

TVS MOTOR

INR 75

Margin squeeze

BUY



TVS Motor (TVSM) announced its Q3FY07 results which were well below our expectations. Net profit declined 63% Y-o-Y to INR 115 mn. Operating margins declined significantly to 3.2%, down 380bps Y-o-Y and 200bps Q-o-Q. Margins were primarily affected by a significant rise in the input costs which climbed 440 bps Y-o-Y. The company's net revenues were downbeat with 7.3% Y-o-Y increase and 13.2% Q-o-Q decline due to tough competitive landscape and aggressive sales promotion schemes of the competitors which the company reportedly did not match. We expect margins to improve sequentially, given stability in input costs and pick up in volumes.

We are revising our FY07E-FY09E earnings estimate on account of the lower than previously expected margins. Our revised EPS estimates for FY08 and FY09 stand around 25% lower than earlier. On the revised estimate the stock is trading at 15.2x FY08E and 11.5x FY09E. We maintain BUY on potential upside from new product launches and significant scope for margin expansion going forward.

Result highlights

- **Lower than expected results in Q3FY07:** TVS Motor's net sales in Q3FY07 were at INR 9.35 bn, up 7.3% Y-o-Y, driven by a marginal 1.4% growth in volumes, and a 5.8% increase in average realizations primarily due to improved product mix with higher sales of the premium motorcycle Apache launched in Dec 2005. However, Q-o-Q net revenues declined 13.2% due to a similar decline in volumes.
- **EBITDA margin take a severe hit on competition:** The company's EBITDA margins in the quarter declined 380bps Y-o-Y and 200bps Q-o-Q primarily on higher input costs. We expect the margins to have bottomed out and expect them to improve sequentially on back of price hikes, lower selling costs and stable input prices.
- **New launches:** TVS Motor plans to launch variants of Apache and Star (electric start) in Q4FY07. This will be followed by the launch of new Victor in July 2007. The company's 3-wheeler range is also likely to be introduced in June 2007. Further, the Himachal plant and the Indonesian project will likely be operational by April 2007. We expect these new products and projects to boost volumes and margins in FY08E and FY09E.
- **Valuation:** We continue to like the stock from a long term perspective on back of robust product pipeline, new projects, and significant scope for margin expansion. However, we are lowering our earnings estimates for FY07E-FY09E on lower than expected earnings and margins. On our revised earnings estimates, the stock is trading at 15.2x FY08E and 11.5x FY09E. We maintain 'BUY'.

Financials

Year to March	Q3FY07	Q3FY06	YoY%	Q2FY07	QoQ%	FY07E	FY08E
Net revenues (INR mn)	9,354	8,714	7.3	10,779	(13.2)	39,204	46,788
EBITDA (INR mn)	296	607	(51.2)	560	(47.1)	1,604	2,478
Net profit (INR mn)	115	311	(63.1)	248	(53.8)	750	1,168
EPS (INR)	0.5	1.3	(63.1)	1.0	(53.8)	3.2	4.9
P/E (x)						23.6	15.2
EV/EBITDA (x)						11.2	7.2
RoE (%)						8.8	12.9

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Reuters : TVSM.BO
Bloomberg : TVSL IN

Market Data

52-week range (INR) : 187 / 74
Share in issue (mn) : 237.5
M cap (INR bn/USD mn) : 17.7 / 400.7
Avg. Daily Vol. BSE/NSE ('000) : 1,061.8

Share Holding Pattern (%)

Promoters : 56.8
MFs, Fls & Banks : 21.2
Fls : 4.1
Others : 17.9

* Earnings revision triggered by lower than expected margins

We have revised our earnings estimate for TVS Motor significantly for FY07E-FY09E. The earnings revision has been triggered by the lower than expected margins. Our expectation of margin improvement has been delayed by one quarter. We expect margins to improve from Q4FY07E though on a lower trajectory than that envisaged earlier.

Our revised earnings for FY08E stand at INR 4.9 per share, down 25% from our earlier estimate. This is based on expectations of a lower EBITDA margin of 5.3%, 76bps lower than previously estimated, largely on account of higher material costs. For FY09E, our revised EPS estimate stands at INR 6.5, 26% lower than previously estimated. This is based on an EBITDA margin of 6.0% compared to 6.9% expected earlier. We believe there is a potential upside on these numbers on back of the significant operating leverage available to the company, particularly in selling and employee cost. Margins could also receive a boost from the commissioning of the company's new plant in Himachal Pradesh (where significant fiscal benefits are available) and the launch of the 3-wheeler range of products which enjoy significantly higher margins, given the lower intensity of competition. We expect both these initiatives to come to fruition in Q1FY08E.

Financial snapshot								(INR mn)
Year to March	Q3FY07	Q3FY06	YoY%	Q2FY07	QoQ%	FY06	FY07E	FY08E
Volumes								
Motorcycles	219,958	222,309	(1.1)	258,321	(14.9)	806,654	950,773	1,140,928
Ungeared scooters	61,243	62,481	(2.0)	73,364	(16.5)	245,276	264,114	277,320
Mopeds	82,469	73,769	11.8	87,510	(5.8)	290,273	333,598	366,958
Vehicles sold	363,670	358,559	1.4	419,195	(13.2)	1,342,203	1,548,485	1,785,205
Realisation (INR)	25,721	24,303	5.8	25,713	0.0	24,102	25,318	26,209
Revenues (net)	9,354	8,714	7.3	10,779	(13.2)	32,350	39,204	46,788
Total revenues	9,354	8,714	7.3	10,779	(13.2)	32,350	39,204	46,788
Dec/(inc) in stock	(833)	(307)		(66)		(607)		
Raw material	7,875	6,481	14.0	8,033	(11.6)	23,818	29,251	35,051
Staff costs	463	413	12.2	461	0.5	1,569	1,829	2,108
Other expenses	1,553	1,520	2.2	1,791	(13.3)	5,525	6,521	7,151
Total expenditure	9,058	8,107	11.7	10,219	(11.4)	30,305	37,600	44,310
EBITDA	296	607	(51.2)	560	(47.1)	2,045	1,604	2,478
Interest	86	35	149.1	62	39.5	131	317	389
Depreciation	245	242	1.2	244	0.2	939	986	1,173
Other income	176	120	46.7	109	61.8	710	779	718
PBT	141	450	(68.7)	363	(61.1)	1,685	1,080	1,633
Tax	27	140	(81.0)	114	(76.8)	515	329	465
Net profit	115	311	(63.1)	248	(53.8)	1,170	750	1,168
Adjusted net profit	115	311	(63.1)	248	(53.8)	1,170	750	1,168
Equity capital (FV INR 1)	238	238		238		238	238	238
No. of shares (mn)	238	238		238		238	238	238
EPS (INR)	0.48	1.31		1.05		4.93	3.16	4.92
Ad EPS	0.48	1.31		1.05		4.93	3.16	4.92
PE (x)						15.1	23.6	15.2
As % of net revenues								
Raw material	75.3	70.9		73.9		71.8	74.6	74.9
Staff costs	5.0	4.7		4.3		4.8	4.7	4.5
Other expenses	16.6	17.4		16.6		17.1	16.6	15.3
EBITDA	3.2	7.0		5.2		6.3	4.1	5.3
Net profit	1.2	3.6		2.3		3.6	1.9	2.5
Tax rate	18.8	31.0		31.5		30.5	30.5	28.5

Company Description

TVS Motor Company, the flagship company of the USD 2.2 billion TVS Group, is the third largest two-wheeler manufacturer in India. Key motorcycle offerings include Star and Star City (entry level), Victor (executive) and Apache (premium). TVS Motors is the largest moped manufacturer in the country and has a significant presence in ungeared scooters with its Scooty brand.

TVSM has two production plants based at Hosur and Mysore with manufacturing capacity of around 2 mn two wheelers per year (1.3 mn motorcycles and 0.7 mn scooters and mopeds). It also plans to set up a new plant at Baddi, in Himachal Pradesh, with a capacity of 300,000 two wheelers per year. It will also set up a plant for manufacturing three-wheelers with a capacity of 100,000 vehicles per year. The company is also setting up an assembly plant in Indonesia.

Investment Thesis

Star City (entry) and Apache (premium), two quality products from TVS Motors have gained market acceptance since their launch in late 2005. The company had been focused on strengthening its brand and product portfolio. TVS Motors' has a strong capabilities in product design and development provide confidence in the sustainability of its volume growth. The company's plans to enter the Indonesian market improve visibility on volume growth in export markets. The company's currently strained operating margins means it has good scope for improvement as brand promotion and R&D expenses stabilize following a stable and mature product portfolio.

Risks to the Recommendation

The two-wheeler industry is reeling under severe margin pressure and intense competition. Higher input costs and intensifying competition in motorcycles, especially in the entry segment, may further strain margins. Higher dependence on the entry segment leaves little room for taking price hikes to offset cost increases. The need to refresh product launch pipelines at a fast pace in this industry exposes the company to product acceptance risks.

Financial Statements

Income statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Total volume (nos)	1,167,016	1,340,375	1,548,485	1,785,205	2,006,906
Income from operations	28,759	32,350	39,204	46,788	53,857
Materials costs	19,814	23,211	29,251	35,051	40,386
Stores and tools	383	387	469	561	592
Staff costs	1,407	1,569	1,829	2,108	2,328
S G & A expenses	5,039	5,138	6,052	6,589	7,332
Total operating expenses	26,643	30,305	37,600	44,310	50,638
EBITDA	2,116	2,045	1,604	2,478	3,218
Non-Operational income	499	789	779	718	743
PBDIT	2,615	2,834	2,382	3,196	3,961
Interest	83	210	317	389	448
Depreciation and amortisation	896	939	986	1,173	1,368
Profit before tax	1,635	1,685	1,080	1,633	2,144
Extraordinary income/ (loss)	369	-	-	-	-
Provision for tax	629	515	329	465	600
Profit after tax	1,376	1,170	750	1,168	
Adjusted profit after tax	1,006	1,170	750	1,168	1,544
Shares outstanding	238	238	238	238	238
Dividend per share	1.5	1.5	0.8	1.2	1.6
Dividend payout (%)	34.9	30.1	25.0	25.0	25.0

Common size metrics- as % of net revenues

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Operating expenses	92.6	93.7	95.9	94.7	94.0
Materials costs	68.9	71.8	74.6	74.9	75.0
Staff costs	4.9	4.8	4.7	4.5	4.3
S G & A expenses	17.5	15.9	15.4	14.1	13.6
Depreciation	3.1	2.9	2.5	2.5	2.5
Interest expenditure	0.3	0.6	0.8	0.8	0.8
EBITDA margins	7.4	6.3	4.1	5.3	6.0
Net profit margins	3.4	3.5	1.9	2.5	2.8

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Revenues	2.0	12.5	21.2	19.3	15.1
EBITDA	(18.4)	(3.4)	(21.6)	54.5	29.8
PBT	(23.8)	3.0	(35.9)	51.3	31.3
Net profit	(27.3)	16.3	(35.9)	55.6	32.2
EPS	(27.3)	16.3	(35.9)	55.6	32.2

Balance sheet					(INR mn)
As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Equity capital	238	238	238	238	238
Pref. capital	0	0	0	0	0
Reserves & surplus	6,551	7,424	8,241	8,804	9,680
Shareholders funds	6,788	7,661	8,479	9,042	9,918
Secured loans	1,750	3,086	3,086	3,086	3,086
Unsecured loans	118	764	1,692	2,742	3,302
Borrowings	1,868	3,850	4,778	5,828	6,388
Deferred tax (Net)	1,485	1,490	1,490	1,490	1,490
Sources of funds	10,142	13,002	14,747	16,360	17,796
Gross block	12,872	13,784	16,554	19,554	22,554
Depreciation	5,236	6,116	7,102	8,276	9,644
Net block	7,636	7,668	9,452	11,278	12,910
Capital work in progress	69	270	0	0	0
Investments	1,754	3,442	3,442	3,442	3,442
Inventories	2,332	3,579	4,296	5,127	5,902
Sundry debtors	396	582	752	897	1,033
Cash and bank balance	739	244	295	352	405
Loans and advances	1,647	2,149	2,149	2,149	2,149
Other current assets	3	3	3	3	3
Total current assets	5,117	6,556	7,495	8,529	9,492
Sundry creditors and others	4,522	5,245	5,907	7,050	8,115
Provisions	556	625	669	774	868
Total current liab. & provisions	5,078	5,869	6,577	7,824	8,983
Net current assets	39	687	918	705	509
Misc. exp. not written off	645	935	935	935	935
Uses of funds	10,142	13,002	14,747	16,360	17,796
Book value per share (BV) (INR)	29	32	36	38	42

Cash flow statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
PBIT	1,589	1,577	1,018	1,730	2,300
Less: Actual tax paid	374	510	329	465	600
Less: Tax shield on interest	-	71	107	131	151
Add: Tax on int. & invest. income	-	107	127	98	98
NOPLAT	1,215	1,104	709	1,232	1,647
Add: Depreciation	896	939	986	1,173	1,368
Gross cash flow	2,111	2,043	1,695	2,405	3,015
Less: Capital expenditure	1,559	1,172	2,500	3,000	3,000
Less: Working capital investment	(269)	710	224	(166)	(155)
Less: Increase in other assets	155	502	-	-	-
Add: Increase in other liab./prov.	125	68	45	104	94
Free cash flow	791	(273)	(984)	(324)	264

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROE (%)	14.8	15.3	8.8	12.9	15.6
ROCE (%)	16.9	14.6	9.5	12.4	14.6
Inventory days	30	40	40	40	40
Debtors days	5	7	7	7	7
Fixed asset turnover (x)	2.2	2.3	2.4	2.4	2.4
Debt/Equity	0.3	0.5	0.6	0.6	0.6

Valuations parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (INR)	4.2	4.9	3.2	4.9	6.5
<i>Y-o-Y growth (%)</i>	<i>(27.3)</i>	<i>16.3</i>	<i>(35.9)</i>	<i>55.6</i>	<i>32.2</i>
CEPS (INR)	8.0	8.9	7.3	9.9	12.3
PE (x)	17.6	15.1	23.6	15.2	11.5
Price/BV (x)	2.6	2.3	2.1	2.0	1.8
EV/Sales (x)	0.6	0.5	0.4	0.4	0.3
EV/EBITDA (x)	8.1	8.4	10.7	6.9	5.3

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Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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