Recovery expected by end-FY10

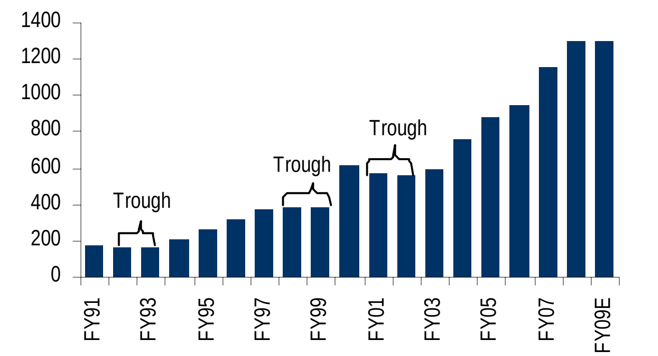
Although not entirely comparable, one can draw inferences from past to predict next economic cycle. Charts below illustrate that (1) trough cycles typically last ~2 years, and (2) fiscal incentives aid recovery. We are into 2nd year of slowdown, which based on this historical data suggests to us that recovery is likely before end-fiscal 2010.

Chart 6: Correlation to GDP is strong



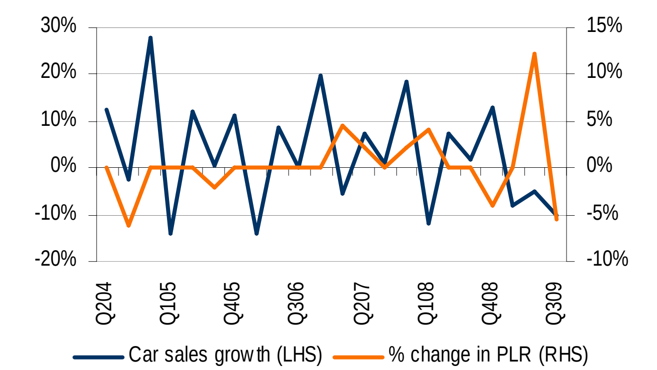
Source: Banc of America Securities-Merrill Lynch Research

Chart 7: Previous trough cycles typically last 2 years



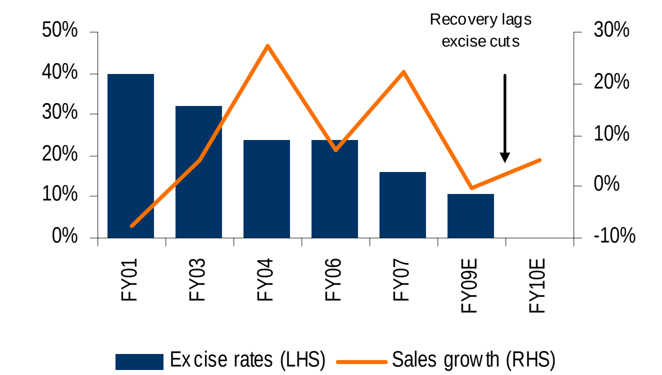
Source: Banc of America Securities-Merrill Lynch Research

Chart 8: Declining interest rates spur car sales growth



Source: Banc of America Securities-Merrill Lynch Research

Chart 9: Excise cuts trigger recovery with a lag



Source: Banc of America Securities-Merrill Lynch Research

Maruti likely to gain market share

We estimate Maruti's FY09 sales growth to be broadly in line with peers at ~2%, after sharp rebound in Q4. We however expect company to significantly beat industry trends over the next year, thanks to:

- Rising exposure to government sector benefiting from pay hikes;
- New products, all more exciting relative to what competition has on offer;
- Easing of competitive threat from new entrants

Table 3: Maruti to grow faster than industry in FY10 & FY11

	FY06	FY07	FY08	FY09E	FY10E	FY11E
Sales Growth						
Maruti	*8.1%*	*20.6%*	*12.0%*	*2%*	*15.0%*	*12.0%*
Industry	7.2%	22.3%	12.5%	1.6%	10.9%	9.7%
Industry (ex Maruti)	5.7%	23.90%	13.10%	1.2%	6.90%	7.3%

Source: Banc of America Securities-Merrill Lynch Research

Government employees get pay hikes

Around 5mn central government employees will benefit from 35-40% hike in salaries, doubling of auto loan limits to Rs 360K, and receipt of 30-month arrears. Following the first month of payout, car sales revived from end-Dec. We therefore expect momentum to sustain in FY10, driven by incremental payouts from, (1) hikes to ~0.5mn PSU employees, (2) balance 60% of arrears, and (3) similar benefits to ~7mn state government employees, towards the latter part of the year.

Maruti likely to be preferred choice

Maruti's sale to government sector has doubled in the past few months to ~9K units/month (15% of aggregate sales). This is reflected in the reversal of compact car sales (YoY up 8% since Dec), which suits price and affordability criteria of target buyer i.e. Rs 300-400K. We expect Maruti's government related sales to increase to 14K units/month in the next year (20% of FY10E sales), driven by expansion in customer base i.e. state government, PSU employees.

Table 4: Segmental sales estimates: beating Urban slowdown

	FY09E		FY10E		FY11E	
Segment	YoY chg	% sales	YoY chg	% sales	YoY chg	% sales
Government	75%	11.5%	100%	19.9%	-7.5%	16.5%
Rural market	15%	15.1%	13.5%	14.9%	12%	14.9%
Urban	-5%	73.5%	2.0%	65.2%	18%	68.7%
Sales- monthly	3.0%	100.0%	15%	100.0%	12%	100.0%

Source: Banc of America Securities-Merrill Lynch Research

New products to drive sales

In fiscal 2009, success of *Swift Diesel* and *Dzire* models enabled Maruti to hold on to ~54% market share. Over the next year, we expect full benefit from hatchbacks *A-star* (Nov 08), *Splash/Ritz* (May 09), *Alto* replacement (H1 CY10), and the mid-sized sedan *Dzire* to drive company's incremental sales. This will more than offset likely declines in *Omni, M800* (due to competition from *Nano*) and the not so successful *Zen Estilo*. We therefore expect Maruti to increase its market position, as:

- In hatchbacks (65% of industry sales), we expect *A-star* and *Splash* to regain share from *Hyundai's i-10*, and *Alto* replacement to gain early advantage over Hyundai's proposed *Santro* upgrade in FY11;
- In mid-sized sedans (15% of industry sales), we expect *Dzire* to ramp up volumes following capacity expansion at Manesar; we do not expect any new competitive model in the near term close to this price point.

A-Star demand has picked up

Despite early apprehensions on pricing (at Rs 3.45L for base version, close to Hyundai's *i-10*), and lack of rear space, customer response has improved, mainly due to exceptional 19.6kmpl fuel efficiency. After averaging below 4K units in the initial months, sales crossed 5K units in February (even as company hiked ASP by ~2%). We believe that sales will sustain, which should enable *A-star* to pull back some of Hyundai's *i-10* related market share gain last year.

Splash/Ritz should be exciting models

After making a promising debut in Europe last year, two variants namely *Splash /Ritz,* will be made available in the domestic market this May. We expect 1.2L petrol version at a distinct price point (*Wagon-R* upgrade), and 1.3L diesel variant. We expect Maruti to gain share, again due to lack of competing models.

Alto replacement likely next year

Although not confirmed, we expect Maruti to replace the *Alto* (Year 2001) with a brand new model next year. We believe this will not only diminish possible threat from Tata Motors' *Nano*, but also give Maruti an early advantage over Hyundai's likely *Santro* replacement, coming up later.

Dzire still on wait list

Maruti has begun to ramp up *Dzire* production, thanks to expanded capacity at Manesar. Still, with a wait list of over a month, and no competitive model in sight, we expect *Dzire* to do continue doing well. Honda's *Jazz* will be the only competitor launch in mid-2009, but with a petrol fitted engine. Hyundai's upgraded *Verna*, albeit fitted with a diesel engine is pricier.

Table 5: Compact Hatchbacks: Maruti better placed compared to Competition

Maruti				Key Competitor		
Key Model	% of Sales	Market Share	Position/Strategy	Model	Market Share	Positioning
M 800	6%	5%	Phase out	Tata *Nano*	New	Entry threat to Maruti
Alto, Wagon R	44%	36%	*Alto* replacement end-FY10	Hyundai *Santro*	9%	Upgrade end-CY10
Splash	0%	New	May 09 launch	None	New	NA
A-Star	3%	2%	Picking up, mainly exports	Hyundai *i10*	12%	Popular
Ritz	0%	0%	*Splash* in diesel	Tata *Indica Vista*	12%	Gaining traction
Swift / Diesel	16%	13%	Most popular model	Hyundai *i20/Verna*	3%	Recent launch

Source: Banc of America Securities-Merrill Lynch Research

Incumbents will be less impactful

Maruti's market position is unlikely to be disturbed by closest competitors in the compact and mid-sized segments. We evaluate the prospects of incumbents, including the recent and upcoming launches.

- **Tata Motors'** *Indica Vista* and *Indigo CS* models, introduced last year are doing well, enabling slightly improve market share. However, we believe the company's weakened financial position will restrict overall ability to compete.
- **General Motors,** with monthly sales of ~4K units is still not a meaningful player. As such, the soon-to-be introduced 800cc version of *Spark* will be limited by GM's marginal franchise.
- **Hyundai's** recently launched *i-20* model is in short supply, but we believe the 1.2L engine is underpowered, and hence may not sustain challenge to Maruti's *Swift*.

Nano effect will be marginal

Tata Motors' low cost car *Nano* is a perceived threat to Maruti, especially to minis *M800* and *Alto*. We however believe that the impact will be marginal, as prospective customers will largely include first time buyers, given the affordability factor of *Nano* (i.e. target market will expand), as well as existing two wheeler owners wanting to upgrade. We believe that Maruti will be impacted to the extent of resale value of used cars, and to a lesser extent, demand for new cars. We estimate ~1% impact to sales.

Table 6: Nano impact marginal

Nano sales in FY10E	% Sales	Sales
Total Sales	100.0%	100,000
New customers	50.0%	50,000
Existing customers	50.0%	50,000
which include:		
Two wheelers	15.0%	15,000
Cars, of which:	35.0%	35,000
- Used cars	*20.0%*	20,000
- New cars	*15.0%*	15,000
Maruti's share in minis/compact @60%		9,000
FY09E sales		726,000
% of sales		1.2%

Source: Banc of America Securities-Merrill Lynch Research

New entrants threat has diminished

Financial impact of global slowdown has forced auto majors to re-think India-specific investment plans. Japanese automaker Honda has already delayed commissioning of second plant by a year, and Toyota remains undecided on timing of small car foray. European major Renault has also scaled down assembly capacity, though Volkswagen stays on track to start operations by end-CY09. Over the next 2 years, we now expect car supply to rise 12.5% annually, down from earlier 20%.

Maruti's Europe re-entry to drive exports

Maruti has re-entered the European market this month through its latest product *A-star* (re-christened *Alto* in Europe). Management has scaled down sales targets from its earlier plans, but still hopes to take the company's exports to 150K units by FY11 (14% of sales), up from estimated 64K units or 8% this fiscal. Our forecasts are in line with revised management guidance, and expect 55% sales growth to 99K units in FY10E, and further 50% growth in FY11E.

Suzuki's small cars to gain amidst slowdown

European car sales have averaged 14.5mn units/year, declining ~2% annually over past 4 years. Suzuki's CY08 share of just 1.6% (212K units) was constrained by lack of competitive products. Smaller and light car segments have fared slightly better during this period (flat at 5.2mn units), where Suzuki has a stronger positioning (4% share). Over CY09-10, BAS-ML forecasts car sales to decline over 5%, but we expect small car demand to gain further share and decelerate at a marginal rate. We however believe Suzuki will be able to substantially raise share to 6%, through competitively positioned *Alto*.

Alto is competitive in its genre

We expect *Alto* to straddle the light and small car segments, competing with models such as Hyundai *i-10*, Fiat *Panda*, Citroen *C2* and Toyota *Aygo*. Maruti's *Alto* offers matching features i.e. aircon, power mirrors and windows, keyless entry, central locking and audio system, plus requisite safety options including dual side and curtain airbags. *Alto's* unique selling point will be fuel efficiency of ~55mpg, which surpasses competitors by over 20%, and low carbon emissions of 103g/km, which save taxes for its car owner. We also expect Maruti to price *Alto* competitively, equivalent to on-road price in the Indian market i.e. Euros 6,000, whereas competing models are priced around Euros 6,500-8000.

Nissan contract may be finalized soon

Nissan Motor Co, Japan is negotiating with Suzuki for offtake of Maruti's *A-star* to feed European demand. The model will be re-chistened *Pixo* and marketed under the Nissan brand. Our forecasts assume ramp up to 50K units by next year, over and above Suzuki's branded *Alto* (~100K units). An early announcement of the details will be viewed positively by the markets.

Table 7: Competitive Scenario in Europe

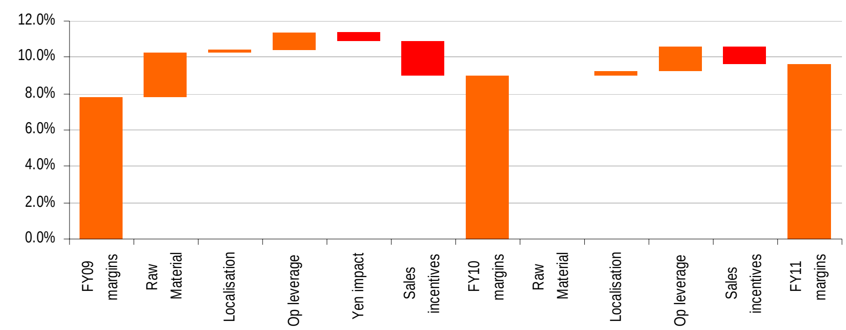
Model	Engine	Fuel efficiency	Price	CO2 Emission (g/km)
Nissan Micra	1.2l	40mpg	8000 Euros	139
Fiat Panda	1.1l	40mpg	6500 Euros	135
Citroen C2	1.1l	38mpg	8000 Euros	138
Suzuki Alto	1l	55mpg	6000 Euros	103
Hyundai i10	1.1l	45mpg	6600 Euros	119
Toyota Aygo	1l	45mpg	6500 Euros	109
Honda Jazz	1.2l	42mpg	8300 Euros	129

Source: Banc of America Securities-Merrill Lynch Research

Margins: Worst is over

We believe that Maruti's EBITDA margin in previous quarter i.e. Q3 FY09, was a trough. We expect 200bps sequential improvement in Q4 FY09E to 7.8% and 180bps cumulative increase over FY09-11E, due to (1) leverage of domestic sales rebound, (2) benefit of lower commodity prices, and (3) ASP hikes on select models, more than offsetting rising incentives.

Chart 10: Margin walk-through



Source: Banc of America Securities-Merrill Lynch Research

Domestic sales rebound to improve leverage

Based on revised sales assumptions, we expect higher domestic sales growth of 15% in FY10E and 12% in FY11E (compared to 5% and 10% respectively earlier). Sales leverage will drive stronger margins compared to earlier forecasts.

Better mix of high end models

We expect Maruti's average sales realization per vehicle to improve, as volumes shift to higher end models such as *Swift/Dzire, A-star* and upcoming *Splash*. Also, mass volume models with high localisation levels i.e. *Alto, Wagon-R* are expected to grow, but relatively low profit making products *SX4, Zen Estilo* will continue to slip. This will raise gross contribution per vehicle sold, as well as margins.

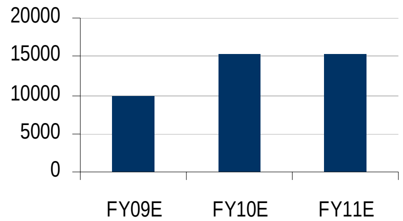
Differential pricing is a sound strategy

Maruti uses differential pricing strategy to maximise profits, without losing sales. For instance, *Swift* (including derivatives such as *Dzire*) has seen higher quantum of hikes this year, but has continued its robust growth given product popularity. This enables Maruti to cross-subsidise other models through discounts and price-led incentives. The recent 1-1.5% hike in *Swift, A-star* and *Sx4* models (~40% of sales) will therefore improve margin profile.

Commodity price decline a positive

Maruti's typically enters into 6 month contracts with material vendors. Although commodity prices corrected sharply from mid-CY08, this was negated by weaker rupee and long tenure contracts. The company since has shifted to shorter duration i.e. 3-month contracts. We therefore expect lower material cost benefit to be reflected through stronger margins from Q4 FY09E.

Chart 11: Rising incentives : (Rs)/vehicle



Source: Banc of America Securities-Merrill Lynch Research

Incentives will hurt contribution

Maruti has raised level and frequency of price-led incentives, as well as direct discounts, which is reflected through lower invoice value. We believe discounts will be regular feature to stay competitive, even for popular models such as *Alto, Wagon-R* (~40% of sales), just as the not so successful *Zen Estilo*. We expect the company to cushion this impact through (1) commodity price benefits, and (2) higher sales of *Swift/Dzire*, which presently do not carry any discounts.

Table 8: Commodity impact (net of incentives)

	FY10E	FY11E
Price (YoY change)		
- Steel	-24%	0.0%
- Aluminium	-18%	0.0%
Margin impact		
- Steel	1.8%	0.0%
- Aluminium	0.6%	0.0%
Commodity impact	2.4%	0.0%
Price incentives	-1.9%	-1.0%
Net impact	0.5%	-1.0%

Source: Banc of America Securities-Merrill Lynch Research

Currency impact to ease next year

Maruti's JPY payments relate to component imports (~8% of RM), and royalty (~55% of outgo, on *Alto/Wagon-R* models), whereas exports are USD denominated. Margins are impacted by cross-currency variations. In FY09, Maruti did not benefit from weaker INR:USD (as 100% hedged), but lost on stronger JPY:USD. In FY10, we expect JPY exposure to impact YoY margins, but net currency impact will be positive due to:

- Reduced hedging of exports, implying partial benefit of weaker INR (this will be reflected through higher gross contribution or lower RM/sales);
- Lower import dependence following localization of transmission components

Sensitivity to JPY

(5% increase to INR)	FY10E	FY11E
EBITDA impact	-3.6%	-1.9%
EPS impact	-4.0%	-2.1%

Source: Banc of America Securities-Merrill Lynch research

Table 9: Impact of JPY movement

	FY10E	FY11E
INR/USD	0.02	0.02
JPY:USD (avg)	95	95
YoY change	5%	0.0%
Impact		
- Imports	-0.4%	0.0%
- Royalty	-0.1%	0.0%
- Loans	0%	0.0%
Total	-0.5%	0.0%

Source: Banc of America Securities-Merrill Lynch research

Localisation will cushion JPY impact

Maruti's annual component imports aggregate ~Rs11bn, mainly towards sourcing of transmission parts. The company has recently commenced manufacture of related components through domestic JV, Suzuki Powertrain India Ltd. (SPIL). We expect this initiative to cut imports by around 20% annually, implying savings of ~Rs500mn per year i.e. 0.25% increase in EBITDA margins.

Table 10: Summary of EBITDA impact

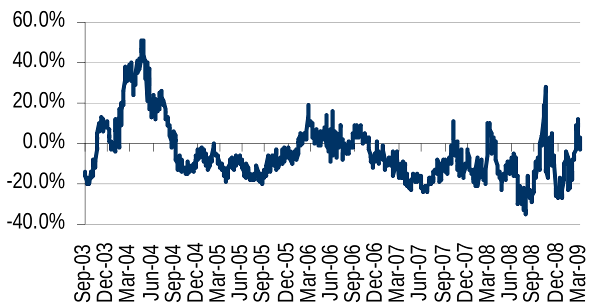
	FY10E		FY11E	
EBITDA (per vehicle)				
Previous year	20264	7.8%	25451	9.0%
Changes due to:				
Commodities				
-Steel	5928	1.9%	0	0.0%
-Aluminium	1969	0.6%	0	0.0%
Leverage	3398	0.9%	4096	1.3%
Localisation of transmission	450	0.2%	628	0.2%
JPY	(1327)	-0.5%	0	0.0%
Price Incentives	(5231)	-1.9%	(2853)	-1.0%
Current year	25451	9.0%	27321	9.6%

Source: Banc of America Securities-Merrill Lynch research

Valuation: Inexpensive on growth

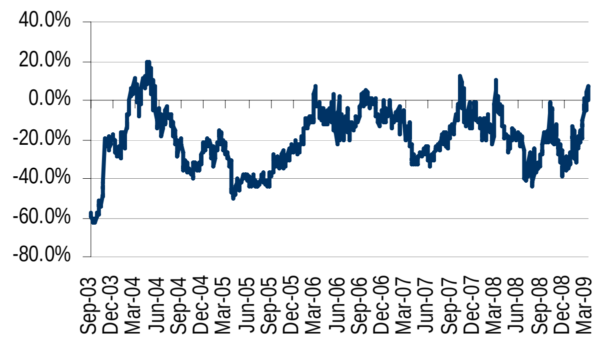
We believe Maruti is attractively valued on traditional valuation parameters, adjusted for strong growth rates. We also justify premium rating of the stock compared to broader market, given the relative growth differential, and low operational and balance sheet risks.

Chart 12: 1-year forward PE: Premium/Discount to Sensex



Source: Bloomberg, Banc of America Securities-Merrill Lynch Research

Chart 13: 1-year forward EV-EBITDA: Premium/Discount to Sensex



Source: Bloomberg, Banc of America Securities-Merrill Lynch Research

Market share gains to continue

Maruti's domestic share in passenger cars has rebounded from August lows of ~52%, taking YTD share close to position last year i.e. 54%. We expect further gains in CY09, thanks to new products and relatively better reach to smaller centres. We believe this will reflect on stock valuations.

Strong earnings visibility, expect consensus upgrades

We expect positive trajectory of sales volumes and higher margins to drive 35.6% EBITDA and 25.6% EPS CAGR over the next 2 years. We are significantly ahead of the street on EPS estimates (~20% in FY10E and 10% in FY11E), and expect consensus upgrades.

Financial strength

Investible stock universe is substantially reduced by balance sheet and operational risks of Indian corporates. However, we estimate Maruti will have cash surplus of Rs45bn FY09E (20% of market capitalization), which is likely to grow. We believe markets will assign a premium multiple for this quality.

Price objective basis & risk

Maruti Suzuki India (MUDGF)

Our PO of Rs900 is based on 7.0x EV/EBITDA FY10E, which is similar to historic average. This is on expectation that forecast growth rates will be similar to historic trends. At our PO, the stock would trade at 13.7x FY10E EPS,in line with historic average. Risks: Economic slowdown, which would adversely affect volume growth, and competitive pricing, which could hurt profitability.

Analyst Certification

I, S.Arun, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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India - Autos Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
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	Maruti Suzuki India	MUDGF	MSIL IN	S.Arun
NEUTRAL				
	Bajaj Auto	XBJBF	BJAUT IN	S.Arun
	Bajaj Hldgs & Inv-G	BJAUF	BAUD LI	S.Arun
	Bajaj Holdings and Investment	BJJAF	BJHI IN	S.Arun
	Eicher Motors	XEICF	EIM IN	S.Arun
	Jet Airways	JTAIF	JETIN IN	S.Arun
UNDERPERFORM				
	Ashok Leyland	XDBVF	AL IN	S.Arun
	Bharat Forge	XUUVF	BHFC IN	S.Arun
	Container Corp	CIDFF	CCRI IN	S.Arun
	Gateway Distriparks	GYDPF	GDPL IN	S.Arun
	M & M	MAHHF	MM IN	S.Arun

India - Autos Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
	M & M -G	MAHMF	MHID LI	S.Arun
	Tata Motors Ltd.	TENJF	TTMT IN	S.Arun
	Tata Motors Ltd.	TTM	TTM US	S.Arun
	TVS Motor	XFKMF	TVSL IN	S.Arun

iQmethod SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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MUDGF Price Chart

B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

"Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of February 28, 2009 or such later date as indicated.

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Neutral	17	19.10%	Neutral	6	46.15%
Sell	42	47.19%	Sell	10	29.41%

Investment Rating Distribution: Global Group (as of 01 Jan 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1297	38.46%	Buy	314	26.81%
Neutral	859	25.47%	Neutral	210	28.23%
Sell	1216	36.06%	Sell	229	20.71%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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