Company In-Depth

27 March 2007 | 11 pages

TVS Motor (TVSM.BO)

Sell: Running Hard to Stay in the Same Spot

Rating change ☐
Target price change ☑
Estimate change ☑

- Cut target price — We cut our target price for TVS Motor by 24%, to Rs65, as we lower EPS by 24-31% for FY07E-09E. Our target price is just above the current stock price, implying limited downside from here; but we see few catalysts for the stock over the next few months.

- EBITDA margins to remain constrained — We have cut our EBITDA margin assumptions to 5.0-5.3% for FY08E-09E (from around 6%), to reflect a) escalating competitive pressures that will manifest themselves through higher advertisement, S&D expenses and b) stable (rather than declining) input costs.

- New product launches to maintain market share — TVS' product portfolio looks well balanced, except for the lacuna in the executive segment, which TVS expects to plug with the launch of the new *Victor.* But we believe that given the competitive intensity in the sector, TVS' product launches will at best enable it to maintain – *not improve* – its market share.

- Greater visibility on long-awaited initiatives — The entry into the highly profitable domestic 3-wheeler market, as also a foray into the Indonesian market, will have a meaningful impact only from FY09E. Near term, execution risks for these projects persist.

- Key upside risks — a) Sustained EBITDA margin expansion over FY08, b) faster than forecast ramp-up of TVS' 3-wheeler sales, and c) stronger than forecast industry growth, which might result in competitive pressures easing.

Sell/Medium Risk	3M
Price (26 Mar 07)	Rs61.95
Target price	Rs65.00
from Rs85.00	
Expected share price return	4.9%
Expected dividend yield	1.9%
Expected total return	**6.9%**
Market Cap	Rs14,716M
	US$339M

Price Performance (RIC: TVSM.BO, BB: TVSL IN)

See Appendix A-1 for Analyst Certification and important disclosures.

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	1,122	4.72	-19.0	13.1	2.2	17.9	2.1
2006A	1,170	4.93	4.3	12.6	1.9	16.2	2.1
2007E	805	3.39	-31.2	18.3	1.8	10.2	1.9
2008E	1,181	4.97	46.7	12.5	1.6	13.8	2.1
2009E	1,527	6.43	29.3	9.6	1.5	16.0	2.4

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	13.1	12.6	18.3	12.5	9.6
EV/EBITDA adjusted (x)	7.0	7.4	9.0	6.2	4.7
P/BV (x)	2.2	1.9	1.8	1.6	1.5
Dividend yield (%)	2.1	2.1	1.9	2.1	2.4
Per Share Data (Rs)					
EPS adjusted	4.72	4.93	3.39	4.97	6.43
EPS reported	5.79	4.93	3.39	4.97	6.43
BVPS	28.58	32.26	34.28	37.77	42.49
DPS	1.30	1.30	1.20	1.30	1.50
Profit & Loss (RsM)					
Net sales	28,759	32,350	38,545	46,464	53,564
Operating expenses	-27,540	-31,244	-37,793	-45,162	-51,869
EBIT	**1,219**	**1,106**	**751**	**1,302**	**1,695**
Net interest expense	-83	-210	-275	-290	-250
Non-operating/exceptionals	868	789	650	664	692
Pre-tax profit	**2,005**	**1,685**	**1,126**	**1,675**	**2,136**
Tax	-629	-515	-321	-494	-609
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**1,376**	**1,170**	**805**	**1,181**	**1,527**
Adjusted earnings	1,122	1,170	805	1,181	1,527
Adjusted EBITDA	2,116	2,045	1,716	2,364	2,822
Growth Rates (%)					
Sales	2.0	12.5	19.2	20.5	15.3
EBIT adjusted	-32.1	-9.3	-32.1	73.3	30.2
EBITDA adjusted	-18.4	-3.4	-16.1	37.7	19.4
EPS adjusted	-19.0	4.3	-31.2	46.7	29.3
Cash Flow (RsM)					
Operating cash flow	**3,190**	**1,641**	**2,740**	**3,014**	**2,973**
Depreciation/amortization	896	939	965	1,062	1,127
Net working capital	164	-1,262	320	107	-373
Investing cash flow	**-1,994**	**-2,801**	**-1,897**	**-2,300**	**-1,000**
Capital expenditure	-1,520	-1,113	-1,900	-500	-1,000
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**-637**	**665**	**-909**	**-703**	**-2,028**
Borrowings	678	1,982	-302	81	-1,189
Dividends paid	-376	-352	-163	-325	-352
Change in cash	**559**	**-495**	**-66**	**12**	**-55**
Balance Sheet (RsM)					
Total assets	**15,220**	**18,871**	**20,474**	**22,737**	**23,660**
Cash & cash equivalent	739	244	178	189	134
Accounts receivable	346	582	739	1,018	1,174
Net fixed assets	7,705	7,938	8,872	8,310	8,183
Total liabilities	**8,432**	**11,210**	**12,333**	**13,766**	**13,568**
Accounts payable	4,522	5,245	6,458	7,733	8,619
Total Debt	1,868	3,850	3,549	3,630	2,441
Shareholders' funds	**6,788**	**7,661**	**8,141**	**8,970**	**10,092**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	7.4	6.3	4.5	5.1	5.3
ROE adjusted	17.9	16.2	10.2	13.8	16.0
ROIC adjusted	7.7	6.5	4.2	8.1	11.3
Net debt to equity	16.6	47.1	41.4	38.4	22.9
Total debt to capital	21.6	33.4	30.4	28.8	19.5

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Figure 1. TVS Motor — Earnings Revision Table

Year End March 31	Net Profit		Diluted EPS			DPS	
	Old	New	Old	New	% Change	Old	New
2007E	1,159	805	4.88	3.39	-30.5	1.3	1.2
2008E	1,551	1,181	6.53	4.97	-23.9	1.5	1.3
2009E	2,071	1,527	8.72	6.43	-26.3	1.7	1.5

Source: Citigroup Investment Research estimates

Figure 2. TVS Motor — Revision in Key Metrics

	FY07E		FY08E		FY09E		Citigroup Investment Research Comments
	Old	New	Old	New	Old	New	
Total 2 wheeler volumes	1,622,646	1,545,850	1,838,512	1,737,436	2,063,520	1,932,838	Volumes forecast to decline as cost of financing rises, coupled with increased competitive intensity
% growth YoY	20.9	15.2	13.3	12.4	12.2	11.2	
3-Wheelers			35,000	40,000	52,500	56,000	
% growth YoY					50.0	40.0	
EBITDA Margin (%)	5.8	4.5	5.9	5.1	6.2	5.3	Downward revision reflects a) impact of higher promotional spends; b) Stable (rather than declining) input costs; c) Reduced operating leverage benefits

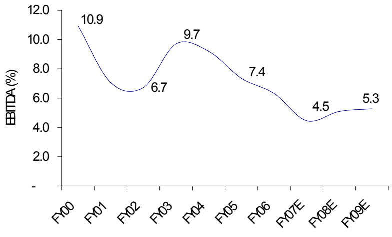
Source: Citigroup Investment Research forecasts

Estimates cut on 2 key factors

1. We expect TVS' 2-wheeler volume growth to taper in FY08E-09E as the rising cost of financing curbs demand growth and industry dynamics remain challenging as the majors, Hero Honda and Bajaj Auto, continue to favor market share gains, at the expense of near-term profitability. The sharp slowdown over 4Q07 (though somewhat exacerbated by a liquidity crunch), is indicative of the trend that going forward demand growth will likely taper if interest rates remain sticky at current levels. Our volume assumptions for TVS reflect this scenario. We also expect TVS' moped sales (nearly 22% of 2-wheeler volumes) growth to mimic that of the moped industry – TVS' FY07 moped volume growth at c18% is exaggerated, and a function of TVS capturing market share from other players, rather than industry growth (which is flat). With TVS now having 85% of the moped market, it will be difficult for TVS to grow substantially above industry rates.

2. We have pared our EBITDA margin assumptions over FY07-09E by 80-130bps: The margin pressure evidenced in 3Q07 results was unprecedented, reflecting the impact of a) declining operating leverage, and b) increase in discounts, dealer subventions, et al, that impacted margins. Our downward revision reflects our expectations that margins will continue to be impacted by the increasing competitive intensity within the industry.

Figure 3. TVS Motor – EBITDA Margins Trend (%)

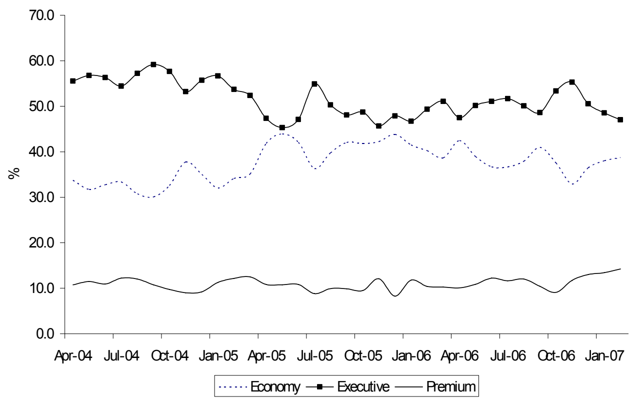


Source: Company and Citigroup Investment Research forecasts

We also note that with margins at current levels of 4-5%, EBITDA (in monetary terms) will likely fluctuate by 25-30% at the minimum (an increase in margin from 4-5% is a 25% increase in operating profits, assuming revenues remain stable). This, in our view, will result in extreme volatility in TVS' stock price (which has already commenced, with the sharp sell- off post 3Q results). With TVS' new initiatives — the new 3-wheeler plant, as also the new 2-wheeler plant coming on-stream in early FY08E — margins should continue to remain volatile, as these initiatives (especially 3 wheelers) will take some time to break even, thus likely resulting in greater volatility in margins.

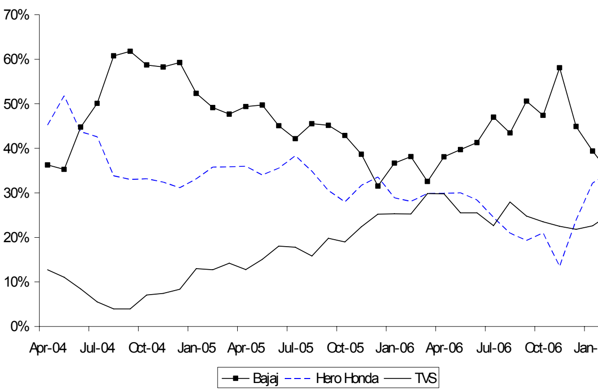
Competition to remain intense in the motorcycle industry

Figure 4. Motorcycle Industry — Segmental Mix (%)



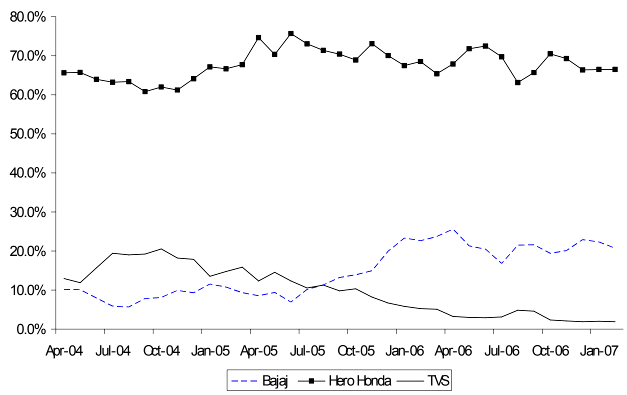
Source: Citigroup Investment Research and Industry estimates

Figure 5. Economy Segment — Market Share Split (%) – Key Players



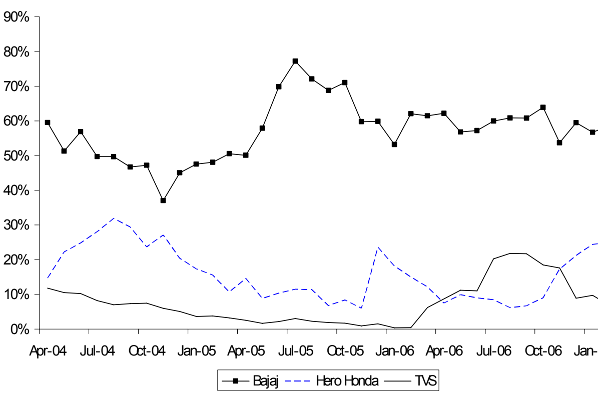
Source: Citigroup Investment Research and Industry estimates

Figure 6. Executive Segment — Market Share Split (%) – Key Players



Source: Citigroup Investment Research and Industry estimates

Figure 7. Premium Segment — Market Share Split (%) – Key Players



Source: Citigroup Investment Research and Industry estimates

The charts above depict 4 key trends:

1. The economy and executive segments continue to dominate the industry, thus players such as TVS that do not have a strong product portfolio with multiple offerings straddling the price range of Rs32,000-45,000 will likely continue to find it difficult to gain and sustain market share.

2. Within the premium segment, TVS' *Apache* has ceded significant market share to Hero Honda's *CBZ Extreme* (and variants). We note this is a setback for TVS, as it impacts TVS' margins adversely (as the product mix becomes less "rich").

3. TVS' competitive position within the executive segment mirrors its performance within the premium segment – the *Victor,* at one point TVS' flagship product, has an extremely modest presence in this segment. We expect the re-launch of the *Victor* in FY08 to result in market share gains – but remain skeptical about the permanence of those gains – given the competitive intensity within this key segment of the motorcycle market.

4. Within the economy segment, TVS' Star and its variants continue to sustain product momentum – creditable – given the competition recently witnessed from Hero Honda's *CD Deluxe*. However, we remain concerned about TVS' ability to retain market share in this segment, as there is little product loyalty in this segment. We expect TVS will continue to have to refresh / introduce new products in this segment, to maintain its market share in this segment.

Initiatives expected to create value only over the longer term

TVS' foray into the 3-wheeler market — expected to commence sometime in late 1Q FY08 — if successful, could partially de-link TVS' revenue model from the intensely competitive 2-wheeler industry. But we would also caution that though that industry has significantly higher margins than the current c5% margin on TVS' 2-wheeler business, it is extremely consolidated with Bajaj and Piaggio as the major players (an aggregate market share of around 83%). Moreover, M&M is also becoming aggressive in that space. TVS will have to establish credibility in this space and offer products across segments and technologies in order to gain meaningful and sustainable market share. Our forecasts assume some degree of success in this foray, thus any further delays or inability to execute on TVS' part will have a fairly substantial impact on our earnings forecasts.

TVS' initiatives in the Indonesian market will, we believe, be value accretive only over the long term; total capex in this initiative is expected to aggregate Rs3bn and management does not envisage substantial profits to accrue in the initial phase. Our standalone forecasts do not reflect the losses that might accrue in this business through FY08/09E.

TVS Motor

Company description

Part of the TVS Group, one of India's leading industrial conglomerates with a strong presence in auto components, TVS Motor is a leading two-wheeler manufacturer in India making motorcycles, scooters and mopeds. Until its exit in FY01, Suzuki was a 26% shareholder in TVS Motors and provided technology support. From a predominantly moped company, TVS Motors has become the third-largest manufacturer of motorcycles in India with a c13% market share in the motorcycle segment and c19% market share in the 2-wheeler industry.

Investment thesis

We reiterate our Sell/Medium Risk rating. Favorable demographics and a poor public-transport system remain structural growth drivers for the 2-wheeler industry. The economic environment should remain supportive, given robust FY07E/08E GDP growth (our estimates are 9.2% and 9.3% respectively) and healthy agricultural growth (we estimate 3% for FY08E). That said, interest rates are on the rise and will increase the cost of financing, and could curb the pace of growth. Consequently, we forecast TVS' 2 wheeler sales to grow at a relatively healthy 12% CAGR over FY07E-09E, which reflects a tapering of the growth rates (c15% CAGR FY05-07E) seen over the past 2 years.

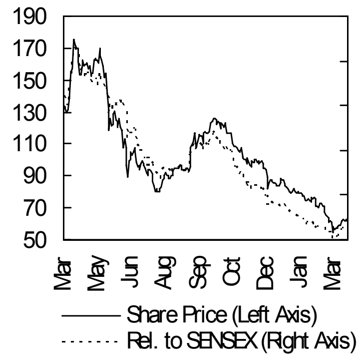
In addition, competitive pressures remain intense and are expected to only increase as the majors (Hero Honda and Bajaj Auto) continually refresh their product portfolios in an attempt to retain market share. New product launches from players like Suzuki, HMSI and also Yamaha could also exacerbate competitive pressures in an industry that is expected to grow at an overall rate of 12-15% over the medium term. Price wars have broken out over the past few months due to increased competition. TVS' EBITDA margins have compressed significantly over the past 2 years (due to rising cost pressures and higher discounts, S&D spends), and are expected to remain under pressure. We believe that with the launch of the StaR and its variants, TVS has stemmed the erosion in its market share. However, its ability to ramp up volumes in this segment and retain and build upon market share in this competitive scenario remains to be seen.

Valuation

Our 12-month target price for TVS of Rs65 is based on 13x FY08E earnings, a discount to the 14.8x P/E over the past 5 years. We believe the historical multiple is inflated: TVS' stock price typically runs up on expectations of margin improvement / new initiatives, but then corrects on disappointing earnings / delays in strategic initiatives. We also contend that 13x is appropriate, given the intense competitive pressures that we forecast.

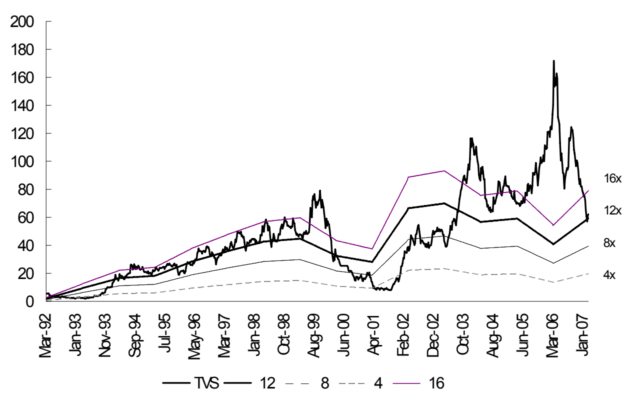
Our valuation multiple is comparable with TVS' peer group. Over the past year, TVS has underperformed its peer group, largely due to unabated margin pressure and a lacuna in its product portfolio (in the executive segment), which it seeks to address through the relaunch of the *Victor*. Its forecast earnings growth is much higher than peers over FY07-09E, because of a low-base effect over FY07E. However, the company lags Hero Honda in technology and does not have a huge cash pile like Bajaj Auto. In a price war scenario, these could constrain TVS' earnings growth. We are therefore not ascribing a premium for higher earnings growth forecast for TVS. We contend that the P/E methodology is most suitable for the 2-wheeler sector, given relatively stable long-term growth trends and limited capex requirements, which ensure that profitability remains relatively stable (in comparison to the 4-wheeler sector).

Figure 8. TVS Motor – Share Price vs Sensex



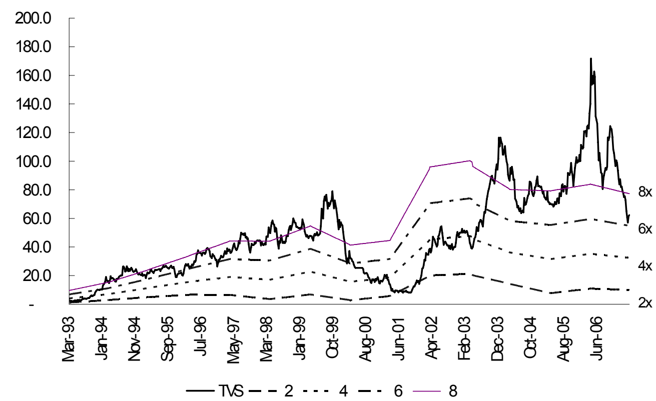
Source: Datastream

Figure 9. TVS Motor — P/E (x) Band Chart



Source: DataStream, Bloomberg, Company and Citigroup Investment Research estimates

Figure 10. TVS Motor — EV / EBITDA (x) Band Chart



Source: DataStream, Bloomberg, Company and Citigroup Investment Research estimates

Risks

We rate TVS as Medium Risk, in line with our quantitative risk-rating system, which tracks 260-day historical share price volatility.

The key upside risks to our target price include:

a) Meaningful and sustained improvement in profitability, driven by a beneficial shift in the product mix;

b) Faster-than-expected ramp-up in 3-wheeler volumes, which would result in a richer product mix over the medium term; and

c) Sustained increase in exports, especially after the setting up of the plant in Indonesia.

Downside risks to our target price include:

a) Competitive pressures in the 2-wheeler industry remain intense and could likely accentuate given declining product life cycles and increasing number of models being launched by not only new players, but also the 3 majors;

b) Macro risk factors include a slowdown in sales (and commensurate erosion in margins) due to any deterioration in macroeconomic variables (including growth, interest rates and fuel prices);

c) Low liquidity in the stock is also a risk as it implies higher transaction costs and volatile swings based on monthly sales numbers.

Appendix A-1

Analyst Certification

I, Jamshed Dadabhoy, research analyst and the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

TVS Motor (TVSM.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Jamshed Dadabhoy (covered since December 20 2006)

#	Date	Rating	Target Price	Closing Price
1:	7 May 04	1H	118.00	87.25

*Indicates change.

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