AUTOS & AUTO PARTS
Autos & Auto Parts

Initiation of Coverage

SECTOR VIEW

New:	BULLISH
Old:	NOT RATED

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Analyst Certification
We, Kapil Singh and Prabhat Awasthi, hereby certify (1) that the views expressed in this Industry Report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Industry Report and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Industry Report.

November 12, 2008

Nomura Financial Advisory and Securities (India) Private Limited

http://www.nomura.com

Cars and two-wheelers

Slow but steady driving

We initiate coverage of the Indian car and two-wheeler segment with a BULLISH view. This segment depends on income growth, which we believe will be supported by: 1) salary hikes for government employees and 2) increasing incomes for rural India because of increased minimum support prices (MSP) for farm products. Affordability should also improve with a fall in interest rates and a possible fall in petrol prices. We estimate stronger growth in earnings because of improved margins resulting from falling commodity prices. Even after factoring in lower volume growth for the next two years, most of the stocks under our coverage are trading at 8-10x FY10E EPS, at the lower end of their trading bands, factoring in low earnings growth. Our top picks are Maruti Suzuki India Limited (MSIL), trading at 8.2x FY11E EPS and Hero Honda (HH), trading at 9.2x FY11E EPS.

- We believe that following a slow 2H FY09E (fiscal year ending March) volume growth will pick up in FY10E. Interest rates have started coming off with the Reserve Bank of India (RBI) infusing liquidity into the system and cutting repo rates. We believe that credit availability will improve considerably by end-FY09E.

- Volume growth should be supported by a 67% increase in salaries for 3.1mn central government employees and expected hikes of a similar proportion for approximately 8mn state government employees (see Appendix II). Increases in incomes in rural India should also continue with the increase in the MSP of food grains (see Appendix I).

- We believe that with falling commodity prices, margins will improve. The Indian auto market is highly consolidated with the two top two-wheeler companies commanding an 83% market share and the three top car companies commanding an 83% market share (end-FY08). Hence, price wars seem unlikely, in our view.

- We estimate domestic car volume growth of 3% in 2H FY09E and 6% in FY10E. We believe that recent credit availability issues will have a much greater impact on two-wheelers, and volumes in 2H FY09E will be flat, followed by 6% growth in FY10E.

- We believe demographics still favour strong growth for the Indian auto sector over a long period, especially for cars. Only nine out of every 1,000 Indians own a car. We estimate that medium-term domestic car volume growth will be around 12%. For two wheelers, we estimate medium-term growth rates of around 4%.

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Coverage summary

Exhibit 1. Summary of ratings and price targets

Company	Reuters	Bloomberg	Rating	Price target (INR)	Current price (INR)	Potential upside (%)
Maruti Suzuki India Limited	MRTI.NS	MSIL IS	BUY	775	594.3	30.4
Hero Honda	HROH.NS	HH IS	BUY	946	756.3	25.1
Bajaj Auto	BAJA.NS	BJAUT IS	BUY	544	425.9	27.7
TVS Motor Company	TVSM.NS	TVSL IS	NEUTRAL	30.4	28.5	7.0

Prices as of 10 November 2008. Source: Nomura estimates

Exhibit 2. Valuation summary

Company	Ticker	Ticker	Rating	Price	EPS CAGR	Current P/E				Target P/E			
	(Reuters)	(Bloomberg)		(INR)*	FY09-FY11E (%)	FY08	FY09E	FY10E	FY11E	FY08	FY09E	FY10E	FY11E
Maruti Suzuki	MRTI.NS	MSIL IS	BUY	594.3	20.4	10.4	11.9	9.4	8.2	13.6	15.5	12.2	10.7
Hero Honda	HROH.NS	HH IS	BUY	756.3	16.1	15.6	12.4	10.4	9.2	19.5	15.5	13	11.5
Bajaj Auto	BAJA.NS	BJAUT IS	BUY	425.9	10.9	7.5	7.3	6.5	6.0	9.5	9.3	8.3	7.7
TVS Motor Co	TVSM.NS	TVSL IS	NEUTRAL	28.5	40.1	15.5	13.7	8.7	7.0	16.5	14.6	9.3	7.4
Average					21.9	12.2	11.3	8.7	7.6	14.8	13.7	10.7	9.3

**Prices as of 10 November 2008. Source: Nomura estimates*

Exhibit 3. Valuation summary for other regions

Stock	Ticker	Price	Currency	Rating	Earnings CAGR	Current P/E			
		(local curr.)			FY09-FY11E (%)	2007A	2008A	2009E	2010E
China									
Dongfeng Motor	489 HK	1.98	RMB	REDUCE	-7.1	4.5	4.1	5.5	4.7
Great Wall Motor	2333 HK	2.95	RMB	REDUCE	-18.0	3.2	4.0	7.1	5.9
Brilliance China	1114 HK	0.335	RMB	REDUCE		13.7	19.7	-9.1	-6.0
Geely Auto	175 HK	0.41	RMB	REDUCE	-35.7	5.9	3.0	7.5	7.2
Denway Motors	203 HK	1.73	RMB	BUY	-20.3	6.0	5.7	5.6	5.3
Shanghai Auto	600104 CH	5.51	RMB	REDUCE	-24.7	7.8	13.8	17.3	14.3
Weichai Power	2338 HK	18.1	RMB	NEUTRAL	-26.9	4.6	4.2	5.5	4.4
Average					-22.1	6.5	7.8	5.6	5.1
Korea									
Hyundai Mobis	012330 KS	76,400	KRW	BUY	9.5	8.2	7.1	6.4	5.9
Hyundai Motor	005380 KS	51,400	KRW	NEUTRAL	4.9	9.2	7.8	8.0	7.1
Kia Motors	000270 KS	9,650	KRW	REDUCE	66.8	246.7	29.6	35.3	10.6
Average(excl. Kia)					7.2	8.7	7.4	7.2	6.5
Japan									
Nissan Motor	7201 JP	440	JPY	REDUCE	-1.6	3.7	11.3	15.7	11.6
Toyota Motor	7203 JP	3,520	JPY	REDUCE	1.5	6.5	11.6	12.3	11.3
Mazda Motor	7261 JP	196	JPY	REDUCE	43.1		30.6	10.9	15.0
Daihatsu Motor	7262 JP	877	JPY	BUY	8.9	10.7	10.7	9.8	9.0
Honda Motor	7267 JP	2,365	JPY	NEUTRAL	-2.6	7.2	8.8	10.1	9.3
Suzuki Motor	7269 JP	1,470	JPY	NEUTRAL	6.5	8.3	10.1	9.2	8.9
Fuji Heavy Industries	7270 JP	329	JPY	REDUCE	3.2	12.8	30.5	34.6	28.6
Isuzu Motors	7202 JP	162	JPY	NEUTRAL	-11.2	3.8	7.5	12.1	9.5
Yamaha Motors	7272 JP	1,079	JPY	NEUTRAL	-11.1%	4.3	7.2	10.0	9.1
Hino Motors	7205 JP	231	JPY	NEUTRAL	133.6	6.0	66.0	17.2	12.1
Mitsubishi Motors	7211 JP	148	JPY	REDUCE	-27.0	38.9	98.7	370.0	185.0
Average(excl. Mitsubishi)					17.0	7.0	19.4	14.2	12.4

Source: Company data, Nomura estimates (Korea analyst – Mike Oh, China analyst – Yankun Hou, Japan analyst – S. Naruse); pricing as of 10 November

Investment summary

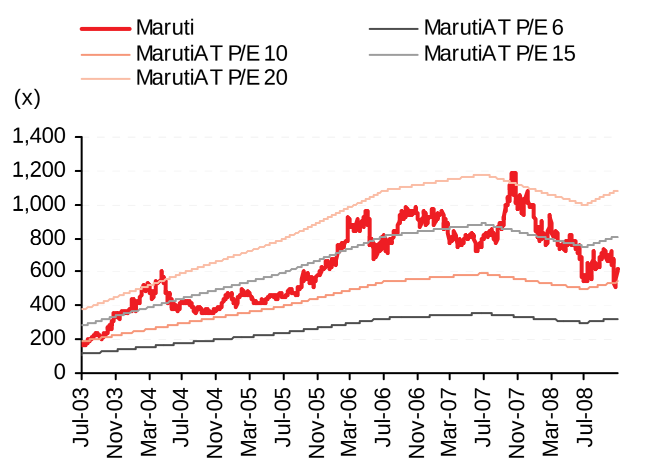
MSIL is trading at 9.4x FY10E EPS. The stock is down 39% YTD, outperforming the BSE Sensex by 9.2%. The market's primary concerns on the stock have been weak volume growth and declining margins. We believe that volume growth will improve next year with the start of MSIL's exports to Europe, improvements in finance availability and a fall in interest rates. Margins should also improve with the fall in commodity prices. We estimate earnings CAGR of 20.4% for MSIL and initiate coverage with a BUY rating and a 12-month price target of INR775, representing 30.4% potential upside. MSIL is trading at the lower end of its trading band (Exhibit 3).

HH is trading at 10.4x FY10E EPS. While the stock has outperformed the market by 56.4% because of strong volume growth and earnings upgrades, we believe that strong earnings growth should continue because of: 1) tax breaks available at its new plant, 2) improving margins because of a fall in commodity prices and 3) its strong competitive position in the market. We initiate coverage with a BUY rating and a 12-month price target of INR946, representing 25.1% potential upside. It is also trading at the lower end of its trading band. In FY07, PAT growth was negative at -11.7% and average one-year forward P/E was 16.7x (Exhibit 4). In FY08 volumes were flat, but average P/E was 12.1x. We are expecting positive volume growth and earnings CAGR of 16% over FY09E to FY11E.

We initiate coverage of Bajaj Auto with a BUY rating and a 12-month price target of INR544 because it is trading at a steep discount to peers. Its export growth is likely to remain strong and the recent depreciation in the rupee should benefit margins next year. The stock is trading at 6.5x FY10E EPS. The stock does not have enough trading history to make a P/E band comparison, but we believe that the approximately 30% discount to HH is fair value for the company.

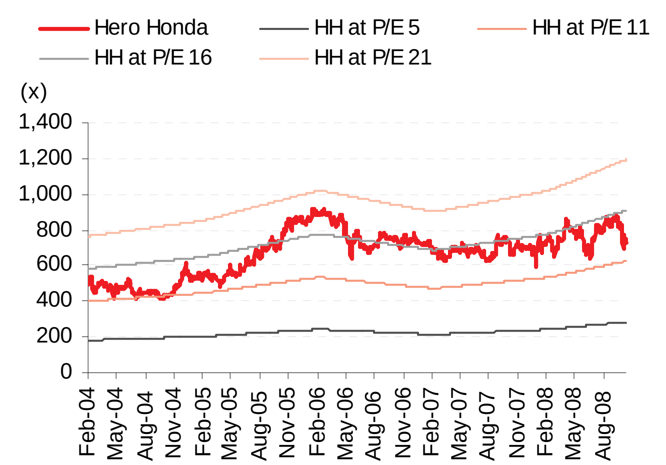
We initiate coverage of TVS Motor Company (TVS) with a NEUTRAL rating and a 12-month price target of INR30.4, because we believe that its weak position in the market and lower financial flexibility justifies a discount to its peers.

Exhibit 4. MSIL: P/E band



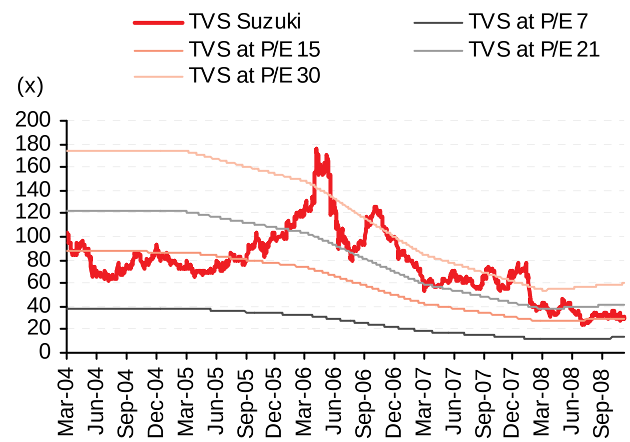
Source: Nomura estimates

Exhibit 5. Hero Honda: P/E band



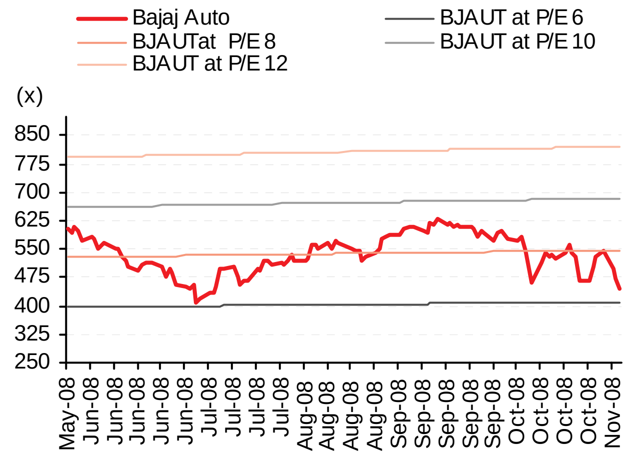
Source: Nomura estimates

Exhibit 6. TVS: P/E band



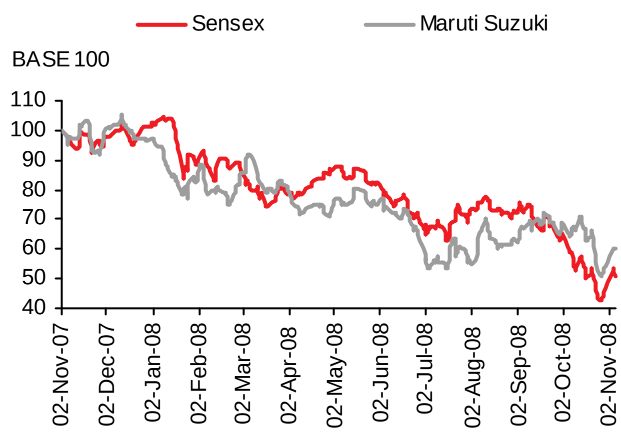
Source: Nomura estimates

Exhibit 7. Bajaj Auto: P/E band



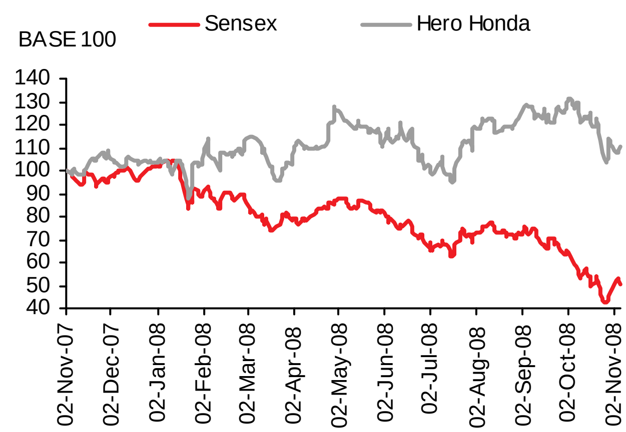
Source: Nomura estimates

Exhibit 8. MSIL vs BSE Sensex: past one year's performance



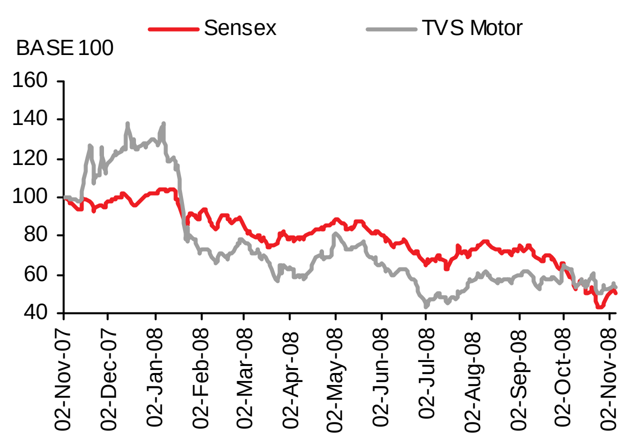
Source: Nomura estimates

Exhibit 9. Hero Honda vs BSE Sensex: past one year's performance



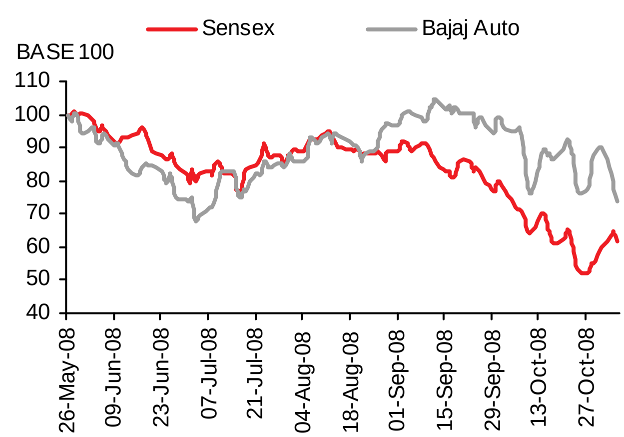
Source: Nomura estimates

Exhibit 10. TVS vs BSE Sensex: past one-year's performance



Source: Nomura estimates

Exhibit 11. Bajaj Auto vs BSE Sensex: performance since listing



Source: Nomura estimates

Sector outlook

Near-term slowdown likely in line with GDP slowdown

Historically, growth in car sales in India has had a strong correlation with industrial growth. Exhibit 12 shows the growth in each sub-segment in automobiles over five four-year periods (from FY90 to FY07). Car sales growth was strongest in 1993-97 when the capex cycle was on an upward trend — and this was despite high interest rates. In this period, car sales registered a CAGR of 26.4%, the fastest in the 18 years we have analysed. Car growth was faster than the growth in commercial vehicles (CV) and two-wheelers.

Exhibit 12. Growth in index of industrial production (IIP) and automobile sub-segments

(%)	IIP	Cars	CVs	Two-wheelers
FY90-FY93	3.8	7.9	-4.1	-4.6
FY93-FY97	8.5	26.4	18.6	18.5
FY97-FY01	5.6	9.4	-10.3	6.1
FY01-FY04	5.1	11.4	22	14.4
FY04-FY07	9.3	15.6	23.8	14.6
FY08	8.3	11.7	5.2	-8

Source: Nomura research

Exhibit 12 also shows that the elasticity of car sales with industrial growth is significantly higher than 1. We believe this is due to income buoyancy in periods of high economic growth. With the slowdown in India's economic growth, we believe that domestic car and two-wheeler volume growth would also remain slow at 5-6% in FY10E.

Margin outlook — expansion likely

With the fall in aluminium prices from a high of US$3,317/tonne (11 July 2008) to US$2,039/tonne (7 November 2008) and steel prices also likely to fall, auto companies' margins are set to expand, in our view. The impact of the fall in aluminium prices is offset by our assumption of a US$1 = INR47 exchange rate. If the rupee appreciates against the US dollar, the impact of falling raw material prices could be much higher.

Exhibit 13. Two-wheelers: impact of raw material prices on margin expansion

(INR/kg)	2Q FY09	Scenario A	Scenario B	Scenario C
Aluminium price (USD/tonne)	2,882.20	2,500	2,400	2,200
Growth y-y (%)		-13.3	-16.7	-23.7
Margin expansion (%)		0.25	0.56	1.17
Steel price (INR/tonne)	45,224	42,000	39,000	37,000
Growth y-y (%)		-7.1	-13.8	-18.2
Margin expansion (%)		0.59	1.13	1.5

Source: Nomura research

Exhibit 14. Four-wheelers: impact of raw material prices on margin expansion

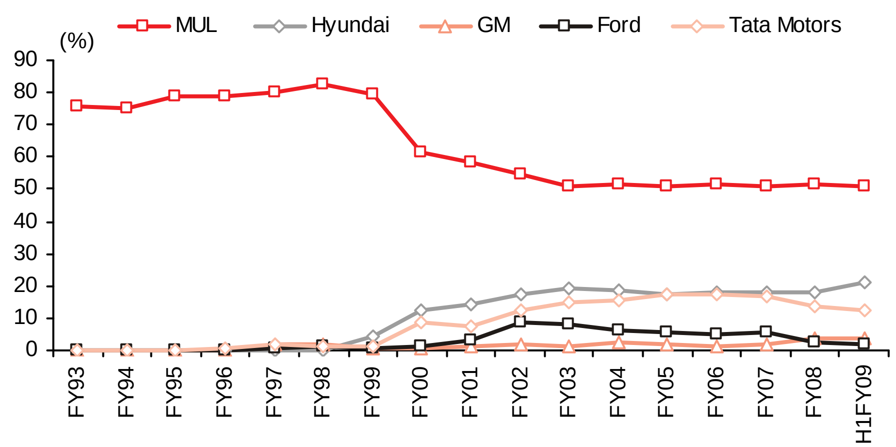
(INR/kg)	2Q FY09	Scenario A	Scenario B	Scenario C
Aluminium price (INR)	2,882.20	2,500	2,400	2,200
Growth y-y (%)		-13.3	-16.7	-23.7
Margin expansion (%)		0.08	0.17	0.36
Steel price (INR)	45,224	42,000	39,000	37,000
Growth y-y (%)		-7.1	-13.8	-18.2
Margin expansion (%)		0.63	1.22	1.61
Margin summary for coverage universe				
OPM (%)	**FY07A**	**FY08A**	**FY09E**	**FY10E**
Hero Honda	11.7	13	13	13.8
Bajaj Auto	14.9	14	13.3	13.9
TVSL	3.6	1.3	3.5	4.1
MSIL	13.2	12.4	8.5	10.3

Source: Nomura research

Cars — industry overview

Total domestic car volumes in India were 1.2mn in FY08, according to data from the Society of Indian Automobile Manufacturers (SIAM). In addition, 200,000 units were exported in FY08. The Indian car market is dominated by MSIL, which commands a 51% market share, according to FY08 figures from SIAM. Before the entry of multinational players in the late 1990s (Exhibit 15), MSIL had about a 75% market share; thereafter it lost market share from FY98 to FY02. While Hyundai has made a significant dent in MSIL's share, other foreign players such as Ford (F US, not rated), Fiat (F IM, not rated) and GM (GM US, not rated) have not been able to make much headway in the market. Another domestic player, Tata Motors (TTMT IS, not rated), has also been able to garner some market share with its diesel cars. However, since FY03, MSIL has been able to maintain its market share at around 51%.

Exhibit 15. Domestic market share of the Indian auto market

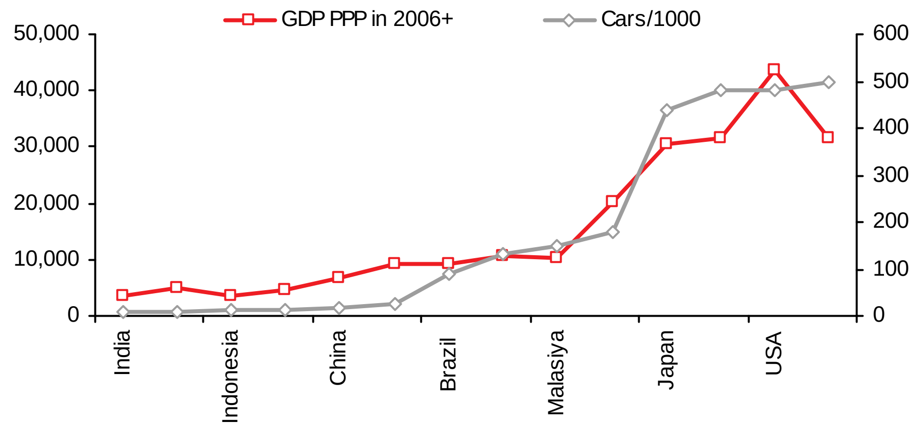


Source: SIAM, Nomura research

Long-term growth potential is high because of low penetration

Globally, car sales are strongly related to GDP per capita (Exhibit 16). Only nine out of every 1,000 people in India own a car. This number is much lower than that in other emerging markets such as China (18), Brazil (90), Mexico (130) and South Korea (180). We estimate that with an expected GDP CAGR of 6.9% over the next seven years (as per estimates from Nomura's economics team), the CAGR for domestic car sales could be about 12% if India follows China in terms of car penetration.

Exhibit 16. Relationship of GDP to cars per thousand people



Source: Nomura research, http://www.econstats.com/weo/V011.htm

Exhibit 17. Estimated domestic CAGR for car sales

	FY08	FY15
GDP per capita (PPP)	4,074	6,620
Population (mn)	1,103	1,279
Cars (mn)	10.2	22.7
CAGR GDP (FY08-FY15) (%)	6.9	
CAGR cars (FY08-FY15) (%)	12.1	

Source: Nomura estimates

Addressable segment is growing

According to the estimates of the National Council of Applied Economic Research (NCAER), the number of households with an annual income greater than INR500,000 (the addressable segment) is set to increase from 4.9mn at the end of FY06 to 9.9mn in FY10, or an average increase of 1.25mn households annually. To put things in perspective, 1.2mn cars were sold in the domestic market in 2008.

Exhibit 18. Income demographics should support car demand

Annual household income ('000 INR)		Number of households in this income bracket ('000)			Average income (INR '000)	+*Cost of ownership of car as % of income
		FY02	FY06	FY10E*		
Deprived	<90	135,378	132,250	114,394	40	302.82
Aspirers	90-200	41,262	53,276	75,304	145	83.54
Seekers	200-500	9,034	13,813	22,268	350	34.61
Strivers	500-1,000	1,712	3,212	6,173	750	16.15
Near rich	1,000-2,000	546	1,122	2,373	1,500	8.08
Clear rich	2,000-5,000	201	454	1,037	3,500	3.46
Sheer rich	5,000-10,000	40	103	255	7,500	1.62
Super rich	>10,000	20	53	141	10,000	1.21
Households with income	> INR 500,000		4,944	9,979	5,035	
New Households with income	> INR 500,000 annually until FY10			1,258		

**Assuming interest rate of 15%annually. +Calculations done for MSIL's entry level Alto*

Source: Nomura research, NCAER

Fall in fuel prices and interest rates should improve affordability

Until 1H FY09E, interest rates have been rising and fuel prices were abnormally high. With the fall in oil prices, and in inflation and interest rates, we estimate that the affordability of cars will improve by the end of FY09E. Therefore, even with the expected slowdown in GDP and income growth, we believe that car demand in India will increase by about 6% in FY10E.

Exhibit 19. Estimated cost of ownership of an entry level car

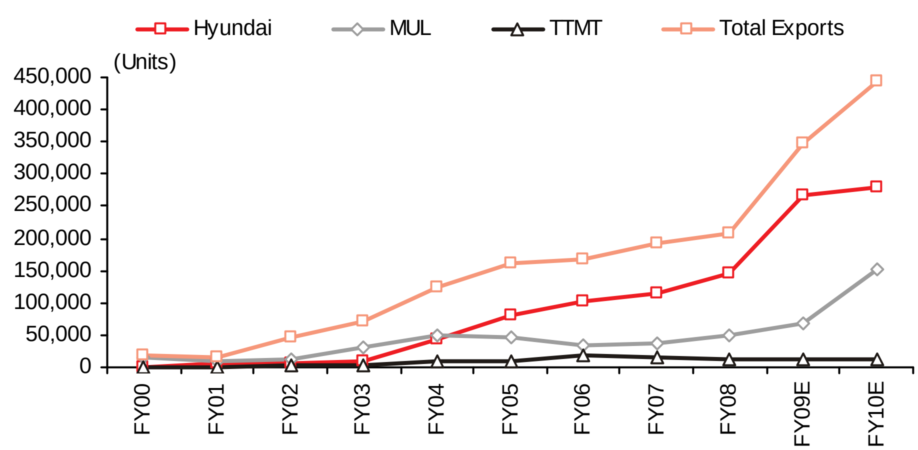
	End FY07	End FY08	End FY09E
Loan amount* (INR)	252,500	255,025	257,575
Increase y-y (%)	1.00	1.00	1.00
Annual interest rate (%)	14.50	14.25	13.25
EMI	5,941	5,967	5,825
Increase y-y (%)	8.10	0.40	-2.40
Annual payments (a) (INR)	71,291	71,605	69,905
Petrol price (Delhi) (INR)	42.85	50.52	49.52
Increase y-y (%)	-1.50	17.90	-2.00
Annual fuel cost [assuming 30Km/day] (b) (INR)	38,565	45,468	44,568
Annual maintenance cost (c) (INR)	5,500	6,050	6,655
Increase in maintenance cost y-y (%)	10	10	10
Actual cost of ownership in INR/year (a)+(b)+(c)	115,356	123,123	121,128
Increase in cost of ownership y-y (%)	4.80	6.70	-1.60
Increase in salaries y-y (%)	12.00	13.00	10.00

**Calculations for MSIL's entry-level Alto. Source: Nomura research*

Exports — India is emerging as a car manufacturing hub

Around 71% of total car exports from India are small cars. Hyundai Motors was India's leading car exporter, with an export market share of around 69%, in FY08. The Santro and i-10 accounted for 55% of total car exports from India. While Hyundai has increased its exports at a rapid rate, MSIL's export growth lost steam after FY04.

Exhibit 20. MSIL and Hyundai: export volumes



Source: SIAM, Nomura research

MSIL stopped exporting the Alto model to Europe when Suzuki's Hungary plant began exports to the region. However, MSIL now targets annualised export sales of 200,000 units by end-FY10. Of these, 50,000 units will be contract manufactured for Nissan. These will be exported under the Nissan brand from 1H09.

Hyundai is also looking at further additions to its export volumes. In the next two to three years, it plans to export around 300,000 cars. Hyundai currently exports to 67 countries in Latin America, Europe, Africa and West Asia. Hyundai is set to export 50,000 completely knocked down (CKD) units to Russia, the CIS countries and Taiwan from India to capitalise on the Indian cost advantage. Given this strong thrust on exports, we believe India will be able to more than double its exports in the three years to FY10.

Conclusions on demand forecasts

We expect the industry to grow at 13.1% y-y in FY09 and 10.7% y-y in FY10. We expect growth to be slower in 1H FY10 because of the slowdown in Indian GDP growth from 9% in FY08 to 7.2% in FY09E and 6.9% in FY10E. A sharp fall in interest rates and fuel prices in India could be a key positive to our estimates. While domestic growth is likely to be slower, we expect exports to remain strong because of the export plans of MSIL and Hyundai. We expect to see the benefits of exports from FY09.

Exhibit 21. Industry volume forecast (units)

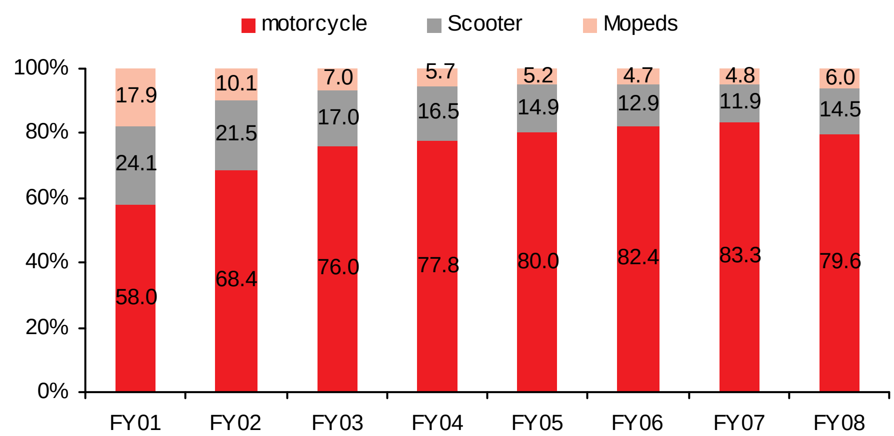
	FY01A	FY02A	FY03A	FY04A	FY05A	FY06A	FY07A	FY08A	FY09E	FY10E
Domestic car sales	572,370	512,637	541,485	696,197	820,164	882,166	1,076,469	1,223,121	1,272,046	1,348,369
Growth y-y (%)	-10.2	-10.4	5.6	28.6	17.8	7.6	22	13.6	4.0	6.0
Export sales	16,604	47,356	70,257	125,325	160,683	168,461	192,745	209,425	347,453	444,570
Growth y-y (%)	-12.2	185.2	48.4	78.4	28.2	4.8	14.4	8.7	65.9	28
Total sales	588,974	559,993	611,742	821,522	980,847	1,050,627	1,269,214	1,432,546	1,619,499	1,792,939
Growth y-y (%)	-10.3	-4.9	9.2	34.3	19.4	7.1	20.8	12.9	13.1	10.7

Source: SIAM, Nomura research

Motorcycles

The Indian two-wheeler market is dominated by motorcycles, which command approximately an 80% market share. Motorcycles have been gaining share consistently for the past eight years, except in FY08. We believe that this trend will continue because motorcycles are more fuel-efficient and deliver more power. Mopeds have been losing market share because they deliver less power. Scooters were the dominant category a decade ago, but since then they have lost out to the more fuel-efficient motorcycles. We believe that motorcycles will continue to dominate the market.

Exhibit 22. Segmentation of the Indian two-wheeler market (FY08A)



Source: SIAM

We expect steady growth amid increased consolidation

We expect volume growth in the domestic two-wheeler market to be flat for 2H FY09E as compared to 11.2% for 1H FY09. With the recent credit crisis, credit availability is likely to emerge as a major issue in 2H FY09E. Leading financers, such as Citibank (India), and Centurion Bank of Punjab [now merged with HDFC Bank (HDFC IS, not rated)] have exited the two-wheeler financing business because of high delinquency rates. Our channel checks suggest that other financers have also reduced their financing business.

A similar credit tightening situation resulted in -8% volume growth in FY08E, which was the largest fall in two-wheeler volumes in the past 15 years. With the low base for FY08, volumes this year have registered 11% growth in 1H. We believe that after a brief period of slow sales in 2H FY09E, an increase in income levels may result in a fall in motorcycle penetration levels in the addressable population, which would aid steady growth in the segment. We estimate that the growth rate will pick up to 6% y-y by FY10E.

We believe Bajaj Auto will top the industry's volume growth because its export initiatives are paying off. We believe HH will continue to lead the domestic market. In our view, other marginal two-wheeler Indian players are likely to be left on the sidelines because they have neither the financial strength nor the product innovation skills to compete effectively.

Exhibit 23. Domestic motorcycle volume growth forecasts for major Indian two-wheeler players

	FY07A	FY08A	FY09E	FY10E	FY11E
Hero Honda					
Domestic motorcycle volumes (numbers)	3,157,429	3,144,270	3,507,322	3,726,737	3,959,403
Growth y-y (%)	9.1	-0.4	11.5	6.3	6.2
Market share (%)	48.2	54.5	57.6	57.7	57.8
Export volumes (numbers)	96,613	90,571	94,605	97,443	100,366
Growth y-y (%)	-10.3	-6.3	4.5	3	3
Total volumes (numbers)	3,254,042	3,234,841	3,601,927	3,824,180	4,059,769
Growth y-y (%)	8.4	-0.6	11.3	6.2	6.2
Bajaj Auto					
Domestic motorcycle volumes (numbers)	2,078,860	1,658,230	1,542,154	1,634,683	1,732,764
Growth y-y (%)	18.9	-20.2	-7	6	6
Market share (%)	31.7	28.7	25.3	25.3	25.3
Export volumes (numbers)	300,639	481,549	650,091	780,109	858,120
Growth y-y (%)	82.8	60.2	35	20	10
Total volumes (numbers)	2,379,499	2,139,779	2,192,245	2,414,793	2,590,884
Growth (%)	24.4	-10.1	2.5	10.2	7.3
TVSL					
Domestic motorcycle volumes (numbers)	844,174	510,455	562,825	592,003	617,423
Growth y-y (%)	12.2	-39.5	10.3	5.2	4.3
Market share (%)	12.9	8.8	9.2	9.2	9.2
Export volumes (numbers)	80,966	100,000	114,780	126,258	143,934
Growth y-y (%)	49.7	23.5	14.8	10	14
Total volumes (numbers)	922,936	610,455	677,605	718,261	761,357
Growth y-y (%)	14.5	-33.9	11	6	6
Industry domestic volumes (numbers)		6,557,405	5,768,881	6,091,938	6,457,455
Volume growth y-y (%)	12.85	-12.02	5.6	6	6

Source: SIAM, Nomura estimates

A three-tier market structure

The Indian motorcycle market has changed from a monolithic structure with most models priced around INR40,000 to a market with three broad price segments: premium (INR50,000-plus), executive (INR40,000-50,000) and economy (INR30,000-40,000).

Exhibit 24.Price segmentation and models of each competitor

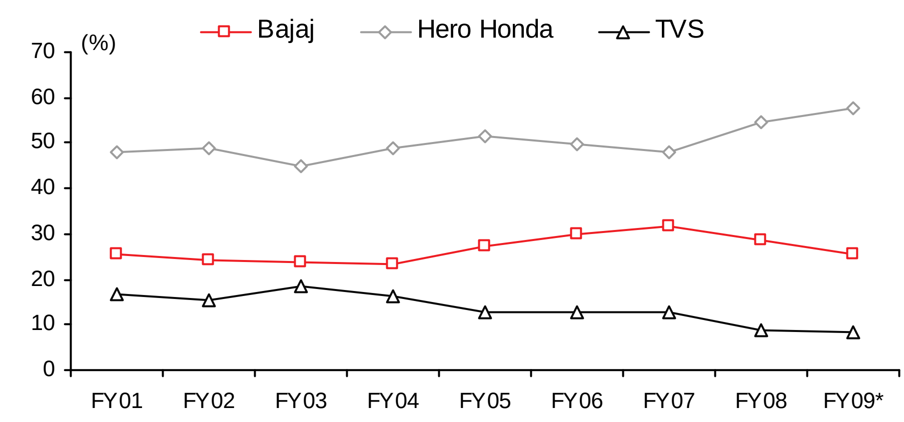
(INR)		Hero Honda	Bajaj Auto	TVS	Suzuki	HMSI	Yamaha
Premium	55,000+	CBZ Xtreme, Karizma; Glamour FI, Hunk	Pulsar 180, Avenger	Apache RTR		Unicorn ES	
	50,000-55,000	Achiever; Glamour	Discover, Pulsar 150	Flame		Stunner	
Executive	45,000-50,000	Super Splendor,		Victor upper end	Zeus CD	Shine	Gladiator SS
	40,000-45,000	Splendor, Passion, Glamour	Discover, XCD, Platina 125	Victor Edge	Zeus DU	Aviator	Gladiator; Alba,G5
Economy	35,000-40,000	CD Deluxe	Platina	Star; Star City ES	Heat, Access		Crux
	30,000-35,000	CD Dawn	CT100		-	-	

Source: Autocar Magazine, October 2007

Competition

HH has been the star performer in the motorcycle segment for the past two years, improving its domestic market share from 48.2% at end FY07 to 57.5% at end 1H FY09. Most of the gain in market share has come at the expense of Bajaj Auto, whose market share has fallen from 31.7% to 25.5% over the same period. Bajaj Auto has gained share in the economy segment against its stated plan of decreasing its share in this segment.

Exhibit 25. Domestic motorcycle market share

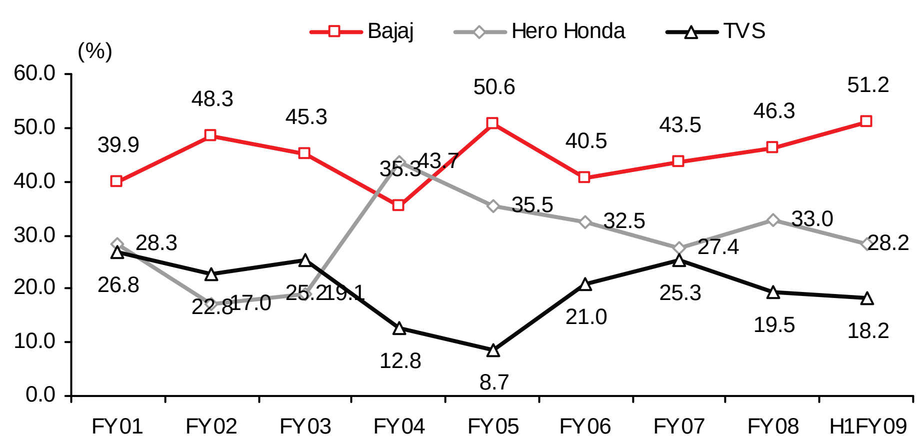


*till H1 FY09E

Source: SIAM, Nomura research

Bajaj Auto gained market share in the economy segment by undercutting prices, contrary to its stated plan of reducing its share in this segment.

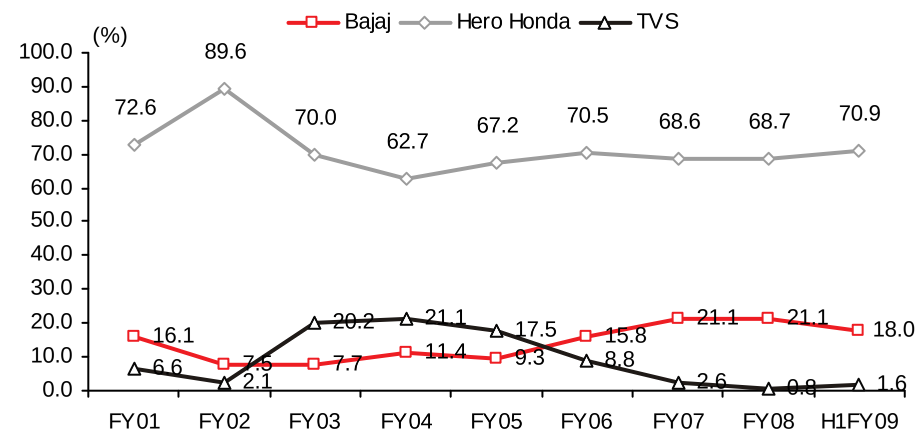
Exhibit 26. Market share in the economy segment



Source: Crisinfac

HH improved its share in the executive segment, because Bajaj's XCD model did not do well.

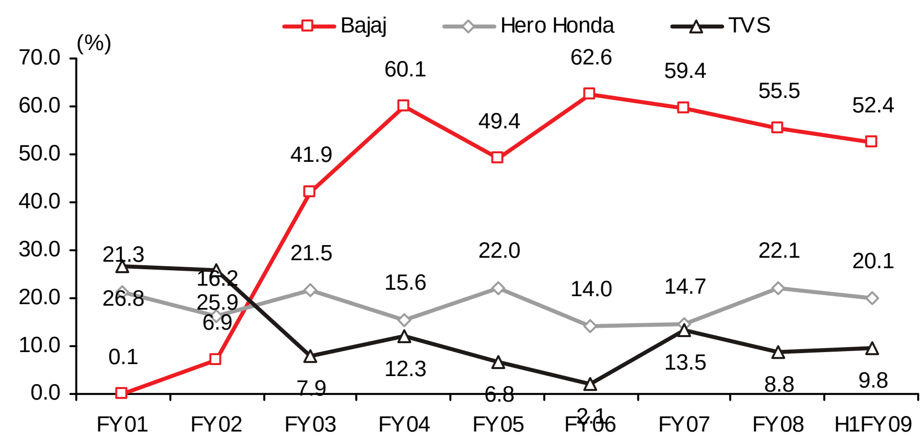
Exhibit 27. Market share in the executive segment



Source: Crisinfac

Bajaj dominated the premium segment for many years, but HH has started to make inroads into this segment over the past two years.

Exhibit 28. Market share in the premium segment

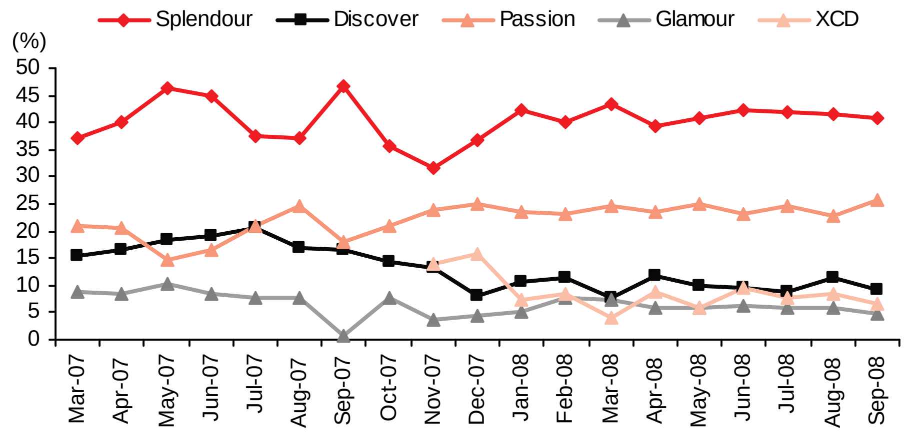


Source: Crisinfac

Bajaj Auto's XCD has not been successful so far

Bajaj Auto's new launch in the executive segment, the 'XCD,' has not done as well as the company hoped (Exhibit 29). There are three launches planned on this platform; if these are unsuccessful, HH's market position is likely to continue to improve. Moreover, according to management HH is also planning 11 launches (including variants) over the next 13 months as against Bajaj's four launches (across all platforms) over FY09.

Exhibit 29. Market share in the economy segment (by model)



Source: Company data, Nomura estimates

TVS's volumes have started to increase again

After a sharp fall in sales in FY08, TVS's volumes have started to grow again. TVS's new model, Apache, has been successful, although the Flame model has not done very well. We believe that the company's near-term margin outlook could improve if auto-grade steel prices were to correct. This would improve its ability to compete, in our view.

Scooters

Scooters, which formed the mainstay of the two–wheeler market until the early 1990s, are now down to 15% of the market's volume sales (based on FY08 sales). Since most buyers have shifted to motorcycles, scooter players have seen a significant shift in product focus.

No USP remains ...

Originally, scooters gained popularity for the following reasons:

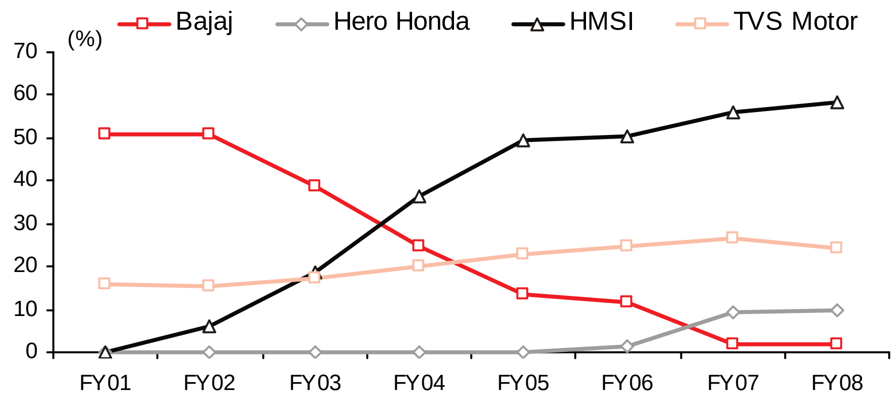
- *Lower pricing.* This is no longer true. Honda Motorcycle and Scooter India (HMSI)'s largest-selling scooter model is priced at INR37,000, higher than the typical entry-level motorcycle at INR33,000. In the past when scooters were the largest-selling two-wheeler category, they were priced INR10,000 less than motorcycles.
- *Family vehicle.* This positioning clearly does not work now because the slot has been taken over by small cars.

Given that these reasons no longer hold, the appeal of scooters as a mass-market product has also disappeared, in our view. In addition, the typical scooter's engine capacity of around 150cc is a natural constraint on fuel efficiency, which is an important consideration in these times of high fuel prices.

... which rules out major volumes from this segment

Since customer preference has shifted to motorcycles, traditional leaders in the scooter business have withdrawn from the market, giving way to new leaders in a significantly smaller market. Yearly scooter sales in FY08 were only 1mn as against 6.5mn for motorcycles.

Exhibit 30. Scooter market share by player



Source: SIAM, Nomura research

TVS's volume sales mainly come from the TVS Scooty, which at INR37,000, is priced about the same as a low-end motorcycle.

Scooters would be a niche market

In our view, the market for scooters is confined to: 1) low-priced vehicles, such as the Scooty, which appeal to low-budget buyers, like youngsters. Yet, in this segment volumes are likely to remain low because buyers would have to stretch their budget to graduate to motorcycles; and 2) niche vehicles, such as HH's scooters, which are positioned as easy-to-ride vehicles for women.

We believe there will be no major change in the fortunes of the scooter market in the near future. Even if there was a major push by any company in the scooter segment, we do not expect this to translate into significant volumes.

Mopeds

Sales of mopeds have shrunk radically over the years, owing to the drop in the prices of entry-level motorcycles and increased availability of inexpensive loans that have made motorcycles more affordable. The fuel-efficiency gap between motorcycles and mopeds has narrowed since the early 1990s.

Overall, we believe that mopeds will remain a small segment. Annual sales of mopeds were only 0.45mn in FY08. Some growth could trickle down to mopeds. We estimate that the moped segment will record a CAGR of 4-5% over the next three years.

Changing demographics to propel two-wheeler sales

To ascertain which two-wheeler stocks offer good investment opportunities, we believe it is important to examine the composition of growth in the market. We believe growth will shift from being affordability-led (i.e., via financing) to being led by the creation of new buyers, given the significant increase in the addressable segment.

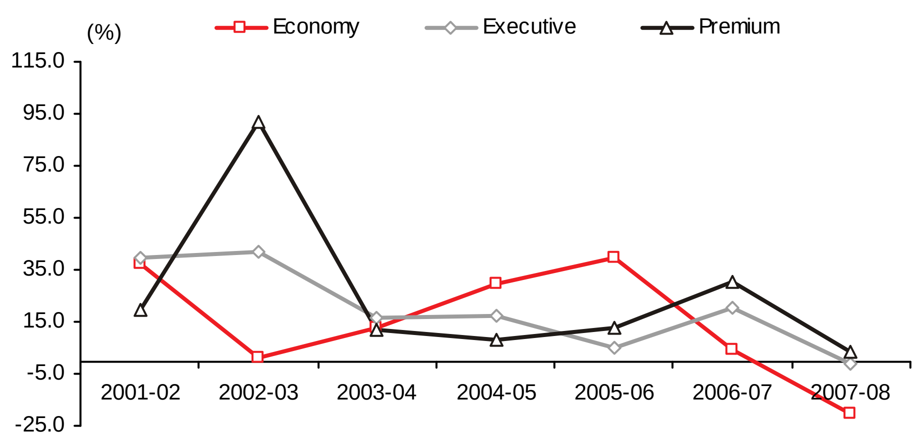
Exhibit 31 shows that the middle-income group is growing at a robust rate, with strong growth seen in the INR90,000-200,000 and INR200,000-500,000 income brackets. Most bicycle owners, who desire to move up to owning motorcycles, fall in the INR90,000-200,000 range. The creation of new buyers in this group constitutes a significant opportunity for two-wheeler players because these new buyers will likely fuel growth in executive segment motorcycles.

Exhibit 31. Growth rate of income classes

Income groups (INR '000)	Expected growth rate from 2005-06 to 2009-10 (%)	Growth rate from 2001-02 to 2005-06 (%)	No. of households (2001-02) (mn)
Up to 90	-13.5	-2.3	135.4
90-200	41.3	29.1	41.3
200-500	61.2	52.9	9
500-1000	92.2	87.6	1.7
1,000-2,000	111.5	105.5	0.5
2,000-5,000	128.4	125.9	0.2
5,000-10,000	147.6	157.5	-
Above 10,000	166	165	0.02
Total	**8.6**	**8.6**	**188.2**

Source: Tata Statistical Outline of India, 2004-05

Exhibit 32. Credit crunch has affected financing-led growth



Source: Crisinfac

We believe that credit availability has been the primary demand dampener in FY08. In the past, a number of banks lent aggressively to two-wheeler customers, pushing the penetration of financing in two-wheeler sales up from 40% in FY03 to 65% in FY07. With the rise in interest rates and credit availability issues, that number has come down to 45%

in FY09E, according to our channel checks with dealers. As long as credit availability remains tight, we estimate that growth in the economy segment will remain subdued.

Margins likely to improve from 3Q FY09E

Commodity prices, especially those of aluminium, softened in 3Q FY09E. We believe that this will translate into margin improvements for most two-wheeler companies. We also believe that steel prices could fall, improving the margins of two-wheeler companies.

Bajaj Auto-HH price war has faded away

Given the tough environment and sharp increases in commodity prices in FY08, players stopped offering discounts to consumers, which augurs well for margins. While another price war cannot be ruled out, given that it has not worked for Bajaj, we believe the likelihood of a price war is rather low.

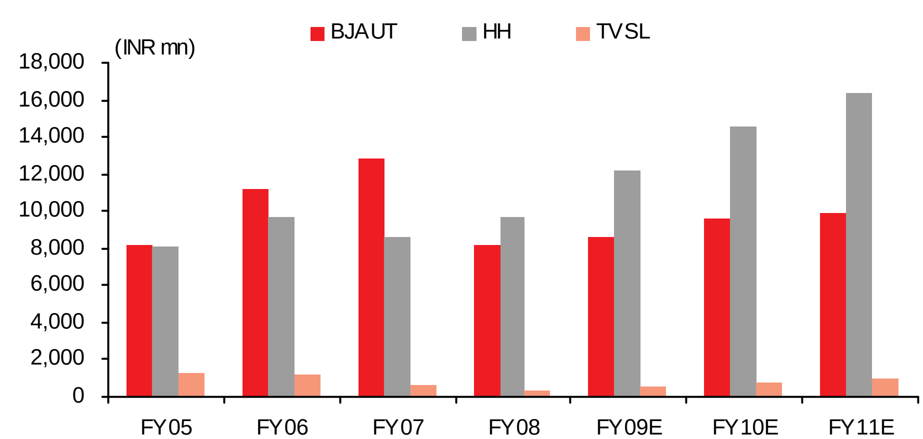
Bajaj's exports would pay rich dividends

Bajaj Auto is India's leading motorcycle exporter with more than a 60% market share in FY08. Its export volumes registered a CAGR of 44% over the past five years. We expect the company to sustain this momentum. HH has global scale and is the world's largest manufacturer of two-wheelers, but it would need a no objection certificate (NOC) from Honda before exporting to a particular country. Given that Honda also has its own 100%-owned subsidiary in India, HMSI (Honda Motorcycles and Scooters India), we believe HH's exports will remain limited.

Smaller players may be gradually edged out

We believe smaller players will find it tougher to compete in the Indian market. One reason is their lack of financial strength (Exhibit 33). Apart from Bajaj Auto, HH is the only company that has managed to succeed in the two-wheeler space. HH's success can be attributed to Bajaj Auto's miscalculations in product offerings (its focus was on scooters), in our view. However, at present, we believe there is no such headroom.

Exhibit 33. Absolute profit differential between various players



Source: Company data, Nomura research

Another influential factor is changing market behaviour, characterised by shrinking product life cycles. This implies that a company's competitive quotient could be determined by its ability to keep churning out new products, which would be a tall order for financially weaker players.

We, therefore, believe that the two-wheeler market will remain consolidated, if it does not become more concentrated among the top players.

Drop in penetration levels in addressable segment likely

We define the target segment as the number of households with an annual income less than INR500,000 but more than INR90,000. Because of a sharp increase in the number of households in the target segment and low growth rates due to the decreased availability of finance, we believe that penetration levels may decrease. Therefore, we expect positive volume growth to continue over the next few years, as there will be more people in the target segment

Exhibit 34. Two wheeler penetration in the addressable segment

('000)	FY02	FY06	FY10	Replacement cycle
No. of households in target group	50,296	67,089	97,572	
No. of two-wheelers in the market	25,875	38,462	54,343	8 years
Penetration (%)	51.4	57.3	55.7	
No. of two wheelers in the market	29,138	44,473	62,230	10 years
Penetration (base case) (%)	57.9	66.3	63.8	
No. of two-wheelers in the market	21,012	31,349	44,143	6 years
Penetration (%)	41.8	46.7	45.2	

Source: Nomura research, National Council for Applied Economic Research

High base would result in a slowdown in long-term growth rates

We believe volume growth will remain steady at a 6% CAGR over FY09E-11E before slowing further to a 4% CAGR during FY11E-16E. We estimate long-term two-wheeler volume growth to be close to 2% thereafter.

Company section

Maruti Suzuki India Limited

Stock rating: BUY
Sector view: BULLISH
Ticker: MSIL IS
Price (INR) 10 Nov: 594.3
Price target (INR): 775
Potential upside/downside: 30.4%

MSIL has held its market share steady at 51% for the past six years, despite intense competition. Trading at 9.4x FY10E EPS, we believe that it is undervalued, given its earnings CAGR of 20% over FY09E to FY11E and its long-term growth potential.

MSIL's margins have been under pressure over the past one year, especially in 1H FY09 because of steep increases in raw material costs. While some of these costs have begun to decrease, Maruti indicated that the resulting benefits will be reflected in margins only by the last quarter of FY09E. We are building in a 180bp improvement in margins in FY10E because of an expected decline in raw material costs and improvement in realisations.

We believe that MSIL's domestic volume growth will slow down in the near term because of a slowdown in GDP growth, but we estimate that overall volume growth will remain strong because of high export growth. MSIL will begin exporting its new model A Star to Europe, to be sold through the Suzuki dealership. MSIL will also contract manufacture 50,000 units of the same car for Nissan in FY10E.

Exhibit 35. MSIL: volume growth estimates

	FY07A	FY08A	FY09E	FY10E	FY11E	CAGR FY08-FY11E (%)
Cars	549,317	618,162	649,070	681,524	736,045	6.00
Growth y-y (%)		12.50	5.00	5.00	8.00	
UVs	86,312	93,656	93,656	98,339	10,5223	4.00
Growth y-y (%)		8.50	0.00	5.00	7.00	
Exports	39,294	53,024	80,978	150,978	196,271	54.70
Growth y-y (%)		34.90	52.70	86.40	30.00	
Total	674,923	764,842	823,704	930,840	1,037,539	10.70
Growth y-y (%)		13.30	7.70	13.00	11.50	
Exports (% of total volumes)	5.80	6.90	9.80	16.20	18.90	

Source: SIAM, Nomura estimates

MSIL has increased its focus on investment in R&D and this should start paying dividends in the form of better margins and lower royalty costs over the long term. Moreover, with support from Suzuki, MSIL may be able to increase its export volumes in some new markets. Suzuki's operating profit margin was 4.3% in FY08 compared with 12.4% for MSIL. Hence, even after adjusting for Suzuki's 54% holding in MSIL, it makes sense for the parent to export from India.

Valuation

On a discounted cash flow (DCF)-based valuation, our 12-month price target of INR775 builds in a terminal free cash flow to equity (FCFE) CAGR of 4%, after an intermediate stage earnings CAGR of 9.3% from FY11E to FY20E (Exhibit 36). The sales CAGR in volume terms for the past five years has been 16% and in value terms has been 19.7%. Given our expectation of strong growth ahead, we believe there are upside risks to our estimates. At INR595.3 (as of 10 November 2008), MSIL is trading at 9.4x FY10E and 8.2x FY11E EPS. We initiate coverage of the stock with a BUY rating.

Exhibit 36. MSIL: DCF-based valuation

(INRmn)	FY08	FY09E	FY10E	FY11E						
Total revenues	182,599	213,072	245,463	281,665						
Growth y-y (%)	22.1	16.7	15.2	14.7						
Operating profit	26,174	22,300	29,852	33,931						
OPM (%)	14.3	10.5	12.2	12.0						
Interest	596	619	620	629						
Depreciation	5,682	6,964	8,578	10,149						
PBT	19,896	14,717	20,654	23,153						
Tax	6,496	4,415	6,506	7,293						
Tax rate (%)	32.6	30.0	31.5	31.5						
PAT	1,300	1,002	1,448	1,560						
Growth y-y (%)	-1.1	-23.1	37.3	12.1						
Depreciation	5,682	6,964	8,578	10,149						
Capex	16,359	19,114	19,090	15,660						
delta WC	-10,748	-692	-993	493						
Debt issued - debt repaid	2,694	53	22	159						
FCFE	16,165	-1,102	4,651	10,015						
	FY12E	**FY13E**	**FY14E**	**FY15E**	**FY16E**	**FY17E**	**FY18E**	**FY19E**	**FY20E**	**TV (INRmn)**
PAT	17,922	20,252	22,884	25,173	27,690	30,182	32,597	33,901	35,257	
Growth y-y (%)	13.0	13.0	13.0	10.0	10.0	9.0	8.0	4.0	4.0	
FCFE	10,156	11,173	12,259	15,850	17,040	19,735	22,166	27,737	28,205	319,886
ROE (%)	30	29	28	27	26	26	25	22	20	
Retention ratio (%)	43	45	46	37	38	35	32	18	20	
NPV of FCFE	150,561									
No. of shares	288.91		**Terminal growth**	**WACC**						
			4%	**13.2%**						
	INR									
Price per share (March 08)	521									
Price per share (Nov 08)	589.8									
Cash/share	184.9									
Total value (Nov 09)	774.6									

Source: Nomura estimates

Investment risks

- Car sales in India are linked to income growth, which is dependent on overall economic growth. We are assuming GDP growth of 6.9% for FY10E. Any downturn in economic growth in India would have a significant negative impact on our growth assumptions and price target. A further rise in interest rates in India would also have a significant negative impact on our estimates.

- We have assumed that MSIL's future product launches will help it maintain steady growth rates. If many of its new launches are unsuccessful, our growth assumptions could be reduced sharply. We have also assumed improvements in operating margins. A sharp increase in raw material costs could have a negative impact on our margin assumptions.

- We have assumed that MSIL will be able to maintain its market share. However, if new or existing players are able to launch successful products, our growth forecasts would be affected negatively.

Exhibit 37. MSIL: income statement

Year-end 31 Mar (INRmn)	FY07	FY08	FY09E	FY10E	FY11E
Net sales	**145,922**	**178,603**	**208,510**	**240,308**	**275,919**
Growth (%)	21.6	22.4	16.7	15.2	14.8
Operating expenses	-126,778	-157,128	-190,970	-215,809	-247,931
Operating profit	**19,144**	**21,475**	**17,540**	**24,499**	**27,987**
Other income	6,601	8,825	10,436	11,196	13,087
EBITDA	**25,745**	**30,300**	**27,976**	**35,694**	**41,074**
Depreciation	-2,714	-5,682	-6,964	-8,578	-10,149
Expenses capitalised	143	198	198	198	198
EBIT	**23,174**	**24,816**	**21,210**	**27,315**	**31,123**
Interest paid	-376	-596	-619	-620	-629
Associates	0	0	0	0	0
Non-recurring items (net of taxes)	0	-1,160	0	0	0
Pre-tax profit	**22,798**	**23,060**	**20,591**	**26,695**	**30,494**
Tax (current + deferred)	-7,178	-7,722	-6,177	-8,409	-9,606
Profit after tax	**15,620**	**15,338**	**14,414**	**18,286**	**20,888**
Minority interests	0	0	0	0	0
Preference dividend	0	0	0	0	0
Net profit	**15,620**	**15,338**	**14,414**	**18,286**	**20,888**
Adjusted net profit	**15,620**	**16,498**	**14,414**	**18,286**	**20,888**
Growth (%)	37	5.6	-12.6	26.9	14.2

Source: Company data, Nomura estimates

Exhibit 38. MSIL: balance sheet

Year-end 31 Mar (INRmn)	FY07	FY08	FY09E	FY10E	FY11E
Current assets	38,459	30,909	36,219	45,440	52,157
Investments	34,092	51,807	53,407	60,407	73,407
Associates	0	0	0	0	0
Net fixed assets	28,986	40,328	52,477	62,989	68,500
Other non-current assets	0	0	0	0	0
Total assets	**101,537**	**123,044**	**142,103**	**168,837**	**194,064**
Current liabilities	22,784	26,608	32,611	42,825	49,048
Total debt	6,308	9,002	9,055	9,077	9,236
Other liabilities	3,906	3,280	3,280	3,280	3,280
Total liabilities	**32,998**	**38,890**	**44,946**	**55,182**	**61,564**
Share capital	1,445	1,445	1,445	1,445	1,445
Reserves and surplus	67,094	82,709	95,713	112,210	131,055
Shareholders' funds	**68,539**	**84,154**	**97,158**	**113,655**	**132,500**
Minorities	0	0	0	0	0
Total equity and liabilities	**101,537**	**123,044**	**142,103**	**168,837**	**194,064**

Source: Company data, Nomura estimates

Exhibit 39. MSIL: cash flow statement

Year-end 31 Mar (INRmn)	FY07	FY08	FY09E	FY10E	FY11E
Pre-tax profit	22,798	23,060	20,591	26,695	30,494
Depreciation	2,714	5,682	6,964	8,578	10,149
Tax paid	-6,023	-8,452	-6,262	-8,286	-9,540
Chg in working capital	2,885	292	1,601	1,711	-73
Other operating activities	0	0	0	0	0
Cash flow from operations (a)	**22,374**	**20,582**	**22,894**	**28,698**	**31,031**
Capital expenditure	-13,391	-16,359	-19,114	-19,090	-15,660
Chg in investments	-13,580	-17,715	-1,600	-7,000	-13,000
Chg in associates	0	0	0	0	0
Other investing activities	0	0	0	0	0
Cash flow from investing (b)	**-26,971**	**-34,074**	**-20,714**	**-26,090**	**-28,660**
Free cash flow (a+b)	**-4,597**	**-13,492**	**2,181**	**2,608**	**2,371**
Equity raised/(repaid)	0	0	0	0	0
Chg in minorities	0	0	0	0	0
Debt raised/(repaid)	5,591	2,694	53	22	159
Dividend (incl. tax)	-1,153	-1,521	-1,691	-1,410	-1,789
Other financing activities	371	0	0	0	0
Cash flow from financing (c)	**4,809**	**1,173**	**-1,638**	**-1,388**	**-1,629**
Net chg in cash (a+b+c)	**212**	**-12,319**	**543**	**1,220**	**741**

Source: Company data, Nomura estimates

Exhibit 40. MSIL: key ratios

Year-end 31 Mar (INRmn)	FY07	FY08	FY09E	FY10E	FY11E
Adjusted EPS (INR)	54	57.1	49.9	63.3	72.3
Adjusted EPS growth (%)	37	5.6	-12.6	26.9	14.2
EBITDA growth (%)	28.7	17.7	-7.7	27.6	15.1
EBITDA margin (%)	17.6	17	13.4	14.9	14.9
Pre-tax margin (%)	15.6	12.9	9.9	11.1	11.1
ROE (%)	25.4	21.6	15.9	17.3	17
ROCE (%)	33.5	28.3	20.6	23.2	23
Net debt/equity (%)	-61.3	-54.7	-49.5	-49.6	-52.8

Source: Company data, Nomura estimates

Exhibit 41. MSIL: valuations

Year-end 31 Mar (INRmn)	FY07	FY08	FY09E	FY10E	FY11E
P/E (x)	11.0	10.4	11.9	9.4	8.2
PCE (x)	9.4	7.7	8.0	6.4	5.5
P/B (x)	2.5	2.0	1.8	1.5	1.3
Yield (%)	0.9	1.0	0.8	1.0	1.2
EV/net sales (x)	0.9	0.7	0.6	0.5	0.4
EV/EBITDA (x)	5.0	4.1	4.4	3.2	2.5

Source: Company data, Nomura estimates

Hero Honda

Stock rating: BUY
Sector view: BULLISH
Ticker: HH IS
Price (INR) 10 Nov: 756.3
Price target (INR): 946
Potential upside/downside: 25.1%

HH is India's leading two-wheeler manufacturer, with a domestic market share of 57.5% in motorcycles. Over the past year, HH has improved its market share from 48.2% at the end of FY07 to 57.5% at the end of 1H FY09. Although we expect volume growth to slow down to 3.4% in 2H FY09E, we believe that over the medium term, earnings will continue to register strong growth, because of tax breaks at its new plant in Haridwar. Trading at 10.4x FY010E EPS, we believe HH is undervalued given we estimate an earnings CAGR of 19% over FY08 to FY11E.

HH's new plant in Haridwar is eligible for a 100% income-tax benefit for the next five years and a 30% income tax benefit for five years thereafter. In addition, HH is also eligible for 100% excise duty benefit for the first ten years of operation. Since we expect volumes from the new plant to pick up from 16% of total volumes in FY09E to 36% in FY11E, we estimate that HH's tax rate could come down to 22% in FY11E from 31.4% in FY08, aiding strong earnings growth.

The stock has outperformed the BSE Sensex by 56% YTD, we believe primarily because of the continuous earnings upgrade by consensus over the past one year because of the strong volume growth in 1H FY09E. Consensus estimates (Bloomberg) for FY09E have increased approximately 15% over the past one year. Our EPS estimate for FY10E is ahead of consensus by 5% for FY10E, and there could be upsides to our estimates if the correction in commodity prices is sharper than our estimates.

Valuation

We value HH based on DCF. For this purpose we have used an 11.8% discount rate (based on Rf=7.5%, Rp=7% and beta = 0.614) with a 5% earnings CAGR from FY11E to FY16E and terminal growth of 2% thereafter. The implied multiple on our target is 11.5x FY11E, which is near the lower end of HH's past five-year trading band.

Exhibit 42. Hero Honda: DCF-based valuation

	FY05A	FY06A	FY07A	FY08E	FY09E	FY10E	FY11E
Total revenues	74551	87,515	99,482	103,729	123,346	131,410	140,673
Growth y-y (%)		17.4	13.6	4.4	19.0	6.6	7.1
Operating profit	11,923	13,910	12,099	13,807	16,484	18,583	20,079
OPM (%)	16.0	15.9	12.2	13.3	13.4	14.1	14.3
Interest	-11	-61	-230	-358	0	0	0
Depreciation	894	1,146	1,398	1,603	1,931	2,302	2,542
PBT	11,040	12,825	10,931	12,562	14,553	16,281	17,537
Tax	3,689	4,004	3,405	3,941	3,961	3,856	3,910
Tax rate	33.42	31.22	31.15	31.37	27.21	23.69	22.30
PAT	7,351	8,821	7,526	8,621	10,593	12,424	13,627
Growth y-y (%)	-	20.00	(14.69)	14.56	22.86	17.29	9.68
Depreciation	894	1,146	1,398	1,603	1,931	2,302	2,542
Increase in WC	-4,097	1,858	1,662	-3,231	-1,922	-1,379	-1,194
Capex	2,499	3,711	4,744	3,567	2,500	2,500	2,500
Debt raised-debt repaid	271	-160	-206	-332	69	-51	898
Equity raised	0	0	0	0	0	0	0
Free cash flow	10,114	4,238	2,311	9,557	12,016	13,555	15,761
	FY12E	**FY13E**	**FY14E**	**FY15E**	**FY16E**		
PAT	14,445	15,311	16,077	16,881	17,387		
Growth y-y (%)	6.00	6.00	5.00	5.00	3.00		
FCFE	11,556	12,249	13,397	13,504	14,779		
ROE	30.00	30.00	30.00	25.00	20.00		
Retention ratio	20.00	20.00	16.67	20.00	15.00		
NPV of FCFE	135,395						
			Terminal ROE (%)	**Terminal growth (%)**	**Cost of equity (%)**	**TV (INRmn)**	
No. of shares	200		20.0	2.0	11.8	162,904	
Price per share [Nov 2008]	678						
Cash per share [March 2009]	168.4						
Total	846.4						
Price per share [Nov 2009]	946.3						

Source: Company data, Nomura estimates

Investment risks

- We have assumed a moderate growth rate for motorcycles. If volume growth is lower than our expectations, there could be downside to our estimates.
- We have assumed that the prevailing tight monetary conditions will begin to ease off by end-FY09E. If credit availability remains tight, volume growth may be negatively affected.
- If the ramp-up at the new plant is slower than our estimates, margins could be lower than our forecasts; in which case, even the tax rate could be higher than our estimates.
- We have assumed that commodity prices will soften in FY10E. If the prices do not fall, there would be downside risks to our margin estimates.

Exhibit 43. Hero Honda: income statement

Year-end 31 Mar (INRmn)	FY07	FY08	FY09E	FY10E	FY11E
Net sales	**99,000**	**103,318**	**122,926**	**131,013**	**140,268**
Growth (%)	13.6	4.4	19	6.6	7.1
Operating expenses	-87,384	-89,922	-106,862	-112,828	-120,593
Operating profit	**11,616**	**13,396**	**16,064**	**18,185**	**19,674**
Other income	2,013	1,966	2,601	3,213	3,997
EBITDA	**13,629**	**15,362**	**18,665**	**21,398**	**23,671**
Depreciation	-1,398	-1,603	-1,931	-2,302	-2,542
Expenses capitalised	0	0	0	0	0
EBIT	**12,231**	**13,759**	**16,734**	**19,096**	**21,129**
Interest paid	230	358	0	0	0
Associates	0	0	0	0	0
Non-recurring items (net of taxes)	0	0	0	0	0
Pre-tax profit	**12,461**	**14,117**	**16,734**	**19,096**	**21,129**
Tax (current + deferred)	-3,882	-4,424	-4,554	-4,523	-4,711
Profit after tax	**8,579**	**9,693**	**12,180**	**14,573**	**16,418**
Minority interests	0	0	0	0	0
Preference dividend	0	0	0	0	0
Net profit	**8,579**	**9,693**	**12,180**	**14,573**	**16,418**
Adjusted net profit	**8,579**	**9,693**	**12,180**	**14,573**	**16,418**
Growth (%)	-11.7	13	25.7	19.6	12.7

Source: Company data, Nomura estimates

Exhibit 44. Hero Honda: balance sheet

Year-end 31 Mar (INRmn)	FY07	FY08	FY09E	FY10E	FY11E
Current assets	28,837	35,001	44,780	54,469	66,293
Investments	35	35	35	35	35
Associates	0	0	0	0	0
Net fixed assets	13,555	15,648	16,216	16,414	16,372
Other non-current assets	14	52	52	52	52
Total assets	**42,440**	**50,736**	**61,083**	**70,970**	**82,752**
Current liabilities	14,429	17,753	21,454	23,522	25,540
Total debt	1,652	1,320	1,389	1,338	2,237
Other liabilities	1,658	1,801	1,801	1,801	1,801
Total liabilities	**17,739**	**20,873**	**24,644**	**26,661**	**29,577**
Share capital	399	399	399	399	399
Reserves and surplus	24,301	29,463	36,040	43,909	52,775
Shareholders' funds	**24,701**	**29,862**	**36,439**	**44,309**	**53,174**
Minorities	0	0	0	0	0
Total equity and liabilities	**42,440**	**50,736**	**61,083**	**70,970**	**82,752**

Source: Company data, Nomura estimates

Exhibit 45. Hero Honda: cash flow statement

Year-end 31 Mar (INRmn)	FY07	FY08	FY09E	FY10E	FY11E
Pre-tax profit	12,461	14,117	16,734	19,096	21,129
Depreciation	1,398	1,603	1,931	2,302	2,542
Tax paid	-3,884	-4,399	-4,554	-4,523	-4,711
Chg in working capital	-2,402	3,681	1,013	381	463
Other operating activities	0	0	0	0	0
Cash flow from operations (a)	**7,573**	**15,002**	**15,124**	**17,256**	**19,423**
Capital expenditure	-4,744	-3,567	-2,500	-2,500	-2,500
Chg in investments	880	-5,930	-8,000	-9,000	-11,000
Chg in associates	0	0	0	0	0
Other investing activities	0	0	0	0	0
Cash flow from investing (b)	**-3,864**	**-9,497**	**-10,500**	**-11,500**	**-13,500**
Free cash flow (a+b)	**3,709**	**5,506**	**4,624**	**5,756**	**5,923**
Equity raised/(repaid)	0	0	0	0	0
Chg in minorities	0	0	0	0	0
Debt raised/(repaid)	-206	-332	69	-51	898
Dividend (incl. tax)	-4,554	-3,972	-4,439	-5,603	-6,704
Other financing activities	-179	0	0	0	0
Cash flow from financing (c)	**-4,939**	**-4,303**	**-4,370**	**-5,654**	**-5,805**
Net chg in cash (a+b+c)	**-1,230**	**1,202**	**254**	**102**	**118**

Source: Company data, Nomura estimates

Exhibit 46. Hero Honda: key ratios

Year-end 31 Mar (INRmn)	FY07	FY08	FY09E	FY10E	FY11E
Adjusted EPS (INR)	43	48.5	61	73	82.2
Adjusted EPS growth (%)	-11.7	13	25.7	19.6	12.7
EBITDA growth (%)	-10.4	12.7	21.5	14.6	10.6
EBITDA margin (%)	13.8	14.9	15.2	16.3	16.9
Pre-tax margin (%)	12.6	13.7	13.6	14.6	15.1
ROE (%)	38.3	35.5	36.7	36.1	33.7
ROCE (%)	47.5	45.1	46.1	43.9	40.4
Net debt/equity (%)	-74.5	-85.8	-92.8	-97	-100

Source: Company data, Nomura estimates

Exhibit 47. Hero Honda: valuations

Year-end 31 Mar (INRmn)	FY07	FY08	FY09E	FY10E	FY11E
P/E (x)	17.6	15.6	12.4	10.4	9.2
PCE (x)	15.1	13.4	10.7	8.9	8.0
P/B (x)	6.1	5.1	4.1	3.4	2.8
Yield (%)	2.6	2.9	3.7	4.4	5.0
EV/net sales (x)	1.3	1.2	1.0	0.8	0.7
EV/EBITDA (x)	9.6	8.2	6.3	5.0	4.1

Source: Company data, Nomura estimates

Bajaj Auto

Stock rating: BUY
Sector view: BULLISH
Ticker: BJAUT IS
Price (INR) 10 Nov: 425.9
Price target (INR): 544
Potential upside/downside: 27.7%

Bajaj's domestic two-wheeler business has been under some stress since its new model XCD is not doing well. Bajaj's market share in the domestic two-wheeler segment has fallen from 31.7% at the end of FY08 to 25.5% in 1H FY09. However, its export volumes have grown rapidly at 61.8% in FY08 and 40.5% in 1H FY09. With strong growth in exports continuing, we estimate Bajaj Auto's two-wheeler volumes will improve by 2.4% in FY09 and 10% in FY10. We initiate coverage of Bajaj Auto with a BUY rating since it is trading at 6.0x FY11E compared with 9.2x for HH. We believe that it is undervalued even after accounting for the near-term weak business outlook.

However, its three-wheeler business is likely to decline. We estimate that Bajaj Auto's three-wheeler volumes will fall 2% in FY10E and 10% in FY11E, after the launch of its four-wheeler. We estimate that in FY08, approximately 21% of Bajaj Auto's net sales and 33% of its operating profit would have come from the three-wheeler business. We expect this to decline to 28% by FY11. There could be downside risks to this estimate if a regulatory change allows Tata Motors new car, Nano, to replace three-wheelers.

Exhibit 48. Bajaj Auto: volume growth estimates

	FY06A	FY07A	FY08A	FY09E	FY10E	FY11E
Total two-wheelers	2,029,176	2,399,996	2,161,095	2,213,561	2,439,306	2,617,849
Growth y-y (%)	35.3	18.3	-10	2.4	10.2	7.3
Three wheelers						
Domestic volumes	176,745	181,133	153,986	146,287	138,972	118,127
Growth y-y (%)	13.1	2.5	-15	-5	-5	-15
Market share (%)	49.1	44.8	42.2	42.2	42.2	37.8
Export volumes	75,261	140,663	136,326	144,025	145,533	137,929
Growth y-y (%)	14.5	86.9	-3.1	5.6	1	-5.2
Total volumes	252,054	321,828	290,312	290,312	284,506	256,055
Growth y-y (%)	13.5	27.7	-9.8	0	-2	-10

Source: Company data, Nomura estimates

Valuation

We value Bajaj Auto based on DCF. Bajaj Auto does not have enough trading history to get a right sense on beta. (With its limited trading history, beta works out to 13.2%). Given the risks to Bajaj's three wheeler business, we have assumed a discount rate of 15% for Bajaj Auto. We have built in a 4.2% earnings CAGR from FY11E to FY16E and terminal growth of 2% thereafter. The implied multiple on our target is 7.7x FY11E, which is around a 30% discount to our target for HH. We believe this is a fair discount because of risks to Bajaj's three-wheeler business and its weak position in the domestic two-wheeler business.

Exhibit 49. Bajaj Auto: DCF-based valuation

		FY09E	**FY10E**	**FY11E**		
Total revenues		97,203	105,555	117,430		
Growth y-y (%)		7.8	8.6	11.3		
Operating profit		12,940	14,352	15,293		
OPM (%)		13.3%	13.6%	13.0%		
Interest		56	68	69		
Depreciation		1,372	1,483	1,593		
PBT		11,511	12,801	13,631		
Extraordinary income/(loss)		-3,515	-1,833	0		
Tax		2,633	3,615	4,499		
Tax rate		32.9	33.0	33.0		
PAT		,5362.4	7,353.3	9,131.8		
Growth y-y (%)		-15.7	37.1	24.2		
Depreciation		1,372	1,483	1,593		
Increase in WC		-317	-286	54		
Capex		2,500	2,500	2,500		
Debt raised-debt repaid		12	20	-17		
Equity raised		0	0	0		
	FY12E	**FY13E**	**FY14E**	**FY15E**	**FY16E**	
PAT	9,680	10,164	10,570	10,887	11,214	
Growth y-y (%)	6.0	5.0	4.0	3.0	3.0	
FCFE	8,018	8,574	9,110	9,629	9,749	
ROE	35.0	32.0	29.0	26.0	23.0	
Retention ratio	17.2	15.6	13.8	11.6	13.1	
			Terminal ROE (%)	**Terminal growth (%)**	**Cost of equity (%)**	**TV (INRmn)**
NPV of FCFE	62,403		20.00	2.00	15.0	79,188
No. of shares	144.68					
Per share[Nov 2008]	431					
Investments	41					
Total [Nov 2008]	473					
Price target [Nov 2009]	544					

Source: Company data, Nomura estimates

Investment risks

- Nano could replace passenger three-wheelers. If the volume decline in three-wheelers is sharper than expected because of regulatory changes allowing products such as Nano to replace passenger three-wheelers, Bajaj Auto's volumes will fall sharply, resulting in a sharp earnings decline.

- Variants of XCD do not succeed. If variants of Bajaj Auto's XCD do not succeed, HH could continue to dominate the segment.

- Failure of new four-wheeler. Bajaj's new four-wheeler will face significant competition from players such as Tata Motors (TTMT IS, not rated), Mahindra & Mahindra (MM IS, not rated), Ashok Leyland (AL IS, not rated) and Piaggio (India) (not listed). We believe the new four-wheeler might not be as successful as its three-wheeler or the profitability of the four-wheeler could be much lower.

- **Significant risks to new small car venture.** Bajaj Auto plans to launch a small car around FY12. We believe that this product may not turn out to be a commercial success because 1) competition in this space is likely to increase further and 2) if the product competes with Tata Motors' 'Nano' the project may not be viable, given the limited payoff from the segment.

Exhibit 50. Bajaj Auto: income statement

Year-end 31 Mar (INRmn)	FY09E	FY10E	FY11E
Net sales	93,840	101,855	113,360
Growth (%)	8.3	8.5	11.3
Operating expenses	-84,494	-91,434	-102,367
Operating profit	9,346	10,421	10,992
Other income	4,433	4,996	5,679
EBITDA	13,779	15,418	16,671
Depreciation	-1,372	-1,483	-1,593
Expenses capitalised	230	230	230
EBIT	12,637	14,165	15,308
Interest paid	-56	-68	-69
Associates	0	0	0
Non-recurring items (net of taxes)	-3,515	-1,833	0
Pre-tax profit	9,065	12,264	15,239
Tax (current + deferred)	-4,143	-4,646	-5,030
Profit after tax	4,922	7,618	10,209
Minority interests	0	0	0
Preference dividend	0	0	0
Net profit	4,922	7,618	10,209
Adjusted net profit	8,437	9,451	10,209
Growth (%)	2.4	12.0	8.0

Source: Company data, Nomura estimates

Exhibit 51. Bajaj Auto: balance sheet

Year-end 31 Mar (INRmn)	FY09E	FY10E	FY11E
Current assets	32,139	37,434	44,852
Investments	6,259	6,259	6,259
Associates	0	0	0
Net fixed assets	14,166	15,183	16,090
Other non-current assets	1,310	1,310	1,310
Total assets	53,874	60,186	68,511
Current liabilities	18,989	20,790	22,954
Total debt	13,355	13,376	13,359
Other liabilities	2,905	2,905	2,905
Total liabilities	35,250	37,071	39,218
Share capital	1,447	1,447	1,447
Reserves and surplus	17,177	21,668	27,846
Shareholders' funds	18,624	23,115	29,293
Minorities	0	0	0
Total equity and liabilities	53,874	60,186	68,511

Source: Company data, Nomura estimates

Exhibit 52. Bajaj Auto: cash flow statement

Year-end 31 Mar (INRmn)	FY09E	FY10E	FY11E
Pre-tax profit	9,065	12,264	15,239
Depreciation	1,372	1,483	1,593
Tax paid	-3,747	-4,210	-4,551
Chg in working capital	-470	-498	-758
Other operating activities	0	0	0
Cash flow from operations (a)	6,220	9,039	11,523
Capital expenditure	-2,505	-2,500	-2,500
Chg in investments	-1,950	-3,780	-5,200
Chg in associates	0	0	0
Other investing activities	0	0	0
Cash flow from investing (b)	-4,455	-6,280	-7,700
Free cash flow (a+b)	1,766	2,759	3,823
Equity raised/(repaid)	0	0	0
Chg in minorities	0	0	0
Debt raised/(repaid)	12	20	-17
Dividend (incl. tax)	-2,894	-3,332	-3,732
Other financing activities	0	0	0
Cash flow from financing (c)	-2,882	-3,311	-3,749
Net chg in cash (a+b+c)	-1,116	-552	74

Source: Company data, Nomura estimates

Exhibit 53. Bajaj Auto: key ratios

Year-end 31 Mar (INRmn)	FY09E	FY10E	FY11E
Adjusted EPS (INR)	58.3	65.3	70.6
Adjusted EPS growth (%)	2.4	12.0	8.0
EBITDA growth (%)	-1.1	11.9	8.1
EBITDA margin (%)	14.7	15.1	14.7
Pre-tax margin (%)	9.7	12.0	13.4
ROE (%)	48.9	45.3	39.0
ROCE (%)	37.7	38.1	36.0
Net debt/equity (%)	-8.1	-23.0	-36.2

Source: Company data, Nomura estimates

Exhibit 54. Bajaj Auto: valuations

Year-end 31 Mar (INRmn)	FY09E	FY10E	FY11E
P/E (x)	7.3	6.5	6.0
PCE (x)	6.3	5.6	5.2
P/B (x)	3.3	2.7	2.1
Yield (%)	4.8	5.4	5.8
EV/Net sales (x)	0.4	0.4	0.3
EV/EBITDA (x)	3.0	2.4	1.9

Source: Company data, Nomura estimates

TVS Motor Company

Stock rating: NEUTRAL
Sector view: BULLISH
Ticker: TVSL IS
Price (INR) 10 Nov: 28.5
Price target (INR): 30.4
Potential upside/downside: 7%

Trading at 8.7x FY10E EPS, TVS appears undervalued when compared with its competitors. However, we believe that its business is more risky than that of its competitors. The company has always banked on a star product. In early 2000-01 it was 'Victor,' and in the past few years it has been 'Star'. However, it has not had a successful product since FY07. TVS's competitors are also much stronger financially and can roll out multiple variants and models quickly.

We believe that even with raw material pressures easing off next year TVS's margins will remain under constant threat from the strong competitive environment and will remain far below those of its competitors. TVS's past successes in volumes came from the economy segment alone, where pricing power is rather low. To improve its performance, TVS must demonstrate success with high-end products, which it has not yet done. TVS has entered the three-wheeler business in 2008 when the market is in a structural decline. Hence, we are not optimistic about its three-wheeler volume growth.

TVS has the least financial flexibility among the three large two-wheeler players in India. It is the only two-wheeler company in our coverage which has positive net debt. It has made significant investments in Indonesia, which are yet to break even. We estimate that the company may just about break even in Indonesia in FY10E and hence are not assigning any value to the venture at this stage.

Valuation

We rate TVS NEUTRAL, with a 12-month price target of INR30.4. We have valued TVS based on DCF. We have used a discount rate of 13.8% (beta=0.9,Rf=7.5, Rp=7) with a 3.2% earnings CAGR from FY11E to FY16E and terminal growth of 2% thereafter. The implied multiple on our target is 7.4x FY11E.

Exhibit 55. TVS: DCF-based valuation

	FY07A	FY08E	FY09E	FY10E	FY11E	
Total revenues	39,101	32,936	38,371	41,263	44,519	
Growth y-y (%)	19.2	-16.5	17.2	7.5	7.9	
Operating profit	1,924	1,154	1,960	2,356	2,551	
OPM (%)	4.9	3.5	5.1	5.7	5.7	
Interest	321	22	378	355	276	
Depreciation	876	946	1,054	1,097	1,141	
PBT	728	186	527	903	1,135	
Tax	243	36	153	275	346	
Tax rate	27	10	29	31	31	
PAT	485	150	374	628	788	
Growth y-y (%)	-47.9	-69.1	150.1	67.7	25.6	
Depreciation	876	946	1,054	1,097	1,141	
Increase in WC	820	107	576	213	271	
Capex	2,835	1,287	750	750	750	
Debt raised-debt repaid	2,485	328	-28	34	-195	
Equity raised	0	0	0	0	0	
Free cash flow	192	29	75	797	713	
	FY12E	FY13E	FY14E	FY15E	FY16E	
PAT	828	853	878	905	923	
Growth y-y (%)	5.00	3.00	3.00	3.00	2.00	
FCFE	478	653	688	722	798	
ROE	11.84	12.84	13.84	14.84	14.84	
Retention ratio	42.2	23.4	21.7	20.2	13.5	
NPV of FCFE	5,489					
			Terminal ROE (%)	**Terminal growth (%)**	**Cost of equity (%)**	**TV (INRmn)**
No. of shares	237.5		14.50	2.00	13.80	6,876
Price per share[Nov 2008]	23.1					
Cash per share	3.6					
Total (Nov 2008)	26.7					
Price per share[Nov 2009]	30.4					

Source: Company data, Nomura estimates

Investment risks

- Key upside risks: We have assumed that TVS's new product launches will be moderately successful. If these are highly successful, there could be significant upside to our estimates. We have not included income from TVS's Indonesia operations in our estimates. If TVS can make significant profits in Indonesia, its earnings could be higher than our estimates.

- Key downside risks: We have assumed that competitive intensity will not increase substantially from current levels. In case of a price war, of the top three TVS would likely suffer the most. We have assumed that there will be no significant increase in raw material costs beyond the current fiscal year. If raw material costs rise further, there could be downside risks to our margin estimates. We have assumed that TVS will improve its performance to start making higher returns on equity in the medium term. If higher returns do not materialise, there will be downside risks to our estimates.

Exhibit 56. TVS: income statement

Year-end 31 Mar (INRmn)	FY07A	FY08A	FY09E	FY10E	FY11E
Net sales	**38,724**	**33,196**	**38,371**	**41,263**	**44,519**
Growth (%)	15.8	-14.3	15.6	7.5	7.9
Operating expenses	-36,799	-32,043	-36,411	-38,907	-41,968
Operating profit	**1,924**	**1,154**	**1,960**	**2,356**	**2,551**
Other income	181	287	169	213	262
EBITDA	**2,105**	**1,441**	**2,129**	**2,569**	**2,813**
Depreciation	-876	-946	-1,054	-1,097	-1,141
Expenses capitalised	0	0	0	0	0
EBIT	**1,229**	**495**	**1,075**	**1,471**	**1,672**
Interest paid	-321	-22	-378	-355	-276
Associates	0	0	0	0	0
Non-recurring items (net of taxes)	0	-119	0	0	0
Pre-tax profit	**908**	**354**	**696**	**1,116**	**1,396**
Tax (current + deferred)	-243	-36	-202	-340	-426
Profit after tax	**666**	**318**	**494**	**776**	**970**
Minority interests	0	0	0	0	0
Preference dividend	0	0	0	0	0
Net profit	**666**	**318**	**494**	**776**	**970**
Adjusted net profit	**666**	**437**	**494**	**776**	**970**
Growth (%)	-43.1	-34.4	13.2	56.9	25.1

Source: Company data, Nomura estimates

Exhibit 57. TVS: balance sheet

Year-end 31 Mar (INRmn)	FY07A	FY08A	FY09E	FY10E	FY11E
Current assets	8,224	7,748	9,193	9,855	10,631
Investments	3,447	3,390	3,390	4,140	4,840
Associates	0	0	0	0	0
Net fixed assets	10,029	10,431	10,126	9,779	9,389
Other non-current assets	0	0	0	0	0
Total assets	**21,701**	**21,568**	**22,709**	**23,774**	**24,859**
Current liabilities	5,770	5,058	5,927	6,376	6,881
Total Debt	6,336	6,663	6,635	6,670	6,474
Other liabilities	2,087	2,159	2,159	2,159	2,159
Total liabilities	**14,193**	**13,880**	**14,722**	**15,205**	**15,515**
Share capital	238	238	238	238	238
Reserves and surplus	7,270	7,451	7,750	8,331	9,107
Shareholders' funds	7,507	7,688	7,988	8,569	9,345
Minorities	0	0	0	0	0
Total equity and liabilities	**21,701**	**21,568**	**22,709**	**23,774**	**24,859**

Source: Company data, Nomura estimates

Exhibit 58. TVS: cash flow statement

Year-end 31 Mar (INRmn)	FY07A	FY08A	FY09E	FY10E	FY11E
Pre-tax profit	908	354	696	1,116	1,396
Depreciation	876	946	1,054	1,097	1,141
Tax paid	-243	-36	-202	-340	-426
Chg in working capital	-647	-952	-311	-190	-246
Other operating activities	350	58	0	0	0
Cash flow from operations (a)	**1,244**	**369**	**1,237**	**1,683**	**1,865**
Capital expenditure	-2,835	-1,287	-750	-750	-750
Chg in investments	-6	58	0	-750	-700
Chg in associates	0	0	0	0	0
Other investing activities	0	0	0	0	0
Cash flow from investing (b)	**-2,840**	**-1,229**	**-750**	**-1,500**	**-1,450**
Free cash flow (a+b)	**-1,596**	**-860**	**487**	**183**	**415**
Equity raised/(repaid)	0	0	0	0	0
Chg in minorities	0	0	0	0	0
Debt raised/(repaid)	2,485	328	-28	34	-195
Dividend (incl. tax)	-231	-195	-195	-195	-195
Other financing activities	-36	0	0	0	0
Cash flow from financing (c)	**2,218**	**133**	**-223**	**-160**	**-390**
Net chg in cash (a+b+c)	**622**	**-727**	**265**	**23**	**26**

Source: Company data, Nomura estimates

Exhibit 59. TVS: key ratios

Year-end 31 Mar (INRmn)	FY07A	FY08A	FY09E	FY10E	FY11E
Adjusted EPS (INR)	2.8	1.8	2.1	3.3	4.1
Adjusted EPS growth (%)	-43.1	-34.4	13.2	56.9	25.1
EBITDA growth (%)	-23.6	-31.6	47.8	20.7	9.5
EBITDA margin (%)	5.4	4.3	5.5	6.2	6.3
Pre-tax margin (%)	2.3	1.1	1.8	2.7	3.1
ROE (%)	9.4	5.8	6.3	9.4	10.8
ROCE (%)	8.6	3.1	6.5	8.6	9.5
Net debt/Equity (%)	57.2	75.0	68.5	55.2	40.8

Source: Company data, Nomura estimates

Exhibit 60. TVS: valuations

Year-end 31 Mar (INRmn)	FY07A	FY08A	FY09E	FY10E	FY11E
PER (x)	10.1	15.5	13.7	8.7	7.0
PCE (x)	4.4	4.9	4.4	3.6	3.2
Price/book (x)	0.9	0.9	0.8	0.8	0.7
Yield (%)	3.4	2.9	2.9	2.9	2.9
EV/net sales (x)	0.3	0.4	0.3	0.3	0.2
EV/EBITDA (x)	5.2	8.7	5.7	4.5	3.8

Source: Company data, Nomura estimates

Appendix I: Minimum support prices for agricultural products

The Government of India defines the MSP of agricultural commodities. There have been sharp increases in MSP this year, with wheat prices increasing 33%, coarse cereals 19%, maize 14.8% and paddy 11.2%. We believe this will lead to sharp growth in the incomes of people living in rural India. According to the 2001 census, more than 70% of India's population lives in rural India.

Exhibit 61. MSP of agricultural products (INR per quintal)

No.	Commodity	Variety	2004-05	2005-06	2006-07	2007-08	y-y (%)
1	Paddy	Common	560	570	580	645	11.2
		Grade "A"	590	600	610	675	5.7
2	Coarse Cereals		515	525	540	600	19.4
	(Jowar, Bajra and Ragi)						
3	Maize		525	540	540	620	14.8
4	Wheat		640	650	750	1,000	33.3
5	Barley		540	550	565	650	15.0
6	Gram		1,425	1,435	1,445	1,600	10.7
7	Arhar (Tur)		1,390	1,400	1,410	1,550	9.9
8	Moong		1,410	1,520	1,520	1,700	11.8
9	Urad		1,410	1,520	1,520	1,700	11.8
10	Masur (Lentil)		1,525	1,535	1,545	1,700	10.0
11	Sugarcane @		74.50	79.50	80.25	81.18	1.2
12	Cotton	F-414/H-777/J-34	1,760	1,760	1,770	1,800	1.7
		H-4	1,960	1,980	1,990	2,030	2.0
13	Groundnut-in-shell		1,500	1,520	1,520	1,550	2.0
14	Jute		890	910	1,000	1,055	5.5
18	Rapeseed/Mustard		1,700	1,715	1,715	1,800	5.0
16	Sunflower Seed		1,340	1,500	1,500	1,510	0.7
17	Soya bean	Black	900	900	900	910	1.1
		Yellow	1,000	1,010	1,020	1,050	2.9
18	Safflower		1,550	1,565	1,585	1,650	4.1
19	Toria		1,665	1,680	1,680	1,735	3.3
20	Tobacco (VFC)	Black Soil (F2;Gr.)	32.00	32.00	32.00	32	0.0
	(INR per kg)	Light Soil (L2;Gr.)	34.00	34.00	34.00	34	0.0
21	Copra	Milling	3,500	3,570	3,590	3,620	0.8
		Ball	3,750	3,820	3,840	3,870	0.8
22	Sesame		1,500	1,550	1,560	1,580	1.3
23	Nigerseed		1,180	1,200	1,220	1,240	1.6

Source: Department of Agriculture & Co-operation, India

Appendix II: Sixth Pay Commission

The Sixth Pay Commission recently recommended salary increases for approximately 3.1mn central government employees. According to our estimates, the average increase in salary is 67%. Since the increase is effective from 1 January 2006, employees will also receive arrears (on average 46% of earlier pay). The employees eligible for this salary hike and falling in the addressable segments form 32% of annual two-wheeler sales and 23% of annual car sales. More importantly, over the next one to two years, approximately 8mn state government employees are also expected to receive a similar increase in salary.

Exhibit 62. Impact of Sixth Pay Commission

Pay scale (INR)	% of employees	% increase in pay	Arrear as a % of earlier pay
2,550-3,050	17.4	64.1	46.5
3,050-4,500	37.3	74.7	43.7
4,500-5,500	15.8	80.3	43.1
5,500-6,500	11.3	71.7	46.0
6,500-8,000	9.3	63.8	43.0
8,000-10,000	5.0	57.8	42.7
10,000-14,300	2.7	66.5	40.9
14,300-18,400	0.8	67.4	59.2
18,400-	0.4	60.6	48.1

Source: Nomura estimates

Exhibit 63. Impact of pay hike on auto market

	FY08 domestic volumes	Addressable population (AP) impacted (mn)	AP as a % of yearly sales
Two-wheeler	7.2	2.3	32.4
Car	1.2	0.3	23.5

Source: Nomura estimates

Important Disclosures:

Bajaj Auto (BAJA.NS) **INR 426.35 (10-Nov-2008)** **Buy / Bullish**

Rating and Price Target Chart:

CHART IS NOT APPLICABLE

Risks Which May Impede the Achievement of the Price Target: 1) Nano could replace passenger three-wheelers. If the volume decline in three-wheelers is sharper than expected because of regulatory changes allowing products such as Nano to replace passenger three-wheelers, Bajaj Auto's volumes will fall sharply, resulting in a sharp earnings decline. 2) Variants of XCD do not succeed. If variants of Bajaj Auto's XCD do not succeed, HH could continue to dominate the segment. 3) Failure of new four-wheeler. Bajaj's new four-wheeler will face significant competition. We believe the new four-wheeler might not be as successful as its three-wheeler or the profitability of the four-wheeler could be much lower.

4) Significant risks to new small car venture. Bajaj Auto plans to launch a small car around FY12. We believe that this product may not turn out to be a commercial success because i) competition in this space is likely to increase further and ii) if the product competes with Tata Motors' 'Nano' the project may not be viable, given the limited payoff from the segment.

Hero Honda (HROH.NS) **INR 755.35 (10-Nov-2008)** **Buy / Bullish**

Rating and Price Target Chart:

CHART IS NOT APPLICABLE

Risks Which May Impede the Achievement of the Price Target: We have assumed a moderate growth rate for motorcycles. If volume growth is lower than our expectations, there could be downside to our estimates. We have assumed that the prevailing tight monetary conditions will begin to ease off by end-FY09E. If credit availability remains tight, volume growth may be negatively affected. If the ramp-up at the new plant is slower than our estimates, margins could be lower than our forecasts; in which case, even the tax rate could be higher than our estimates. We have assumed that commodity prices will soften in FY10E. If the prices do not fall, there would be downside risks to our margin estimates.

Maruti Suzuki India Limited (MRTI.NS) **INR 596.05 (10-Nov-2008)** **Buy / Bullish**

Rating and Price Target Chart:

CHART IS NOT APPLICABLE

Risks Which May Impede the Achievement of the Price Target: Car sales in India are linked to income growth, which is dependent on overall economic growth. We are assuming GDP growth of 6.9% for FY10E. Any downturn in economic growth in India would have a significant negative impact on our growth assumptions and price target. A further rise in interest rates in India would also have a significant negative impact on our estimates. We have assumed that MSIL's future product launches will help it maintain steady growth rates. If many of its new launches are unsuccessful, our growth assumptions could be reduced sharply. We have also assumed improvements in operating margins. A sharp increase in raw material costs could have a negative impact on our margin assumptions. We have assumed that MSIL will be able to maintain its market share. However, if new or existing players are able to launch successful products, our growth forecasts would be affected negatively.

TVS Motor (TVSM.NS) **INR 28.55 (10-Nov-2008)** **Neutral / Bullish**

Rating and Price Target Chart:

CHART IS NOT APPLICABLE

Risks Which May Impede the Achievement of the Price Target: Key upside risks: 1) We have assumed that TVS' new product launches will be moderately successful. If these are highly successful, there could be significant upside to our estimates. 2) We have not included income from TVS' Indonesia operations in our estimates. If TVS can make high profits in Indonesia, its earnings could be higher than our estimates.

Key downside risks: 1) We have assumed that competitive intensity will not increase substantially from current levels. In case of a price war, TVS will be hurt the most among the top three. 2) We have assumed that there will be no significant increase in raw material costs beyond the current fiscal year. If raw material costs rise further, there could be downside risks to our margin estimates. 3) We have assumed that TVS will improve its performance to start making higher returns on equity in the medium term. If higher returns do not materialise, there will be downside risks to our estimates.

Important Disclosures Continued:

Mentioned Company	Ticker	Price	Price Date	Stock / Sector Rating
Bajaj Auto	**BAJA.NS**	**INR 426.35**	**10 Nov 2008**	**Buy / Bullish**
Hero Honda	**HROH.NS**	**INR 755.35**	**10 Nov 2008**	**Buy / Bullish**
Maruti Suzuki India Limited	**MRTI.NS**	**INR 596.05**	**10 Nov 2008**	**Buy / Bullish**
TVS Motor	**TVSM.NS**	**INR 28.55**	**10 Nov 2008**	**Neutral / Bullish**

All share prices mentioned are closing prices unless otherwise stated.

Bajaj Auto: We value Bajaj Auto based on DCF. We have used a discount rate of 13.2% (beta=0.82,Rf=7.5, Rp=7) with a 4.2% earnings CAGR from FY11E to FY16E and terminal growth of 2% thereafter.
Hero Honda: We value HH based on DCF. For this purpose we have used 11.8% discount rate (based on Rf=7.5%, Rp=7% and beta = 0.614) with 5% earnings CAGR from FY11E to FY16E and terminal growth of 2% thereafter.
Maruti Suzuki India Limited: On a discounted cash flow (DCF)-based valuation, our target price of INR775 builds in a terminal FCFE [Free cash flow to Equity] CAGR of 4%, after an intermediate stage earnings CAGR of 9.3% from FY11E to FY20E.
TVS Motor: Our 12-month price target of INR30.4 is based on DCF. We have used a discount rate of 13.8% (beta=0.9,Rf=7.5, Rp=7). with a 3.2% earnings CAGR from FY11E to FY16E and terminal growth of 2% thereafter.

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- A rating of "1", or **"Buy"**, indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months.
- A rating of "2", or **"Neutral"**, indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months.
- A rating of "3", or **"Reduce"**, indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months.
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A **"Neutral"** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next 12 months.
A **"Bearish"** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next 12 months.

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- A rating of "3", or **"Neutral"**, indicates that the analyst expects the stock to either outperform or underperform the Benchmark by less than 5% over the next six months.
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A **"Neutral"** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next six months.
A **"Bearish"** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next six months.

Benchmarks are as follows: **Japan**: TOPIX; **United States**: S&P 500, MSCI World Technology Hardware & Equipment; **Europe**, by sector — *Hardware/Semiconductors*: FTSE W Europe IT Hardware; *Telecoms*: FTSE W Europe Business Services; *Business Services*: FTSE W Europe; *Auto & Components*: FTSE W Europe Auto & Parts; *Communications equipment*: FTSE W Europe IT Hardware; **Ecology Focus:** Bloomberg World Energy Alternate Sources; **Global Emerging Markets:** MSCI Emerging Markets ex-Asia.

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- A "**Buy**" recommendation indicates that potential upside is 15% or more.
- A "**Neutral**" recommendation indicates that potential upside is less than 15% or downside is less than 5%.
- A "**Reduce**" recommendation indicates that potential downside is 5% or more.
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- A "**Strong buy**" recommendation indicates that upside is more than 20%.
- A "**Buy**" recommendation indicates that upside is between 10% and 20%.
- A "**Neutral**" recommendation indicates that upside or downside is less than 10%.
- A "**Reduce**" recommendation indicates that downside is between 10% and 20%.
- A "**Sell**" recommendation indicates that downside is more than 20%.

Sectors:

A "**Bullish**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation.
A "**Neutral**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation.
A "**Bearish**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

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