Flashnote

HSBC Global Research

Industrials
Autos
Equity – India

Maruti Suzuki India (MSIL)

Overweight (V)

Target price (INR)	**1880.00**
Share price (INR)	**1559.25**
Potential total return (%)	**20.9**

Performance	1M	3M	12M
Absolute (%)	2.9	19.8	202.0
Relative^ (%)	6.2	5.7	57.9

Index^	BOMBAY SE SENSITIVE INDEX
RIC	MRTI.BO
Bloomberg	MSIL IN
Market cap (USDm)	9,648
Market cap (INRm)	450,483
Enterprise value (INRm)	377820
Free float (%)	28

Note: (V) = volatile (please see disclosure appendix)

OW(V): The Swift shift

- **Near-term trigger: capacity constraint alleviation next month, when the production of Swift is shifted**
- **Robust demand trends are supported by increased bank financing (now 71% of Maruti's cars sold vs. 60% last year)**
- **OW(V), with potential total return of 21% and TP of INR1880**

Stock underperformed over production constraints. Since September 2009, Maruti's stock price underperformed BSE Auto Index and Sensex by 12% and 7% respectively (Fig 2 and 3), as production constraints affected the ability to meet demand (Fig 4).

Solutions to release constraint – rejig production and expand capacity. The Manesar plant (where Swift and Dzire are produced) is operating at peak capacity, while the Gurgaon plant offers scope for expansion. Next month, the company is likely to shift production of Swift petrol to Gurgaon, with the option of shifting Dzire petrol. This is likely to release 5-6% of total capacity to meet demand in the near term. With increased output, we expect monthly sales to be strong from December 2009 onwards and this could be a stock catalyst. Addition to the Manesar plant is a long-term solution. At the AGM in January 2010, Maruti expects make an official decision about potential capacity expansion at the Manesar plant, which could add 100-300k units (9-27%) to capacity, which should meet demand for the next three years.

Our FY11e EPS is 10% above consensus. Our estimates are unchanged, and our FY11e EPS of INR101 is 10% above consensus (Fig 9). There could be an upside risk to our estimates if consumer confidence surprises on the upside.

OW(V) with 21% return potential. We reiterate our Overweight (V) rating and target price of INR1880 as we believe that the company should be a key beneficiary of urban demand recovery. Our TP implies a target PE of 19x FY11e EPS of INR101. The key downside risks include more intense competition than anticipated, adverse currency movement and higher-than-estimated input cost.

1. Key financial data

	03/2009a	03/2010e	03/2011e	03/2012e
Revenue (INRm)	210,982	282,490	316,317	356,571
HSBC EPS (INR)	44.06	85.58	100.96	117.65
ROE (%)	14	23	22	20.9
PE (x)	35.4	18.2	15.4	13.3
EV/EBITDA (x)	22.6	10.4	8.8	7.2

Source: Company, HSBC

20 November 2009

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Financials & valuation

Financial statements

Year to	03/2009a	03/2010e	03/2011e	03/2012e
Profit & loss summary (INRm)				
Revenue	210,982	282,490	316,317	356,571
EBITDA	17,934	36,337	40,387	44,907
Depreciation & amortisation	-6,710	-8,168	-9,477	-10,641
Operating profit/EBIT	11,224	28,169	30,910	34,266
Net interest	6,242	7,252	10,511	13,727
PBT	17,466	35,421	41,422	47,993
HSBC PBT	17,466	35,421	41,422	47,993
Taxation	-4,737	-10,697	-12,253	-14,004
Net profit	12,729	24,724	29,168	33,989
HSBC net profit	12,729	24,724	29,168	33,989
Cash flow summary (INRm)				
Cash flow from operations	17,863	41,220	38,613	45,513
Capex	-16,408	-12,326	-13,000	-14,000
Cash flow from investment	3,469	-46,805	-37,010	-43,590
Dividends	-1,122	-1,283	-1,603	-1,924
Change in net debt	2,663	-30,316	-24,010	-29,590
FCF equity	1,455	28,894	25,613	31,513
Balance sheet summary (INRm)				
Intangible fixed assets	0	0	0	0
Tangible fixed assets	59,511	54,995	58,518	61,877
Current assets	84,783	115,901	145,226	180,220
Cash & others	48,435	78,751	102,762	132,352
Total assets	148,499	172,396	205,244	243,597
Operating liabilities	34,986	44,115	49,397	55,684
Gross debt	7,588	7,588	7,588	7,588
Net debt	-40,847	-71,163	-95,174	-124,764
Shareholders funds	95,653	119,095	146,661	178,727
Invested capital	60,873	48,030	51,585	54,062

Ratio, growth and per share analysis

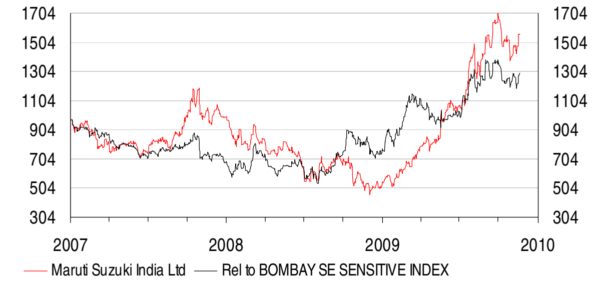
Year to	03/2009a	03/2010e	03/2011e	03/2012e
Y-o-y % change				
Revenue	13.4	33.9	12.0	12.7
EBITDA	-33.6	102.6	11.1	11.2
Operating profit	-47.3	151.0	9.7	10.9
PBT	-32.2	102.8	16.9	15.9
HSBC EPS	-28.9	94.2	18.0	16.5
Ratios (%)				
Revenue/IC (x)	4.1	5.2	6.4	6.8
ROIC	16.1	36.1	43.7	45.9
ROE	14.0	23.0	22.0	20.9
ROA	9.6	15.6	15.6	15.3
EBITDA margin	8.5	12.9	12.8	12.6
Operating profit margin	5.3	10.0	9.8	9.6
EBITDA/net interest (x)				
Net debt/equity	-42.7	-59.8	-64.9	-69.8
Net debt/EBITDA (x)	-2.3	-2.0	-2.4	-2.8
CF from operations/net debt				
Per share data (INR)				
EPS reported (fully diluted)	44.06	85.58	100.96	117.65
HSBC EPS (fully diluted)	44.06	85.58	100.96	117.65
DPS	3.88	4.44	5.55	6.66
Book value	331.08	412.22	507.64	618.63

Valuation data

Year to	03/2009a	03/2010e	03/2011e	03/2012e
EV/sales	1.9	1.3	1.1	0.9
EV/EBITDA	22.6	10.4	8.8	7.2
EV/IC	6.7	7.9	6.9	6.0
PE*	35.4	18.2	15.4	13.3
P/Book value	4.7	3.8	3.1	2.5
FCF yield (%)	0.3	6.4	5.7	7.0
Dividend yield (%)	0.2	0.3	0.4	0.4

Note: * = Based on HSBC EPS (fully diluted)

Price relative



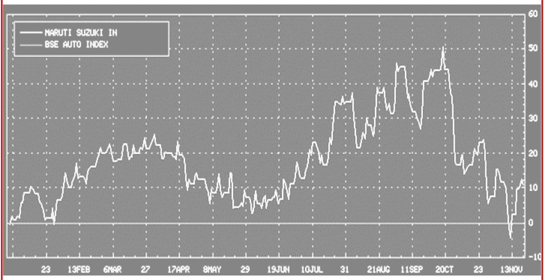
Source: HSBC

Note: price at close of 19 Nov 2009

Stock has underperformed

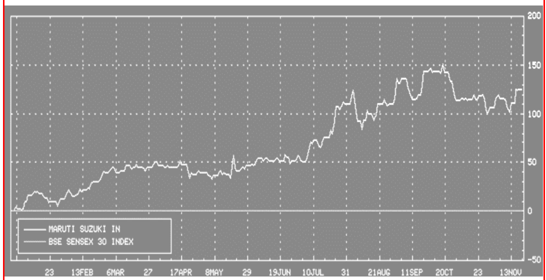
Since September 2009, Maruti has underperformed both BSE Auto Index and Sensex by 12% and 7% respectively. A key reason has been its ability to meet demand, given the production constraints at the Manesar plant. We believe concerns are overdone, given the flexibility Maruti has in production.

2. Performance: Maruti Suzuki relative to BSE Auto Index



Source: Bloomberg

3. Performance: Maruti Suzuki relative to Sensex



Source: Bloomberg

Capacity constraints at Manesar leading to waiting period

Due to capacity constraints at Manesar, Maruti is unable to match the strong demand for Swift and Dzire (key models produced from that facility). Hence, there is a waiting period of up to three months on both.

4. Production constraints leading to waiting period in the key models produced from Manesar

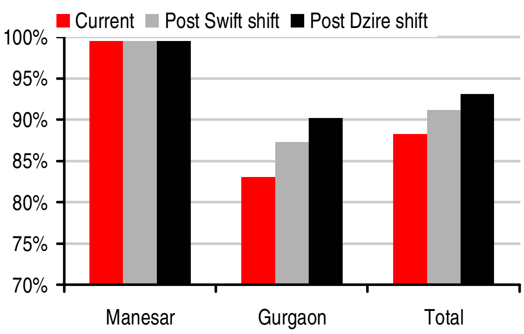
	Rated capacity	Peak capacity	% total sales contribution	Key models	Waiting period
Manesar Plant	300,000	350,000	42%	Swift, Dzire, A-Star and SX4	0-3 Months
Gurgaon Plant	700,000	750,000	58%	Alto, Wagon R, Ritz, Omni	0

Source: Company, HSBC

Shifting production to Gurgaon a near-term remedy

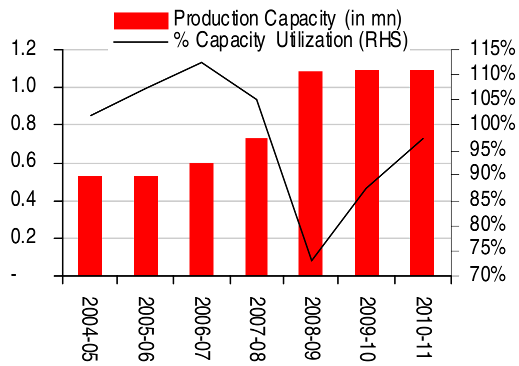
While the Manesar plant is operating at a peak capacity of 350k units p.a., there is scope for capacity ramp-up in the Gurgaon plant. The company plans to shift production of Swift petrol from Manesar to Gurgaon in December and also has the option of shifting Dzire petrol to Gurgaon. This should release 5-6% capacity (50-70k units). The shift requires minimal capex and can be done in just a couple of months.

5. Capacity utilisation to improve once production shifts to Gurgaon



Source: Company, HSBC estimates
Note: 1. Capacity utilisation shown above is at peak capacity
Note 2. The plan is to shift Swift (petrol), and consider shifting Dzire (petrol)

6. Maruti has a history of operating at peak capacity level and managing demand through productivity improvement



Source: Company, HSBC estimates

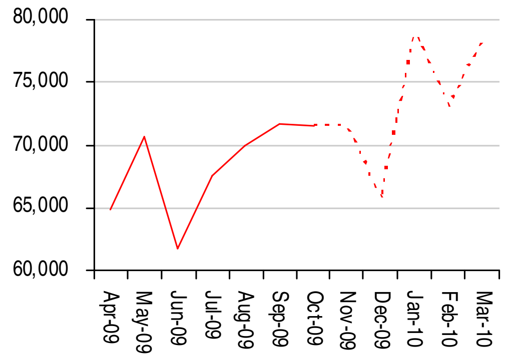
Addition to Manesar plant is a long-term solution

During its AGM in January 2010, the company plans to make a decision on increasing capacity at Manesar – a feasibility study is on. The incremental capacity could be in the range of 100k-300k units p.a. which we expect to be operational in FY12 – this should be a long-term solution. The quantum of capex will also indicate management outlook on demand.

Expect sales to ramp up after capacity is rejigged

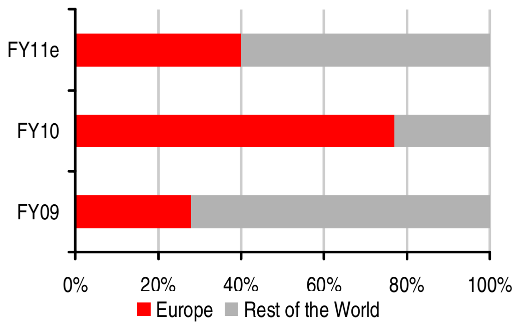
Car demand continues to be strong against a backdrop of economic recovery. Bank financing continues to improve; Maruti's cars sold on credit reached 71% now from 60% last year. The prospects of car financing through private banks have improved, with ICICI Bank announcing its intention become aggressive in the field again. Freeing up capacity should help Maruti meet demand. We expect strong car sales growth to continue in H2FY10e, and act as a potential trigger for the stock price.

7. Domestic car sales to pick up post capacity ramp-up



Source: Company, HSBC estimates

8. Exports: increased contribution from ROW to compensate for loss of Europe sales



Source: Company, HSBC estimates

Our numbers are 10% above consensus

The Street is still conservative, in our view, on sales and margin prospects. Going into Q3, the company does not see any major cost escalation. Given the strong demand outlook, we believe Maruti should be able to hike prices to protect margins. Our numbers are 10% above consensus for FY11e.

9. We are ahead of consensus (INR)

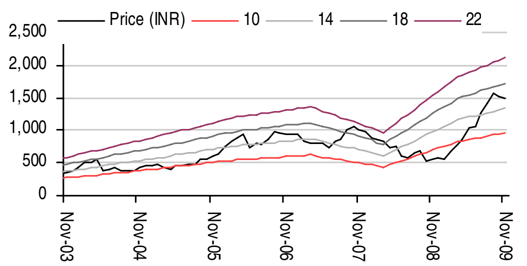
	HSBCe EPS	Consensus EPS	% Deviation
FY10e	86	79	8%
FY11e	101	92	10%

Source: HSBC estimates, Thomson Datastream

Overweight (V), target price INR1,880

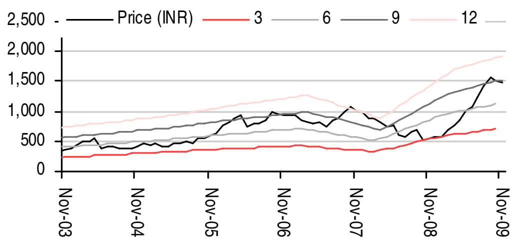
Our DCF-based one-year target price is INR1,880. We have assumed the cost of equity to be 13.5% and have explicit estimates until FY10. In our semi-explicit forecast period of 10 years, starting from FY11, we assume 15% NOPLAT CAGR (equity risk premium: 5.5%, beta: 1.1, risk-free rate: 7.5%). We have assumed the fade period will start in FY21 and last for 17 years. During the fade period, we have assumed that the ROIC will decline to the level of cost of capital.

10. One-year forward PE multiple



Source: Company, HSBC

11. One-year forward EV/EBITDA



Source: Company, HSBC

In our research model, for India stocks with a volatility indicator, the Neutral band is 10 percentage points above and below the hurdle rate of 10.5%. This translates into a Neutral band of 0.5-20.5% around the current share price. Our target price, unchanged at INR1,880, implies c21% total potential return from current levels; we therefore reiterate our Overweight (V) rating.

In relative valuation terms, we value Maruti at high-EPS growth phase multiples. On reaching our one-year target price of INR1,880, we expect the stock to trade at 19x our FY11e EPS of INR101 and at 10.5x FY11e EV/EBITDA. Historically during its EPS growth phase, the company had traded in a one-year forward PE range of 18-21x and EV/EBITDA of 9-12x.

Key risks

The key potential downside risks include appreciating yen (c12% of raw materials are imported from Japan), sales collapse in export markets after scrappage schemes run out, stronger-than-expected competition, any increase in excise duty which could increase acquisition cost of cars for customers and hurt demand, any increase in interest rates, and higher-than-estimated increase in raw material prices.

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Overweight (Buy)	41%	(18% of these provided with Investment Banking Services)
Neutral (Hold)	38%	(17% of these provided with Investment Banking Services)
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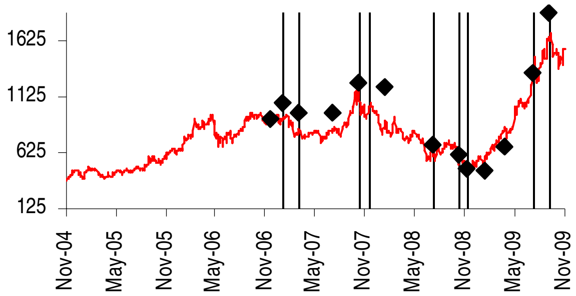
Share price and rating changes for long-term investment opportunities

Maruti Suzuki India Ltd (MRTI.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Underweight	Neutral	23 January 2007
Neutral	Overweight	21 March 2007
Overweight	Underweight	30 October 2007
Underweight	Overweight	05 December 2007
Overweight	Neutral	22 July 2008
Neutral	Neutral (V)	27 October 2008
Neutral (V)	Underweight (V)	24 November 2008
Underweight (V)	Neutral (V)	24 July 2009
Neutral (V)	Overweight (V)	24 September 2009
Target Price	**Value**	**Date**
Price 1	925.00	05 December 2006
Price 2	1080.00	23 January 2007
Price 3	990.00	21 March 2007
Price 4	980.00	27 July 2007
Price 5	1250.00	30 October 2007
Price 6	1225.00	29 January 2008
Price 7	695.00	22 July 2008
Price 8	600.00	27 October 2008
Price 9	481.00	24 November 2008
Price 10	468.00	29 January 2009
Price 11	682.00	17 April 2009
Price 12	1343.00	24 July 2009
Price 13	1880.00	24 September 2009

Source: HSBC

HSBC & Analyst disclosures

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Company	Ticker	Recent price	Price Date	Disclosure
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Source: HSBC

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