MARKET UPDATE

ESPIRITO SANTO INVESTMENT BANK
Research

India | Auto & Auto Ancillary | Large Cap | 13-November-2013

Accounting & corporate governance	GREEN
Franchise Strength	GREEN
Earnings Momentum	AMBER

Bosch

Impressive amid challenges

Bosch's Q3 CY13 numbers were ahead of our estimates, primarily driven by strong performance in exports and non-auto business as well as margin expansion. Although the near-term outlook for commercial vehicles (CV), Bosch's key target segment, remains subdued, regulatory changes related to mining should in our view spur a gradual pick-up in demand. Given its formidable technological edge and strong brand with near monopolistic market share in fuel injection systems, we think Bosch would be the prime beneficiary of a pick-up in the CV cycle. We roll forward our valuation and reduce our estimates to reflect a delayed recovery in the CV cycle and reiterate BUY with an updated FV of Rs9,725 (from Rs10,625 previously).

Strong quarter, ahead of estimates

Bosch reported Q3 CY13 results ahead of our estimates, primarily led by improvement in margin. Revenue during the quarter grew by 4.7% YoY, ahead of our estimates of 2% YoY growth, primarily driven by strong growth in exports and the non-auto segment (both of which grew by 19% YoY). Auto segment sales remained sluggish at 1.8% YoY growth, with OEM sales being flattish while aftermarket sales grew 7%YoY. Amongst OEMs, commercial vehicles and passenger vehicles remained under stress while tractors reported strong performance due to good monsoons. EBITDA margin expanded by 189bps YoY (vs. flat expectations) due to increased localization and cost control initiatives which led to PAT growth of 15% YoY, ahead of our expectation of marginal decline.

Relaxation of mining regulations a positive for the CV cycle

The economic slowdown, the mining ban (in Karnataka and Goa) and regulatory overhang on mining of iron ore (IO) in Odisha had an overwhelmingly negative impact on CV demand. Our Basic Materials team however feels the tide is slowly but surely changing, with favourable regulatory changes with regard to IO mining starting to come in. In our view, a relaxation in regulatory requirements on mining should increase volumes in the domestic market and export, which in turn will spur an increase in utilisation levels of fleet operators, increase freight rates and thereby improve the demand outlook of CVs.

Revival of manufacturing & mining key

Management commentary from NBFCs, banks and OEMs suggest there is no escaping the pain in the near term for the CV industry. Capacity utilisation of fleet operators remains low at ~60%, which is further exerting pressure on fresh sale of CVs. Although there might be some improvement in 2H FY14 primarily on the back of good monsoon, a significant uptick in demand would be dependent on mining and investment cycle revival.

Valuation

We roll forward valuation and reduce our estimates to reflect delayed recovery in CV cycle and reiterate BUY with an updated FV of Rs. 9,725 (Rs 10,625 previously). Bosch is trading at 24.6x CY14E earnings; we think the current valuation is sustainable given its formidable technological edge, a strong brand with near monopolistic market share, combined with stable earnings growth of 18% CAGR in CY14E and CY15E.

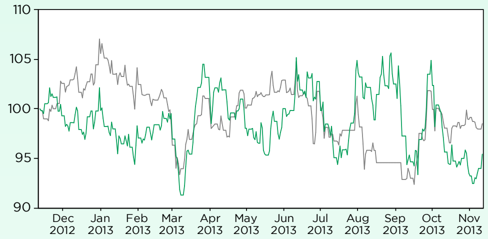
BUY	12% upside
Fair Value	Rs9,725.00

Bloomberg ticker	**BOS IN**
Share Price	Rs8,717.00
Market Capitalisation	Rs279,140.00m
Free Float	29%

INR m Y/E 31-Dec	2011A	2012A	2013E	2014E
Sales	81,658	86,591	88,434	100,065
EBITDA	15,119	13,495	14,003	16,095
Net Profit	11,226	9,583	9,366	11,142
EPS	358	305	298	355
DPS	135	60	60	71

Y/E 31-Dec	2011A	2012A	2013E	2014E
P/E (x)	24.4	28.6	29.2	24.6
P/B (x)	5.8	4.9	4.3	3.8
ROE (%)	24%	17%	15%	16%
Dividend yield (%)	1.5%	0.7%	0.7%	0.8%

Share Price Performance



Source: Espirito Santo Investment Bank Research, Company Data, Bloomberg

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BOSCH

Recommendation:	**BUY**
Fair Value:	**INR 9725**
Share Price:	INR 8717
Upside / Downside	12%
3 Month ADV ($m)	0.5
Free Float	28.8%
52 Week High / Low	INR 8001 - 9,620
Bloomberg:	BOS IN
Model Published On:	13 November 2013

Shares In Issue (mm)	31
Market Cap ($mn)	4,502
Net Debt ($mn)	-279
Enterprise Value ($mn)	4,223

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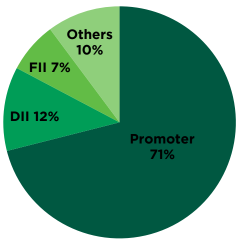
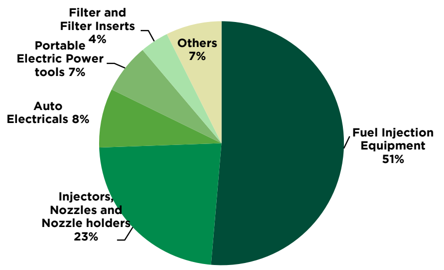
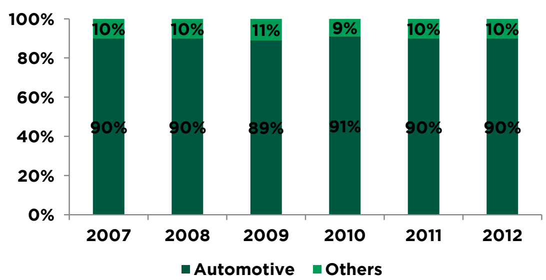
Shareholding Pattern



Revenue breakdown - CY12



Revenue breakdown by sectors



Valuation Metrics	**2010A**	**2011A**	**2012A**	**2013E**	**2014E**	**2015E**
P/E	31.9	24.4	28.6	29.2	24.6	20.8
Reported P/E	31.9	24.4	28.6	29.2	24.6	20.8
EV / Sales	3.9	3.2	3.0	2.9	2.6	2.3
EV / EBITDA	24.8	17.2	19.3	18.6	16.2	13.8
EV / EBIT	32.6	20.8	26.5	26.2	22.4	18.6
FCF Yield	-0.1%	1.2%	-1.3%	1.1%	-0.9%	0.8%
Dividend yield	0.5%	1.5%	0.7%	0.7%	0.8%	1.0%

Key ratios	**2010A**	**2011A**	**2012A**	**2013E**	**2014E**	**2015E**
EBITDA margin	15.8%	18.5%	15.6%	15.8%	16.1%	16.3%
EBIT margin	12.0%	15.4%	11.3%	11.3%	11.6%	12.1%
Capex / Revenue	4.5%	6.6%	8.4%	5.1%	6.0%	4.8%
Capex / Depreciation	1.19	2.09	1.98	1.11	1.35	1.13
Net Debt / EBITDA	-1.0	-0.5	-1.0	-1.2	-1.0	-1.1
EBITDA / Net Interest	267.7	3,779.8	245.4	252.3	290.0	340.6
ROE	23%	25%	19%	16%	17%	17%

P&L Summary	**2010A**	**2011A**	**2012A**	**2013E**	**2014E**	**2015E**
Revenue	**66,817**	**81,658**	**86,591**	**88,434**	**100,065**	**115,729**
% change	38.9%	22.2%	6.0%	2.1%	13.2%	15.7%
EBITDA	**10,531**	**15,119**	**13,495**	**14,003**	**16,095**	**18,904**
% change	99.0%	43.6%	-10.7%	3.8%	14.9%	17.5%
% margin	15.8%	18.5%	15.6%	15.8%	16.1%	16.3%
Depreciation & Amortisation	-2,540	-2,578	-3,670	-4,037	-4,441	-4,885
EBIT	**7,991**	**12,541**	**9,825**	**9,966**	**11,655**	**14,019**
% change	109.0%	56.9%	-21.7%	1.4%	16.9%	20.3%
% margin	12.0%	15.4%	11.3%	11.3%	11.6%	12.1%
Interest Expenses	-39	-4	-55	-56	-56	-56
Other Income	4,076	3,203	3,692	3,663	4,549	5,131
Pre Tax Profit	**12,028**	**15,740**	**13,462**	**13,574**	**16,148**	**19,095**
Income Tax Expense	-3,439	-4,514	-3,879	-4,208	-5,006	-5,919
Net Income	**8,589**	**11,226**	**9,583**	**9,366**	**11,142**	**13,176**
ESIB Net Income	8,589	11,226	9,583	9,366	11,142	13,176
Reported EPS	273.5	357.5	305.2	298.3	354.9	419.6
EPS	273.5	357.5	305.2	298.3	354.9	419.6
DPS	**40.00**	**135.00**	**60.00**	**59.66**	**70.97**	**83.92**
Payout Ratio	14.6%	37.8%	19.7%	20.0%	20.0%	20.0%
Shares In Issue (Less Treasury)	31	31	31	31	31	31

Cash Flow Summary	**2010A**	**2011A**	**2012A**	**2013E**	**2014E**	**2015E**
EBITDA	10,531	15,119	13,495	14,003	16,095	18,904
Taxes Paid	-3,439	-4,514	-3,879	-4,208	-5,006	-5,919
Interest Paid / Received	4,037	3,199	3,637	3,608	4,494	5,076
Change in Working Capital	-5,346	-7,967	478	319	-1,388	-1,067
Associate & Minority Dividends	0	0	0	0	0	0
Other Operating Cash Flow	3,076	-1,391	-4,140	889	-2,332	47
Operating cash flow	**8,859**	**4,446**	**9,591**	**14,612**	**11,862**	**17,040**
Capital Expenditure	-3,021	-5,388	-7,262	-4,500	-6,000	-5,500
Other Investing Cash Flow	-2,043	7,358	-2,068	-3,594	-3,771	-4,255
Free Cash Flow	**3,795**	**6,416**	**261**	**6,517**	**2,091**	**7,284**
Dividends Paid To Shareholders	-942	-3,925	-1,570	-1,873	-2,228	-2,635
Equity Raised / Bought Back	0	0	0	0	0	0
Other Financing Cash Flow	-272	-334	8	-355	-412	-477
Net Cash Flow	**2,581**	**2,157**	**-1,301**	**4,289**	**-549**	**4,172**

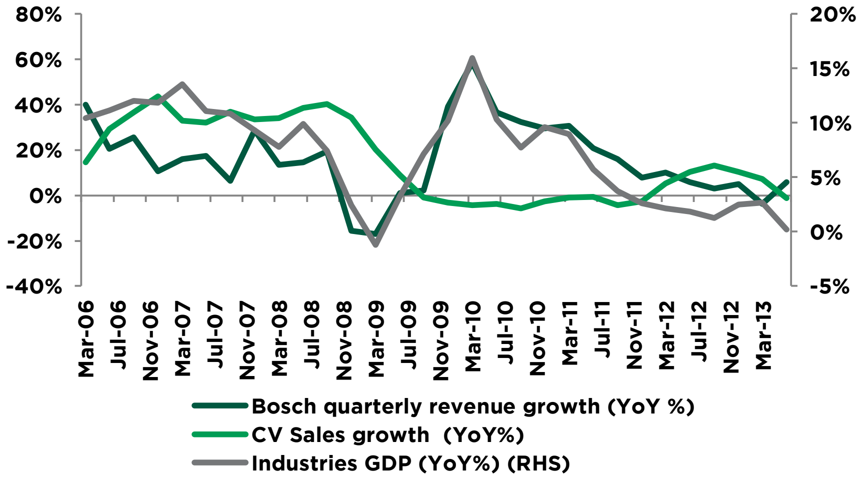
Balance Sheet Summary	**2010A**	**2011A**	**2012A**	**2013E**	**2014E**	**2015E**
Cash & Equivalents	13,259	9,515	14,872	19,161	18,611	22,784
Tangible Fixed Assets	4,360	5,917	8,633	9,096	10,655	11,271
Goodwill & Intangibles	0	0	0	0	0	0
Investments	16,073	16,347	15,198	21,198	28,198	36,198
Other Assets	28,686	39,531	40,336	40,017	41,405	42,472
Total Assets	**62,378**	**71,310**	**79,039**	**89,471**	**98,870**	**112,724**
Interest Bearing Debt	2,764	2,454	1,850	1,850	1,850	1,850
Other Liabilities	15,194	15,988	21,122	24,361	25,202	28,938
Liabilities	**17,958**	**18,442**	**22,972**	**26,211**	**27,052**	**30,788**
Shareholders' Equity	40,980	47,284	55,733	62,926	71,483	81,602
Total Liabilities	**58,939**	**65,726**	**78,705**	**89,137**	**98,536**	**112,390**
Net Debt	-10,495	-7,061	-13,022	-17,311	-16,761	-20,934

Source: Espirito Santo Investment Bank estimates, Company data, Bloomberg

Bosch's dependence on CV makes it a prime beneficiary of turn in cycle

Commercial vehicles form the major part of the target segment for Bosch in India. As seen in Figure 1, Bosch's revenue growth shows a strong correlation with commercial vehicles (CV) volume growth and Industrial GDP growth, indicating Bosch is a key beneficiary of the turn in commercial vehicle cycle. Along with slowdown in economic activity, imposition of a mining ban and regulatory overhang on mining of iron ore (IO) have in our view impacted demand of commercial vehicles quite significantly. In this report we highlight the changes in the Indian mining sector and its impact on the CV cycle as well as read across from the commentary of industry participants.

Figure 1 Bosch performance highly dependent on CV cycle and Industries GDP growth



Source: Espirito Santo Investment Bank Research, Company Data, SIAM & Bloomberg

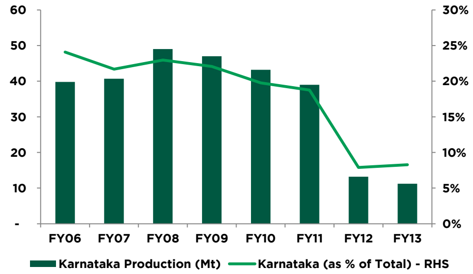
Relaxation of mining ban to be a big swing factor in CV cycle

The imposition of a mining ban on iron ore (IO) in Karnataka and Goa also impacted demand for commercial vehicles. These two states, along with Odisha, which is facing regulatory overhang, accounted for 75% of total ore production in India in FY10. As per our Basic Materials team the combined production of the aforementioned three states has dropped by ~50% in FY13 (from FY10 levels of 218MT) to 85MT. Several external variables such as mining bans, logistics constraints and higher freight costs/export duties have since put the brakes on production in the sector.

The approval process has been moving in the right direction in Karnataka and our Basics Materials team is expecting Karnataka's iron ore production volumes to increase from the lows of 11.2MT in FY13 to 17MT/25MT/30 MT by FY14/FY15/16, respectively. Goa is also seeing some positive development in mining leases. Of the 118 operational leases in Goa, 28 have already secured the nod from the state government to operate. The remaining 90 leases need to apply for fresh renewals and their fate will be decided in three months' time, if all approvals are in place. **Channel checks by our Basic Material's team indicate most of the larger mines have already secured approvals to operate and are waiting for the go ahead from the Supreme Court to restart fresh mining operations.** However the fate of Odisha mining is dependent on am impending report from the Justice M B Shah commission. We understand that the report has been submitted to the Ministry of Mines and is expected to be tabled in the winter session of parliament. Odisha's IO production for FY13 stood at 64.2MT, i.e. ~20% below the peak registered in FY10. Whilst we see little probability of a blanket mining ban, we don't rule out the possibility of minor disruptions post the MB Shah Report and factor in ~57MT run-rate from FY14E onward.

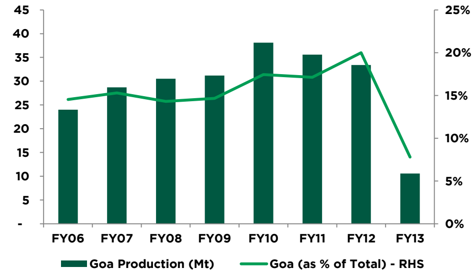
Recently Supreme Court has approved e-auction of already excavated 11.49MT of iron ore in Goa

Figure 2 Karnataka IO production down 74% in FY13 from 43Mt in FY10



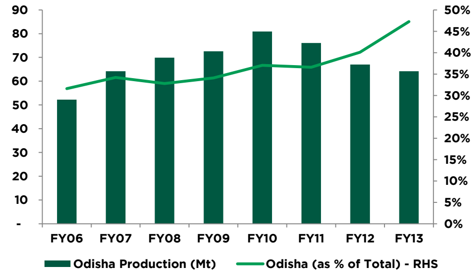
Source: Espirito Santo Investment Bank Research, IBM, FIMI

Figure 3 Goa IO production down 72% in FY13 from peak level of 38Mt in FY10



Source: Espirito Santo Investment Bank Research, IBM, FIMI

Figure 4 Odisha IO production down 21% in FY13 from peak level of 81Mt in FY10



Source: Espirito Santo Investment Bank Research, IBM, FIMI

On the contrary India's widening current account deficit has increased the focus on its imports/exports and our Basic Material's team highlight that there has been increasing discussions regarding a possible reduction in export duties (from 30% to 20%) to revive ore export volumes and boost dollar inflows into the country. As per Federation of Indian Mineral Industries (FIMI), India exported 117MT of ore in FY10, which sharply dropped to 18-20MT in FY13 on the back of mining bans in Goa/Karnataka, higher export duties and increased outbound freight rates. Our Basic Material's team forecasts India IO exports to be at 13.5MT in FY14E. However factoring in inventory liquidation in Goa (10-15MT) and excluding potential dumps exports, we think IO exports for FY14E could be as high as ~30MT.

Relaxation of the regulatory stand on mining and an increase in exports will in our opinion lead to an increase in utilisation of fleet operators as well as an increase freight rates and thereby improve the demand outlook.

Snippets from calls with NBFCs/banks on CV cycle

Sriram Transport Finance: Stress persists in the CV industry, moderate pick-up expected in 2H FY14 but significant improvement would happen post manufacturing/mining sector pick-up.

a) Stabilization is there overall, but in some regions and some segments there is more stress. So on average, the stress levels remain the same.

b) In second half of the year, we expect it (commercial vehicles) to be a little more stable.

c) As far as asset quality is concerned, if the economic situation improves, things can become much better. Right now, it looks as if freight availability is good and freight rates are reasonably good. But one cannot be fully assured of that till the manufacturing side comes back into some growth. Right now, neither manufacturing nor mining has come back to normalcy

From earnings call held on 29th Oct'13

Sundaram Finance: CV industry is under strain, hopeful of good monsoon led recovery in H2

There is lot of strain in commercial vehicles. The cash flows are stressed for commercial vehicle owners as they are getting payments from their customers after 3-4 months of delay. Also, the number of trips per vehicle has come down and almost 30%-35% of vehicles are not deployed. Andhra has been impacted due to multiple factors, political factors and excess rain. We are hopeful of some recovery in H2 due to monsoon effects.

From earnings call held on 7th Nov'13

Snippets from earnings calls of OEMs on CV cycle

Tata Motors: Near term pain to continue, but moderate pick-up in sight

a) Looking forward from the India business point of view in Commercial Vehicles, we expect the economy will continue to remain subdued throughout this financial year, which will keep our sales of Commercial Vehicles under pressure.

b) Few positives developments:
   i. The above average monsoon should hopefully lead to better rural consumption demand
   ii. Some of the government approvals for projects that have been postponed or stalled have started coming in, which hopefully should generate further demand for our products
   iii. JNNURM (Jawaharlal Nehru National Urban Renewal Mission) Phase 2 announced should also drive some bus volume.

c) From a company point of view in Commercial Vehicles, we will launch new products in the Prima Range, Ultra trucks and offer product refreshes in both small Commercial Vehicles and pick-ups. We'll continue to expand the export potential for our vehicles.

From earnings call held on 8th Nov'13

Ashok Leyland: CV industry under pressure with moderate uptick in pockets; mining revival will be a major swing

a) CV industry is under pressure with OEMs offering high discounts

b) Capacity utilization with fleet operators is at 60%

c) Demand from certain pockets has picked up, like perishable/food commodities, but key drivers of mining and construction are still to pick up

d) Some green shoots are visible the mining sector and according to the management if the mining sector revives, significant demand can be generated for commercial vehicles.

From earnings call held on 7th Nov'13

Earnings snapshot

Table 1 Bosch's 3Q CY13 earnings snapshot

Rs m	3Q CY13	3Q CY12	YoY (%)
Net sales	21,499	20,538	4.7%
EBITDA	3,266	2,732	20%
EBITDA Margin	15.2%	13.3%	189
Net Profit	2,343	2,028	15%
Net Margin	10.9%	9.9%	102

Source: Espirito Santo Investment Bank Research, Company Data

Reduce estimates

We reduce our revenue estimates by 13% and 17% for CY13 and CY14 respectively primarily to reflect the delayed recovery in the CV cycle. Furthermore we cut our EPS estimate by c.30% after incorporating a higher tax rate going forward. We roll forward valuation and incorporate changes in estimates to arrive at an updated fair value of Rs 9725/share (Rs 10625 previously).

Table 2 Change in estimates

Rs m	New CY13E	Old CY13E	% change	New CY14E	Old CY14E	% change
Revenue	88,434	101,751	-13%	100,065	120,282	-17%
EBITDA	14,003	15,967	-12%	16,095	19,176	-16%
EPS	298	421	-29%	355	507	-30%

Source: Espirito Santo Investment Bank Research, Company Data

Valuation Methodology

We roll forward valuation and reduce our estimates to reflect the delayed recovery in the CV cycle and reiterate BUY with an updated FV of Rs. 9725 (Rs 10,625 previously). Bosch is trading at 24.6x CY14E earnings; we think current valuation is sustainable given its formidable technological edge, a strong brand with near monopolistic market share, combined with stable earnings growth of 18% CAGR in CY14E and CY15E. A slower than anticipated pick-up in demand by OEMs is the key risk to our estimates.

Figure 5 DCF Snapshot

DCF Snapshot	
WACC	**11.1%**
Equity Risk Premiur	7.0%
Beta	0.5
Risk Free Rate	8%
Terminal Growth R	**5%**
DCF fair value	**INR 9,725**

Source: Espirito Santo Investment Bank Research, Bloomberg

DCF calculation

Table 3 DCF calculation

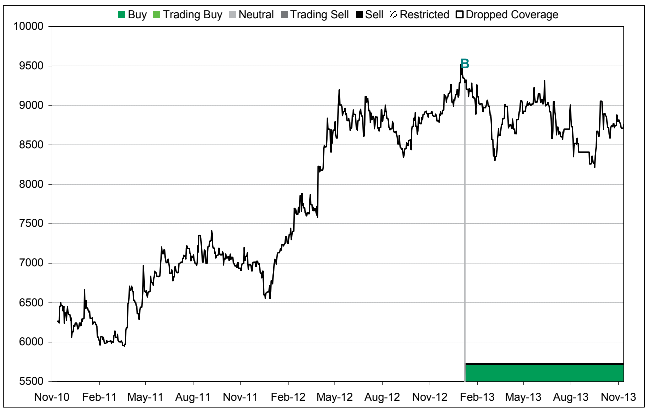
	2012	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Revenue	86,591	88,434	100,065	115,729	134,246	155,054	178,312	204,167	232,750	263,008	294,569	326,972	359,669	392,039
% growth	6%	2%	13%	16%	16%	16%	15%	15%	14%	13%	12%	11%	10%	9%
EBIT	9,825	9,966	11,655	14,019	16,598	19,558	22,492	25,753	29,359	33,176	37,157	41,244	45,368	49,451
% growth	-22%	1%	17%	20%	18%	18%	15%	15%	14%	13%	12%	11%	10%	9%
Less: Cash Taxes	3,879	4,208	5,006	5,919	7,008	8,258	9,497	10,874	12,396	14,008	15,689	17,415	19,156	20,880
Add: Depreciation & Amortiza	3,670	4,037	4,441	4,885	4,474	4,892	5,309	5,716	6,103	6,429	6,678	6,832	6,876	6,798
Less: Capital Expenditures	7,262	4,500	6,000	5,500	5,038	5,508	5,978	6,436	6,872	7,239	7,519	7,692	7,742	7,654
Add: Change in WC	-2,280	3,559	-547	2,669	3,095	3,575	4,112	4,708	5,367	6,065	6,792	7,539	8,293	9,040
Total Cash Flow + Terminal V	**74**	**8,854**	**4,542**	**10,153**	**12,122**	**14,259**	**16,438**	**18,867**	**21,561**	**24,422**	**27,419**	**30,508**	**33,639**	**668,104**
CF + TV per share	2	282	145	323	386	454	524	601	687	778	873	972	1,071	21,278
ROE	17	15	16	16	16	16	15	15	15	14	14	13	13	12
Present value of cash flow/share		278	128	258	277	294	305	315	324	330	333	334	331	5,919
Enterprise Value/Share	**INR 9,191**													
Total Debt (mn)	1,850	1,850	1,850											
Total Equity (mn)	55,733	62,926	71,483											
Net Debt (Cash)/Share	-415	-551	-534											
PV/Share	**INR 9,725**													

Source: Espirito Santo Investment Bank Research, Company Data

Risks to Fair Value

A slower than anticipated pick-up in demand for commercial vehicles and diesel passenger cars could impact revenue momentum significantly.

Bosch *BOS IN*



Report date	Recommendation	Fair value	Share price
2013 January 8	Buy	Rs10625.00	Rs9302.00

Source: Bloomberg, Espirito Santo Investment Bank Research

Please visit our website at www.EspiritoSantoIB.co.uk for up to date recommendation charts.

<u>IMPORTANT DISCLOSURES</u>

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Neutral	121	29.4%	6	15.4%	1.5%
Sell	84	20.4%	2	5.1%	0.5%
Restricted	0	0.0%	0	0.0%	0.0%
Under Review	2	0.5%	0	0.0%	0.0%
Trading Rating:					
Trading Buy	0	0.0%	0	0.0%	0.0%
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