

MICO

Rs3110
UPGRADE TO OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs99.8bn; US \$2.2bn

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Result: Q4CY06 and CY06

Comment: Strong growth ahead

Last report: 03 November 2006 (Price Rs3600; Recommendation: Neutral)

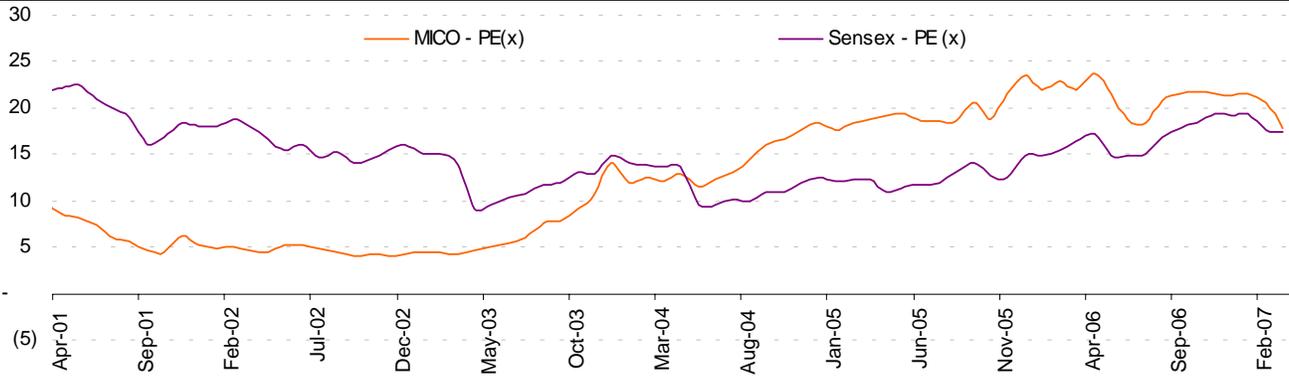
Key valuation metrics

Year to December 31 (Rs m)	Net sales	yoy chg (%)	Net profit	EPS (Rs)	yoy chg (%)	PER (x)	EV/E (x)
2004	24,169	23.1	3,670	114.3	44.1	27.2	15.0
2005	30,892	27.8	3,350	104.5	(8.6)	29.8	13.8
2006	39,098	26.6	3,921	122.1	16.9	25.5	10.6
2007E	46,323	18.5	5,257	163.8	34.1	19.0	8.2
2008E	54,391	17.4	6,531	203.4	24.2	15.3	6.5

MICO's Q4CY06 performance was lower than our expectations due to very high one-time other expenses and higher depreciation charges in view of the change in the company's depreciation policy reducing the effective life of P&M from 8 years to 6 years (the company follows the WDV method of depreciation). CY06 net sales grew by 26.7% to Rs39.1bn and EBIDTA margin stood at 20.8% (23.5% - adjusted for one-time expenses). CY06 net profit before extraordinary expenses grew by 21.8% to Rs3.92bn.

MICO continues to benefit from its strong parentage and is the undisputed leader in diesel injection systems in India for CVs and Tractors. In the passenger car segment MICO presently supplies CRDI systems for MUL's diesel *Swift* and for M&M's *Scorpio*. CRDI based diesel systems for passenger vehicles are likely to gather momentum in India going forward and we believe MICO, with Robert Bosch's global leadership in CRDI systems, is well placed to capitalize on this opportunity. It is also likely to cater to Tata Motors' CRDI platforms based on Fiat's diesel technology as globally Fiat uses Bosch's CRDI systems. Bulk of the company's current phase of CRDI related capex has been completed which would lead to increase in localization for CR components and also lead to significant leverage coming into play from CY08 onwards. We had a Neutral rating on MICO and the stock's underperformance vis-à-vis the Sensex during the last 12 months has been in line with our expectations. Going forward, we expect 18% revenue CAGR and 29% earnings CAGR for MICO over CY06-08E. At CMP, MICO trades at EV/EBIDTA of 6.5x and PER of 15.3x CY08E estimates. We have a target price of Rs4069 for MICO based on PER of 20x CY08 vis-à-vis SSKI's target PER of 17-18x FY09E earnings for the Sensex. Our premium for MICO is in line with the historic premium enjoyed by the company over the Sensex given the company's global parentage, global leadership of its parent Robert Bosch in diesel injection systems, very strong cash generation and high operating margins (>20%). Given these factors, we upgrade our recommendation for MICO from Neutral to Outperformer.

MICO's premium over the Sensex has narrowed in the recent past



Source: SSKI Research

RESULTS HIGHLIGHTS

Q4CY06 Performance Review

- MICO's Q4CY06 net sales were higher than our expectations. Net sales grew by 20.8%yoy to Rs10.5bn against our estimate of Rs9.83bn.
- Operating margins were lower by 300bps qoq (higher by 30bps yoy) at 18.7% due to adverse impact of higher one-time other expenditure of Rs400m during the quarter. The one-time other expenditure pertained to one-time license fees, higher advertising spends, higher one-time royalty charges (besides running royalty payments), tooling costs for the new plant, etc. Adjusting for the impact of this one-time other expenditure, the company's margins at 22.5% would have been higher by 410bps yoy and 80bps qoq. The company's operating profit grew by 22.7% yoy to Rs1.96bn.
- The company's depreciation charges were higher at Rs786m vis-à-vis Rs498m in Q3CY06 and Rs777m in Q4CY05. The increase in depreciation charges for the company was due to change in the company's depreciation policy as regards to its plant and machinery whereby it reduced the useful life of the assets from 8 years to 6 years. This impact was partly offset by the positive impact due to another change in the company's depreciation accounting policy whereby, in respect of addition to fixed assets from January 01, 2006 the company has charged depreciation on pro-rata basis from the quarter in which the additions were made instead of full year depreciation in the year of addition. The net impact of these two changes has been to increase the depreciation charges by Rs311.2m in Q4CY06.
- The company's tax provisioning for Q4CY06 has also been higher due to tax provisioning in respect of the profits of Rs1.38bn from the sale of company's land in Chennai in Q2CY06. The company had earlier planned to invest the same in tax free government bonds but was unable to do so due to investment cap in such instruments. While the company has taken the legal route for resolving the matter, it has nevertheless made a provision for the likely tax impact due to the same resulting in a high deferred tax provisioning of Rs285m for the quarter.
- Net profit before extraordinary expenses increased by 2.9%yoy to Rs648m, significantly lower than the growth in operating profit growth of 22.7%, due to impact of higher depreciation charges and higher tax provisioning.

CY06 Performance Review

- MICO has reported total operating revenue growth of 26.7% at Rs39.1bn for CY06, with domestic sales growing by 24.1% to Rs31.7bn and exports growing by 45% to Rs6.1bn. The company's other operating income grew by 13% to Rs1.3bn. The company's export growth in CY06 has been strong on the back of exports of injector components to Bosch's Korean subsidiary, initiated in CY06.
- OPM declined by 30bp yoy to 20.8% impacted mainly by one-time higher other expenditure to the tune of Rs1.2bn during the year. Adjusted for the impact of the one-time higher other expenditure, the company's margins at 23.7% would have been higher by 260bps yoy. The one-time other expenditure pertained to license fees, higher advertising

spends, higher royalty charges, tooling costs for the new plant, etc. MICO's CY06 operating profit grew by 24.5% at Rs8.11bn.

- MICO's CY06 net profit before extraordinary expenses grew by 21.8% to Rs3.92bn impacted by higher depreciation charges and higher tax provisioning. There was a net increase of Rs284m in depreciation charges for the year due to change in the company's depreciation policy during the year. The company's reported net profit, including an extraordinary income of Rs1.38bn from sale of the company's land in Chennai, grew by 59.7% to Rs5.48bn. The company has declared dividend of 160% for CY06 (Rs16/share).

□ Valuations & View – Upgrade to Outperformer, Target price Rs4069

MICO continues to benefit from its strong parentage and is the undisputed leader in diesel injection systems in India for CVs and Tractors. In the passenger car segment MICO presently supplies CRDI systems for MUL's diesel Swift and for M&M's Scorpio. CRDI based diesel systems for passenger vehicles are likely to gather momentum in India going forward and we believe MICO, with Robert Bosch's global leadership in CRDI systems, is well placed to capitalize on this opportunity. It is also likely to cater to Tata Motors' CRDI platforms based on Fiat's diesel technology as globally Fiat uses Bosch's CRDI systems. Bulk of the company's current phase of CRDI related capex has been completed which would lead to increase in localization for CR components and also lead to significant leverage coming into play from CY08 onwards. We had a Neutral rating on MICO and the stock's underperformance vis-à-vis the Sensex during the last 12 months has been in line with our expectations. Going forward, we expect 18% revenue CAGR and 29% earnings CAGR for MICO over CY06-08E. At CMP, MICO trades at EV/EBIDTA of 6.5x and PER of 15.3x CY08E estimates. We have a target price of Rs4069 for MICO based on PER of 20x CY08 vis-à-vis SSKI's target PER of 17-18x FY09E earnings for the Sensex. Our premium for MICO is in line with the historic premium enjoyed by the company over the Sensex given the company's global parentage, global leadership of its parent Robert Bosch in diesel injection systems, very strong cash generation and high operating margins (>20%). Given these factors, we upgrade our recommendation for MICO from Neutral to Outperformer.

Earnings model

Year to Dec 31 (Rs m)	Q4CY05	CY05	Q1CY06	Q2CY06	Q3CY06	Q4CY06	CY06
Net Sales	8,684	30,855	9,231	9,247	10,132	10,488	39,098
yoy change (%)	36.4	27.7	40.0	21.2	27.5	20.8	26.7
Operating Profit	1,601	6,518	2,008	1,946	2,195	1,965	8,114
yoy change (%)	2.4	7.1	32.0	17.3	26.4	22.7	24.5
Other income	29	137	62	63	82	79	287
Interest	(104)	(535)	(113)	(153)	(151)	(114)	(530)
Depreciation	777	1,981	548	633	498	786	2,465
Profit before tax	957	5,209	1,636	1,529	1,930	1,372	6,467
Tax	328	1,990	612	537	673	724	2,546
Net profit before extraordinary items	630	3,219	1,024	992	1,257	648	3,921
yoy change (%)	(26.6)	(13.2)	29.8	(3.0)	46.8	2.9	21.8
Extraordinary items	(1)	(212)	(125)	(1,436)	3	(2)	(1,559)
Net profit	631	3,431	1,149	2,428	1,254	650	5,480
yoy change (%)	3.8	(8.5)	25.3	137.3	46.0	2.9	59.7
Cash profit	1,407	5,200	1,572	1,625	1,755	1,434	6,386
OPM (%)	18.4	21.1	21.8	21.0	21.7	18.7	20.8
NPM (%)	7.3	10.4	11.1	10.7	12.4	6.2	10.0
Other income/PBT	3.0	2.6	3.8	4.1	4.3	5.8	4.4
Outstanding shares (m)	32.1	32.1	32.1	32.1	32.1	32.1	32.1
EPS (Rs)	19.7	100.4	31.9	30.9	39.1	20.2	122.1
Cash EPS (Rs)	43.9	162.2	49.0	50.6	54.7	44.7	198.9
PER (x)		31.0					25.5
P/CEPS (x)		19.2					15.6

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

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