Sharekhan
by BNP PARIBAS

Maruti Suzuki

Not out of woods yet

Sector: Automobiles
Result Update

		Change
Reco: **Hold**		↔
CMP: **Rs. 7,390**		
Price Target: **Rs. 7,500**		↑

↑ Upgrade ↔ No change ↓ Downgrade

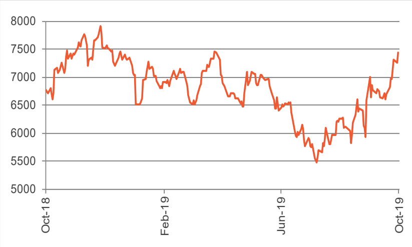
Company details

Market cap:	Rs. 223,249 cr
52-week high/low:	Rs. 7,929 / 5447
NSE volume: (No of shares)	11.6 lakh
BSE code:	532500
NSE code:	MARUTI
Sharekhan code:	MARUTI
Free float: (No of shares)	13.2 cr

Shareholding (%)

Promoters	56.2%
Institutions	15.0%
Foreign	23.4%
Public and Others	5.3%

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.9	28.4	7.0	11.4
Relative to Sensex	7.8	24.5	4.7	-4.8

Sharekhan Research, Bloomberg

Maruti Suzuki Ltd (MSIL) Q2 FY20 results were ahead of our as well as consensus estimates on operating margins as well profitability front. MSIL posted better than expected operating margins due to cost control measures such as productivity improvement measures, controlling cost overheads and increased localisation. Further, a steep surge in other income on account of fair value gain on investments & lower tax due to adoption of new corporate tax structure led to profit beat. While the management has indicated a marginal positive growth in the festive season of October, sustenance of growth post festivities still remains a challenge. MSIL believes that the festive growth was supported by higher discounting and a sustained demand improvement would still take time. We expect PV industry to remain muted in the near term. Hence we retain a Hold rating on the stock with a revised PT of Rs 7,500.

Key positives

- MSIL other income at Rs 920 cr grew a robust 75% y-o-y and was ahead of our estimates. Higher fair value gain on an invested surplus boosted other income.
- Tax rate (Tax/PBT) of 13.6% was lower than our estimates. Adoption of new tax regime led to a lower tax rate during the quarter
- MSIL inventory levels stood at 30-32 days which is very close to the normalized inventory.

Key negatives

- MSIL volumes dropped steeply 30% yoy driven by a 32% drop in the domestic demand. Weak consumer sentiment and increased cost of ownership led to a volume decline
- MSIL lost market share in the PV space. Market share dropped from 51.7% in Q2FY2019 to 48.4% in Q2FY20.

Our Call

Demand recovery unlikely in near term; Retain Hold: PV industry has been under pressure on the back of slowing economic growth and steep increase in cost of ownership. The industry demand is unlikely to improve in the near term and we expect muted volumes over the next two to three quarters. We have retained our earnings estimates for FY2021. Recent run up in the stock price (12% in past one month) is led by probability of personal income tax cut. However given muted earnings CAGR of 2% over FY2019-2021 period, we maintain Hold rating on the stock with revised PT of Rs 7,500. Stock is already trading at rich valuations of 29xFY21 earnings leaving limited scope of upside from current levels.

Key Risks

Prolonged weakness in the PV industry demand could impact the financials of the company.

Valuation Rs cr

Particulars	FY18	FY19	FY20E	FY21E
Net sales	79,763	86,020.3	82,624.1	89,045.2
Growth (%)	17.2	7.8	-3.9	7.8
EBITDA	12,062	10,999	9,349	10,756
EBIDTA %	15.1	12.8	11.3	12.1
PAT	7,722	7,500.6	6,564.2	7,681.7
Growth (%)	5.1	-2.9	-12.5	17.0
FD EPS (INR)	255.6	248.3	217.3	254.3
P/E (x)	28.9	29.8	34.0	29.1
P/B (x)	5.3	4.8	4.4	3.9
RoE (%)	18.5	16.3	12.9	13.5
RoCE (%)	24.8	20.8	16.1	17.0
EV/Sales(x)	2.8	2.5	2.2	2.0
EV/EBITDA (x)	18.4	19.8	19.7	16.6

Source: Company; Sharekhan estimates

Operating results ahead of estimates; higher other income and lower tax leads to PAT beat: MSIL results were ahead of our as well as street estimates driven by better than anticipated margins, higher other income and a reduction in tax rates. Revenues dropped 24% y-o-y driven by 30% drop in the volumes. Realisation improved by ~7% driven by price hikes and higher share of BS6 variants. OPM dropped by a steep 580 bps y-o-y driven by negative operating leverage, higher discounting and adverse currency movement. However operating margins at 9.5% was better than our estimates of 8.7% driven by cost control measures. Other income rose sharply 75% y-o-y to Rs 920 cr (ahead of our estimates) driven by higher fair value gain on invested surplus. Moreover, Maruti's tax rate dropped sharply (Tax/PBT of 14%) driven by adoption of new corporate tax regime which further boosted profitability. Net Profit at Rs 1,359 cr was ahead of our estimates of Rs 935 cr.

Demand recovery unlikely in near term: PV industry demand has been under pressure declining for the past five consecutive quarters. Slowing economic growth coupled with an increased cost of ownership in the form of mandatory third party insurance, safety norms and steep increase in road taxes in key states have dampened the consumer sentiments. While MSIL indicated a marginal growth in the festive period, the management is not confident of sustaining the growth momentum. MSIL believes that marginal growth seen in the festive season was on account of higher discounts and a sustained demand improvement would take time. We believe that PV industry demand growth is likely to remain muted and demand recovery is unlikely in the near term.

Concall highlights

Festive demand: MSIL indicated that the retail festive demand (Navratra and Dusherra) showed marginal growth on a y-o-y basis.

Inventory levels: MSIL indicated that the inventory levels currently stand at 30-32 days which are near normal levels.

Near term demand outlook: The management indicated that while the festive demand is showing small positive growth, but the sustainability of the same beyond the festive season is not certain and the same needs to be monitored.

BS 6 transition: MSIL has been the leader in transition to BS6 emission norms with 8 models already being introduced with the BS variants. In fact about 70% of the sales of petrol models come from BS 6 variants.

Discounting: Discounting per vehicle reached multi-year high levels of Rs 25,761/vehicle. This compares with Rs 18,750/vehicle in Q2FY19

Commodities: The management indicated that a large benefit of recent commodity softening would be realized in margins in Q3FY2020

Share of petrol variants: Share of petrol variants for MSIL increased from 74.2% in Q2FY2019 to 77.5% in Q2FY20.

Financing: Share of financing stood at ~80% which is similar to levels seen recently. However management indicated slight improvement in level of financing.

Results Rs cr

Particulars	Q2FY20	Q2FY19	YoY %	Q1FY20	QoQ %
Revenues	16,985.3	22,433.2	-24.3	19,719.8	-13.9
EBIDTA	1,606.3	3,431.3	-53.2	2,047.8	-21.6
EBIDTA Margins (%)	9.5	15.3	(580) bps	10.4	(90) bps
Depreciation	926.1	721.2	28.4	918.6	0.8
Interest	28.2	25.7	9.7	54.7	-48.4
Other Income	920.0	526.6	74.7	836.4	10.0
PBT	1,572.0	3,211.0	-51.0	1,910.9	-17.7
Tax	213.4	970.6	-78.0	475.4	-55.1
Adjusted PAT	1,358.6	2,240.4	-39.4	1,435.5	-5.4
EPS	45.0	74.2	-39.4	47.5	-5.4

Source: Company; Sharekhan Research

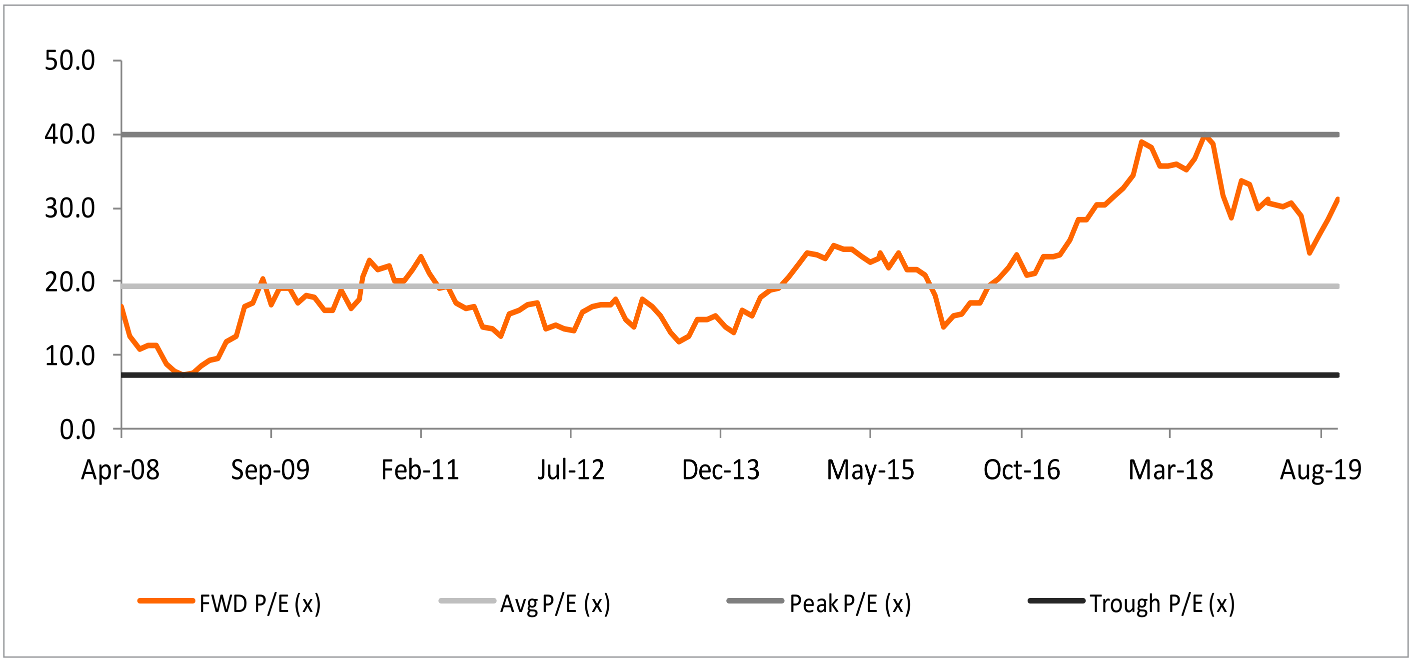
Outlook

Demand pressures to sustain in the near term; expect muted earnings over FY19-21: PV industry demand is not expected to recover in the near term given the weak consumer sentiments and increased cost of ownership. We expect muted 2% earnings CAGR over FY2019-2021 period.

Valuation

Retain estimates; Maintain Hold with revised PT of Rs 7,500: We have retained our earnings estimates for MSIL. Demand environment is expected to remain challenging in the near term. Post the sharp 12% run up in the past one month, stock is trading at rich valuations of 29xFY21 earnings, leaving limited scop of upside from current levels. We retain Hold rating on the stock with a revised PT of Rs 7,500.

One year forward P/E band



Source: Sharekhan Research

About company

MSIL is the market leader in the PV segment, commanding a market share of about 50%. In the PV segment, MSIL's market share in passenger cars stands at 58%, utility vehicles at 28% and vans at 82%. Petrol vehicles contribute about 75% to sales, whilst the contribution of diesel vehicles stands at 25%. MSIL has been steadily ramping up its presence in the hinterlands, with rural sales currently contributing about 30% to overall sales.

Investment theme

MSIL is the market leader in the PV segment with a 50% market share. The PV industry is passing through a phase of agony, wherein weak consumer buying sentiment, liquidity crunch, slow economic growth and cost pressures have dented overall performance. Further, heightened competitive intensity due to new launches by competition, elevated inventory levels and cost increase due to BS6 norms would exert demand pressures. We expect MSIL's earnings to decline in FY2020.

Key Risks

- MSIL is exposed to forex risks as raw material and royalty payment are payable in Yen. About 20-21% of revenue is exposed to INR-YEN movement and any adverse movement can impact margins.
- The parent company would manufacture and supply products from MSIL's portfolio to Toyota India. This would enhance competition for MSIL.
- Rollout of BS6 version and upgraded safety features can result in phase out of certain models especially entry-level diesel variants, which would impact sales.
- Any measures announced by the government to boost sales would be key positive and pose as risk.

Additional Data

Key management personnel

R C Bhargava	Chairman
Kenichi Ayukawa	Managing Director & CEO
A Seth	Sr Executive Officer (Finance)
R S Kalsi	Sr Executive Officer (Marketing & Sales)

Source: Annual report

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Suzuki Motor Corp	56.2
2	Life Insurance Corp of India	6.8
3	Blackrock Inc	1.4
4	Vanguard Group Inc	1.4
5	Capital group companies	1.3
6	GIC Pte	1.1
7	SBI Funds Management Pvt Limited	1.1
8	JP Morgan Chase	1.0
9	Nomura Holdings	1.0
10	UTI Asset Management Co	0.8

Source: Bloomberg

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