IDFC INSTITUTIONAL SECURITIES
India Research

Rs1234
UNDERPERFORMER

Maruti Suzuki

RESULT NOTE

Mkt Cap: Rs357bn; US$7.8bn

Analyst: Bhushan Gajaria (91-22-6622 2562; bhushan.gajaria@idfc.com)

Result: Q3FY11

Comment: Mix and employee costs impact margins

Key valuation metrics

YE Mar 31 (Rs m)	Sales	yoy chg	Net profit	EPS (Rs)	yoy chg	P/E (x)	EV/EBITDA (x)
FY08	183,856	23.1	18,220	63.0	18.7	19.6	13.3
FY09	208,549	13.4	11,936	41.3	(34.5)	29.9	19.1
FY10	296,157	42.0	24,606	85.1	106.2	14.5	9.3
FY11E	367,549	24.1	23,206	80.2	(5.7)	15.4	9.5
FY12E	431,917	17.5	27,874	96.4	20.1	12.8	7.4

Key highlights

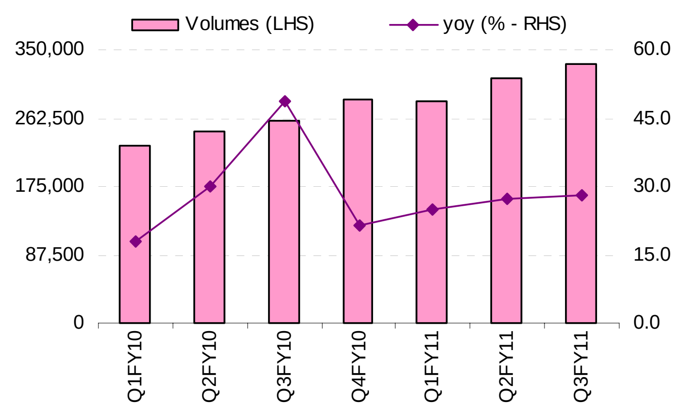
- Maruti Suzuki's (MSIL) operational numbers for the quarter Q3FY11 were in line with estimates, but PAT beat estimates due to higher other income and lower interest cost.
- MSIL's revenues came in at Rs94.9bn (up 26.2%, vs our estimate of 26%), EBITDA was at Rs9.02bn (our estimate, Rs9.02bn) and PAT was down by 17.8% to Rs5.65bn (our estimate, Rs5.5bn).
- Net sales have grown by 26.5% to Rs92.8bn, with underlying volumes growing by 28.2% to 330687 units. While gross realizations have improved by 0.7% yoy, excise duty has increased from 8.9% to 10.7%, thereby impacting net realization.
- With lower-end brands like Alto and Wagon R growing faster and higher festive discounts (Rs10700 per unit, as against normal discounts of Rs9500 per unit), gross realization dropped by 1.8% qoq to Rs313978 (our estimate, Rs313295).
- Domestic volumes have grown by 37% yoy and realization by 2.4% yoy (though 2.1% lower qoq).
- Export revenues have declined by 37% to Rs8.4bn, with underlying volumes declining by 20% to 31160 and realizations impacted by currency movement and higher non-European sales.

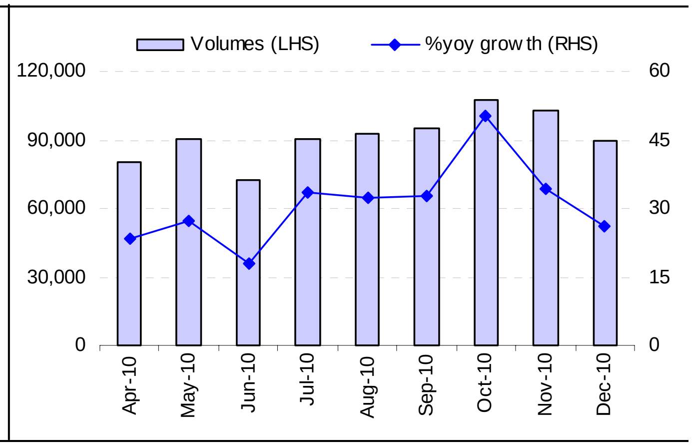
Segmentwise performance

	Q3FY11	Q3FY10	yoy (%)	Q2FY11	qoq (%)
Domestic Volumes (nos)	299,527	218,910	36.8	277,936	7.8
Domestic Realization (Rs)	281,702	274,988	2.4	287,633	(2.1)
Domestic Revenues (Rs m)	84,377	60,198	40.2	79,944	5.5
Exports Volumes (nos)	31,160	39,116	(20.3)	35,718	(12.8)
Exports Realization (Rs)	269,255	335,924	(19.8)	275,211	(2.2)
Exports Revenues (Rs m)	8,390	13,140	(36.1)	9,830	(14.6)

Source: IDFC Securities Research

Strong volume momentum





Source: IDFC Securities Research

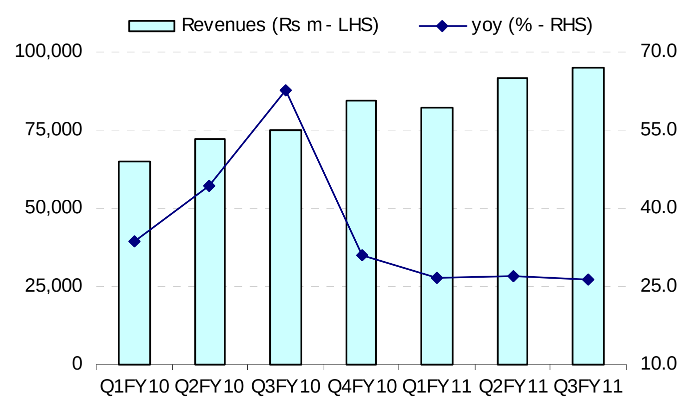
- Operating other income has grown by 15.7% yoy to Rs2.18bn, with income from services at Rs494m (Rs389m in Q3FY10) and scrap sales of Rs682m.
- Impacted by product mix and higher commodity costs, the ratio of cost of goods sold to sales increased by 100bp qoq and 410bp yoy to 78.4%. MSIL effected price hikes of ~3% in January, which should ease some pressure hereon.
- Employee costs increased by a sharp 48% qoq and 76% yoy to Rs2.3bn due to of the annual salary revision. Of the 75bp increase in employee costs, ~55bp is attributable to the previous quarters.
- Other expenditure during the quarter stood at 9.6% of revenues (as against 10.4% in Q2FY11), with lower selling and distribution costs (2.2%, vs 2.6% last quarter), royalty cost at 5.2% (lower on account of lower volumes), and other manufacturing expenses and power fuel at 2.5% (down from 2.8% in Q2FY11).
- EBITDA margins have eroded by 560bp yoy and 100bp qoq to 9.5%, marginally lower than our estimate of 9.6%. EBITDA per vehicle stood at Rs27270, down from Rs30617 in Q2FY11 and Rs43946 in Q3FY10.

Per Vehicle Analysis

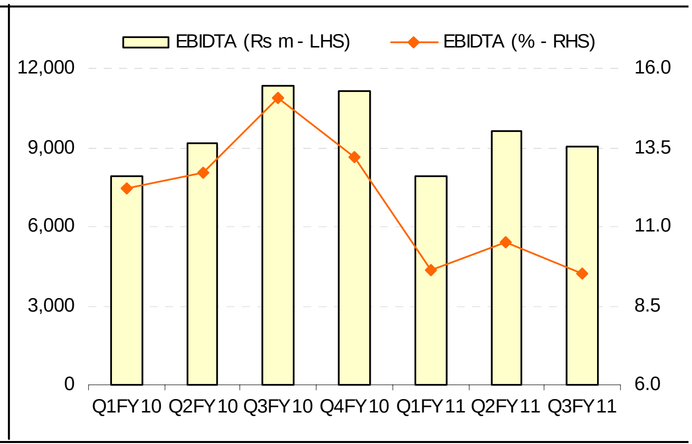
	Q3FY11	Q3FY10	yoy (%)	Q2FY11	qoq (%)
Gross Realization	313,978	311,846	0.7	319,689	(1.8)
Net Realization	280,529	284,226	(1.3)	286,219	(2.0)
Other Operating income	6,584	7,296	(9.8)	5,417	21.5
Material Cost	225,152	216,649	3.9	225,587	(0.2)
Employee Cost	7,029	5,133	36.9	5,000	40.6
Selling and Distribution Cost	6,172	8,527	(27.6)	7,442	(17.1)
Royalty	14,588	10,232	42.6	15,170	(3.8)
Other manufacturing Expenses	6,902	7,035	(1.9)	7,820	(11.7)
EBITDA (including operating income)	**27,270**	**43,946**	**(37.9)**	**30,617**	**(10.9)**

Source: IDFC Securities Research

Sustained high growth momentum



But margins have been on a downhill



Source: IDFC Securities Research

- Other income has come in higher at Rs1.28bn, while interest cost stood at Rs3.6m. Depreciation was Rs2.37m.
- The share of rural sales during the quarter was ~20%, while the proportion of first-time buyers dropped from 52% to 45%.
- MSIL would increase capacity to an annualized 1.4m by 1 April 2011. A further increase would come from additional capacity in Manesar, which is expected to become operational in H2FY12 (annualized capacity of 250,000 units).
- The launch of MSIL's premium car, Kizashi, is scheduled for February 2011.
- On the currency front, while MSIL has forward contracts for the Euro, its Yen exposure remains open as the management expects currency movement to turn favorable.
- At the end of the quarter, MSIL's sales network comprised 889 outlets covering 631 cities (up from 802 outlets in 555 cities in March 2010). Its service network has 2879 workshops covering 1373 cities (v/s 2740 workshops across 1335 cities in March 2010).

❑ Growth and margin outlook

With the Indian passenger car market growing by 30% in the past few quarters, the compact car segment (MSIL's market share is 55%+; brands include Alto, Swift and Wagon R) growing the fastest, and MSIL's unmatched distribution network, the company has been witnessing 30%+ growth in the domestic market. However, we expect growth to moderate to ~22% in Q4FY11 due to a high base and capacity constraints. Exports continue to remain a concern in the near term as discontinuation of the scrappage incentive scheme continues to impact European sales. So we expect MSIL to end the year with sales of 1.26m vehicles. For FY12, we are building in passenger car segment growth of 17%. MSIL's capacity constraints would at best allow it to grow in line with market levels. Increasing interest rates and tightening liquidity in the economy are the potential risks to our volume growth estimates. On the margins front, we expect them to improve in Q4FY11 as price hikes and lower discounts help improve gross margins and employee cost normalizes. We expect MSIL to end the year with margins of 10.2% and improve them to 10.4% in FY12.

Valuations and view

Low penetration, growing affluence and increasing launches at the bottom end put the Indian passenger car industry on a high growth path. We remain upbeat on the long-term structural growth story for passenger cars. Despite being a leader with a 50% share of the Indian passenger car market, MSIL has managed to grow in line with the market. This is mainly attributable to its deep distribution network and the fact that the compact car segment is growing the fastest within passenger cars. However, we see the competitive environment intensifying the most in the compact car and mid-size sedan segments, with the likes of Toyota (launched Etios in the mid-sized sedan category and plans to launch a compact car on the same platform), Honda, Hyundai, General Motors and Nissan lining up more launches. This implies continued pressure on business economics and continued margin pressure for MSIL. While the stock price correction of more than 20% in the past couple of months limits downside risk (valuations of 13x FY12E earnings), near-term macro-economic risks, increasing competitive intensity, and capacity constraints prompt us to maintain our Underperformer call with price target of Rs1280.

Quarterly results

Year to 31 March (Rs m)	Q3FY10	Q4FY10	FY10	Q1FY11	Q2FY11	Q3FY11	FY11E	Comments
Revenues	**75,220**	**84,246**	**296,157**	**82,315**	**91,473**	**94,945**	**367,549**	Volume growth of 28%, however, adverse mix and higher excise duty impact net realization
yoy change (%)	*62.6*	*31.0*	*42.0*	*26.8*	*27.0*	*26.2*	*24.1*	
Operating Profit	**11,339**	**11,111**	**39,173**	**7,925**	**9,603**	**9,018**	**37,559**	100bp qoq increase in material cost and higher employee cost impact margins
EBITDA margin (%)	*15.1*	*13.2*	*13.2*	*9.6*	*10.5*	*9.5*	*10.2*	
Other income	913	790	4,967	1,002	1,340	1,283	4,880	
Interest	83.7	128.5	334.8	79.8	97.2	3.6	164.3	
Depreciation	2,028	2,230	8,250	2,417	2,382	2,369	9,591	
Profit before tax	**10,140**	**9,542**	**35,555**	**6,430**	**8,464**	**7,928**	**32,684**	
Tax	3,265	2,976	10,949	1,777	2,481	2,276	9,478	
PAT	*6,875*	*6,566*	*24,606*	*4,654*	*5,982*	*5,652*	*23,206*	
yoy change (%)	*221.9*	*170.0*	*106.2*	*(20.3)*	*5.0*	*(17.8)*	*(5.7)*	

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Explanation of Ratings:

1. Outperformer: More than 5% to Index
2. Neutral: Within 0-5% to Index (upside or downside)
3. Underperformer: Less than 5% to Index