SSKI

INDIA RESEARCH

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Sector strategy

# Automobiles

## *All's well*

**The automobile industry has begun FY07 on a positive note with strong volume growth (19%yoy YTD) across segments; more importantly, the growth momentum appears sustainable going forward. Our estimates factor in the impact of higher interest rates and fuel price hikes. We believe the impact of further rise in interest rates and fuel price hikes will not pose a threat to our demand estimates. Among our top picks, we expect strong volume uptick to be a major growth driver for Maruti Udyog (MUL), Tata Motors and Bajaj Auto while M&M is a conglomerate play with tremendous value being generated in its subsidiaries. Earnings visibility, capability to withstand margin pressure, position of strength in the respective segments and strong growth witnessed in key subsidiaries make MUL, Tata Motors, M&M and Bajaj Auto good buys at the current valuations.**

**Industry witnessing strong growth:** Auto manufacturers have posted impressive 19%yoy volume increase over April-May 2006; we expect 15-18% volume CAGR for key segments (cars, motorcycles and CVs) over FY06-08. Our estimates factor in the impact of higher interest rates and fuel price hikes. We believe the impact of further rise in interest rates and fuel price hikes will not pose a threat to our demand estimates. However, steep increases in input costs going forward could result in frequent price hikes by manufacturers and thereby lead to deferred purchases.

**Earnings momentum remains intact:** We foresee good volume growth for our top picks over FY06-08, which we expect to translate into strong 17% earnings CAGR for them. Earnings of Tata Motors and M&M would be aided by good growth witnessed in key subsidiaries. These players have demonstrated their ability to withstand margin pressure and have managed to actually increase margins in the face of intensifying competition and escalating input costs through product mix changes and cost control.

**Valuations come off the peaks:** Our top picks have corrected 18-20% in the last month, and are attractive at current valuations. While we maintain our Overweight stance on the sector, we have cut price targets of our universe by 6-10% to adjust for the higher borrowing rates and resultant increase in discounting rates. We reiterate Outperformer on MUL, Bajaj Auto, Tata Motors and M&M.

**Key financials**

| Company | Price | Mkt Cap | Reco | FY08E | | Target | Upside |
|---|---|---|---|---|---|---|---|
| | (Rs) | (Rs bn) | | PER (x) | EV/EBITDA (x) | (Rs) | (%) |
| Ashok Leyland | 34 | 41.0 | Neutral | 10.3 | 5.5 | 40 | 21.0 |
| Bajaj Auto | 2627 | 265.8 | Outperformer | 17.2 | 10.0 | 3,255 | 23.9 |
| Hero Honda | 788 | 157.3 | Neutral | 13.4 | 7.9 | 853 | 8.4 |
| M&M (consol) | 599 | 139.7 | Outperformer | 9.9 | 7.0 | 792 | 32.0 |
| Maruti Udyog | 734 | 212.1 | Outperformer | 12.5 | 6.7 | 908 | 23.7 |
| Tata Motors (consol) | 761 | 305.2 | Outperformer | 2.9 | 28.8 | 905 | 18.8 |
| TVS Motors | 94 | 22.3 | Underperformer | 11.9 | 7.4 | 103 | 9.4 |


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# INVESTMENT ARGUMENT

**The automobile industry has grown 19%yoy in the first two months of FY07. Key segments like M&HCVs and passenger vehicles, laggards in FY06, have also posted a strong recovery. With sustained growth momentum, we estimate 18% volume CAGR for key industry segments over FY06-08. The impact of interest rate and fuel price hikes has been offset by price cuts on passenger cars and freight hikes by fleet operators. Though further increases in interest rates (up to 50-150bp) and fuel prices would lead to a small incremental cash outgo for buyers, we do not expect demand to slow down in the near term on this count. Given strong earnings visibility (17% CAGR over FY06-08), we reiterate Outperformer on MUL, Bajaj Auto, Tata Motors and M&M.**

## ❑ Growth momentum intact –19% growth YTD in FY07

*Volumes have grown at an impressive pace across segments*

Volume momentum remains strong across key product segments of the auto industry. Passenger car sales, aided by excise duty cut on small cars, have increased by 24%yoy during April-May 2006 (to 194,710 units) while overall passenger vehicle volumes are up by 21%. Total M&HCV volumes have grown by a whopping 58% over these two months, albeit on a lower base of the previous year when volumes were impacted by supply chain constraints. Total LCV volumes have grown by 41% during the same period, led primarily by Tata Motors' *ACE*.

Overall, CV volumes have grown by 50% over these two months. In the two-wheeler space, motorcycles continue their dream run with sales growing by 22% to 1,165,391 units during April-May 2006. Three-wheelers have grown by 33% over this period to 75,991 units, with both passenger and goods segments registering strong growth. Tractors too have grown by an impressive 37% in the period.

*Industry has witnessed 19% volume growth YTD in FY07*

**Exhibit 1: Volumes rise unabated**

| | FY05 | FY06 | Change (%) | YTD '06 | YTD '07 | Change (%) |
|---|---|---|---|---|---|---|
| **Passenger Vehicles** | | | | | | |
| Passenger Cars | 980,849 | 1,052,287 | 7.3 | 156,415 | 194,710 | 24.5 |
| **Total PVs** | **1,227,974** | **1,318,809** | **7.4** | **195,641** | **237,292** | **21.3** |
| **Commercial Vehicles** | | | | | | |
| M&HCVs | 211,980 | 221,542 | 4.5 | 25,195 | 39,752 | 57.8 |
| LCVs | 136,390 | 169,722 | 24.4 | 20,143 | 28,381 | 40.9 |
| **Total CVs** | **348,370** | **391,264** | **12.3** | **45,338** | **68,133** | **50.3** |
| **Total 3 Ws** | **374,657** | **437,072** | **16.7** | **56,985** | **75,991** | **33.4** |
| **Two wheelers** | | | | | | |
| Motorcycles | 5,241,876 | 6,201,619 | 18.3 | 953,474 | 1,165,391 | 22.2 |
| **Total 2Ws** | **6,576,172** | **7,569,573** | **15.1** | **1,179,946** | **1,375,647** | **16.6** |
| **Total** | **8,527,173** | **9,716,718** | **14.0** | **1,477,910** | **1,757,063** | **18.9** |

*Source: SIAM*

## ❑ MUL, Tata Motors and Bajaj Auto lead the pack

*MUL – the biggest beneficiary of the excise duty cut on small cars*

After a weak FY06, MUL has witnessed a sharp bounce back in sales volumes (up 26% YTD to 101,401 units) in FY07. With ~80% of its volumes accounted for by small cars, MUL has been the biggest beneficiary of the excise duty cut on small cars. MUL's exports, led by *M-800*, grew by 13% during April-May 2006 to 3,945 units as against a 29% decline in FY06 to 34,781 units.

*For Tata Motors, growth has been strong in both CV and PV segments over April-May 2006*

Tata Motors has registered strong growth in both CV and PV businesses over April-May 2006. In the CV segment, growth has been quite robust in the MHCV and LCV segments, though growth in the MHCV segment has to be viewed in context of a lower base of the previous fiscal. The company's LCV sales have received a boost from strong demand for its mini truck *ACE*. To cater to the increasing demand, Tata Motors is doubling its *ACE* manufacturing capacity from 30,000 units to 60,000 units in FY07. Growth in PV segment has been aided by incremental volumes from *Indica Zeta* – the aggressively priced petrol version of *Indica*.

*Motorcycle volumes of Bajaj Auto have jumped by 32% over April-May 2006*

Bajaj Auto has maintained its stellar performance of the previous fiscal, with motorcycle sales increasing by a whopping 32% (to 384,638 units) over April-May 2006 as against the industry growth rate of 22% during the period. The company's performance appears more spectacular when viewed in the light of the high base of the previous fiscal, when volumes for the corresponding period had grown by 64% yoy (291,833 units). Bajaj Auto's sales have been boosted by an overwhelming response to its recently launched *Bajaj Platina* (100cc), which averaged sales of 25,000 units over April-May 2006. The company's three-wheeler sales too have surged strongly, up 36% during April-May 2006 to 45,188 units.

*M&M's tractor volumes up 27% over April-May 2006*

M&M's tractor sales have remained strong over April-May 2006 – tractor volumes have grown by 27% during this period to 16,956 units. UV sales, however, have remained weak and registered a rise of only 4.5% over this period to 18,134 units.

**Exhibit 2: MUL, Bajaj Auto, Tata Motors and M&M – on the fast track**

| | Apr-06 | May-06 | YTD'07 | YTD'06 | % growth |
|---|---|---|---|---|---|
| **Maruti Udyog** | | | | | |
| **Total volumes** | **43,127** | **53,396** | **96,523** | **80,476** | **19.9** |
| **Tata Motors** | | | | | |
| MHCVs | 12,184 | 13,461 | 25,645 | 13,254 | 93.5 |
| LCVs | 9,196 | 11,049 | 20,245 | 12,292 | 64.7 |
| Total CVs | 21,380 | 24,510 | 45,890 | 25,546 | 79.6 |
| PVs | 14,702 | 19,847 | 34,549 | 28,932 | 19.4 |
| **Total volumes** | **36,082** | **44,357** | **80,439** | **54,478** | **47.7** |
| **Bajaj Auto** | | | | | |
| Motorcycles | 188,518 | 196,120 | 384,638 | 291,833 | 31.8 |
| 3 Ws | 21,159 | 24,029 | 45,188 | 33,345 | 35.5 |
| **Total volumes** | **211,148** | **222,074** | **433,222** | **343,690** | **26.1** |
| **M&M** | | | | | |
| UVs | 8,701 | 9,433 | 18,134 | 17,349 | 4.5 |
| Tractors | 8,998 | 7,958 | 16,956 | 13,321 | 27.3 |
| **Total volumes** | **20,231** | **20,075** | **40,306** | **34,548** | **16.7** |

*Source: Company*

*We believe rising interest rates have not significantly increased EMI burden on customers*

## ❑ Rising interest rates unlikely to dampen demand in the near term

Interest rates on auto loans have been increasing over the last six months and may inch up further in case of another hike in the benchmark lending rates. We have analyzed the impact of the recent interest rate hikes on cash outgo for customers. We have also considered three different scenarios of rate hikes in future and the impact of the same on monthly EMIs.

**Exhibit 3: Sensitivity of interest rate hikes – passenger cars**

| | 6mths back | Current | Case1 | Case2 | Case3 |
|---|---|---|---|---|---|
| **Total loan amount - Rs311,000** | | | | | |
| **Tenure - 3 years** | | | | | |
| Rate of interest - reducing balance (%) | 12.4 | 13.2 | 13.7 | 14.2 | 14.7 |
| EMI (Rs) | 10,389 | 10,506 | 10,581 | 10,657 | 10,732 |
| Increase in EMI/ month (Rs)* | | 117 | 192 | 267 | 343 |
| % change | | 1.1 | 1.8 | 2.6 | 3.3 |
| **Tenure - 5 years** | | | | | |
| Rate of interest - reducing balance (%) | 12.0 | 12.5 | 13.0 | 13.5 | 14.0 |
| EMI (Rs) | 6,918 | 7,000 | 7,079 | 7,159 | 7,240 |
| Increase in EMI/month (Rs)* | | 82 | 161 | 241 | 322 |
| % change | | 1.2 | 2.3 | 3.5 | 4.6 |

*Source: SSKI Research*    ** - from base of 6mths back*

*We do not expect further interest rate hikes to have any material impact on demand for passenger cars*

EMIs on passenger car loans have registered a moderate rise of 1.0-1.2% over the last six months. However, the impact of incremental cash outgo has been negated by price cuts (Rs15,000~25,000) announced by manufacturers post the reduction in excise duty on small cars. In fact, over Mar-May 2006 (the period after the excise duty cut), the industry has witnessed an accelerated growth of 22%yoy in volumes.

We believe further interest rate hikes (50-150bp over the next 18-24 months) would lead to only a small incremental cash outgo and as such might not result in a demand slowdown for the industry in the near term.

**Exhibit 4: Sensitivity of interest rate hikes – commercial vehicles**

| | 6mths ago | Current | Case1 | Case2 | Case3 |
|---|---|---|---|---|---|
| **Total loan amount - Rs800,000** | | | | | |
| **Tenure - 4 years** | | | | | |
| Rate of Interest - reducing balance (%) | 7.25 | 10.0 | 10.5 | 11.0 | 11.5 |
| EMI (Rs)* | 19,250 | 20,290 | 20,483 | 20,676 | 20,871 |
| Increase in EMI/month (Rs) | | 1,040 | 1,233 | 1,426 | 1,621 |
| *% change* | | *5.4* | *6.4* | *7.4* | *8.4* |

*Source: SSKI Research*    ** - from base of 6mths back*

*Truck operators would likely pass on the impact of interest rate hikes in the form of freight rate hikes*

Commercial vehicle financing remains highly competitive and EMIs have increased by only ~5% over the last six months. To adjust for the costlier finance as also the tonnage loss due to a ban on overloading, freight rates have moved up by ~30% in the last one year. As a result, there has been no negative impact on operator profitability due to increase in interest rates. With demand outlook remaining buoyant, we believe fleet operators would compensate for any further increase in EMIs by increasing freight rates – therefore, we do not see any slowdown in CV offtake in the near term.

In case of two-wheelers, the increase in EMIs has been negligible and has had no adverse impact on the demand.

*Our calculations suggest that the impact of increase in fuel prices is very marginal to affect demand*

**Exhibit 5: Sensitivity of interest rate hikes - motorcycles**

| | 6 mths back | Current | Case1 | Case2 | Case3 |
|---|---|---|---|---|---|
| **Total Loan amount - Rs35,800** | | | | | |
| **Tenure - 2 years** | | | | | |
| Rate of Interest - reducing balance (%) | 16.8 | 19.2 | 19.7 | 20.2 | 20.7 |
| EMI (Rs)* | 1,767 | 1,808 | 1,817 | 1,825 | 1,834 |
| Increase in EMI/month (Rs) | | 41 | 50 | 59 | 68 |
| *% change* | | *2.3* | *2.8* | *3.3* | *3.8* |
| **Tenure - 3 years** | | | | | |
| Rate of Interest - reducing balance (%) | 16.7 | 19.1 | 19.6 | 20.1 | 20.6 |
| EMI (Rs)* | 1,271 | 1,314 | 1,323 | 1,332 | 1,341 |
| Increase in EMI/month (Rs) | | 43 | 52 | 61 | 70 |
| *% change* | | *3.4* | *4.1* | *4.8* | *5.5* |

*Source: SSKI Research * - from base of 6mths back*

Our sensitivity analysis to interest rate hikes across auto segments leads us to believe that the impact of incremental rate hikes will be minimal, and as such is unlikely to dampen demand for the auto industry.

## ❑ Fuel price hikes impact – nominal increase in cash outgo

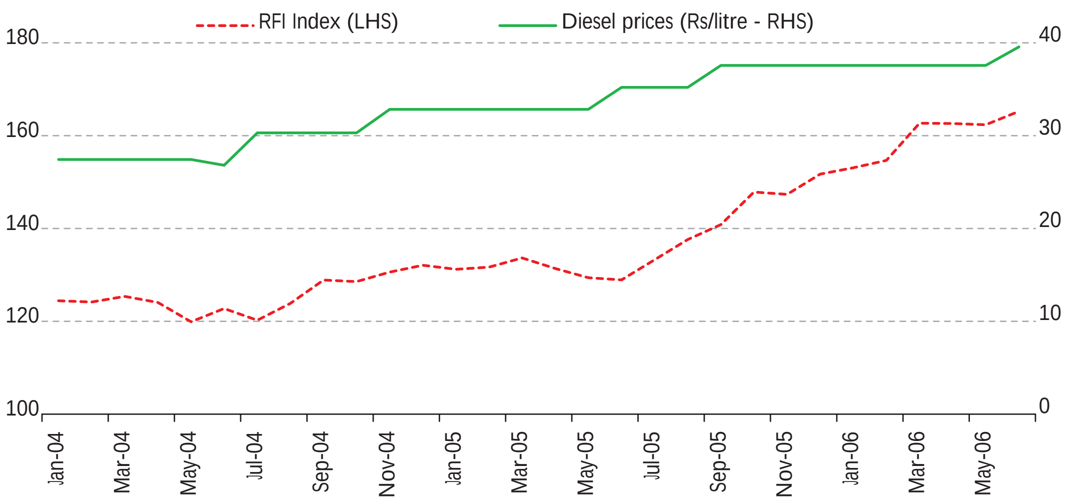
Another concern that looms large over the auto industry is the impact of increase in petrol and diesel prices. Our analysis leads us to believe that the recent fuel hike will lead to only a very small increase in cash outgo for an average motorcycle and car user. However, in case of commercial vehicles, the increase could be substantial at ~3% of revenues. Nevertheless, we believe that truck operators – like in the past – would pass on the fuel price hike to customers. Therefore, we do not expect the fuel price increase to adversely impact fleet operators' profitability. To that extent, we do not expect any adverse impact on demand for CVs.

**Exhibit 6: Impact of fuel price hikes on an average user**

| | Motorcycles | Passenger cars | CVs |
|---|---|---|---|
| Fuel type | Petrol | Petrol | Diesel |
| Rate - earlier - Mumbai (Rs/litre) | 49.16 | 49.16 | 37.57 |
| Rate - currently - Mumbai (Rs/litre) | 53.15 | 53.15 | 39.96 |
| Average Usage - Km/month | 1200 | 1050 | 9000 |
| Fuel efficiency - Km/litre | 55 | 11 | 4.8 |
| Fuel cost - earlier (Rs/month) | 1,073 | 4,693 | 70,444 |
| Fuel cost - now (Rs/month) | 1,160 | 5,073 | 74,925 |
| Incremental fuel cost (Rs/month) | 70 | 305 | 3,731 |
| *% increase in fuel cost* | *6.5* | *6.5* | *5.3* |

*Source: SSKI Research*

**Exhibit 7: Rising freight rates – compensate for tonnage losses, interest rates & fuel price hikes**




*Source: TCI Road Freight Index, SSKI Research*

## ❑ Industry momentum expected to remain strong

*Key segments likely to witness11-16% volume CAGR over FY06-08*

We expect strong volume growth across key auto segments in the coming period. We expect growth in passenger car segment to rebound sharply on the back of the excise duty cut on small cars and new product launches by leading players (especially in the diesel segment). Demand for motorcycles is expected to remain strong owing to increasing affordability and convenience. Positive macro economic factors and the robust pace of industrial activity would likely lead to strong volume growth for the commercial vehicles segment. Freight rates have increased by 30% over the last 12 months to compensate for the lost tonnage due to ban on overloading, increase in interest rates and higher diesel prices. As a result, operators' profitability remains good.

**Exhibit 8: Growth estimates for key segments**

| Segment ('000s) | FY05 | FY06 | FY07E | FY08E | CAGR '06- '08E |
|---|---|---|---|---|---|
| Passenger Cars | 980 | 1,051 | 1,214 | 1,397 | 15.3 |
| Motorcycles | 5,222 | 6,213 | 7,545 | 8,700 | 18.3 |
| MHCVs | 211 | 220 | 244 | 271 | 11.0 |
| LCVs | 135 | 169 | 199 | 230 | 16.6 |

*Source: SIAM, SSKI Research*

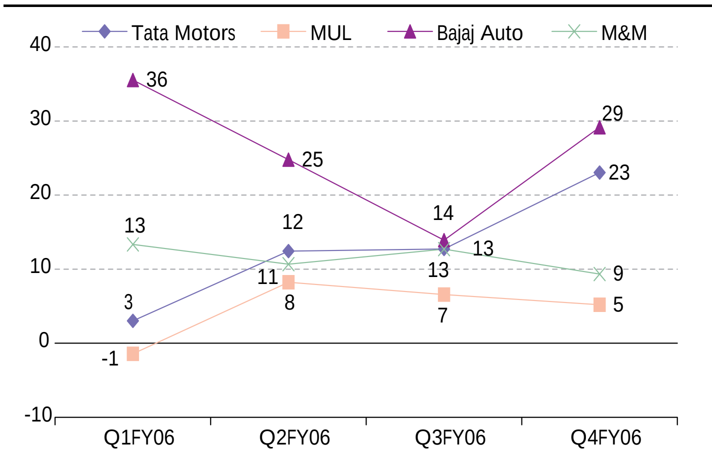
## ❑ Proven capability to withstand margin pressure

*In FY06, auto companies managed their margins through product mix changes and cost control measures*

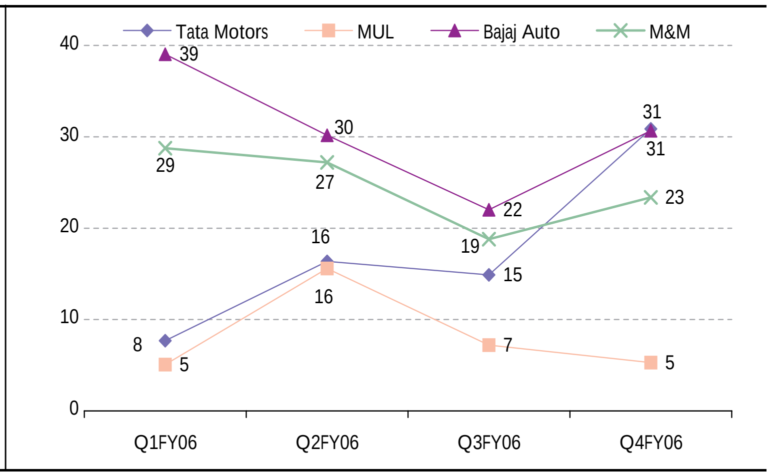
Auto companies, in FY06, faced significant pressure from surging metal prices, lower volume growth in key segments (passenger vehicles and CVs) and increased competition leading to pricing pressure for manufacturers. Companies had to resort to increased discounting to tackle intensifying competition while simultaneously grappling with increasing prices of key raw materials such as steel and aluminium. In such a scenario, most auto companies have done well to maintain, or even improve, their margins in FY06 on the back of product mix changes and aggressive cost reduction strategies adopted by them.

In case of Bajaj Auto, margins were aided by higher proportion of sales of executive and premium segment motorcycles in total revenues and increasing sales of three-wheelers. MUL's margins were supported by higher share of compact cars in its sales mix. Strong tractor sales and robust sales growth for *Scorpio* helped M&M maintain its margins. Tata Motors is pursuing aggressive cost reduction strategies and seeks to save Rs10bn in its cost base by FY08 (the company achieved cost reduction of Rs4.7bn in FY06). Similarly, MUL improved its productivity by 46% under its 'Challenge 50' program during the 3-year period ended FY05. In FY06, the company embarked upon a new productivity improvement program – 'The Next Leap' (also encompassing vendors).

**Exhibit 9: Volume growth trend in FY06**



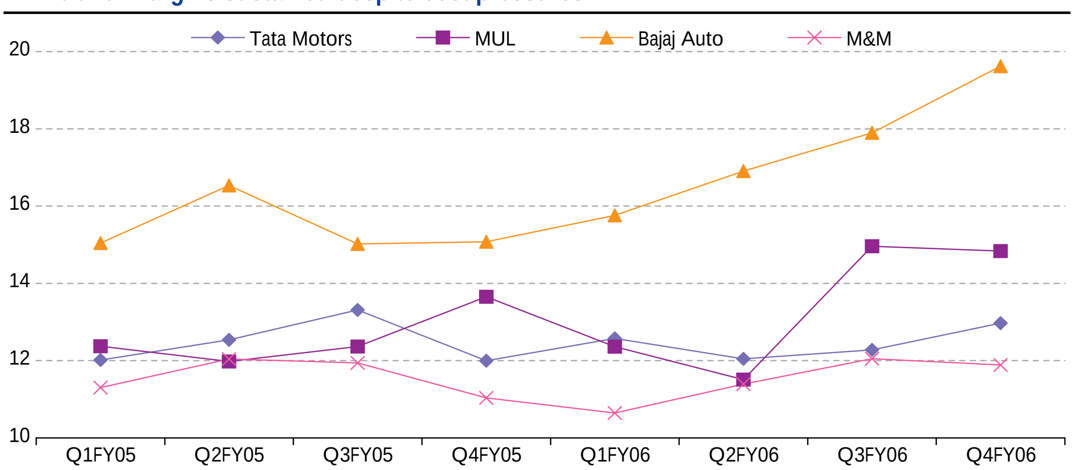

**Raw material costs growth trend**




*Source: Company*

Companies are now focusing on diversifying their raw material sourcing, rationalizing the vendor base for component sourcing, reducing wastage through value engineering and controlling development costs by using computer aided designing and testing techniques.

**Exhibit 10: Margins sustained despite cost pressures**

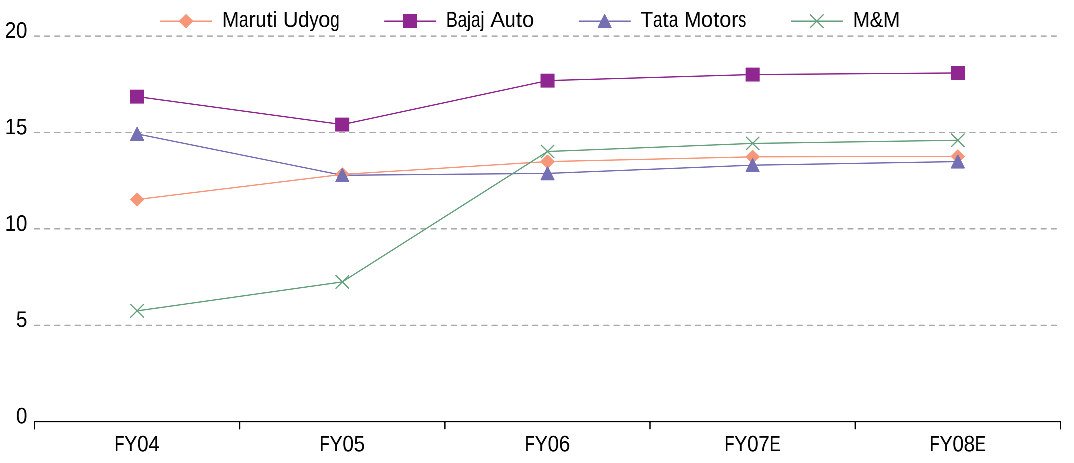



*Source: Company*

***We expect strong volume growth witnessed by auto companies to lead to further expansion in margins***

We expect our top picks to sustain their margins going forward, aided by cost reduction efforts and strong volume growth. For Tata Motors, margin expansion will also be aided by strong volume growth in the MHCV segment (~52% of revenues) and for Bajaj Auto by higher volumes in the three-wheeler segment (~30% of revenues).

**Exhibit 11: Operating margins to sustain going forward**



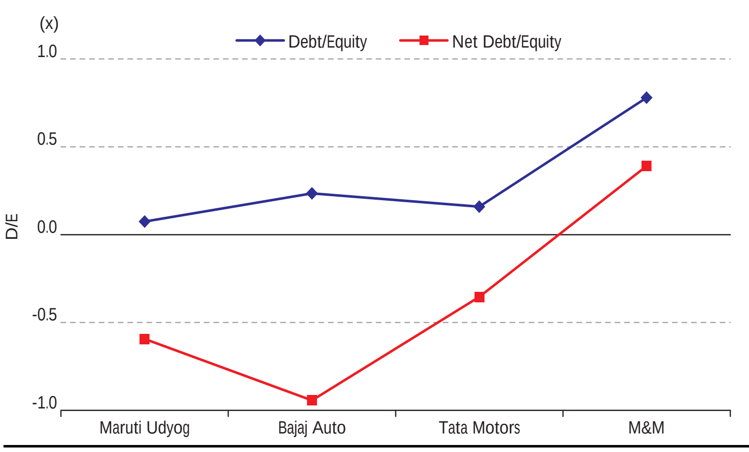

*Source: Company, SSKI Research*

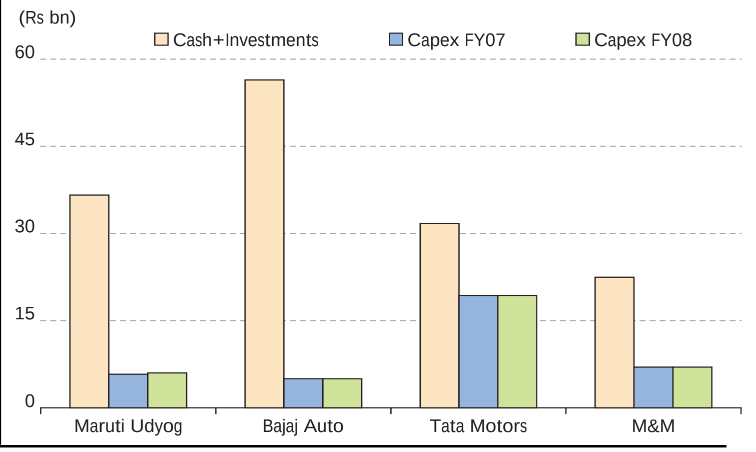
## ❑ Auto companies relatively more immune to borrowing rate hikes

***Low debt, ample cash on books and positive free cash flows – to cushion impact of higher interest rates***

MUL, Bajaj Auto and Tata Motors are relatively more immune to the hike in corporate lending rates by banks due to their low gearing (0.1-0.2x gross debt/equity), ample cash on books to meet future capex requirement and positive free cash flows generated by these companies. However, interest rate hikes could have a moderate impact on M&M's consolidated earnings due to higher gearing. Nevertheless, companies have been increasingly using the FCCB route, mostly zero coupon, to finance their fund requirement. This would minimize the impact of hikes in borrowing rates on their profitability in the near term.

**Exhibit 12: Low interest burden, ample cash – immunity from interest rate hikes**




*Source: Company, SSKI Research*

Tata Motors and M&M have used the FCCB route to finance their capex requirement. Most of these bonds are zero coupon with 3-5 years due for redemption. As a result, the recent fund raisings by companies have not led to increased interest burden for these companies. Also, with the call options on most of these bonds vesting with the companies, we do not expect redemption pressure for these companies in the foreseeable future.

**Exhibit 13: Increasing use of FCCBs to fund capex plans**

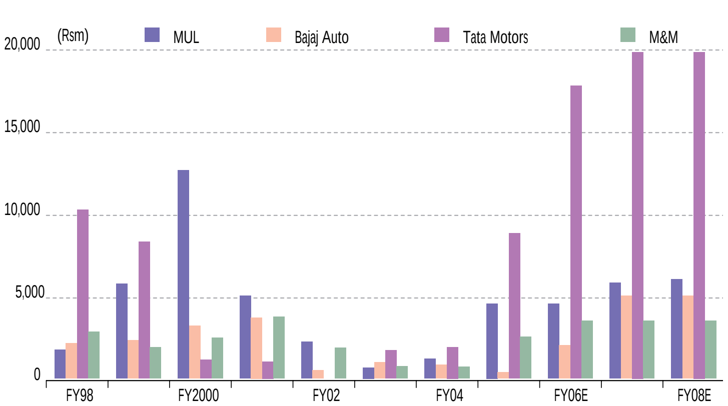
| | Issue size ($m) | Conv price (Rs) | Coupon (%) | Due date | Incremental Dilution (%) | FY08E Diluted EPS (consol) | Conversion status |
|---|---|---|---|---|---|---|---|
| **Tata Motors** | | | | | | **61.8** | |
| April - 04 issue T1 | 100 | 573 | 0.0 | Apr-09 | 2.0 | | Factored |
| April - 04 issue T2 | 300 | 780 | 1.0 | Apr-11 | 4.4% | | Factored |
| JPY Issue - Feb-06 | 100 | 1,001 | 0.0 | Feb-11 | 1.1 | | Not factored |
| **Total** | **500** | | | | | | |
| **M&M** | | | | | | **60.3** | |
| May-04 issue | 100 | 637 | 0.0 | Apr-09 | 3.0 | | Factored |
| April-06 issue | 200 | 922 | 0.0 | Apr-11 | 4.0 | | Not factored |
| **Total** | **300** | | | | | | |

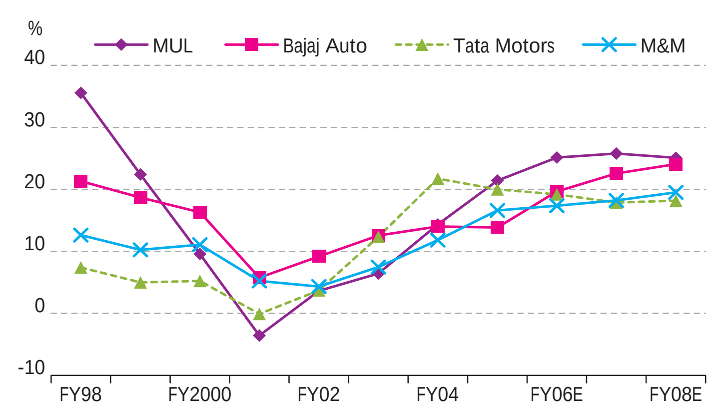
*Source: Company, SSKI Research*

## ❑ Companies in capex mode – expect no adverse impact on valuations

Auto companies have embarked upon aggressive capex programs to enhance their capacities in line with the increasing demand. However, we do not expect the capex plans to have a major impact on their return ratios, and hence valuations. We expect RoCE of our top picks to hover in the 18-24% range. We expect strong earnings growth for our top picks going forward – 17% CAGR over FY06-08E – led by strong volume growth and margin expansion.

**Exhibit 14: Companies in aggressive capex mode** **not to significantly impact return ratios**



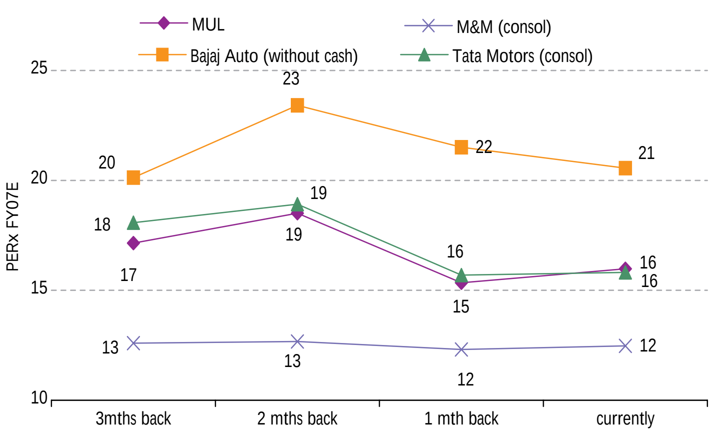

*Source: Company, SSKI Research*

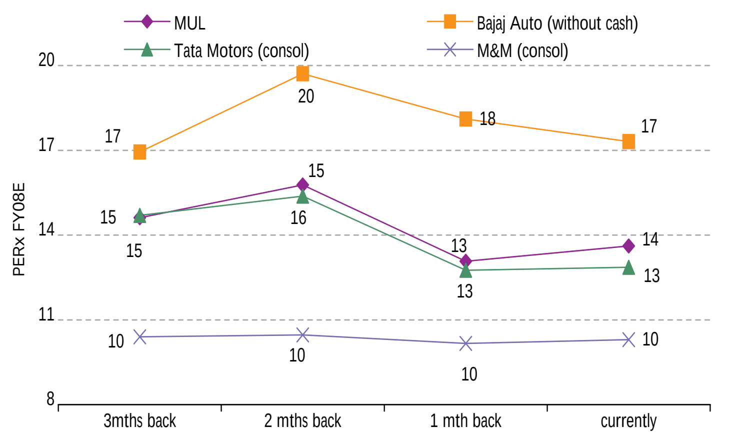
## ❑ High earnings visibility; valuations attractive

***MUL, Bajaj Auto, Tata Motors and M&M look attractive at current valuations***

We expect the strong volume growth outlook and good performance of key subsidiaries (Tata Motors and M&M) to result in revenue CAGR of 21% for our auto universe over FY06-08. In view of the stable margins, we expect earnings of our top picks to witness a 17% CAGR over this period. Stock prices of leading auto companies have come off sharply (18-20% on an average) from their highs over the past month. With the earnings momentum remaining intact, valuations appear very attractive at current levels.

**Exhibit 15: Valuations attractive**




*Source: SSKI Research*

***M&M a conglomerate play with huge value generated in subsidiaries; volume uptick to be a key growth driver for MUL, Tata Motors and Bajaj Auto***

While M&M is a conglomerate play with tremendous value being generated in its subsidiaries, we expect the volume uptick to be a major growth driver for MUL, Tata Motors and Bajaj Auto. Our preference for these companies rests on the visibility of their earnings growth, proven capability to withstand margin pressure and leadership in the respective segments. We also give due consideration to the strategic initiatives undertaken by these companies which include Tata Motors' JV with Marcopolo, Hitachi's stake hike in Telcon, MUL's diesel foray and possible benefits arising out of the Nissan-Suzuki agreement to MUL. These strategic initiatives have the potential to become future growth drivers for the respective companies. We believe the recent correction offers an excellent opportunity to invest in these companies. While we maintain our Overweight stance on the sector, we have cut price targets of our universe by 6-10% to adjust for the higher borrowing rates and resultant increase in discounting rates. In view of sustained volume growth and a strong 17% CAGR in earnings estimated over FY06-08, we reiterate Outperformer on MUL, Bajaj Auto, Tata Motors and M&M.

## ❑ Key risks to our estimates

Maruti Udyog is likely to increase prices by Rs10,000 to Rs15,000 in the near future and we expect Tata Motors to follow suit. In view of the ongoing discounts and freebies offered by dealers and financing companies, the net increase for the customer is likely to be only Rs5000 to Rs7000, which we believe would not have an adverse impact on the demand. However, if prices of key commodities (steel and aluminium) were to escalate significantly, manufacturers may increase product prices further to pass on the higher input costs. This, combined with inflationary pressures could lead to deferred purchases.

## MARUTI UDYOG

**OUTPERFORMER**

***Excise duty cut fueling growth***

**Mkt Cap: Rs230.5bn; US$5.0bn**

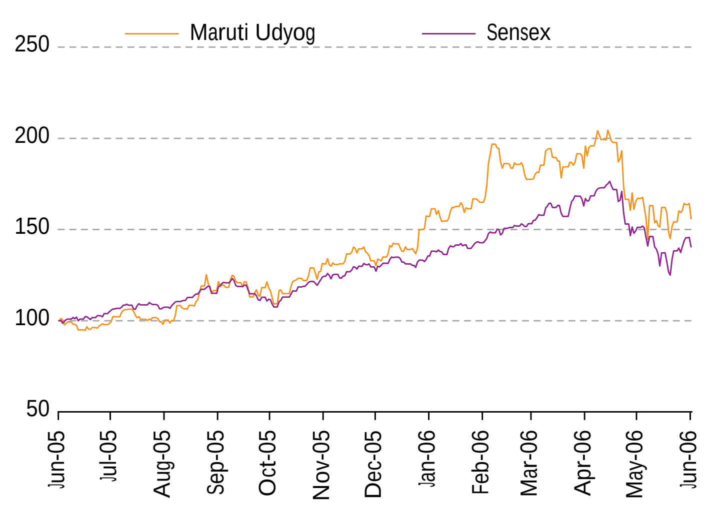
- *Swift* – a major growth driver – records highest sales by a new model in the first year of launch
- Volume CAGR of 15.8% estimated over FY06-08; revenue CAGR of 22%
- Margins on an upswing – better product mix, cost cutting to sustain margins going forward
- Earnings CAGR of 19% over FY06-08E
- Diesel launch expected in Jan-07 – to give the company increased presence in the industry
- Buyback of 30% stake in MSAIL from Suzuki – high degree of investor friendliness
- Nissan-Suzuki agreement - potential to become future growth driver for the company
- Price target of Rs908 – 14% upside from CMP. Maintain Outperformer

**Exhibit 16: Key financials**

| As on 31 March (Rs m) | FY05 | FY06 | FY07E | FY08E |
|---|---|---|---|---|
| Net sales | 109,624 | 120,582 | 149,610 | 179,434 |
| *% growth* | *20.3* | *10.0* | *24.1* | *19.9* |
| EBITDA | 14,063 | 16,266 | 20,555 | 24,690 |
| *% margin* | *12.8* | *13.5* | *13.7* | *13.8* |
| Shares in issue (m) | 289 | 289 | 289 | 289 |
| Adj. EPS (Rs) | 29.7 | 41.1 | 49.9 | 58.6 |
| *% growth* | *29.7* | *38.5* | *21.3* | *17.3* |
| PER (x) | 26.9 | 19.4 | 16.0 | 13.6 |
| Price/Book (x) | 5.3 | 4.2 | 3.4 | 2.7 |
| EV/EBITDA (x) | 15.0 | 12.4 | 9.5 | 7.4 |
| ROE (%) | 21.6 | 24.1 | 23.4 | 22.3 |
| ROCE (%) | 21.4 | 25.1 | 25.8 | 25.1 |
| EV/CE (x) | 3.9 | 3.0 | 2.3 | 1.8 |

*Source: Company, SSKI Research*

**Relative price performance**



## BAJAJ AUTO — OUTPERFORMER

***Strong volumes & better product mix*** **Mkt Cap: R276.9bn; US$6.1bn**

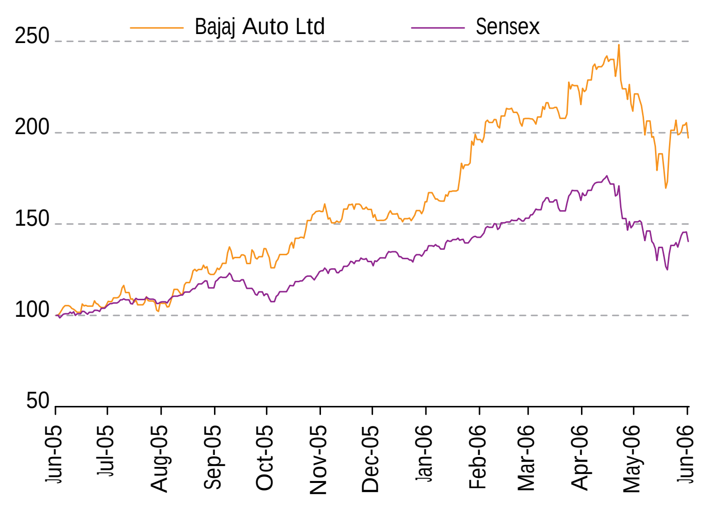
- Proven product development capability
- Gaining market share in motorcycles
- Strong export focus – highest exporter of two and three-wheelers in the country
- CAGR of 24% in motorcycle sales over FY06-08E, market share expected to increase
- Total volume CAGR of 22% over FY06-08E
- Revenue CAGR of 22% over FY06-08E, earnings CAGR of 17% over FY06-08E
- Fast growing Insurance subsidiaries – highly value accretive
- SOTP based price target of Rs3,225, upside of 19% from CMP. Maintain Outperformer

### Exhibit 17: Key financials

| As on 31 March (Rs m) | FY05 | FY06 | FY07E | FY08E |
|---|---|---|---|---|
| Net sales | 59,271 | 76,679 | 96,229 | 114,941 |
| *% growth* | *-34.9* | *29.4* | *25.5* | *19.4* |
| EBITDA | 9,134 | 13,563 | 17,323 | 20,788 |
| *% margin* | *15.4* | *17.7* | *18.0* | *18.1* |
| Shares in issue (m) | 101 | 101 | 101 | 101 |
| Adj. EPS (Rs) | 77.1 | 111.1 | 133.1 | 153.1 |
| *% growth* | *236.6* | *44.1* | *19.8* | *15.0* |
| PER (x) | 35.5 | 24.6 | 20.6 | 17.9 |
| Price/Book (x) | 6.7 | 5.8 | 5.0 | 4.3 |
| EV/EBITDA (x) | 27.0 | 17.5 | 13.2 | 10.6 |
| ROE (%) | 19.9 | 25.2 | 26.0 | 25.7 |
| ROCE (%) | 13.9 | 19.7 | 22.6 | 24.1 |
| EV/CE (x) | 4.2 | 3.6 | 3.1 | 2.6 |

*Source: Company, SSKI Research*

### Relative price performance




### Exhibit 18: Sum-of-parts valuation

| | Bajaj's Shareholding (%) | Basis of Valuation | Driver Value (Rs m) | PE (x) multiple | Market Cap (Rs m) | Value of Invt (Rs m) | Value (Rs/share) |
|---|---|---|---|---|---|---|---|
| Standalone business | NA | PERx FY08E | 12,407 | 16 | 198,510 | 198,510 | 1,962 |
| Life insurance business | 76% | PERx FY08E NBAP | | | | | 601 |
| First Year premium | | | 4,368 | 18 | 78,624 | 59,754 | 472 |
| Single premiums+Renewals | | | 2,136 | 10 | 21,356 | 16,231 | 128 |
| Non-life insurance | 76% | PERx FY08E | 774 | 12 | 9,288 | 7,059 | 56 |
| Value of Investments | NA | Mkt Value | 68,165 | 0.9 | 61,349 | 61,349 | 606 |
| Bajaj Auto Finance | 46% | CMP | 394 | NA | 6,497 | 2,998 | 24 |
| Mah scooters | 24% | CMP | 312 | NA | 3,566 | 856 | 7 |
| **SOTP Valuation*** | | | | | | | **3,255** |

** -assuming 20% holding company discount*

## TATA MOTORS

**OUTPERFORMER**

***Aided by volume recovery***

**Mkt Cap: Rs318.4bn; US$6.9bn**

- Expect 10% volume CAGR in MHCVs over FY06-08E, 14% total volume CAGR.
- New Indica *Xeta* – petrol version well received in the market
- 'One lakh' car project – on track – expected launch by early 2008.
- Key subsidiaries – Telcon, TDCV, TTL, TAL – witnessing high growth. Hitachi's stake hike in Telcon to 60% – a big positive for the company
- JV with Marcopolo – entry into rapid passenger transport systems to lead to market share expansion
- CAGR of 22% estimated in consolidated revenues and 17% in consolidated earnings over FY06-08
- SOTP based price target of Rs905 - 14% upside from CMP. Maintain Outperformer

**Exhibit 19: Key financials**

| As on 31 March (Rs m) | FY05 | FY06 | FY07E | FY08E |
|---|---|---|---|---|
| Net sales | 195,328 | 237,182 | 281,656 | 351,985 |
| *% growth* | *40.3* | *21.4* | *18.8* | *25.0* |
| EBITDA | 24,966 | 30,539 | 37,460 | 47,472 |
| *% margin* | *12.8* | *12.9* | *13.3* | *13.5* |
| Shares in issue (m) | 362 | 383 | 401 | 401 |
| Adj. EPS (Rs) | 38.7 | 45.4 | 50.2 | 61.8 |
| *% growth* | *48.4* | *17.2* | *10.6* | *23.0* |
| PER (x) | 20.5 | 17.5 | 15.8 | 12.9 |
| Price/Book (x) | 6.5 | 4.9 | 3.6 | 3.0 |
| EV/EBITDA (x) | 11.8 | 10.7 | 8.8 | 7.0 |
| ROE (%) | 34.6 | 32.5 | 26.6 | 25.3 |
| ROCE (%) | 27.7 | 26.1 | 25.8 | 28.8 |
| EV/CE (x) | 3.6 | 3.0 | 2.6 | 2.3 |

*Source: Company, SSKI Research*

**Relative price performance**

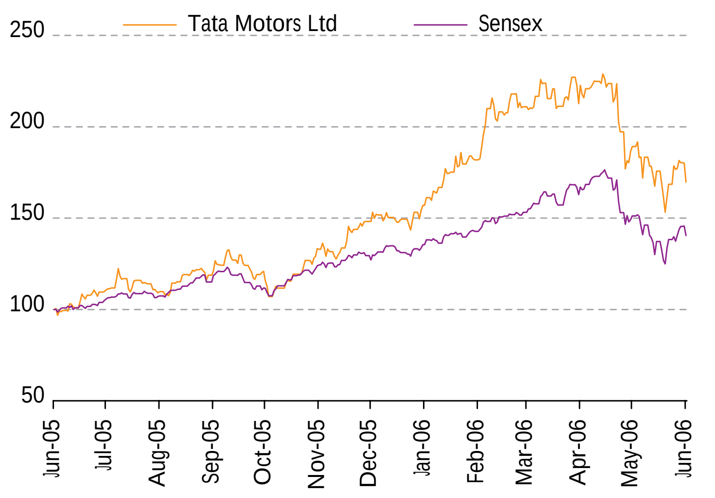



**Exhibit 20: Sum of parts valuation**

| | Tata Motors' Shareholding (%) | Basis of Valuation | Driver Value (Rs m) | PE (x) multiple | Market Cap (Rs m) | Value of Invt (Rs m) | Value (Rs/share) |
|---|---|---|---|---|---|---|---|
| Tata Motors standalone | NA | PER | 19,988 | 15 | 299,825 | 299,825 | 748 |
| Telcon | 60.0% | PER | 2,669 | 15 | 40,037 | 24,022 | 54 |
| TDCV | 100.0% | PER | 1,189 | 13 | 15,452 | 15,452 | 35 |
| Tata Technologies | 94.6% | PER | 545 | 15 | 8,172 | 7,730 | 17 |
| Tata Marcopolo JV | 51.0% | PER | 1,600 | 13 | 20,800 | 10,608 | 24 |
| HV Axles | 100.0% | PER | 596 | 12 | 7,148 | 7,147 | 16 |
| HV Transmissions | 100.0% | PER | 397 | 12 | 4,764 | 4,764 | 11 |
| **SOTP Valuation*** | | | | | | | **905** |

**- 10% holding company discount*

## MAHINDRA & MAHINDRA — OUTPERFORMER

### *Increasing value from subsidiaries* — Mkt Cap: Rs144.9bn; US$3.2bn

- Key subsidiaries – Tech Mahindra, Mahindra Gesco, Mahindra Finance and Mahindra Holidays & Resorts on a high growth trajectory
- Contribution of subsidiaries to consolidated profits on the rise – 38% in FY06 from 25% in FY05
- Public listing of Tech Mahindra and Mahindra Holidays to unlock value
- Entry into passenger cars and HCVs through JVs – widening product portfolio
- 19% CAGR in consolidated revenues and 17% CAGR in consolidated earnings over FY06-08 (EPS of Rs60.3 by FY08)
- SOTP based price target Rs792, upside of 27% from CMP. Reiterate Outperformer

**Exhibit 21: Key financials**

| As on 31 March (Rs m) | FY05 | FY06 | FY07E | FY08E |
|---|---|---|---|---|
| Net sales | 88,527 | 123,354 | 147,755 | 175,835 |
| *% growth* | *35.5* | *39.3* | *19.8* | *19.0* |
| EBITDA | 6,419 | 17,288 | 21,322 | 25,668 |
| *% margin* | *7.3* | *14.0* | *14.4* | *14.6* |
| Shares in issue (m) | 232 | 233 | 246 | 246 |
| Adj. EPS (Rs) | 28.8 | 44.4 | 49.8 | 60.3 |
| *% growth* | *78.9* | *53.8* | *12.2* | *21.1* |
| PER (x) | 21.5 | 14.0 | 12.5 | 10.3 |
| Price/Book (x) | 5.3 | 3.3 | 2.8 | 2.3 |
| EV/EBITDA (x) | 26.4 | 9.7 | 8.6 | 7.2 |
| ROE (%) | 26.9 | 28.9 | 24.7 | 24.3 |
| ROCE (%) | 11.1 | 22.5 | 23.0 | 20.4 |
| EV/CE (x) | 2.4 | 1.9 | 1.8 | 1.6 |

*Source: Company, SSKI Research*

**Relative price performance**

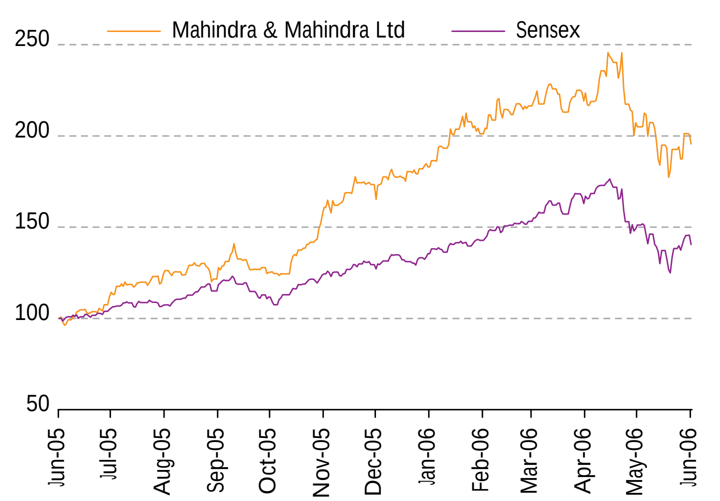



**Exhibit 22: Sum-of-parts valuation**

| | M&M's Shareholding (%) | Basis of Valuation | Driver Value (Rs m) | PE (x) multiple | Market Cap (Rs m) | Value of Invt (Rs m) | Value (Rs/share) |
|---|---|---|---|---|---|---|---|
| M&M standalone | NA | PER FY08E | 9,265 | 13 | 120,441 | 120,441 | 516 |
| Tech Mahindra | 56.6 | PER FY08E | 4,365 | 15 | 65,477 | 37,073 | 143 |
| MMFSL | 67.7 | CMP | 192 | NA | 16,512 | 11,181 | 43 |
| Mahindra Gesco | 55.0 | CMP | 590 | NA | 18,307 | 10,069 | 39 |
| MUSCO | 53.2 | CMP | 132 | NA | 4,288 | 2,283 | 9 |
| MASPL (Amforge - Chakan unit) | 47.1 | PER FY08E | 459 | 12 | 12,865 | 6,061 | 23 |
| Mahindra Holidays and Resorts India Ltd | 100.0 | PER FY08E | 414 | 12 | 4,970 | 4,970 | 19 |
| **SOTP Valuation*** | | | | | | | **792** |

**-10% holding company discount*

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

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