Maruti Suzuki MRTI.NS MSIL IN

AUTOS & AUTO PARTS

NOMURA
EQUITY RESEARCH

Not attractive unless JPY moves in favour

Strong volume growth in FY13F and increase in localization not enough to offset JPY impact

November 2, 2011

Rating Down from Buy	**Neutral**
Target price Reduced from 1480	INR 1153
Closing price November 1, 2011	INR 1134
Potential upside	+1.7%

Action: We downgrade MSIL to Neutral with a new TP of INR1153

MSIL had a weak H1FY12, impacted by strikes and weak demand. Given the low base, we expect volume growth to be strong in FY13F. However, that may not be enough to offset the impact of 12% JPY appreciation over the last four months, which will impact margins from Q3FY12 onwards. Targeted localization over the next three years will compensate for a mere 5% JPY appreciation, in our view. We prefer Tata Motors and Ashok Leyland as plays on an improving interest-rate scenario next year.

Catalysts: Downsides from weaker demand, tough competition; JPY depreciation could be positive

- Weaker-than-expected demand: We expect volume growth to improve to 15% in FY13F. In case the demand remains weak due to factors like steep competition, increased duty on diesel cars or further increases in fuel prices, it could have a material negative impact on our estimates.
- Competition to limit ROEs: While we expect that MSIL will continue to maintain a leadership position, we believe that it will come at the cost of lower ROEs. Pricing power to offset increases in costs will be limited.
- JPY depreciation could be a positive: 5% depreciation in JPY from its current levels could lead to up to 100bps margin expansion for MSIL.

Valuation: TP of INR1153; based on 14x 1-yr fwd consolidated EPS

We value MSIL at 14x one-year forward consolidated EPS (average of FY13F and FY14F) of INR82.4. We note that the ROEs of the company have declined to 11% and there is a risk the stock can de-rate further if the company is not able to achieve targeted localization.

31 Mar	FY11	FY12F		FY13F		FY14F	
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	369,199	388,759	351,209	446,355	412,847		470,283
Reported net profit (mn)	22,886	22,491	16,129	27,531	19,510		24,897
Normalised net profit (mn)	21,685	22,491	16,129	27,531	19,510		24,897
Normalised EPS	75.03	77.82	55.81	95.26	67.51		86.15
Norm. EPS growth (%)	-13.2	-2.3	-25.6	22.4	21.0		27.6
Norm. P/E (x)	15.1	N/A	20.3	N/A	16.8	N/A	13.2
EV/EBITDA (x)	7.3	9.4	9.4	7.3	7.5		5.7
Price/book (x)	2.3	N/A	2.1	N/A	1.9	N/A	na
Dividend yield (%)	0.7	N/A	0.3	N/A	0.4	N/A	na
ROE (%)	15.7	13.0	9.9	13.8	10.7		13.5
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash		net cash

Source: Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*
Rating: *See report end for details of Nomura's rating system.*

Anchor themes

We estimate 15% car sales growth in India for FY13F, based on our house forecast of 7.9% GDP growth. However, increased competition in small-car segment and sharp JPY appreciation will impact MSIL's margins.

Nomura vs consensus

Our FY13F earnings estimates are around 24% below consensus. We believe that consensus is not yet building in the negative impact of JPY appreciation against INR on the company's EBITDA margins

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Key data on Maruti Suzuki

Income statement (INRmn)

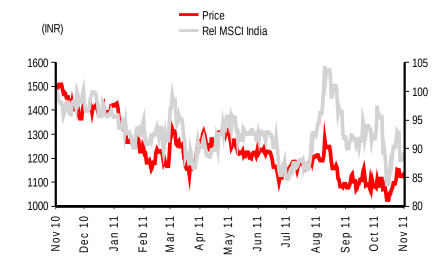
Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Revenue	**296,231**	**369,199**	**351,209**	**412,847**	**470,283**
Cost of goods sold	-233,547	-299,639	-288,834	-341,207	-386,900
Gross profit	**62,684**	**69,560**	**62,375**	**71,640**	**83,383**
SG&A	-25,935	-37,217	-37,892	-42,355	-47,175
Employee share expense	-5,456	-7,036	-7,880	-8,668	-9,709
Operating profit	**31,293**	**25,307**	**16,602**	**20,616**	**26,500**
EBITDA	**39,543**	**35,442**	**27,691**	**33,708**	**41,722**
Depreciation	-8,250	-10,135	-11,089	-13,092	-15,222
Amortisation					
EBIT	31,293	25,307	16,602	20,616	26,500
Net interest expense	-335	-244	-244	-244	-244
Associates & JCEs					
Other income	4,967	4,824	5,587	5,993	7,163
Earnings before tax	**35,925**	**29,887**	**21,945**	**26,365**	**33,419**
Income tax	-10,949	-8,202	-5,815	-6,855	-8,522
Net profit after tax	**24,976**	**21,685**	**16,129**	**19,510**	**24,897**
Minority interests					
Other items					
Preferred dividends					
Normalised NPAT	**24,976**	**21,685**	**16,129**	**19,510**	**24,897**
Extraordinary items	0	1,201			
Reported NPAT	**24,976**	**22,886**	**16,129**	**19,510**	**24,897**
Dividends	-1,733	-2,167	-1,123	-1,359	-1,734
Transfer to reserves	**23,243**	**20,719**	**15,006**	**18,151**	**23,163**
Valuation and ratio analysis					
FD normalised P/E (x)	13.1	15.1	20.3	16.8	13.2
FD normalised P/E at price target (x)	13.3	15.4	20.7	17.1	13.4
Reported P/E (x)	13.1	14.3	20.3	16.8	13.2
Dividend yield (%)	0.5	0.7	0.3	0.4	na
Price/cashflow (x)	8.7	7.7	8.2	8.0	6.6
Price/book (x)	2.7	2.3	2.1	1.9	na
EV/EBITDA (x)	6.7	7.3	9.4	7.5	5.7
EV/EBIT (x)	8.5	10.2	15.7	12.3	9.0
Gross margin (%)	21.2	18.8	17.8	17.4	17.7
EBITDA margin (%)	13.3	9.6	7.9	8.2	8.9
EBIT margin (%)	10.6	6.9	4.7	5.0	5.6
Net margin (%)	8.4	6.2	4.6	4.7	5.3
Effective tax rate (%)	30.5	27.4	26.5	26.0	25.5
Dividend payout (%)	6.9	9.5	7.0	7.0	7.0
Capex to sales (%)	4.1	6.4	9.1	6.0	5.1
Capex to depreciation (x)	1.5	2.3	2.9	1.9	1.6
ROE (%)	19.4	15.7	9.9	10.7	13.5
ROA (pretax %)	34.1	24.5	13.6	14.6	16.8
Growth (%)					
Revenue	42.1	24.6	-4.9	17.6	13.9
EBITDA	115.8	-10.4	-21.9	21.7	23.8
EBIT	178.0	-19.1	-34.4	24.2	28.5
Normalised EPS	104.9	-13.2	-25.6	21.0	27.6
Normalised FDEPS	104.9	-13.2	-25.6	21.0	27.6
Per share					
Reported EPS (INR)	86.42	79.19	55.81	67.51	86.15
Norm EPS (INR)	86.42	75.03	55.81	67.51	86.15
Fully diluted norm EPS (INR)	86.42	75.03	55.81	67.51	86.15
Book value per share (INR)	416.51	488.56	535.66	598.65	na
DPS (INR)	6.00	7.50	3.89	4.70	na

Source: Nomura estimates

Notes

We expect EBITDA margin to decline in FY12-FY13F due to the adverse impact of JPY appreciation against INR

Price and price relative chart (one year)



(%)	1M	3M	12M
Absolute (INR)	4.7	-6.3	-24.8
Absolute (USD)	4.0	-16.2	-32.2
Relative to index	-3.2	-3.5	-10.0

Market cap (USDmn)	6,650.1
Estimated free float (%)	46.0
52-week range (INR)	1599.9/1010
3-mth avg daily turnover (USDmn)	16.99
Major shareholders (%)	
Suzuki Motor Corporation	54.2
LIC	11.4

Source: Thomson Reuters, Nomura research

Cashflow (INRmn)

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
EBITDA	39,543	35,442	27,691	33,708	41,722
Change in working capital	-710	3,161	4,787	168	244
Other operating cashflow	-1,075	3,781	7,378	6,990	7,629
Cashflow from operations	**37,758**	**42,384**	**39,856**	**40,866**	**49,595**
Capital expenditure	-12,124	-23,720	-31,879	-24,862	-23,862
Free cashflow	**25,634**	**18,664**	**7,977**	**16,004**	**25,733**
Reduction in investments					0
Net acquisitions					
Reduction in other LT assets					0
Addition in other LT liabilities					0
Adjustments					
Cashflow after investing acts	**25,634**	**18,664**	**7,977**	**16,004**	**25,733**
Cash dividends	-1,011	-2,021	-2,518	-1,305	-1,579
Equity issue	0	0	0	0	0
Debt issue	1,225	-5,121	0	0	0
Convertible debt issue					
Others	1,009	-2,041			
Cashflow from financial acts	**1,223**	**-9,183**	**-2,518**	**-1,305**	**-1,579**
Net cashflow	**26,857**	**9,481**	**5,459**	**14,699**	**24,154**
Beginning cash	47,297	68,912	72,191	69,800	76,402
Ending cash	74,154	78,393	77,650	84,498	100,556
Ending net debt	-60,698	-69,098	-66,707	-73,309	-88,231

Source: Nomura estimates

Notes

Operating cash flows to remain strong over FY12-14F

Balance sheet (INRmn)

As at 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Cash & equivalents	68,912	72,191	69,800	76,402	91,324
Marketable securities					
Accounts receivable	23,806	22,655	23,712	27,925	31,775
Inventories	12,088	14,150	13,705	16,062	18,155
Other current assets	848	1,673	0	0	0
Total current assets	**105,654**	**110,669**	**107,217**	**120,389**	**141,255**
LT investments	3,836	3,961	3,961	3,961	3,961
Fixed assets	54,123	69,580	90,370	102,140	110,780
Goodwill					
Other intangible assets					
Other LT assets					
Total assets	**163,613**	**184,210**	**201,548**	**226,490**	**255,996**
Short-term debt					
Accounts payable	25,670	31,276	34,559	40,434	45,821
Other current liabilities	9,357	8,648	9,091	9,954	10,755
Total current liabilities	**35,027**	**39,924**	**43,650**	**50,388**	**56,576**
Long-term debt	8,214	3,093	3,093	3,093	3,093
Convertible debt					
Other LT liabilities					
Total liabilities	**43,241**	**43,017**	**46,743**	**53,481**	**59,669**
Minority interest					
Preferred stock					
Common stock	1,445	1,445	1,445	1,445	1,445
Retained earnings	116,906	137,230	152,054	169,985	192,868
Proposed dividends	2,021	2,518	1,305	1,579	2,015
Other equity and reserves					
Total shareholders' equity	**120,372**	**141,193**	**154,804**	**173,009**	**196,327**
Total equity & liabilities	**163,613**	**184,210**	**201,548**	**226,490**	**255,996**
Liquidity (x)					
Current ratio	3.02	2.77	2.46	2.39	2.50
Interest cover	93.4	103.7	68.0	84.5	108.6
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable	30.4	23.0	24.2	22.8	23.2
Days inventory	16.5	16.0	17.6	15.9	16.1
Days payable	41.3	34.7	41.7	40.1	40.7
Cash cycle	5.6	4.3	0.1	-1.4	-1.4

Source: Nomura estimates

Notes

Significant increase in cash balance could potentially lead to higher dividend payouts

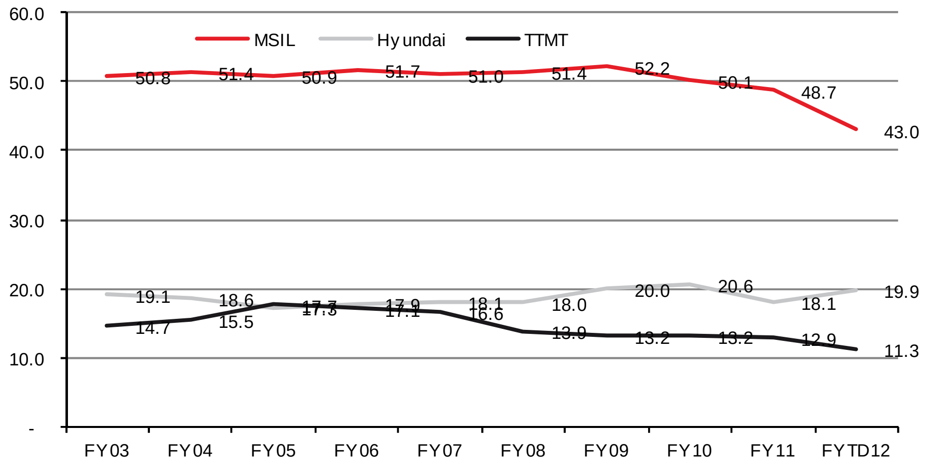
Impacted by JPY appreciation and higher competition

MSIL's margins are likely to be impacted by 140bps compared to FY11 levels due to 12% JPY appreciation over the past four months, in our view. In addition, volume growth for the current year has been impacted by steep increases in petrol prices and by strikes. We expect the company to report strong 15% volume growth in FY13F backed by new launches and improved demand. However, that may not be enough to offset the impact of JPY appreciation. Despite MSIL's recent underperformance vis-a-vis peers and the broader market we see limited upside.

We expect MSIL to improve market share over the next six months

MSIL has lost significant market share due to strikes. As production normalizes, we expect the company to gain back market share. This will be backed by the huge waiting list of 100,000 units on the Swift. MSIL is also planning to launch a shortened version of D'zire Sedan which will qualify for lower excise duty of 10%, compared to 22% currently, and its first foray into the SUV segment with the new product RIII. We note that many of the competing products in the highly competitive 1.2L space have failed to maintain volume momentum beyond the first few months of launch. Dealers are already offering discounts on Toyota Etios Liva and Hyundai Eon within a few months of launch compared to NIL discount on MSIL's Swift.

Fig. 1: Domestic car market share



Source: Company, Nomura research

Fig. 2: MSIL's performance by segment

Segemnt	MSIL		Industry		Market share (%)		Comments
	1HFY11	1HFY12	1HFY11	1HFY12	1HFY11	1HFY12	
Mini (M800, A-Star, Alto, Wagon R)	252,994	234,900	309,025	297,384	81.9	79.0	Higher base effect due to launch of Alto K-10 in Aug-10
Compact (Ritz, Swift, Estilo)	128,585	100,515	397,697	377,041	32.3	26.7	Swift volumes impacted by strike at Manesar
Super Compact (Dzire)	50,361	45,383	62,089	82,184	81.1	55.2	Significant Impact of strike at Manesar
Mid-size (SX4)	9,959	9,909	81,220	92,312	12.3	10.7	Diesel variant impacted by strike

Source: SIAM

Fig. 3: Performance of key competitor models

	Sep-10	Sep-11	yoy (%)	1HFY11	1HFY12	yoy (%)	Comments
Ford Figo	6,465	5,220	(19)	38,179	33,016	(14)	
Chevrolet Spark	2,415	1,596	(34)	16,342	14,614	(11)	
Nissan Micra	1,183	1,475	25	3,293	8,743	166	Launched in July-10; Diesel variant launched in Dec-10
Volkswagen Polo	2,891	3,050	5	12,022	19,092	59	Delievery of diesel variant started in mid 1HFY11
Chevrolet Beat	2,743	5,254	92	16,439	21,364	30	Diesel variant launched in July-11
Hyundai i10	14,434	9,784	(32)	75,332	62,719	(17)	
Hyundai Santro	6,451	6,396	(1)	39,689	40,682	3	
Total	**36,582**	**32,775**	**(10)**	**201,296**	**200,230**	**(1)**	

Source: SIAM

Margins to decline due to JPY appreciation and lower volumes

We now expect domestic volumes to decline by 10.4% in FY12F due to longer-than-expected production issues owing to labour strikes at MSIL's Manesar plant. We have also been surprised by the extent of the slowdown in industry volumes post the increases in petrol prices in September 2011. Nomura's GDP growth estimates have also been lowered from 7.7% for FY12F to 7.3% in October 2011. Hence we are now expecting India's car industry to grow at 3% for FY12F, compared with our earlier forecast of 7%.

However, due to the lower base effect, we are now building in higher growth of around 16% in domestic volumes of MSIL in FY13F. We have reduced our FY13F EBITDA margin estimates by 170bps to factor in the sharp 12% appreciation of JPY against INR over the past four months. We note that the theoretical impact on margins because of this is around 250bps (35% impact on EPS), however the company should be able to control costs through cost-reduction initiatives and limit the impact to only 170bps, in our view.

MSIL is targeting localization to bring down vendor imports from 14% of sales to 7% of sales over the next three years. We believe that there may not be any significant benefits visible from the same till FY14 as these are projects with a long gestation period. While there could be a 20% cost reduction that may be achieved through this, we note that some of it may also be shared with the vendors who will make investments for the same. Thus the overall benefit from the same may be around 100bps, in our view, over the next three years.

Overall, we have cut our FY12/13F EPS estimates by around 30%. Our FY13F earnings estimates are 24% below consensus; we expect consensus to downgrade earnings to build in the impact of JPY appreciation and lower volumes.

Fig. 4: Change in estimates

	New			Old		%change	
	FY12F	FY13F	FY14F	FY12F	FY13F	FY12F	FY13F
Domestic volumes	1,015,476	1,177,192	1,318,455	1,174,558	1,315,505	-13.5%	-10.5%
YoY(%)	-10.4%	15.9%	12.0%	3.7%	12.0%		
Export volumes	126,000	138,600	155,232	132,000	147,840	-4.5%	-6.3%
YoY(%)	-8.9%	10.0%	12.0%	-4.5%	12.0%		
Total Volumes	1,141,476	1,315,792	1,473,687	1,306,558	1,463,345	-12.6%	-10.1%
YoY(%)	-10.2%	15.3%	12.0%	2.8%	12.0%		
EBITDA (INR m) (incl other op. income)	27,691	33,708	41722	36,940	44,940	-25.0%	-25.0%
EBITDA margin %(incl other op. income)	7.9%	8.2%	8.9%	9.3%	9.9%	-1.4%	-1.7%
EPS (INR)	55.8	67.5	86.1	77.8	95.3	-28.3%	-29.1%
CEPS (INR)	94.2	112.8	138.8	120.3	147.1	-21.7%	-23.3%
Consolidated EPS (INR)	60.6	72.8	91.9	83.6	101.7	-27.5%	-28.4%

Source: Company data, Nomura estimates

Fig. 5: Our estimates are significantly below consensus

INR mn	Nomura			Consensus			% difference		
	FY12F	FY13F	FY14F	FY12F	FY13F	FY14F	FY12F	FY13F	FY14F
Sales	351,209	412,847	470,283	368,749	441,290	515,383	(4.8)	(6.4)	(8.8)
EBITDA	27,691	33,708	41,722	31,311	40,906	49,069	(11.6)	(17.6)	(15.0)
EBITDA margin (%)	7.9	8.2	8.9	8.5	9.3	9.5	(0.6)	(1.1)	(0.6)
Net profit	16,129	19,510	24,897	19,792	25,710	30,670	(18.5)	(24.1)	(18.8)
EPS (INR)	55.8	67.5	86.1	68.5	89.0	106.1	(18.5)	(24.1)	(18.8)

Source: Bloomberg, Nomura estimates

Recent stock underperformance largely builds in these concerns

MSIL has underperformed peers and the broader market over the past three months (down 7% against 3-18% increase in other 4-wheeler companies), thereby largely factoring in some of these concerns, in our view.

Fig. 6: MSIL has underperformed peers and Sensex in last 3 months

		Stock performance			
B'berg Ticker	Price	1M	3M	6M	1Y
SENSEX	17,481	8.2	(2.6)	(5.7)	(14.1)
TTMT IN	193	25.9	4.2	(16.8)	(16.2)
AL IN	26	3.1	3.6	6.2	(31.1)
MSIL IN	1,134	5.2	(6.5)	(11.0)	(24.1)
MM IN	834	2.9	17.7	17.8	10.1

Note: Pricing as on 1st Nov, 2011

Source: Bloomberg

TP of INR1153 implies 3% potential upside; downgrade to Neutral

We value MSIL at 14x one-year forward consolidated EPS (average of FY13F and FY14F EPS) of INR82.4. Our valuation multiple remains unchanged. We note that the stock's five-year average multiple on one-year forward consensus earnings is 14x.

Fig. 7: MSIL India 1yr fwd P/E

Source: Bloomberg, Nomura research

Fig. 8: MSIL India 1yr fwd P/E based on Cash EPS

Source: Bloomberg, Nomura research

Fig. 9: Relative valuations

			Price	EPS CAGR	P/ E			P/ E on cash EPS			ROE (%)		
Company	Ticker	Rating	INR	FY11-13E	FY11	FY12F	FY13F	FY11	FY12F	FY13F	FY11	FY12F	FY13F
Ashok Leyland	AL IN	Buy	26.2	8.1%	11.0	12.7	9.4	7.8	7.8	6.3	16.5	13.4	16.6
Bajaj Auto	BJAUT IN	Neutral	1,713.5	9.2%	19.0	16.9	15.9	18.1	16.2	15.2	85.2	51.4	42.7
Hero MotoCorp	HMCL IN	Neutral	2,137.4	21.2%	21.3	17.4	14.5	18.3	11.9	10.3	60.0	79.5	88.1
M&M*	MM IN	Buy	834.1	4.0%	13.7	14.0	12.7	11.7	11.5	10.2	29.2	22.4	21.2
Maruti Suzuki	MSIL IN	Neutral	1,133.5	-3.6%	14.5	18.7	15.6	10.3	12.0	10.0	15.7	9.9	10.7
Tata Motors	TTMT IN	Buy	193.5	1.4%	6.8	7.1	6.6	4.5	4.3	3.8	67.7	38.5	31.3
TVS Motor	TVSL IN	Buy	66.0	17.5%	15.6	11.5	11.3	10.0	8.1	7.9	19.8	23.1	20.5

Note: PE for MSIL is based on consolidated EPS; * Adjusted for subsidiary values; Pricing as on 1st Nov, 2011

Source: Bloomberg, Nomura research

Key risks

Downside risks

- Slower-than-expected GDP growth — our FY13F domestic volume growth estimates of 16% are based on Nomura's GDP growth assumption of 7.9% in FY13F. In case GDP growth slows substantially, there would be downside risks to our estimates.
- Increase in raw material costs — we have assumed stable commodity prices; in case commodity prices increase from current levels, there would be downside risks to our estimates.
- Increased competition — there could be downside risks to our volume estimates, if recent launches by competitors, especially the Hyundai EON, are very successful.
- Yen appreciation against the INR — MSIL imports components are worth 16% of net sales in JPY. We estimate that a 5% change in the JPY/INR rate would affect margins by 100bps. If JPY appreciates further, there could be downside risks to our estimates. We are currently factoring in an average rate of INR1:JPY0.615.

Upside risks

- Decline in raw material costs — there would be upside risks to our estimates if there is a significant decline in commodity prices.
- Yen depreciation against the INR — JPY appreciated by around 12% against INR from July-October 2011, to INR1:JPY0.615. If JPY depreciates, there could be upside risks to our estimates. Every 5% depreciation of JPY could lead to around 1% higher EBITDA margins.

Fig. 10: EPS sensitivity to JPY/INR exchange rate

Change in JPY/INR rate	-5%	0%	5%
JPY/INR rate	**0.584**	**0.615**	**0.646**
Impact on FY13 EBITDA margins (bps)	105	-	(105)
Impact on FY13 EPS (%)	16	-	(16)

Source: Nomura research

2QFY12 results disappoint on higher raw material and other costs

MSIL's 2QFY12 PAT came in at INR2.4bn; significantly below our and consensus estimates of INR3.5bn and INR4.1bn, respectively. As per the company, JPY appreciation has led to other costs (royalty expenses) being higher by INR1bn in the quarter, of which INR0.5bn pertains to 1QFY12. Further, other operating income includes one-off provision write-backs of around INR0.4-0.55bn; raw-material costs include a mark-to-market hedging loss of INR0.26bn, as per the management. Adjusted for these one-offs, EBITDA margin (including operating income) came in at 6.6%, still well below our expectations of around 8%. Margins are likely to remain under pressure in 3Q as well due to the impact of JPY appreciation, we think; however, company expects margins should improve in 4QFY12.

Company expects a tax rate of 26-27% for FY12; at 28.1%, the tax rate for the quarter was higher due to lower R&D expenses. Average realization increased by 1.1% qoq due to the higher proportion of diesel vehicles sold during the quarter. Company incurred capex of INR14bn in 1HFY12 and expects to spend another INR18bn in 2HFY12.

Other result highlights

- Net sales came in at INR75.7bn, largely in line with our estimate of INR 74.6bn.
- EBITDA margins (including operating income) came in at 6.3% lower than our estimate of 8.1%.

- Other operating income came in at INR2.56bn, compared with our estimate of INR1.68bn.
- RM/sales came in at 81.3%, compared with our estimate of 80.3%.
- Employee cost/sales came in at 2.6%, compared with our estimate of 2.2%.
- Other expenses/sales came in at 13.0%, compared with our estimate of 11.5%.
- Company has decided to buy 1400 acres of land to set up its new manufacturing facility in Gujarat.

Fig. 11: 2QFY12 results

INR mn	2QFY11(A)	1QFY12(A)	2QFY12(A)	Q/Q	Y/Y	2QFY12(F)
Net Sales	**89,774**	**83,615**	**75,754**	-9.4	-15.6	**74,586**
Change (%)	*26.8*	*3.4*	*-15.6*			*-16.9*
(Inc)/Dec in stock	(1,482)	(1,527)	955			
Raw Materials	72,238	65,024	56,497			
Net Raw materials	70,307	66,917	61,566	-8.0	-12.4	59,892
Staff Welfare	1,568	1,794	1,995	11.2	27.2	1,647
Other costs	9,545	8,438	9,814	16.3	2.8	8,581
Total Cost	81,421	77,149	73,374	-4.9	-9.9	70,120
Operating Profit	**8,353**	**6,466**	**2,380**	-63.2	-71.5	**4,466**
OPM (%)	*9.3*	*7.7*	*3.1*	-4.6	-6.2	*6.0*
OPM incl other income(%)	*10.89*	*9.5*	*6.3*			*8.1*
Change (%)	*0.7*	*0.8*	*-71.5*			*-46.5*
Other Income	2,939	3,479	3,740	7.5	27.3	2,979
Extraordinary Income	-349	0	0			0
Interest	97	58	109	89.9	12.3	58
Gross Profit	**10,846**	**9,887**	**6,010**	-39.2	-44.6	**7,388**
Less: Depreciation	2,382	2,425	2,664	9.9	11.8	2,725
PBT	**8,464**	**7,463**	**3,347**	-55.2	-60.5	**4,663**
Tax	2481	1970	942	-52.2	-62.0	1166
Effective Tax Rate (%)	*29.3*	*26.4*	*28.1*			*25.0*
PAT	**5,982**	**5,492**	**2,405**	-56.2	-59.8	**3,497**
Adj. PAT	**6,223**	**5,492**	**2,405**	-56.2	-61.4	**3,497**
YoY	*4.7*	*19.8*	*-61.4*			*-43.8*
Adjusted EPS	*21.5*	*19.0*	*8.3*	-56.2	-61.4	*12.1*

Source: Company data, Nomura estimates

Fig. 12: Cost ratios

	2QFY11(A)	1QFY12(A)	2QFY12(A)	Q/Q	Y/Y	2QFY12(F)
RM/Sales (%)	78.3	80.0	81.3	1.2	3.0	80.3
Staff/Sales (%)	1.7	2.1	2.6	0.5	0.9	2.2
Other Exp./Sales (%)	10.6	10.1	13.0	2.9	2.3	11.5
Net Sales/Vehicle (INR)	286,219	297,005	300,246	1.1	4.9	295,616
RM/Vehicle (INR)	224,156	237,695	244,010	2.7	8.9	237,379

Source: Company data, Nomura estimates

Key takeaways from the conference call

MSIL management sounded cautious on the demand outlook for 2HFY12. Company was hedged for direct raw-material imports till October 2011; MSIL has started to hedge for 2HFY12 at current exchange-rate levels. The impact of JPY on indirect imports will hit the company from next quarter. Thus we expect the margins to bottom in Q3FY12 and improve from there on as Swift / D'zire production increases and diesel production increases.

Other takeaways

- Diwali festival season sales up 2-3% yoy; overall demand environment remains weak, as per the company and a price increase seems unlikely in the near term.
- Diesel vehicle growth at +24% yoy, petrol vehicle growth at -11% yoy in 6m FY12.
- RM/sales increased in 2Q primarily due to higher discount levels in the quarter.
- Discount levels increased to INR13,500 in 2Q from INR9,500 in 2Q; expect average discounts to decline going ahead due to higher proportion of Swift and D'zire volumes.
- Company hedged for direct raw-material imports till October 2011; MSIL has started to hedge for 2HFY12 at current exchange-rate levels.
- MSIL compensates vendors for indirect import components (accounts for 14% of RM) with a lag of one quarter; therefore the impact of JPY appreciation will be there in 3QFY12.
- The impact of new Manesar plant was felt for only one month in terms of higher depreciation in 2QFY12; depreciation can be higher by INR0.2bn in 3QFY12.
- On average, inventory declined to 2-3 weeks in 2QFY12 from 4-5 weeks earlier.
- Swift has bookings of around 100,000 vehicles currently; of which 80-85% is for the diesel variant.
- Company expects the supply of diesel engines from Fiat to start from January 2012. Diesel production to increase to 25,000 units per month in January 2012 from 20,000 units currently.
- Currently, capacity of Swift is 16-18k vehicles and around 10k vehicles for D'zire; company expects supply of diesel engines to increase to 25k/month in January 2012 from 20k currently.
- Post the labour strike, company is ramping up capacity slowly at Manesar; expects to reach pre-strike capacity levels by end December.
- New capacity of 250k vehicles at Manesar will be operational by end FY13.

Appendix A-1

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Mentioned companies

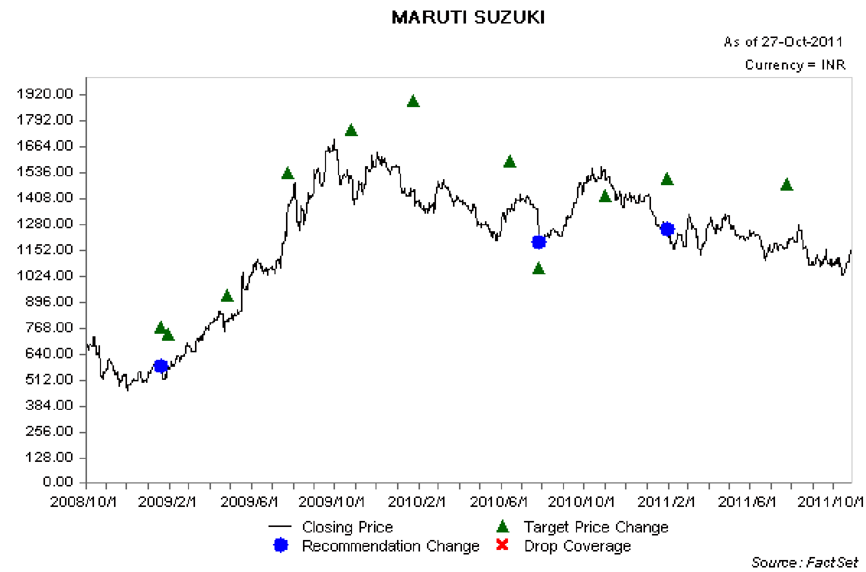
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Maruti Suzuki	MSIL IN	INR 1134	01-Nov-2011	Neutral	Not rated	

Previous Rating

Issuer name	Previous Rating	Date of change
Maruti Suzuki	Buy	01-Nov-2011

Maruti Suzuki (MSIL IN) **INR 1134 (01-Nov-2011)** Neutral (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
26-Jul-2011		1480.00	1177.95
31-Jan-2011		1505.00	1252.80
31-Jan-2011	Buy		1252.80
01-Nov-2010		1418.00	1508.70
26-Jul-2010		1062.00	1191.05
26-Jul-2010	Reduce		1191.05
15-Jun-2010		1591.00	1343.95
25-Jan-2010		1892.00	1445.25
26-Oct-2009		1748.00	1517.40
24-Jul-2009		1533.00	1377.85
27-Apr-2009		930.00	807.50
30-Jan-2009		734.00	571.00
19-Jan-2009		774.60	578.45
19-Jan-2009	Buy		578.45

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value MSIL at 14x one-year forward consolidated EPS (average of FY13F and FY14F EPS) of INR82.4, to give a TP of INR 1,153. We note that the stock's five-year average multiple on one-year forward consensus earnings is 14x.

Risks that may impede the achievement of the target price Downside risks: (1) Slower-than-expected GDP growth — our FY13F domestic volume growth estimates of 16% is based on Nomura's GDP growth assumption of 7. 9% in FY13F. In case GDP growth slows substantially, there would be downside risks to our estimates. (2) Increases in raw material costs — we have assumed stable commodity prices; in case commodity prices increase from current levels, there would be downside risks to our estimates. (3) Increased competition — there could be downside risks to our volume estimates, if recent launches by competitors especially Hyundai EON are very successful. (4) JPY appreciation against the INR — MSIL imports components worth 16% of net sales in JPY. We estimate that a 5% change in the JPY/INR rate would affect margins by 100bps. If the JPY appreciates further, there could be downside risks to our estimates. We are currently factoring in an average rate of INR1:JPY0.615. Upside risks: (1) Decline in raw material costs — there would be upside risks to our estimates if there is a significant decline in commodity prices. (2) JPY depreciation against the INR — JPY appreciated by around 12% against INR from July-October 2011, to INR1:JPY0.615. If JPY depreciates, there could be upside risks to our estimates. Every 5% depreciation of JPY could lead to around 1% higher EBITDA margins.

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