

# Stronger performance likely; stock fairly valued

## Weak Q4, but expect improved performance hereon

TVS Motor's Q4 results disappointed, impacted by higher raw material and marketing expenses. We believe this is a temporary blip in the recovery which was witnessed earlier in the year. We expect improvement hereon following (1) correction of mix, presently skewed toward low-priced products, and (2) neutralization of raw material cost impact through improved pricing power. While we have cut our FY07E earnings by 9.8% to reflect this performance, we expect TVS Motor to register a healthy 30% EPS CAGR over the next 2 years. At 16x our FY07E and 11.8x our FY08E EPS, the stock is fairly valued. Retain Neutral.

## Sales in line, margins decline

Q4 sales at Rs8.4bn were in line with expectations, outgrowing industry on the back of recent product successes. Margins, grew 87bps YoY but declined 122bps QoQ) to 5.7%, and EBITDA increased 37.8% YoY at Rs482mn (MLe 784mn) impacted by higher raw material and marketing expenses.

## Earnings revised

Our forecasts are revised down 9.8% for FY07 to reflect the weak results. We however expect margin expansion on the back of improved product mix and return to pricing power. We expect earnings to deliver 30% CAGR over FY06-08.

## Business outlook strong

Further launches (value priced motorcycle, three wheelers) and foray to international markets will be key volume drivers for the company.

## Retain Neutral

Despite expectations of high growth rates, at 16x our FY07E and 11.8x our FY08E EPS, the stock is fairly valued compared to peers. We retain Neutral.

## Estimates (Mar)

(Rs)	2004A	2005A	2006E	2007E	2008E
Net Income (Adjusted - mn)	1,385	1,006	1,170	1,461	1,981
EPS	5.83	5.79	4.93	6.15	8.34
EPS Change (YoY)	5.3%	-0.7%	-14.9%	24.8%	35.6%
Dividend / Share	1.30	1.30	1.30	1.80	2.00
Free Cash Flow / Share	(3.17)	1.84	2.39	2.91	4.80

## Valuation (Mar)

	2004A	2005A	2006E	2007E	2008E
P/E	16.88x	17.00x	19.98x	16.01x	11.80x
Dividend Yield	1.32%	1.32%	1.32%	1.83%	2.03%
EV / EBITDA*	9.94x	12.18x	12.61x	9.44x	7.36x
Free Cash Flow Yield*	-3.22%	1.87%	2.43%	2.95%	4.87%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 6.



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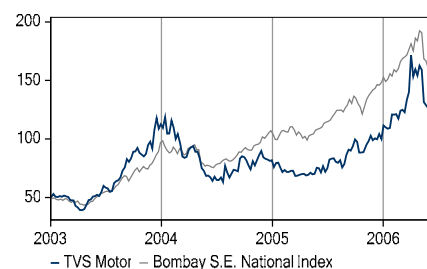
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## Stock Data

Price	Rs98.45
Investment Opinion	C-2-7
Volatility Risk	HIGH
52-Week Range	Rs70.65-Rs186.70
Mrkt Val / Shares Out (mn)	US\$504 / 237.5
Average Daily Volume	182,659
ML Symbol / Exchange	XFKMF / BSE
Bloomberg / Reuters	TVSL IN / TVSM.BO
ROE (2006E)	16.3%
Net Dbt to Eqty (Mar-2005A)	16.6%
Est. 5-Yr EPS / DPS Growth	10.0% / 10.0%
Free Float	41.0%



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Refer to important disclosures on page 7 to 8. Analyst Certification on page 6.

27 June 2006

# iQprofile<sup>SM</sup> TVS Motor

## Key Income Statement Data (Mar)

	2004A	2005A	2006E	2007E	2008E
<b>(Rs Millions)</b>					
Sales	28,202	28,759	32,350	38,035	43,582
Gross Profit	8,313	7,538	7,570	9,018	10,733
Sell General & Admin Expense	(5,719)	(5,422)	(5,525)	(6,287)	(7,232)
Operating Profit	1,795	1,219	1,106	1,596	2,226
Net Interest & Other Income	350	416	579	506	469
Associates	0	0	0	0	0
Pretax Income	2,145	1,635	1,685	2,102	2,695
Tax (expense) / Benefit	(760)	(629)	(515)	(641)	(714)
Net Income (Adjusted)	1,385	1,006	1,170	1,461	1,981
Average Fully Diluted Shares Outstanding	238	238	238	238	238

## Key Cash Flow Statement Data

Net Income (Reported)	1,385	1,006	1,170	1,461	1,981
Depreciation & Amortization	799	896	939	1,136	1,275
Change in Working Capital	293	(289)	(58)	156	366
Deferred Taxation Charge	211	255	5	96	107
Other Adjustments, Net	(925)	128	112	(408)	(839)
Cash Flow from Operations	1,762	1,996	2,167	2,440	2,890
Capital Expenditure	(2,514)	(1,559)	(1,599)	(1,750)	(1,750)
(Acquisition) / Disposal of Investments	(401)	(474)	0	0	0
Other Cash Inflow / (Outflow)	0	0	0	0	0
Cash Flow from Investing	(2,915)	(2,033)	(1,599)	(1,750)	(1,750)
Shares Issue / (Repurchase)	440	0	0	0	0
Cost of Dividends Paid	(305)	(351)	(347)	(481)	(534)
Cash Flow from Financing	317	582	457	65	(427)
Free Cash Flow	(752)	436	569	690	1,140
Net Debt	1,010	1,130	903	598	(114)
Change in Net Debt	808	134	(226)	(305)	(712)

## Key Balance Sheet Data

Property, Plant & Equipment	6,947	7,636	8,295	8,910	9,385
Other Non-Current Assets	129	695	695	695	695
Trade Receivables	519	346	532	834	1,194
Cash & Equivalents	180	739	1,765	2,520	3,232
Other Current Assets	1,495	1,650	1,400	1,600	1,800
Total Assets	12,811	15,220	17,257	19,820	22,308
Long-Term Debt	1,190	1,868	2,668	3,118	3,118
Other Non-Current Liabilities	0	0	0	0	0
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	431	556	347	481	534
Total Liabilities	7,062	8,432	9,646	11,229	12,271
Total Equity	5,750	6,788	7,611	8,591	10,037
Total Equity & Liabilities	12,811	15,220	17,257	19,820	22,308

## iQmethod<sup>SM</sup> - Bus Performance\*

Return On Capital Employed	16.7%	8.7%	7.3%	9.3%	12.2%
Return On Equity	27.8%	16.1%	16.3%	18.0%	21.3%
Operating Margin	6.4%	4.2%	3.4%	4.2%	5.1%
EBITDA Margin	9.2%	7.4%	6.3%	7.2%	8.0%

## iQmethod<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	1.3x	2.0x	1.9x	1.7x	1.5x
Asset Replacement Ratio	3.1x	1.7x	1.7x	1.5x	1.4x
Tax Rate (Reported)	35.4%	38.5%	30.5%	30.5%	26.5%
Net Debt-to-Equity Ratio	17.6%	16.6%	11.9%	7.0%	-1.1%
Interest Cover	NM	14.6x	8.4x	9.9x	12.3x

## Key Metrics

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 6.

## Company Description

TVS Motor, the flagship company of the US\$2.2bn TVS Group, is the third largest two-wheeler manufacturer in India and among the top 10 in the world. The company operates out of twin manufacturing locations in Hosur (Tamil Nadu) and Mysore (Karnataka), both in southern India. Key products include Star and Victor in motorcycles, scooty (ungeared scooters) and Super XL (mopeds).

## Stock Data

Price to Book Value 3.1x

## Weak Q4, retain Neutral

TVS Motor's Q4 results disappointed, impacted by higher raw material and marketing expenses. We believe this is a temporary reversal in recovery which was witnessed earlier in the year, we expect improvement hereon following (1) correction of mix, presently skewed toward low-priced products, and (2) neutralization of raw material cost impact through improved pricing power. While we cut our FY07E earnings by 9.8% to reflect this performance, we expect TVS Motor to register a healthy 30% EPS CAGR over the next 2 years. At 16x our FY07E and 11.8x our FY08E EPS, the stock is fairly valued. Retain Neutral.

### Q4 Highlights:

- Sales up 16.8% at Rs8.4bn, driven by 18.2% YoY increase in aggregate volumes (particularly motorcycles which grew 24.1%, and now accounts for 62.6% of sales volume). Growth was largely driven by the continuing success of the entry model, as well as the newly launched premium bike. Unit realization declined 1.1% YoY, as product mix remained skewed toward low-priced products;
- EBITDA margins improved 87bps YoY, but declined 122bps QoQ at 5.7%, which was sharply lower than our expectations; this was largely due to impact of higher raw material expenses, also a function of product mix (most volumes come from low priced models/segments), and higher marketing spend (recent sports events);
- Interest outgo increased from nil to Rs 46mn, as the company raised funds to meet its growing capex requirements, to commission new plant in North India, and to expand its presence in overseas markets;
- Net profit of Rs291mn was lower than MLe of Rs421mn, in tandem with lower than expected operating income.

### Business Outlook

TVS Motor has come back strongly in the two wheeler market, on the back of product successes in motorcycles (*StarCity*, *Apache*). FY06 volumes were up 14.9% (in-line with industry), led by motorcycles at 18.7% (industry 18.3%). We believe that the company needs to demonstrate its capability in the economy/value segment to sustain this growth momentum. We believe that its foray in Indonesia as well in domestic three wheelers should be long term positives.

In the **Entry level (40% of market)**, we estimated TVS Motors' segmental market share to have doubled to ~30% last fiscal. The *StarCity* model has been a huge success, and continues to gain traction. With variants having been launched recently, we expect the company to continue to expand presence in this segment;

At the **value price point (50% of market)**, TVS Motor has completely lost its presence, as volumes of the erstwhile popular model *Victor* have continued to slip (presently estimated market share <5%). We believe that the company is looking to introduce another new model in FY07, and the company's continued recovery in motorcycles will depend to a large extent on this product;

In the **premium bike space (10% of market)**, TVS Motor introduced a new model recently. Initial reports indicate that it has chalked up another winner in *Apache*, which has taken on dominant model *Pulsar* (from Bajaj Auto). We expect continued increase in sales of this product to improve its overall share, as well as correct the skewed mix towards low priced products.

In **Scoters**, TVS Motor has managed to maintain its share with upgraded version of the popular *Scooty Pep*. Volume growth last fiscal at 8.7% was significantly higher than industry average of less than 1%, despite the presence of a new competitor in Hero Honda. We believe that Scooters will continue to remain a steady growth segment for the company;

**Mopeds** are a losing proposition. However since demand is largely regional, the company's strong franchise will enable it to hold on to existing volumes. No investments are planned towards this segment;

The much delayed foray in **three wheelers** is expected in CY2007. We believe that like most of the company's products, this too will be cost competitive. Also, the market has started accepting brands other than dominant manufacturer Bajaj Auto, indicating that there is opportunity to make a mark in this segment;

## Earnings estimates revised

We are revising forecasts, on the back of the weaker than expected Q4 results. We are raising volume expectations, given the stronger than expected volume traction. We also expect margins to improve hereon, with improving mix and improving scale of operations. We also expect tax outgo to be lower, as the company rolls out products from its new tax free manufacturing unit from late-FY07. As a result, we have revised down our earnings forecast by 9.8% in FY07. We are also introducing estimates for FY08. Based on revised estimates, we expect earnings to grow 30% FY06E-08E CAGR.

Table 1: Revision in Estimates

	Old	New		Revision
Rsmn	FY07E	FY07E	FY08E	FY07E
Volumes (nos)	1,568,255	1,558,522	1,765,746	-0.6%
of which;				
Motorcycles	994,500	967,985	1,088,983	-2.7%
Others	573,755	590,537	676,763	2.9%
Net Sales	39,575	38,035	43,582	-3.9%
EBITDA	3,079	2,731	3,501	-11.3%
Margin	7.8%	7.2%	8.0%	-60 bps
EPS	6.8	6.1	8.3	-9.8%

Source: Merrill Lynch estimates

## Retain Neutral

Stock trades at 16x our FY07E and 11.8x our FY08E EPS. This is a slight premium to the sector, indicating the market has factored expectations of relatively stronger growth rates. As such, we believe the stock is fairly valued, and retain Neutral.

**Table 2: Quarterly Results Summary**

(Rsmn)	4QFY06	4QFY05	YoY	QoQ
<b>Net Sales</b>	<b>8,393</b>	<b>7,183</b>	<b>16.8%</b>	<b>-3.7%</b>
Expenditure	7,911	6,833	15.8%	-2.4%
Raw Materials	6,122	5,242	16.8%	-5.5%
Staff Cost	373	297	25.4%	-9.8%
Other Expenditure	1,416	1,294	9.4%	-6.8%
<b>EBITDA</b>	<b>482</b>	<b>350</b>	<b>37.8%</b>	<b>-20.6%</b>
Other Income	214	152	40.6%	78.2%
<b>Operating Profit</b>	<b>696</b>	<b>502</b>	<b>38.7%</b>	<b>-4.3%</b>
Interest	46	-	NM	31.8%
Depreciation	240	239	0.4%	-0.9%
Ext. Ord Income	-	369		
<b>PBT</b>	<b>410</b>	<b>632</b>	<b>-35.1%</b>	<b>-8.9%</b>
Tax	120	153	-22.0%	-14.5%
Reported PAT	291	479	-39.3%	-6.3%
<b>PAT</b>	<b>291</b>	<b>199</b>	<b>46.0%</b>	<b>-6.3%</b>
<b>Key Ratios</b>				
OPM	5.7%	4.9%	87 bps	-122 bps
NPM	3.5%	6.7%	-321 bps	-10 bps
RM/Sales	72.9%	73.0%	-3 bps	209 bps
Staff Cost/Sales	4.4%	4.1%	30 bps	-30 bps
Other Expenses/Sales	16.9%	18.0%	-115 bps	-57 bps
Effective Tax Rate	29.1%	24.2%	489 bps	-191 bps
<b>Sales Volume (nos)</b>	<b>350,689</b>	<b>296,705</b>	<b>18.2%</b>	<b>-2.2%</b>
Motorcycle	219,565	176,921	24.1%	-1.2%
Mopeds	79,705	71,025	12.2%	8.0%
Scooters	51,419	48,759	5.5%	-17.7%
<b>Realisation</b>	<b>23,932</b>	<b>24,208</b>	<b>-1.1%</b>	<b>-1.5%</b>

Source: TVS Motor

**Table 3: Annual Results Summary**

(Rsmn)	FY06	FY05	YoY
<b>Net Sales</b>	<b>32,350</b>	<b>28,759</b>	<b>12.5%</b>
Expenditure	30,305	26,643	13.7%
Raw Materials	23,211	19,814	17.1%
Staff Cost	1,569	1,407	11.5%
Other Expenditure	5,525	5,422	1.9%
<b>EBITDA</b>	<b>2,045</b>	<b>2,116</b>	<b>-3.4%</b>
Other Income	710	499	42.3%
<b>Operating Profit</b>	<b>2,755</b>	<b>2,615</b>	<b>5.4%</b>
Interest	131	83	57.5%
Depreciation	939	896	4.8%
Ext. Ord Income	-	369	
<b>PBT</b>	<b>1,685</b>	<b>2,004</b>	<b>-16.0%</b>
Tax	515	629	-18.2%
Reported PAT	1,170	1,376	-15.0%
<b>PAT</b>	<b>1,170</b>	<b>1,122</b>	<b>4.3%</b>
<b>Key Ratios</b>			
OPM	6.3%	7.4%	-104 bps
NPM	3.6%	4.8%	-117 bps
RM/Sales	71.8%	68.9%	285 bps
Staff Cost/Sales	4.8%	4.9%	-4 bps
Other Expenses/Sales	17.1%	18.9%	-177 bps
Effective Tax Rate	30.5%	31.4%	-83 bps
<b>Sales Volume (nos)</b>	<b>1,341,012</b>	<b>1,167,516</b>	<b>14.9%</b>
Motorcycle	806,654	679,536	18.7%
Mopeds	290,273	263,393	10.2%
Scooters	244,085	224,587	8.7%
<b>Realisation</b>	<b>24,123</b>	<b>24,633</b>	<b>-2.1%</b>

Source: TVS Motor

## Analyst Certification

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Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	$\text{Net Debt} = \text{Total Debt, Less Cash \& Equivalents}$	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	$\text{Market Cap.} = \text{Current Share Price} * \text{Current Basic Shares}$
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

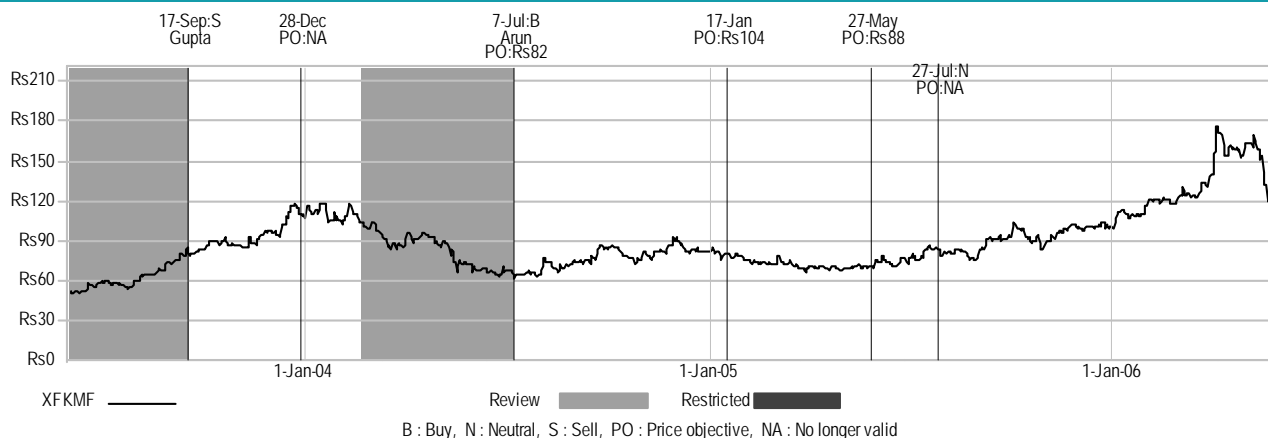
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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	31	40.26%	Buy	8	25.81%
Neutral	31	40.26%	Neutral	8	25.81%
Sell	15	19.48%	Sell	5	33.33%

### Investment Rating Distribution: Global Group (as of 31 Mar 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1145	40.29%	Buy	393	34.32%
Neutral	1474	51.86%	Neutral	430	29.17%
Sell	223	7.85%	Sell	44	19.73%

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