

October 26, 2018

Maruti Suzuki

Dampened Sentiments – Applied brakes on Maruti..

Q2FY19 – the quarter to forget!

The industry reported de-growth of 3.6%, while Maruti's domestic volumes reported a decline of 1.2% in the 2nd quarter. The dull consumer sentiment has put-up the brakes on Maruti's growth. Starting with unfortunate floods in Kerala and heavy monsoons across certain states has impacted the demand environment. Along with it, the insurance bouncer, which we believe has come up at a wrong time, has added further pain. The sentiments turned more negative as the fuel prices increased sharply over the last few months and the interest rates are climbing higher.

The net revenues marginally grew by 3.1% YoY to Rs. 22,433 crores in Q2FY19, but, the margins declined sharply by 160bps YoY to 15.3%, led by stringent cost rationalization efforts, which were clearly visible in the reduction of raw material costs. The employee costs shoot up and the other expenses were higher led by an increase in the sales promotion expenses. Maruti has reported a decline in its profits for the first time in the past more than 16 quarters owing to subdued demand and depressed macro-economic environment and its profits declined by 9.8% YoY to Rs. 2,240 crores in Q2FY19.

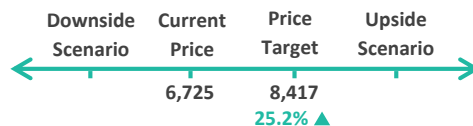
Margins to remain upbeat

We expect the margins to remain soft in FY19E on account of increase in the commodity prices & higher sales promotional expenses. However, **there are multiple levers for the margins to climb higher** led by the operating leverage benefits, increase in the localization and reduction in the royalty payments (as per the new MoU with Suzuki). Along with it, the increase in the safety standards from FY20 & post the implementation of BS6 will raise the realization per vehicle. Additionally, the cost rationalization efforts has started yielding the benefits and expect the commodities to remain stable in the foreseeable future.

Eye-catching Valuations

We believe **all the uncertainties for the next few months are already priced in** and trust that the moat of Maruti remains intact w.r.t. low cost manufacturer, an unmatched distribution reach & over the years has created a loyalty among the consumers. The company has been gaining market share (46.2% in Q1FY17 to 52.3% in Q2FY19) from the last few years as they keep innovating & introducing newer products/refreshers which kept the consumers excited. **We have arrived the fair value of Maruti Suzuki at Rs. 8,417 per share**, valued it by averaging P/E & EV/EBITDA valuation methodology. The company has been trading at a forward P/E multiple of close to 21.4x in the past few years and 13.3x on EV/EBITDA. We have rolled over to FY21E and assigned similar earning multiples to its FY21E EPS & EBITDA to arrive at a fair value, **seeking an upside of 25.2% from the current levels.**

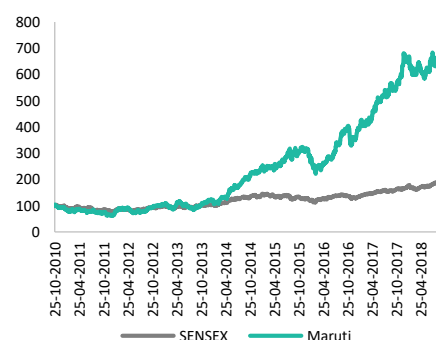
STRONG BUY*



Market Data	
Industry	Automobile
Sensex	33,690
Nifty	10,125
Bloomberg Code	MSIL:IN
Eq. Cap. (INR Crores)	151
Face Value (INR)	5
52-w H/L	10,000/6,625
Market Cap (INR Crores)	2,03,140

Valuation Data	FY19E	FY20E	FY21E
OPM	15.1%	15.4%	16.1%
NPM	9.3%	9.6%	10.1%
P/E (x)	25.5	21.3	17.5
EV/EBITDA (x)	15.4	12.8	10.5

Maruti Suzuki vs SENSEX



Shareholding Pattern (%)

	Sep-17	Mar-18	Sep-18
Promoters	56.2%	56.2%	56.2%
FII	25.5%	25.4%	22.8%
DII	14.7%	14.3%	13.4%
Retail	3.7%	4.1%	7.6%
Total	100%	100%	100%

(INR Crores)	FY17	FY18	FY19E	FY20E	FY21E
Revenue	68,035	79,763	86,273	1,00,186	1,15,443
Growth (%)	18.2%	17.2%	8.2%	16.1%	15.2%
EBITDA	10,248	11,962	13,013	15,469	18,615
Growth (%)	16.5%	16.7%	8.8%	18.9%	20.3%
EBITDA Margin (%)	15.1%	15.0%	15.1%	15.4%	16.1%
PAT	7,350	7,722	8,022	9,609	11,703
Growth (%)	37.0%	5.1%	3.9%	19.8%	21.8%
EPS (INR)	243	256	266	318	387
P/E (x)	20.1	30.7	25.5	21.3	17.4
EV/EBITDA (x)	14.2	19.7	15.3	12.7	10.4

Source: Company, NSPL Research

* Read last page for disclaimer & rating rationale



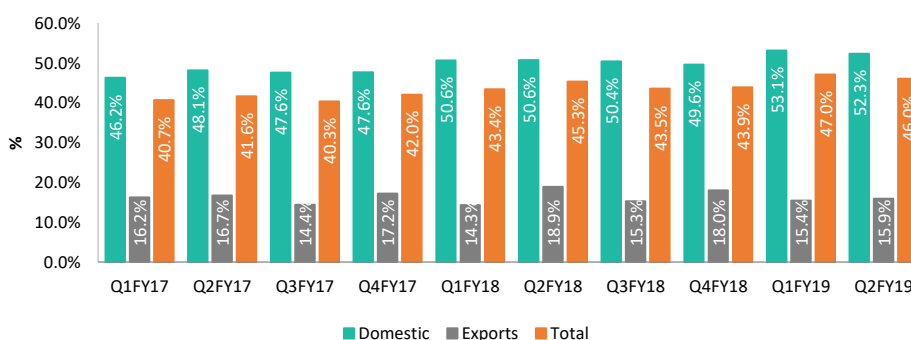
Q2FY19 Result Analysis

(INR Crores)	Q2FY19	Q2FY18	YoY (%)	Q1FY19	QoQ (%)	H1FY19	H1FY18	YoY (%)
Volumes (Nos)	4,84,848	4,92,118	-1.5%	4,90,479	-1.1%	9,75,327	8,86,689	10.0%
Realization (Rs)	4,62,685	4,42,337	4.6%	4,57,907	1.0%	4,60,283	4,68,548	-1.8%
Net sales	22,433	21,768	3.1%	22,459	-0.1%	44,893	41,546	8.1%
COGS	15,285	14,978	2.0%	15,502	-1.4%	30,787	27,266	12.9%
Employee Expenses	792	667	18.8%	765	3.5%	1,557	1,319	18.1%
Other Expenses	2,962	2,490	19.0%	2,858	3.7%	5,820	4,785	21.6%
EBITDA	3,431	3,678	-6.7%	3,351	2.4%	6,782	6,009	12.9%
D&A	721	683	5.7%	720	0.2%	1,441	1,366	5.5%
Other income	527	523	0.7%	272	93.7%	798	1,206	-33.8%
EBIT	3,237	3,518	-8.0%	2,903	11.5%	6,140	5,848	5.0%
Interest Expense	26	15	71.3%	21	24.2%	46	46	0.2%
PBT	3,211	3,503	-8.3%	2,882	11.4%	6,093	5,802	5.0%
Tax	971	1,019	-4.7%	907	7.0%	1,878	1,761	6.6%
PAT	2,240	2,484	-9.8%	1,975	13.4%	4,216	4,041	4.3%
EPS in INR	74	82	-9.8%	65	13.4%	140	134	4.3%

Margin Analysis	Q2FY19	Q2FY18	YoY (%)	Q1FY19	QoQ (%)	H1FY19	H1FY18	YoY (%)
Material Expenses % Net Sales	68.1%	68.8%	-0.7%	69.0%	-0.9%	68.6%	65.6%	2.9%
Gross Margin	31.9%	31.2%	0.7%	31.0%	0.9%	31.4%	34.4%	-2.9%
Employee Expenses % Net Sales	3.5%	3.1%	0.5%	3.4%	0.1%	3.5%	3.2%	0.3%
Other Expenses % Net Sales	13.2%	11.4%	1.8%	12.7%	0.5%	13.0%	11.5%	1.4%
EBITDA Margin (%)	15.3%	16.9%	-1.6%	14.9%	0.4%	15.1%	14.5%	0.6%
Tax Rate (%)	30.2%	29.1%	1.1%	31.5%	-1.2%	30.8%	30.4%	0.5%
PAT Margin (%)	10.0%	11.4%	-1.4%	8.8%	1.2%	9.4%	9.7%	-0.3%

- Maruti reported a volume de-growth of 1.5%** YoY to 4.85L units for the quarter. The domestic volumes declined marginally by 0.4% YoY to 4.55L units, while the exports were sharply down by 15.2% YoY to 29.4K units in Q2FY19. The domestic volume declined majorly led by 6.6% YoY decrease in its 'entry level' segment Alto & WagonR. The *Ciaz* too declined by 28% YoY to 13.2K units led by intense competition from *Verna*, *City* and the newly launched *Yaris*. While, the sales for UVs declined by 4.5% YoY to 64K units. The only major saviour was its 'Compact' segment, which reported an increase of 4.7% YoY to 2.2L units.
- The **other operating income** was much higher at Rs. 881 crores in Q2FY19 vis-à-vis Rs. 330 crores in Q2FY18. It includes one-off of Rs. 200 crores relates to recovery of engineering servicing fees from Suzuki.
- Maruti Suzuki has been doing a good job on the cost rationalization**, as the raw materials to net revenues has come down by 70bps YoY to 68.1% for the quarter. On the other side, higher sales promotions and discounting has led to increase in the other expenses by 180bps YoY to 13.2% of net revenues. Maruti has been putting rigorous efforts on the cost reduction starting with increasing localization, value engineering, volume discounts from vendors and many such steps. All this is reflected in RM costs for the quarter. We don't see commodities as a cause of concern as more or less the commodities have stabilized.
- However, the cost reduction has not saved the EBITDA Margin** from falling as it declined by 160bps YoY to 15.3% for the quarter. The decline in the margins was due to adverse price movement in the commodities and forex, along with higher sales promotion expenses.
- The bottom-line declined for the first time in the past multi-quarters** by 9.8% YoY to Rs. 2,240 crores in Q2FY19 on account overall hit from all the fronts viz. decline in the volumes, poor operational performance, higher effective tax rate (+110bps YoY to 30.2%).

Maruti's Rising Market Share (%)



Source: Company, NSPL Research

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Volume Projections	FY17	FY18	FY19E	FY20E	FY21E
Domestic Sales (in units)					
Utility Vehicles	1,95,741	2,53,759	2,66,447	2,98,421	3,25,278
Vans	1,52,009	1,55,137	1,70,651	1,89,422	2,02,682
Passenger Cars	10,95,891	12,34,571	13,45,682	15,20,621	16,72,683
Goods Carriers	900	10,033	30,099	45,149	58,693
Total Domestic Volume Sales	14,44,541	16,53,500	18,12,879	20,53,612	22,59,337
YoY Growth (%)	-	14.5%	9.6%	13.3%	10.0%
Export Sales (in units)					
Utility Vehicles	11,423	5,463	7,648	9,178	10,096
Vans	1,868	1,480	1,628	1,807	1,952
Passenger Cars	1,08,742	1,16,960	1,07,603	1,12,983	1,18,633
Goods Carriers	1,968	2,171	3,257	4,071	4,681
Total Export Volume Sales	1,24,001	1,26,074	1,20,136	1,28,039	1,35,361
YoY Growth (%)	-	1.7%	-4.7%	6.6%	5.7%
Domestic + Exports (in units)					
Utility Vehicles	2,07,164	2,59,222	2,74,095	3,07,598	3,35,374
Vans	1,53,877	1,56,617	1,72,279	1,91,229	2,04,633
Passenger Cars	12,04,633	13,51,531	14,53,286	16,33,604	17,91,316
Goods Carriers	2,868	12,204	33,356	49,219	63,374
Total Volume Sales	15,68,542	17,79,574	19,33,015	21,81,651	23,94,698
YoY Growth (%)	-	13.5%	8.6%	12.9%	9.8%
Blended Realization (Rs.)					
	4,33,729	4,48,212	4,46,313	4,59,219	4,82,077
YoY Growth (%)	-	3.3%	-0.4%	2.9%	5.0%

Source: Company, NSPL Research

Key Risks:

- Higher than expected increase in the commodity prices can impact its margins
- Weakness in the domestic passenger vehicle industry
- Rising competition
- Sharp weakness in the export markets led by a correction in the oil and commodity prices, etc.

Key Quarterly Highlights:

- The discounts/offers were Rs. 18,750 per vehicle, higher by Rs. 3,500 as compared to the last year. We think there are no chances for any price increase as the market remains soft.
- The exposure of Royalty expenses is 60% in JPY and rest in rupee. Maruti will have to pay royalty in rupee terms on the new model. At present, it pays a royalty in Indian Rupee for Brezza, Dezire and Swift. The royalty expense for the quarter was 5.7% (included 0.7% in the raw material expense).
- Maruti won't sacrifice the margins for the volume growth. Its focus is to balance the volume growth and margin improvement.
- The company is aggressively pursuing the volume growth in LCV. It has 200+ network and the outlook remains very optimistic.
- Its focus is also on the alternative fuel engines like CNG, which we also think has a mega opportunity in the domestic market. Maruti has reported a 50% YoY growth in CNG vehicles in Q2FY19 as higher fuel prices has shifted the consumer preference towards alternate fuel. The company has been ramping up the production of CNG vehicles and already has eight models.

Demand Environment

We believe the company won't be able to achieve the guided double digit volume growth in FY19E. The Q2FY19 quarter was impacted by floods and heavy monsoons and we think the 3rd quarter is expected to remain soft led by higher insurance prices and soft festive season. However, the pent-up demand and heavy discounts/schemes can pull the demand higher in Q4FY19.

Export Markets

The export markets are also facing challenges as the macro-economic situation doesn't look stable. Few of the market has imposed restriction on its imports and currencies sharply devalued for those countries. We feel, globally there are many headwinds on the exports as most of the markets are facing the economic slowdown and hence, we expect a decline in Maruti's exports in FY19E. The focus remains on the domestic market.

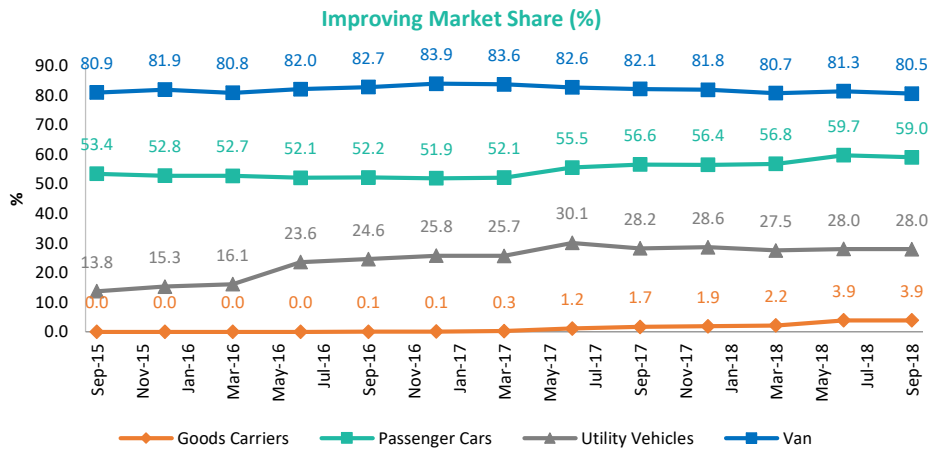
Difficult to Achieve Volume Guidance

Maruti has earlier guided for a double digit volume growth in FY19E, which we believe to remain shaky on account of soft domestic demand and uncertainties in the export market. Hence, we have conservatively projected and expects the volumes to shoot up in FY20E (especially in H2FY20) led by pre-buying before the implementation of BS6.

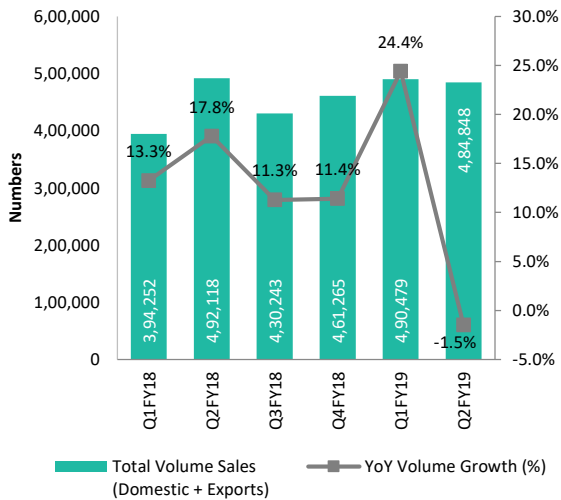
Realization to drop in FY19E majorly on account of higher sales promotional expenses. We have estimated moderate realization growth in FY20E led by higher sales from the premium launches, along with mandatory safety standards from next year and expect higher realization growth in FY21E led by the implementation of BS6.



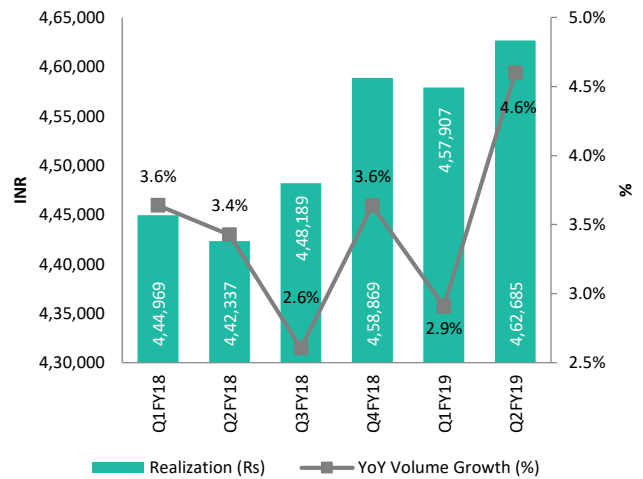
Story in Charts



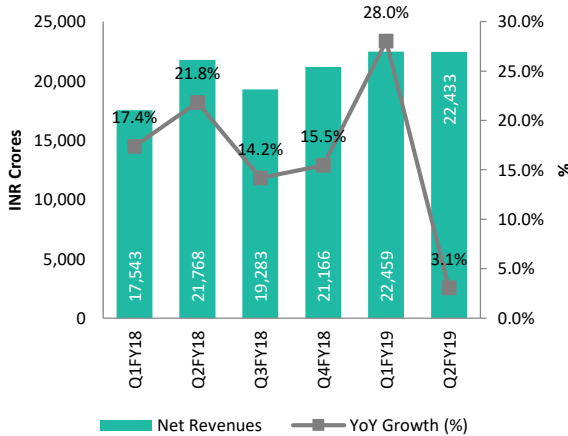
Volumes Higher than Industry Growth



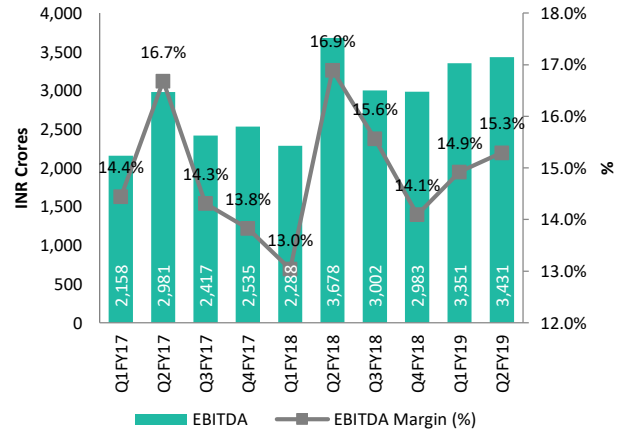
Healthy & Consistent Realization Growth



Superlative Double Digit Revenue Growth



EBITDA Margins at Healthy Levels



Source: Company, NSPL Research

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Profit & Loss (INR Crores)	FY17	FY18	FY19E	FY20E	FY21E
Net Revenues	68,035	79,763	86,273	1,00,186	1,15,443
COGS	46,732	54,975	59,011	69,529	80,810
Employee Expenses	2,331	2,834	3,036	3,410	3,832
Other Expenses	8,724	9,992	11,214	11,778	12,186
EBITDA	10,248	11,962	13,013	15,469	18,615
D&A	2,602	2,758	3,222	3,687	4,151
Other income	2,300	2,046	2,177	2,528	2,912
EBIT	7,646	9,205	9,791	11,782	14,464
Interest Expense	89	346	376	424	465
PBT	9,960	11,003	11,592	13,886	16,912
Tax	2,610	3,282	3,570	4,277	5,209
PAT	7,350	7,722	8,022	9,609	11,703
EPS in INR	243	256	266	318	387

Balance Sheet (INR Crores)	FY17	FY18	FY19E	FY20E	FY21E
ASSETS					
Non-Current Assets					
Property, plant and equipment	12,920	13,047	13,526	13,569	13,177
Capital work-in-progress	1,252	2,126	2,126	2,133	2,071
Intangible assets	373	312	249	168	68
Financial assets					
Investments	26,302	34,073	36,854	42,797	49,315
Loans	0	0	0	0	0
Other financial assets	24	32	35	41	47
Other non-current assets	1,603	1,858	2,010	2,334	2,690
Total Non-Current Assets	42,474	51,449	54,801	61,042	67,368
Current Assets					
Inventories	3,262	3,161	3,393	3,998	4,646
Financial assets					
Investments	2,179	1,217	1,317	1,529	1,762
Trade receivables	1,199	1,462	1,581	1,836	2,116
Cash and cash equivalents	13	70	2,616	4,451	7,750
Loans	3	3	3	3	3
Other financial assets	95	285	308	357	412
Current tax assets (Net)	486	412	434	520	633
Other current assets	1,539	1,312	1,419	1,648	1,899
Total Current Assets	8,776	7,921	11,070	14,342	19,220
Total Assets	51,251	59,370	65,871	75,384	86,588

EQUITY AND LIABILITIES

Equity					
Equity Share capital	151	151	151	151	151
Other equity	36,280	41,606	46,795	53,011	60,581
Total Equity	36,431	41,757	46,946	53,162	60,732

LIABILITIES

Non-current liabilities					
Provisions	22	27	29	33	38
Deferred tax liabilities (net)	467	560	590	706	860
Other non-current liabilities	1,105	1,585	1,715	1,991	2,294
Total Non - Current Liabilities	1,594	2,172	2,333	2,731	3,192
Current liabilities					
Financial liabilities					
Borrowings	484	111	120	139	160
Trade Payables	8,367	10,497	11,268	13,276	15,430
Other financial liabilities	1,303	1,334	1,443	1,675	1,930
Provisions	449	560	606	703	811
Current tax liabilities (Net)	799	854	900	1,078	1,313
Other current liabilities	1,825	2,086	2,257	2,621	3,020
Total Current Liabilities	13,226	15,442	16,592	19,492	22,664
Total Liabilities	14,820	17,613	18,924	22,222	25,855
Total Equity and Liabilities	51,251	59,370	65,871	75,384	86,588

Source: Company, NSPL Research

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Cash Flow (INR Crores)	FY17	FY18	FY19E	FY20E	FY21E
Profit Before Tax	9,960	11,003	11,592	13,886	16,912
Operating Profit before Working Capital Changes	10,407	12,034	13,013	15,469	18,615
Cash Generated from Operations	12,601	14,840	13,658	17,193	20,519
Less: income tax paid	-2,321	-3,055	-3,570	-4,277	-5,209
Cash Flow from Operating	10,279	11,785	10,087	12,917	15,311
(Incr)/ Decr in Gross PP&E	-3,250	-3,892	-3,701	-3,737	-3,697
Cash Flow from Investing	-9,178	-8,282	-4,343	-7,283	-7,435
Dividends Paid (including tax on dividend)	-1,057	-2,266	-2,354	-2,819	-3,434
Finance costs	-110	-346	-376	-424	-465
Cash Flow from Financing	-1,129	-3,446	-3,199	-3,798	-4,577
Incr/(Decr) in Balance Sheet Cash	-28	57	2,546	1,835	3,299
Cash at the Start of the Year	41	13	70	2,616	4,451
Cash at the End of the Year	13	70	2,616	4,451	7,750

RATIOS	FY17	FY18	FY19E	FY20E	FY21E
Growth (%)					
Net Revenues	18.2%	17.2%	8.2%	16.1%	15.2%
EBITDA	16.5%	16.7%	8.8%	18.9%	20.3%
PAT	37.0%	5.1%	3.9%	19.8%	21.8%
Profitability					
Return on Capital (%)	21.0%	22.0%	20.9%	22.2%	23.8%
Return on Equity (%)	20.2%	18.5%	17.1%	18.1%	19.3%
Margin Trend					
EBITDA Margin (%)	15.1%	15.0%	15.1%	15.4%	16.1%
Net profit Margin (%)	10.8%	9.7%	9.3%	9.6%	10.1%
Solvency					
Total Debt / Equity	0.0	0.0	0.0	0.0	0.0
Net Debt / Equity	0.0	0.0	-0.1	-0.1	-0.2
Valuation Ratios					
P/E	20.1	30.7	25.3	21.1	17.4
EV/EBITDA	14.2	19.7	15.3	12.7	10.4

Source: Company, NSPL Research



Maruti Suzuki				Rating Legend	
Date	CMP (INR)	Target Price (INR)	Recommendation	Strong Buy	More than 15%
October 26, 2018	6,725	8,417	Strong Buy	Buy	5% - 15%
				Hold	0 - 5%
				Reduce	-5% - 0
				Sell	Less than -5%

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