MARUTI UDYOG LTD.

Full speed ahead...

Q2 FY 2007 update

SUMMARY

- Maruti Udyog Ltd. (MUL) posted a 12.4% YoY rise in net revenues to Rs 34 bn in Q2FY07. Domestic sales rose by 16% YoY to 150k units driven by a 22% YoY rise in 'B' segment sales on ramp up in sales of Alto & WagonR/Duo. Exports declined by 31% YoY to 8k units.
- Realisations were stagnant YoY at Rs 216k/vehicle as the company passed on the full benefit of the excise duty cut on small cars to customers.
- RM costs declined by 300 bps YoY & 60 bps QoQ to 75.2% due to the cost reduction measures undertaken by the company. Staff Costs rose marginally by 20 bps to 2.1% of sales while other expenditure rose by 50 bps to 9.3% of sales due to a rise in royalty on new products, power & fuel cost and advertising & sales promotion. OPM expanded by 230 bps to 13.4%.
- Income from services & other income rose by 14% YoY to Rs 1.4 bn. Gross interest charges fell by 50% YoY to Rs 31 mn while depreciation declined by 10% YoY to Rs 596 mn due to completed write-off of dies of *Zen* & *Alto* in FY06.
- Net profit grew by 40% YoY to Rs 3.7 bn. The company has undertaken a price hike (Rs 500-5000) for various models effective Aug'06.
- The company intends to enter the diesel segment with *Swift Diesel* launch in H2FY07. Also planned is the launch of the new *Zen*.
- As part of the Nissan-Suzuki alliance, MUL will manufacture a small car for Nissan (launch in CY2008) with volumes of 50k p.a. under Nissan brand and 100k p.a. under Suzuki brand for export markets.
- *At the CMP of Rs 906, MUL is quoting at a PE of 16.7x and 12.6x its FY07E and FY08E earnings. MUL is an attractive play on the growing car market with its models placed favorably on the price-value matrix. We expect strong growth backed by aggressive capacity expansion and a strong product pipeline. Thus, we upgrade our recommendation to 'BUY'.*

COMPANY DETAILS

Auditors	Price Waterhouse
Chairman	S. Nakanishi
MD	Jagdish Khatter
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Website	www.marutiudyog.com

SCRIP DETAILS

Market Capitalisation	Rs. 262 bn.
Book Value per share	Rs. 189
Equity Shares O/S (F.V. Rs 5)	289 mn
Med. Vol. (12 mths)	1.49 mn (BSE+NSE)
52 Week H/L	Rs. 991 / 570
BSE Scrip Code	532500
NSE Scrip Code	MARUTI
Bloomberg Code	MUL@IN
Reuters Code	MRTI.BO

SHAREHOLDING PATTERN (%)

Qtr. Ended	Mar-06	Jun-06	Sep-06
Promoter	64.5	64.5	64.5
MFs/FIs/Insu Co	15.2	16.9	5.0
FIIs / NRIs / OCBs	15.5	14.5	15.3
PCBs	1.6	1.4	1.9
Indian Public/Others	3.1	2.6	2.5

KEY FINANCIALS (STANDALONE)

Rs Mn	Quarter Ended			Year Ended (Mar)		
	Mar-06	Jun-06	Sep-06	2006	2007E	2008E
Net Sales	32,603	31,140	34,006	120,034	143,560	181,560
YoY Gr. (%)	*7.5*	*19.2*	*12.4*	*10.0*	*19.6*	*26.5*
Op. Profits	4,695	4,452	4,570	15,778	20,421	25,065
Op. Marg.(%)	*14.4*	*14.3*	*13.4*	*13.1*	*14.2*	*13.8*
Net Profits	3,609	3,696	3,674	11,891	15,693	20,810
Eq Capital	1,445	1,445	1,445	1,445	1,445	1,445

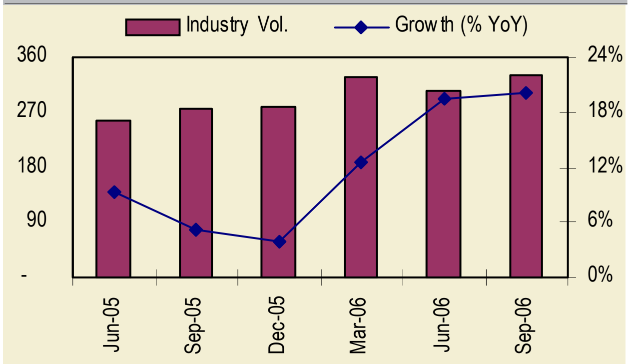
KEY RATIOS

Year Ended (Mar)	EPS (Rs.)	ROCE (%)	RONW (%)	P/E (x)	EV/Sales (x)	EV/EBIDTA (x)
2006	41.2	31.0	21.8	22.0	2.1	12.4
2007E	54.3	31.5	22.3	16.7	1.8	9.9
2008E	72.0	29.9	23.0	12.6	1.4	8.3

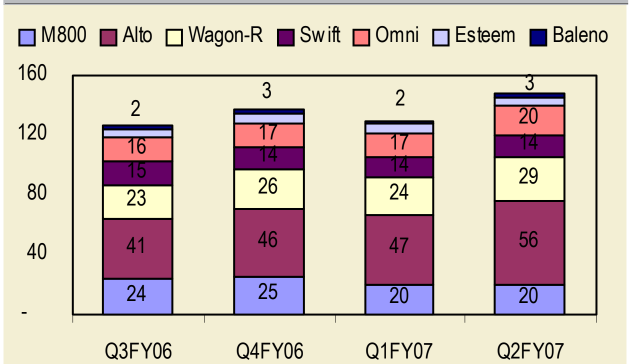
Nov 14, 2006	Sensex : 13425	Nifty : 3866	CMP : Rs 906	Recomm : BUY

Analyst - Rishabh Bagaria

Passenger Vehicles Industry Vol. (in 000s)



MUL's segment-wise volumes (000s)



Industry Scenario

In Q2FY07, domestic passenger vehicles segment grew by 20% YoY to 331k units driven primarily by passenger cars (PC) which grew by 22% YoY to 259k units and utility vehicles (UV) segment which grew by 14% YoY to 72k units.

Growth in the PC segment was led by the compact segment (Rs 0.25-0.45 mn) which has seen good volumes and improving penetration post excise duty cut. In Q2FY07, volumes of compact segment surged by 28% YoY to 177k units.

The other growth driver in PC was the executive segment (Rs 0.8-1.2 mn band) which rose by 154% YoY to 12k units, albeit on a small base. The mid-size segment (Rs 0.45 - 0.8 mn) also witnessed a marginal 3% YoY rise in volumes to almost 49k units. The mini segment shrunk by 3% YoY .

Exports rose marginally by 0.8% YoY to 51k units led by by 10% YoY growth in utility vehicles to 2k units. Passenger cars exports grew by 0.4% YoY to 49k units. MUL's exports declined by 31% YoY to 8k units while Hyundai's exports improved by 5% YoY to 29k units.

Passenger Cars (PCs) & Utility Vehicles (UVs)

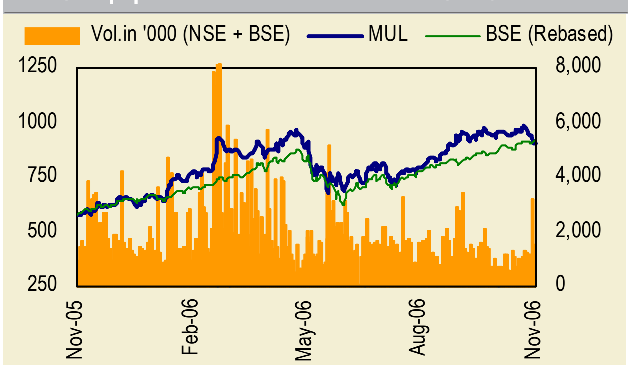
After a smart pick-up in volumes of 19% YoY in Q1FY07, MUL's volume growth slowed marginally in Q2FY07 to 12% YoY. This was led by the 'B' segment (Zen/ Alto/ Wagon R/ Swift) which grew by 22% YoY to 100k units.

MUL continued to remain the largest player in the 'B' segment with a market share of 56% in Q2FY07, on back of 22% YoY growth in volumes to 100K units. However, MUL's market share declined by 300 bps YoY primarily to Hyundai's *Santro* and Tata's *Indica* post the launch of *Indica Xeta.*

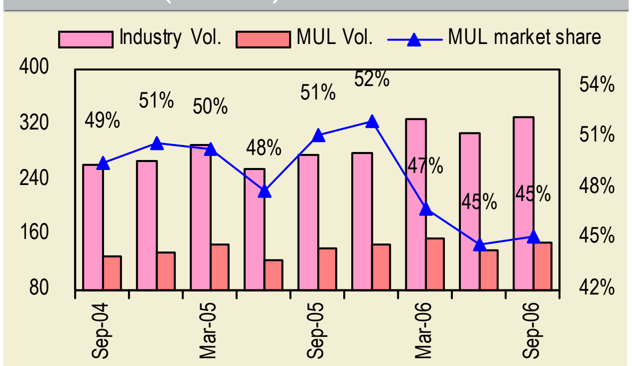
Alto continued to show robust growth and maintain its status as the largest selling car in India. *Alto* volumes improved by 48% YoY to 56k units. *WagonR* also witnessed a 46% YoY increase in volumes to 29k units post launch of the new look version and the huge success of the LPG version.

The company has discontinued production of the old *Zen* as they will soon be launching a variant of the same with an entirely new look and styling features. As a result Zen volumes were almost negligible.

Scrip performance vis-a-vis BSE Sensex



Volumes (in 000s) vs MUL's market share



The company was in the process of shifting production facilities of *Swift* to its new plant at Manesar resulting in partial disruption of production. Resultantly, volumes declined 4% YoY to 14.5k units. The production lines have since been shifted and production has normalized. Further, the company is most likely to launch the *Swift Diesel* in Jan 07 marking its entry in the diesel segment.

After the excise duty cut (24% to 16%) for small cars, the 'A' segment viz Maruti 800 saw a spurt in volumes in Mar'06 to 10,937 units. However, the company was not able to hold on to this initial gain and saw volumes stagnate at 20k units in Q1 & Q2 FY07.

The 'C' segment also witnessed a marginal 2.6% increase in volumes to 8.4k units in line with the industry growth. Volumes of *Esteem* were stagnant at 5.3k units in Q2FY07. However, volumes of *Baleno* dropped by 65% YoY to 3k units. MUL's market share in 'C' segment stood at 17%.

The major losers in this segment were Hyundai's *Accent* (down 10% YoY to 7.8%) and Tata *Indigo* (loss of 3%YoY to 17%). The major gainers were Ford's *Fiesta* and Chevrolet's *Aveo* 5% (market share of 15% & 5% respectively) .

We understand that MUL is working on a new platform to strengthen its position in 'C' segment. While precise date is not known, we expect the same to be launched in H1FY08.

The share of UV's in the total passenger vehicles industry has been ranging between 20-25% and the same was 21.8% in Q2FY07. MUL with its *Omni* continues to be the second largest player behind Mahindra & Mahindra. MUL's utility vehicles (UV) segment saw a 17% YoY increase in volumes to 21k units led by the Omni.

Performance Review

The performance of the company was below expectations on volumes front though it surprised on margins & profitability side.

Raw material (RM) cost was down by 300 bps YoY & 60 bps QoQ to 75.2% of sales due to the cost reduction & cost efficiency measures (VAVE) undertaken by the company. Also, the company has a sourcing policy of 12-month contracts for steel and an average of 3-6 months for other raw materials. Besides, the company has a hedging strategy for steel and will be starting the same for aluminum going forward.

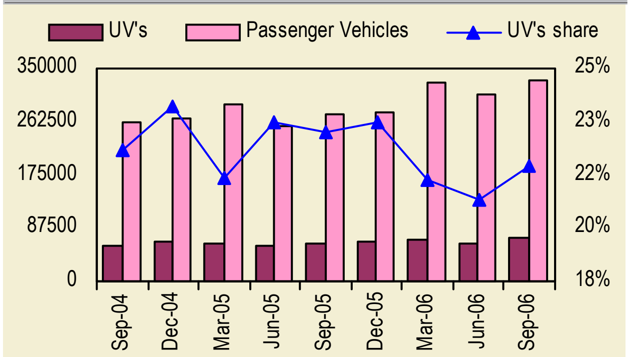
The company has recently renewed its contracts with an upward revision of prices by 1.5% for its raw materials which could put pressure on the margins QoQ. However we expect the same to be countered by higher volumes, better product mix and savings from power & fuel.

Staff costs rose by 20 bps YoY to 2.1% due to revision in wages & expenses towards productivity linked wages. Other expenses also rose by 50 bps YoY & 140 bps QoQ to 9.3% of sales due to higher royalty outgo . Further, power & fuel cost were higher due to disruption in fuel supplies leading to consumption of high-speed diesel. There was a sharp increase in sales promotion & advertising expenses due to the festive season.

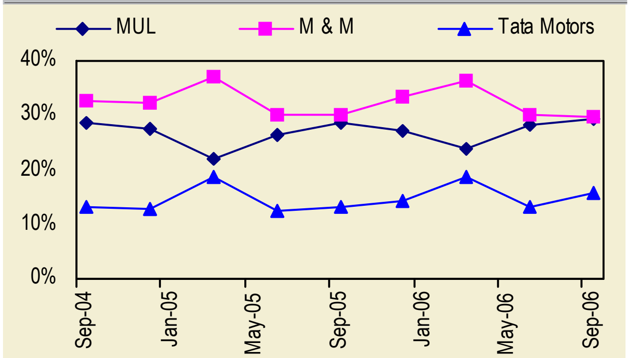
Despite pressure from rise in staff cost and other expenses, operating margins rose by 230 bps YoY to - 13.4% due to the sharp decline in RM costs resulting in operating profits rising by 36% YoY to Rs 4.6bn.

Interest outgo was lower by 50% YoY to Rs 31 mn. Depreciation was lower by 10% YoY at Rs 596 mn due to completion in depreciation of dies of *Alto & Zen* in FY06. Lower interest and depreciation aided in net profits rising by 40% YoY to Rs 3.7 bn.

UV Volumes (000s) and share (%)



Market share in UV segment



In the near future, growth in the domestic passenger vehicles industry will be driven by rising disposable incomes, growing number of middle and high income households and easy access to credit. After posting growth in excess of 20% in FY04 & FY05 and a subdued performance in FY06, we expect sales growth to be around 15% in FY07. MUL, with its wide product portfolio and a leading presence in the 'B' segment, is well poised to benefit from the emerging scenario.

In the domestic market, MUL's leading car models are *Alto, Swift* and *Wagon-R* with Alto having replaced the Maruti 800 as an entry level car. The response to the *Swift* has also been good and MUL has hiked capacities for its *Swift* model by 1,500 units per month to 6000 units/month.

The response to new *LPG WagonR* has been good with volumes of 29k units in Q2FY07. Apart from better styling of the car, the biggest factor contributing to the success has been the improved fuel efficiency (Petrol version – 10% & Duo/LPG version – 33%). We expect volumes to improve further as MUL works on capacity constraints for the LPG version.

Also, MUL is keen to have a presence in the fast growing diesel car segment which constituted ~20% of the market. The market is set to grow further given the improvement in diesel engine technology and price differential vis-a-vis petrol. The company has planned a launch of *Swift Diesel* in H2 FY 07.

This will mark MUL's entry in the diesel segment, filling in the gap in its products portfolio. We believe this launch will help Maruti establish a foothold in this segment and get a better understanding of the intricacies of this segment.

Considering the fact that fuel costs have risen and there is a price differential in diesel vis-à-vis petrol, the entry of MUL is strategically important as we expect the diesel segment to grow further. The management has indicated that the pricing strategy of the diesel variant would ensure minimal cannibalisation with its petrol offerings.

MUL currently has a market share of 17% of the 'C' segment. It intends to step-up its presence in this segment to ensure retention of customers migrating to higher end cars. In line with this strategy, the company intends to launch 2 new models in the segment in the next 3-5 years.

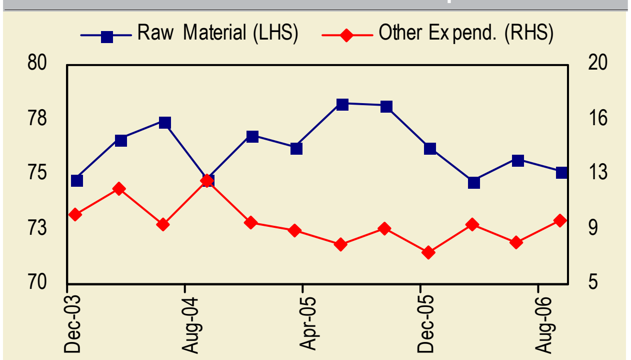
Post discontinuation of exports of Alto to Europe, exports constitute a very small portion (5% in Q2FY07) of the overall volumes of the company. In Q2FY07, exports declined by 31% YoY though they improved marginally QoQ to 8.2k units.

MUL's European exports have been impacted as it has now become economically viable to source from Suzuki's Hungarian plant. The company plans to ramp-up exports and the Nissan-Suzuki tie-up will help strengthen its presence in the export markets.

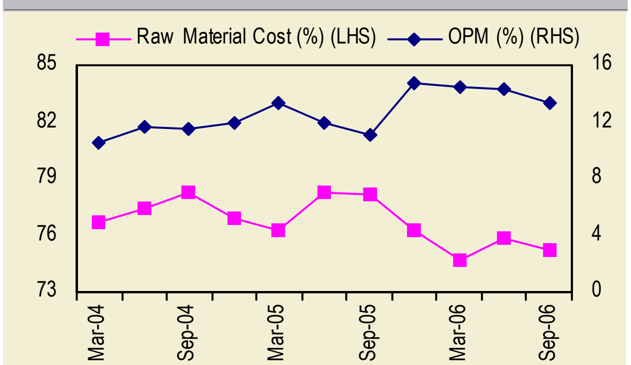
Nissan and Suzuki have entered into an alliance in emerging markets to share their manufacturing facilities. As a part of this deal, Maruti will manufacture a small car for Nissan to be launched in CY08 for which a new production line will be setup at MUL's plant with production expected to reach 200,000 units p.a. (50k units will be exported to Europe under Nissan brand and 100k units under Suzuki brand name).

The company has also indicated its strategy to introduce 5 new models in the next 5 years. We believe, 2 out of these 5 models will be in the mid-size segment.

MUL's RM Cost and Other Expenditure



MUL's RM Cost vs OPM



The company has laid down a capex plan of Rs 90 bn for the next 3-5 years. Of this, Rs 40 bn will be invested at the Gurgaon plant for capacity expansion, automation and new product development.

In order to get over its capacity constraint and cater to future growth, MUL is setting up a new manufacturing plant at Manesar (Haryana). The production of *Swift* has been shifted to the new plant with initial capacity of 100k units p.a. to be scaled up to 250k units p.a. by FY09 at an investment of Rs 27 bn in this plant.

Post expansion, the company will have a total installed capacity of 850,000 vehicles p.a. (currently 600k vehicles p.a.) which it plans to increase to 1 mn vehicles by 2010.

Besides, the company will hold 30% (49% earlier) in Suzuki Powertrain India Ltd which will have capacities of 100k diesel engines (to be ramped up to 300k), 20k petrol engines and 140k transmission assemblies. The total investment at this plant is expected to be around Rs 23 bn.

However, the competitive scenario remains extremely challenging with India gaining importance in the long term growth strategy of big global players. In the immediate term strong competition is expected from GM, Hyundai & Tata Motors in the 'B' Segment.

General Motors (GM) is entering the segment with plans to launch *Spark* by Q3FY08. The Tata-Fiat combine is also expected to launch a stream of new products including a new *Indica* Platform and a replacement for Palio among others. Hyundai is also expected to launch a new platform to compliment *Santro*.

With the recent tie-up of M&M with Renault and the expected joining of Nissan we believe that the alliance would also seriously look at the segment. Both Toyota and Honda are also working on India specific models for the 'B' segment.

The seriousness of the large players can be gauged the $ 300-500 mn investment being lined by up by each of them. Needles to mention MUL being the largest player in India is the most vulnerable to competition in terms of market share.

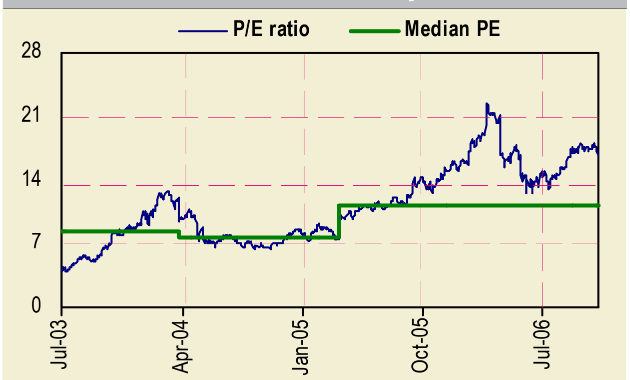
Fully aware of the upcoming competition and to capitalise on India's competitive advantage in manufacturing small cars, MUL has drawn up a strategy envisaging a sharp increase in exports.

In FY07, we expect MUL's volumes to grow by 15% YoY to 645k units led by the 'B' segment which we estimate will grow by 25% YoY to 419k units coupled with the UV's segment growth of 12% YoY to ~79k units. In FY07, we expect realisations to improve by almost 4% YoY to Rs 222k per vehicle. Consequently, net revenues growth at 19.6% YoY will outpace volume growth, with revenues rising to Rs 143 bn.

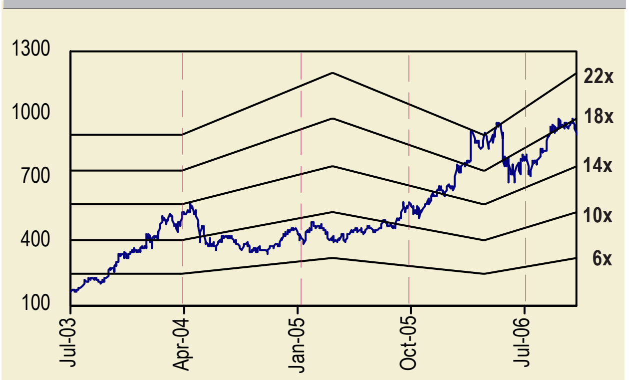
Improved product mix coupled with better realisations will help improve operating margins though raw material costs could be a drag on the same. We expect full year FY07 operating margins to be around 14.2% with operating profits soaring by 30% to Rs 20.4 bn. Higher other income at Rs 5.1 bn coupled with lower interest and depreciation will help net profits rise by 32% to Rs 15.7 bn translating into an EPS of Rs 54.3 for FY07.

At the CMP of Rs 906, MUL is quoting at a PE of 16.7x and 12.6x its FY07E and FY08E earnings. MUL is an attractive play on the growing car market with its models placed favorably on the price-value matrix. We expect strong growth backed by aggressive capacity expansion and a strong product pipeline. Thus, we upgarde our recommendation to 'BUY'.

Median PE v/s Daily PE



PE Band



Standalone results for the quarter and half year ended Sep'30, 2006

Particulars (Rs mn)	Quarter Ended			Half Year Ended			Yr Ended
	30/09/06	30/09/05	Gr %	30/09/06	30/09/05	Gr %	31/03/06
Gross Sales	**40,021**	**37,036**	**8.1**	**76,690**	**69,158**	**10.9**	**147,043**
Less: Excise Duty	*6,015*	*6,778*		*11,544*	*12,771*		*27,009*
Net Sales	**34,006**	**30,258**	**12.4**	**65,146**	**56,388**	**15.5**	**120,034**
Total Expenditure	29,436	26,901	9.4	56,124	49,925	12.4	104,256
(Inc.)/dec. in stock-in-trade	(377)	1,324		(595)	371		(2,233)
Materials	25,947	22,335		49,760	43,747		94,403
Staff Cost	714	576	23.8	1,339	1,137	17.8	2,287
Other expenditure	3,152	2,666	18.2	5,620	4,671	20.3	9,799
Operating Profit	**4,570**	**3,357**	**36.1**	**9,022**	**6,463**	**39.6**	**15,778**
Income from Services	186	141		301	283		488
Other Income	1,217	1,091		2,650	2,073		**4,292**
PBDIT	**5,973**	**4,589**	**30.2**	**11,972**	**8,819**	**35.8**	**20,558**
Gross Interest	31	61	**(49.8)**	63	153	**(58.5)**	204
Depreciation	596	665	**(10.4)**	1,237	1,448	**(14.6)**	2,854
PBT	**5,346**	**3,863**	**38.4**	**10,672**	**7,219**	**47.8**	**17,500**
Provision for tax	1,701	1,239		3,411	2,427		5,873
Provision for deferred tax	(40)	(21)		(129)	(138)		(320)
Provision for FBT	11	18		20	38		57
Net Profit	**3,674**	**2,627**	**39.9**	**7,370**	**4,891**	**50.7**	**11,891**
Equity Capital	1,445	1,445		1,445	1,445		1,445
Reserves (excl. rev. res.)							53,081
EPS for the period (Rs)	**12.7**	**9.1**		**25.5**	**16.9**		**41.2**
Book Value							189
OPM (%)	**13.4**	**11.1**	**2.3**	**13.8**	**11.1**	**2.8**	**13.1**
NPM (%)	10.8	8.7		11.3	8.7		9.9
Sales Volumes	**157,683**	**140,543**	**12.2**	**302,631**	**262,409**	**15.3**	**561,124**
Exports	**8,165**	**11,880**	(31.3)	**16,009**	**18,773**	(14.7)	**34,784**
M 800	20,145	20,801	(3.2)	40,445	40,214	0.6	89,223
Omni/Versa	20,523	17,467	17.5	37,332	32,232	15.8	65,665
Zen/Alto/Wagon-R/Swift	99,747	81,491	22.4	191,197	154,504	23.7	335,139
Esteem / Baleno	8,389	8,177	2.6	15,960	14,935	6.9	31,939
Gypsy	714	727	(1.8)	1,688	1,751	(3.6)	4,374
Domestic	**149,518**	**128,663**	16.2	**286,622**	**243,636**	17.6	526,340
Expend. (% of net sales)							
Raw materials	75.2	78.2	(3.0)	75.5	78.2	(2.7)	76.8
Staff costs	2.1	1.9	0.2	2.1	1.9	0.2	1.9
Other expenses	9.3	8.8	0.5	8.6	8.8	(0.2)	8.2

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