31 March 2017

Update | Sector: Automobiles

Maruti Suzuki

BSE SENSEX	S&P CNX
29,621	9,174

CMP: INR5,954 TP: INR7,443 (+25%) Buy

Gujarat plant adds much needed capacity for growth

Gradual ramp-up to have impact of 80-100bp on EBIT margins in 1HFY18

Stock Info

Bloomberg	MSIL IN
Equity Shares (m)	302.0
52-Week Range (INR)	6230 / 3419
1, 6, 12 Rel. Per (%)	-1/4/45
M.Cap. (INR b)	1815.5
M.Cap. (USD b)	27.7
Avg Val, INRm	3709
Free float (%)	43.8

Financials Snapshot (INR b)

Y/E Mar	2017E	2018E	2019E
Sales	676.9	821.7	949.0
EBITDA	104.6	132.7	157.8
Adj. PAT	74.8	92.9	112.8
*Adj. EPS (INR)	252.7	313.1	379.5
EPS Gr. (%)	62.5	23.9	21.2
BV/Sh. (INR)	1,087	1,323	1,612
RoE (%)	22.8	23.2	23.2
RoCE (%)	30.7	31.2	30.6
P/E (x)	23.8	19.2	15.8
P/CE (x)	17.7	14.6	12.3

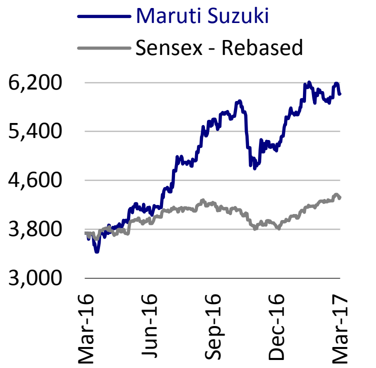
*Consolidated

Shareholding pattern (%)

As On	Dec-16	Sep-16	Dec-15
Promoter	56.2	56.2	56.2
DII	12.4	12.3	12.4
FII	24.5	25.0	25.2
Others	6.9	6.5	6.2

FII Includes depository receipts

Stock Performance (1-year)



Phase-1 of Gujarat plant starts operations; adds much needed capacity for growth: Suzuki Motor Gujarat (SMG), 100% parent owned, has started first phase of Gujarat plant with initial capacity of 0.25m units and investments of ~INR30b. MSIL would be sourcing 100% of production of SMG and supplies to MSIL would be on cost to cost basis. Gujarat plant offers several advantages including land at concessional price, sales tax benefit, centrally located, stable industrial environment, good power connectivity, excellent infrastructure etc. Gujarat plant would add ~13% to total MSIL capacity in FY18E and contribute ~23% by FY20E. The Gujarat plant is expected to ease capacity constraints and help to drastically reduce waiting periods for products like Baleno, Brezza and Ignis.

Gujarat plant ramp-up to be back-ended in FY18 and beyond…: The volume for Gujarat plant in FY18 is estimated at 0.15m units, with utilization at ~40% in 1HFY18 but ramping up to almost 100% by 4QFY18. Suzuki plans to expand the Gujarat plant, with further 0.25m capacity addition by 4QFY19, along with engine plant. Vendors are expected to have local presence gradually over next 3-4 years, whereas engine and transmission facility would be put in phase-2 for FY19 commissioning.

…impacting FY18 EBIT margins by 40bp in the ramp-up phase…: We believe there could be a transitory impact on MSIL's margins in the next few quarters due to (1) negative operating leverage due to gradual ramp-up of the Gujarat plant (refer exhibit 5), (2) inward freight on components sourced from Haryana plant (refer exhibit 9) and (3) higher depreciation rate. Also, 4QFY17 would see non-recurring pre-operative costs (estimated impact of ~INR1.5b or ~80bp in 4QFY17E). We estimate impact on reported EBIT margins by 40bp in FY18 (implying 80-100bp impact in 1HFY18), but estimate no material impact in FY19E as we expect almost 50% of vendors to have Gujarat presence by FY19.

…but has several levers to offset impact of negative impact: Gujarat plant would have superior profitability on full ramp-up due to a) sales tax incentives (15-20bp accretion to blended margins), b) lower lead distance (5-10bp savings), c) lower wage cost, and d) better efficiency (higher automation than average at MSIL plant, but similar to line-3 added at Manesar in FY14).

Valuation and view: The stock trades at 19x/15.6x FY18E/19E EPS. We value MSIL at 20x Mar-19 core EPS (~20% premium to 5 year average core PE). We have increased premium to LPA from 10% to 20%, with improved comfort on quantum/longevity of impact of Gujarat plant and have cushion to estimates (Our JPYINR assumption adverse by 14% than the spot rate). Buy with TP of ~INR7,443.

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Exhibit 1: Pro-forma P&L of MSIL standalone and Gujarat plant

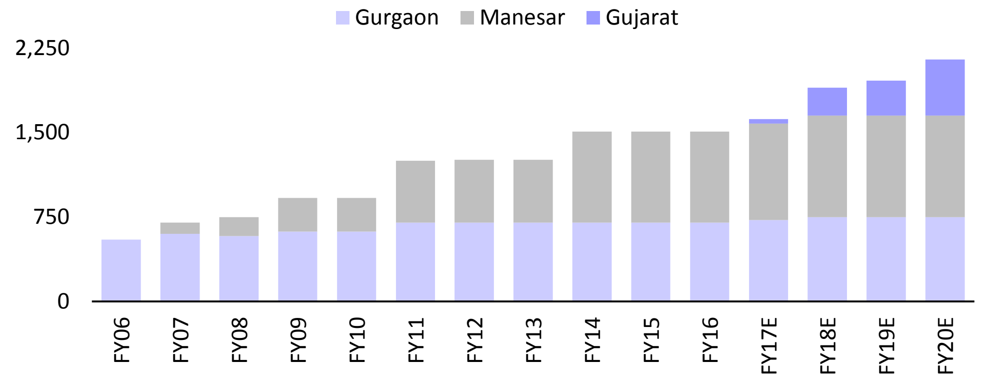
INR M	FY15	FY16	FY17E	FY18E			FY19E		
				S/A	Gujarat	Total	S/A	Gujarat	Total
Capacity	1,510,000	1,510,000	1,620,000	1,650,000	250,000	**1,900,000**	1,650,000	312,500	**1,962,500**
Volumes	1,292,403	1,429,200	1,571,469	1,666,921	150,000	**1,816,921**	1,748,608	275,000	**2,023,608**
Growth (%)		10.6	10.0	6.1		15.6	4.9	83.3	11.4
Realizations	386,649	403,394	432,761	453,776	453,776	**453,776**	470,573	470,573	**470,573**
Growth (%)		4.3	7.3	4.9		4.9		3.7	3.7
Net Revenues	499,706	576,530	680,071	756,409	68,066	**824,476**	822,848	129,408	**952,255**
Growth (%)		15.4	18.0	11.2		21.2	8.8	90.1	15.5
Net operating revenues				**756,409**	**68,066**	**824,476**	**822,848**	**129,408**	**952,255**
RM Cost	350,771	388,402	465,187	509,491	45,847	555,338	553,600	87,064	640,664
RM Cost (% of sales)	70.2	67.4	68.4	67.4	67.4	67.4	67.3	67.3	67.3
RM Cost (INR/unit)	271,410	271,762	296,020	305,648	305,648	305,648	316,595	316,595	316,595
Staff Cost	16,066	19,777	24,128	26,897	3,263	30,160	30,146	4,538	34,684
Staff Cost (% of sales)	3.2	3.4	3.5	3.6	4.8	3.7	3.7	3.5	3.6
Staff Cost (INR/unit)	12,431	13,838	15,354	16,136	21,751	16,599	17,240	16,503	17,140
Power	7,123	6,926	6,801	7,564	681	8,245	8,228	1,294	9,523
Power (% of sales)	1.4	1.2	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Power (INR/unit)	5,511	4,846	4,328	4,538	4,538	4,538	4,706	4,706	4,706
Tools & Spares	2,498	3,432	3,400	3,782	753	4,535	3,909	861	4,769
Tools & Spares (% of sales)	0.5	0.6	0.5	0.5	1.1	0.6	0.5	0.7	0.5
Tools & Spares (INR/unit)	1,933	2,401	2,164	2,269	5,017	2,496	2,235	3,130	2,357
Royalty	26,574	32,443	43,609	46,482	4,183	50,665	49,723	7,820	57,543
Royalty (% of sales)	5.3	5.6	6.4	6.1	6.1	6.1	6.0	6.0	6.0
Royalty (INR/unit)	20,562	22,700	27,751	27,885	27,885	27,885	28,436	28,436	28,436
Advertisement	7,634	12,290	9,011	11,543		11,543	13,332		13,332
Advtg (% of sales)	1.5	2.1	1.3	1.5		1.4	1.6		1.4
Advtg (INR/unit)	5,907	8,599	5,734	6,925		6,353	7,624		6,588
Freight	6,188	5,416	5,951	6,214	2,031	8,245	6,578	2,944	9,523
Freight (% of sales)	1.2	0.9	0.9	0.9	3.0	1.0	0.9	2.3	1.0
Freight (INR/unit)	4,788	3,790	3,787	3,728	13,538	4,538	3,762	10,706	4,706
Other Fixed Cost	15,723	18,882	17,938	19,272	3,150	22,422	19,133	4,410	23,543
Other Fixed Cost (% of sales)	3.1	3.3	2.6	2.5	4.6	2.7	2.3	3.4	2.5
Other Fixed Cost (INR/unit)	12,166	13,212	11,415	11,562	21,001	12,341	10,942	16,037	11,634
Add Pre-operative cost			1484			0			0
Less: SGST Refund					1,118	1,118		1,883	1,883
% of sales					1.6	0.1		1.5	0.2
Total Cost	**432,577**	**487,568**	**577,508**	**631,245**	**58,789**	**690,034**	**684,649**	**107,047**	**791,697**
EBITDA	**67,129**	**88,962**	**102,563**	**125,164**	**9,278**	**134,442**	**138,198**	**22,360**	**160,559**
EBITDA Margins (%)	13.4	15.4	15.1	16.5	13.6	16.3	16.8	17.3	16.9
EBITDA (INR/unit)	51,941	62,246	65,266	75,087	61,853	73,994	79,033	81,310	79,343
Depreciation	24,703	28,239	25,967	26,362	3,750	30,112	27,746	5,625	33,371
% of sales	4.9	4.9	3.8	3.5	5.5	3.7	3.4	4.3	3.5
Depriciation (INR/unit)	19,114	19,759	16,524	15,814	25,000	16,573	15,867	20,455	16,491
EBIT	**42,426**	**60,723**	**76,596**	**98,802**	**5,528**	**104,330**	**110,452**	**16,735**	**127,188**
EBIT Margins (%)	8.5	10.5	11.3	13.1	8.1	12.7	13.4	12.9	13.4
EBIT (INR/unit)	32,827	42,487	48,742	59,272	36,853	57,421	63,166	60,855	62,852
Interest Cost	2,060	815	875	850	0	850	1,000	0	1,000
Other Income	8,316	14,610	23,958	24,012	0	24,012	26,397	0	26,397
PBT	48,682	74,518	99,679	121,965	5,528	127,492	135,849	16,735	152,585
PBT Margins (%)	9.7	12.9	14.7	16.1	8.1	15.5	16.5	12.9	16.0
PBT (INR/unit)	37,667	52,140	63,431	73,168	36,853	70,170	77,690	60,855	75,402
Tax	11,570	20,864	26,664	31,515	1,658	33,173	32,705	5,021	37,725
Tax rate (% of PBT)	23.8	28.0	26.8	25.8	30.0	26.0	24.1	30.0	24.7
PAT	37,112	53,654	73,015	90,450	3,870	94,319	103,145	11,715	114,859
PAT Margins (%)	7.4	9.3	10.7	12.0	5.7	11.4	12.5	9.1	12.1
PAT (INR/unit)	28,715	37,541	46,463	54,262	25,797	51,912	58,987	42,599	56,760
Growth (%)		44.6	36.1	23.9	-95.7	29.2	14.0	202.7	21.8
S/A EPS (INR/Sh)	**122.8**	**177.6**	**241.7**	**299.4**	**12.8**	**312.2**	**341.4**	**38.8**	**380.2**

Source: Company, MOSL

Phase-1 of Gujarat plant starts operations

- Suzuki Motor Gujarat (SMG), 100% parent owned, has started first phase of Gujarat plant with initial capacity of 0.25m units and investments of ~INR30b. MSIL would be sourcing 100% of production of SMG and supplies to MSIL would be on cost to cost basis.
- This new plant is third location in MSIL manufacturing network and the first one outside existing two at Haryana.
- Suzuki has also announced further increase in capacity by 0.25m units along with engine plant, which would be commissioned in 2HFY19.
- This plant would increase MSIL's production capacity to 1.9m units in FY18 and ~2.15m units by FY20.
- SMG would supply components as well as completely built vehicles to MSIL for both domestic and export markets. The new plant would start with *Baleno* and would produce one more model in FY18.
- Gujarat plant offers several advantages including land at concessional price, sales tax benefit, centrally located, stable industrial environment, good power connectivity, excellent infrastructure etc.

Exhibit 2: Gujarat plant to play key part in next leg of growth for MSIL (Capacity '000 units)



Source: Company, MOSL

Exhibit 3: Key highlights of agreement between MSIL and SMGPL

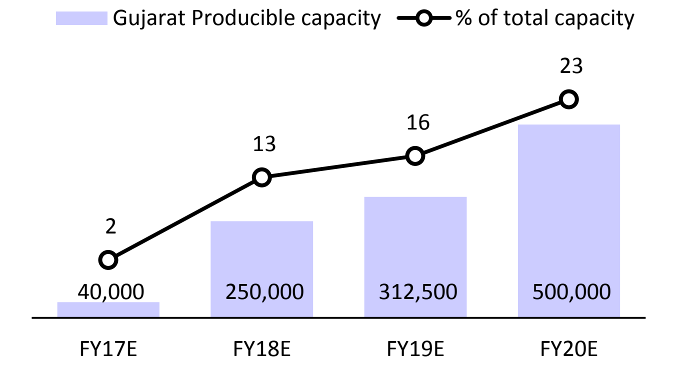
Heads	Particulars
Capex	❖ Capex to be funded through equity infusion by the parent and depreciation (rate at-par with MSIL)
Tenure	❖ Tenure of the agreement 15 years, and can be further extended by 15 years
Pricing	❖ Pricing on 'No-Profit No-Loss' basis
	❖ Fiscal incentives to be passed to MSIL
	❖ Royalty payable by SMG in-line with that of MSIL
Exclusivity	❖ Related party transaction based on prior MSIL approval
	❖ SMG to work exclusively for MSIL
	❖ MSIL has right to inspect SMG's books
	❖ Termination of contract gives MSIL option to purchase SMG at net book value
Control	❖ MSIL to determine product mix and production schedule, which SMG shall follow
	❖ Jointly appointed Coordination Committee to oversee SMG's operations
	❖ MSIL to support SMG on need basis

Source: Company, MOSL

Adds much-needed capacity for growth

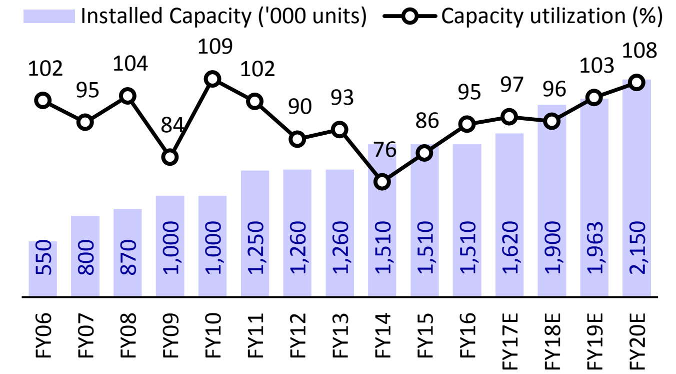
- MSIL has a waiting period of up to 8 months for the *Baleno*, *Vitara Brezza* and *Ignis*. There is an order backlog of ~85,000 for the *Baleno*, ~50,000 for the *Brezza* and ~12,500 for the *Ignis*.
- Gujarat plant would add ~13% to total MSIL capacity in FY18E and contribute ~23% by FY20E.
- The Gujarat plant is expected to ease capacity constraints and allow it to sell more of the *Baleno*.
- The new plant would also drastically reduce waiting periods for other products that have had to be sacrificed to meet the demand for more popular models like the *Baleno* and *Vitara Brezza*.

Exhibit 4: Gujarat capacity to reach 0.5m and overall capacity to reach 2m by 4QFY19



Source: MOSL, Company

Exhibit 5: Utilization to remain high despite capacity addition led by new launches and higher deamnd

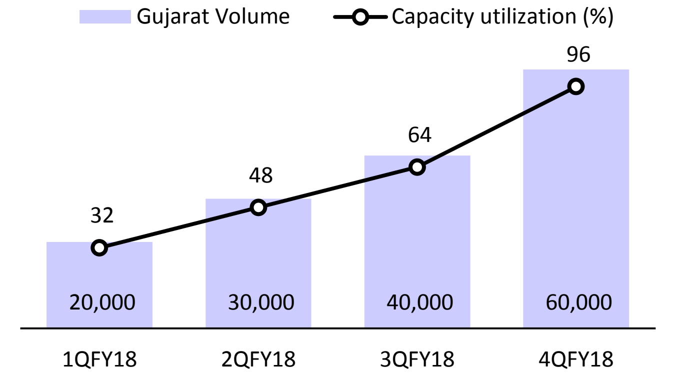


Source: MOSL, Company

Gujarat plant ramp-up to be back-ended in FY18 and beyond…

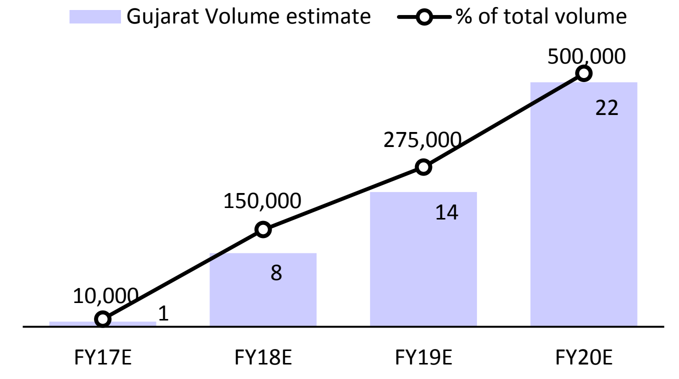
- The volume for Gujarat plant in FY18 is estimated at 0.15m units, with 60% utilization. The ramp-up is likely to be gradual, with utilization at ~40% in 1HFY18 but ramping up to almost 100% by 4QFY18.
- Suzuki plans to expand the Gujarat plant, with further 0.25m capacity addition by 4QFY19, along with engine plant.
- This plant would start operations with very few vendors having local presence in Gujarat, and no engine and transmission plant in phase-1.
- Vendors are expected to have local presence gradually over next 3-4 years, whereas engine and transmission facility would be put in phase-2 for FY19 commissioning.
- The management intends to first produce the *Baleno* at the Gujarat plant and add one more model in FY18 (maybe new Swift as it is on same platform as Baleno).

Exhibit 6: Ramp-up to happen gradually with majority volume in 2HFY18



Source: MOSL, Company

Exhibit 7: By FY20, Gujarat to contribute significantly to overall volume

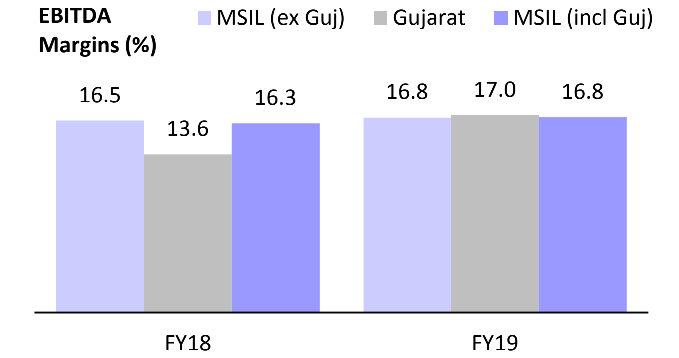


Source: MOSL, Company

…impacting FY18 EBIT margins by 40bp in the ramp-up phase

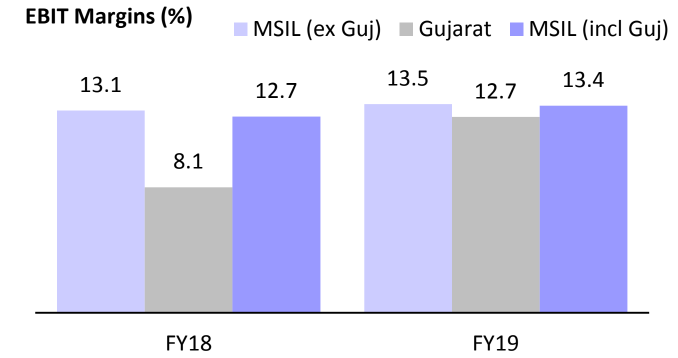
- Gujarat plant would have superior profitability on full ramp-up due to a) sales tax incentives, b) lower wage cost, c) lower lead distance and d) better efficiency.
- We believe there could be a transitory impact on MSIL's margins in the next 2-3 quarters due to (1) negative operating leverage due to **gradual ramp-up** of the Gujarat plant (refer exhibit 5 above), (2) inward freight on components sourced from Haryana plant and (3) higher depreciation rate.
- Gujarat plant will have lower volume contribution at ~8% of total volumes in FY18E and ~14% by FY19E, thereby diluting impact on consolidated numbers.
- Also, 4QFY17 would see non-recurring pre-operative costs (estimated impact of ~INR1.5b or ~80bp in 4QFY17E).
- There would be two impact of SMG's Gujarat plant on MSIL profitability viz a) economic impact (as mentioned above) and b) accounting impact due to entire cost (including depreciation) for Gujarat plant would reflect in MSIL's RM Cost, though this wouldn't have any impact on EBIT margin level.
- We estimate Gujarat plant commissioning would impact reported EBIT margins by 40bp in FY18 (implying 80-100bp impact in 1HFY18), but estimate no material impact in FY19E as we expect almost 50% of vendors to have Gujarat presence by FY19.
- We estimate Gujarat plants EBIT margins at 8.1%/12.9% for FY18/FY19 (v/s ~13.1%/13.5% for Haryana operations in FY18/19).

Exhibit 8: Gujarat plant's EBITDA margins are estimated to be lower by ~290bps in FY18, but to normalize in FY19…



Source: MOSL

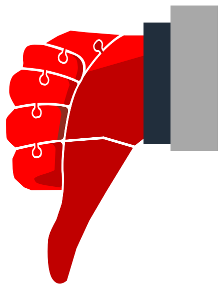
Exhibit 9: …but EBIT margins are estimated to be lower by ~500bp in FY18 and ~80bp in FY19E



Source: MOSL

Exhibit 10: We are highlighting below the important differentiated factors between Gujarat plant and existing MSIL operations at Haryana, which are likely to have a major impact on overall EBITDA margin:

- ✓ Sales tax incentives (for sale in Gujarat)
- ✓ Savings in outward freight (for Exports & Sales from Gujarat to South & West)
- ✓ Lower wages
- ✓ Lower power cost



- ✓ Inward freight cost
- ✓ Negative operating leverage
- ✓ Pre-operative cost
- ✓ Higher depreciation

We highlight below key factors having negative impact on margins:

- **Inward freight on components supplied from Haryana**

While MSIL has started production at the Gujarat plant, its entire supply chain is in process of setting-up factories in Gujarat. Although it would take 3-4 years for MSIL to get entire ecosystem in place, we are hopeful of ~50% of vendors to have local manufacturing footprint in Gujarat in next 12-15 months. In the interim, MSIL would source components from its ecosystem at Haryana plants. This would result in very high inward freight (including packaging and warehousing) in the initial phase. We estimate inward freight to have impact of ~20bp on MSIL's FY18/FY19 EBITDA margins.

Exhibit 11: Inward freight to remain high initially till the whole ecosystem is set up

	FY18E	FY19E
Manesar to Gujarat plant (Kms)	900	900
Gujarat Volumes (units)	150,000	275,000
Freight cost for components (INR/Car)	9,000	6,000
Total Inward Freight cost (INRm)	**1,350**	**1,650**
% of Gujarat sales	2.0	1.3
% of total sales	0.2	0.2

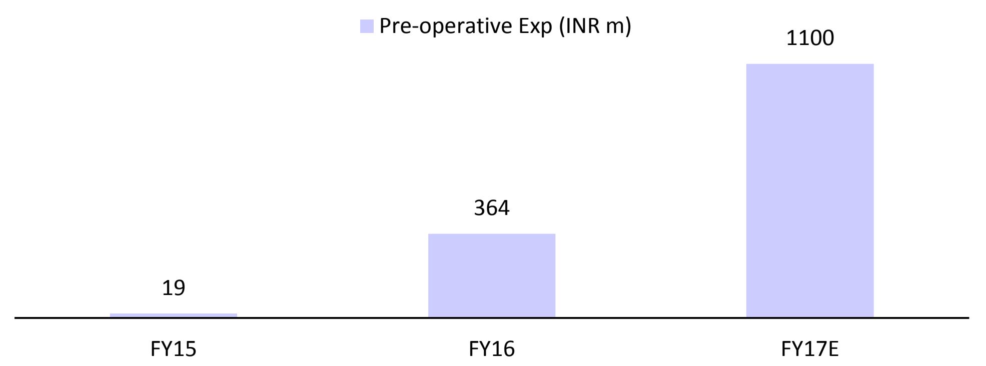
Assuming local sourcing of 15% in first year and 50% in 2nd years — Source: MOSL

- **Negative operating leverage**
  Considering gradual ramp-up to 100% utilization only by 4QFY18, negative operating leverage (for staff cost and fixed overheads) would impact Gujarat plant's margins by ~390bp in FY18 and ~110bp in FY19 (as line-2 and engine plant starts operations by 4QFY19). There would be further negative operating leverage impact at EBIT margin level due to depreciation (beyond impact of higher depreciation rate).

- **Higher depreciation**
  MSIL's depreciation policy for Plant and Machinery is based on useful life of 8-11 years. Assuming, Gujarat plant would be depreciated in 8 years or at 12.5%, as against current blended rate of 8.5% of gross block due to vintage of Haryana plants. Depreciation (as % of sales) would be higher for the Gujarat plant by ~200bp for FY18 and ~100bp for FY19, impacting EBIT margins.

- **Pre-operative costs estimated at ~INR1.5b to reflect in 4QFY17 (~80bp impact)**
  Expenses (which can't be capitalized) incurred during construction of plant and trial-run would be expensed to MSIL on commencement of supplies from 4QFY17. Pre-operative expenses like training activities, trial runs, start-up costs, employee cost during trial-runs etc would be expensed in 4QFY17. Based on our analysis of SMG's FY15 and FY16 annual report, it had expense of ~INR19m and ~INR364m respectively. However, for FY17 we estimate it to be ~INR1.1b considering most of these expenses is incurred in between completion of construction and near to commissioning. We estimate total pre-operative cost at ~INR1.5b (~5% of gross block) reflecting entirely in 4QFY17 (~80bp in 4QFY17E).

Exhibit 12: Pre-operative expenses estimated to be ~INR1.5b over FY15-17E

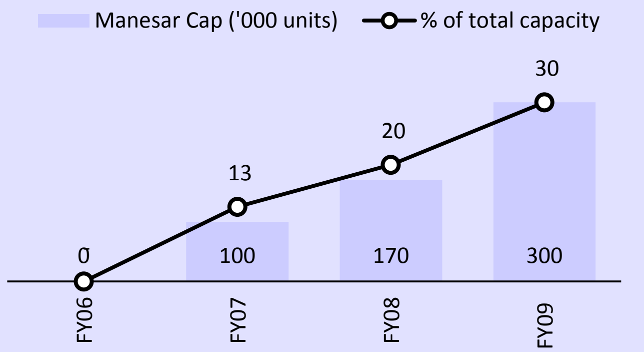


Source: SMG, MOSL

Comparison with Manesar plant shows an initial impact of upto 100bp on EBITDA Margins

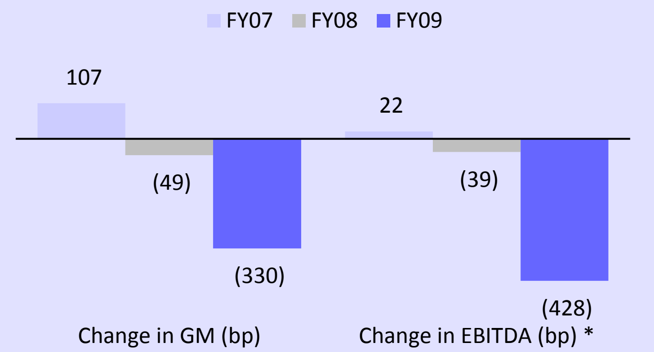
- Decade back, MSIL commissioned started line-1 at its Manesar plant in Feb-07. Since the Manesar plant was commissioned in FY07 with a capacity of 0.1m, MSIL has continuously added capacity at Manesar to reach 0.8m in FY14.
- We believe there are many similarities between Manesar and Gujarat plant, but also one key difference.
- Like Gujarat plant, Manesar constituted ~13% of then total capacity, started without engine plant and ecosystem was minimal. However, unlike Gujarat plant, Manesar plant was in proximity of Gurgaon plants ecosystem.
- Manesar plant led to negative operating leverage impact on EBITDA margins of ~85bp in FY07, no impact in FY08 and ~100bp in FY09 (led by 50bp jump in freight cost, not attributable to Manesar plant).

Exhibit 13: Manesar plant had similar contribution to overall capacity as Gujarat plant



Source: Company, MOSL

Exhibit 14: We infer impact of negative operating leverage due to Manesar plant commissioning at upto ~100bp



* Adj for change in royalty rates

Source: Company, MOSL

Several levers to offset impact of negative operating leverage in Gujarat

- Gujarat plant would have superior profitability on full ramp-up due to a) sales tax incentives, b) lower wage cost, c) lower lead distance and d) better efficiency.

- **Sales tax incentive:** The Gujarat plant is eligible for sales tax refund only for the cars sold in the state of Gujarat from the Gujarat government (state GST under GST regime). Gujarat contributes 7.5% of MSIL's domestic volume. While the current sales tax rate in Gujarat is 15%, state GST on cars would be 14%. We estimate sales tax refund of INR1.1b/1.9b in FY18/FY19. This could contribute 160bp/150bp to Gujarat plant's EBIT margin and 15-20bp to MSIL's overall EBIT margin in FY18/19.

Exhibit 15: Sales tax refund to contribute ~20bp to MSIL margins

	FY18	FY19
Total Gujarat plant volume	150,000	275,000
Gujarat share in overall (%)	7.5	7.5
Baleno & New Swift contbn (% of total Vols)	14	20
Total Domestic Volume	1,676,262	1,870,369
Sales in Gujarat (units)	17,601	28,589
Realization (INR/unit)	453,776	470,573
Sales in Gujarat (INR m)	7,987	13,453
SGST Rate	14%	14%
SGST refund (INR m)	**1,118**	**1,883**
% of Guj. Revenues	1.6	1.5
% of Total Revenues	0.1	0.2

Source: MOSL

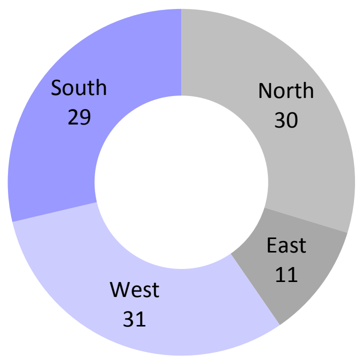
- **Savings in outward freight:** With the Gujarat plant, MSIL's lead distance for ports and the western and southern regions (53% of volumes excluding MP, CTG and 50% of Rajasthan) would reduce by ~900km. This would lower outward freight for MSIL by INR3,000 per car for cars exported and cars sold in the South and the West. Baleno wouldn't be exported from Gujarat plant and hence benefit of lower lead distance for exports would only come in FY19 (we are not factoring in for the same). We estimate 5-10bp savings for MSIL due to lower outward freight.

Exhibit 16: Outward freight savings could help dilute impact of inward freight

Gujarat plant logistic savings	FY18E	FY19E
Total Gujarat plant volume	150,000	275,000
Baleno & New Swift contbn (% of total Vols)	14	20
West & South Vols (% of total) *	53	53
MSIL domestic sales	1,676,262	1,870,369
West & South Vols from Gujarat	124,379	202,026
Cost savings/unit	3,000	3000
Total outward freight cost savings (INR m)	**373**	**606**
% of Gujarat sales	0.55	0.47
% of Total sales	0.05	0.06

West excludes MP, CTG and only 50% of Raj; Source: MOSL

Exhibit 17: MSIL's region-wise sales in 9MFY17



Source: Company, MOSL

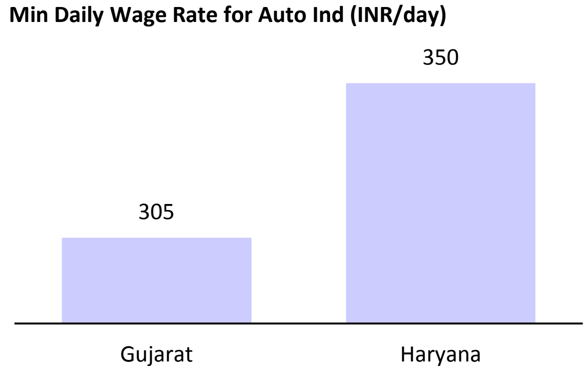
- **Lower staff cost:** In the initial phase, staff cost (as % of sales) would be higher due to negative operating leverage. However, overall staff cost would be lower at Gujarat than the Haryana plant due to (a) younger age profile at Gujarat, (b) location (Haryana plants are in city), and (c) lower minimum wages (15% lower in Gujarat than Haryana).

Exhibit 18: Initially, staff cost to be higher, then subside as volume ramps up

Particulars	FY18	FY19
Staff cost per unit of capacity at Haryana (FY17)	15,364	16,133
Staff cost per unit @ Gujarat (15% lower)	13,060	14,519
Gujarat capacity (units)	250,000	320,000
Total staff cost for Gujarat plant in INR m (FY18)	**3,265**	**4,646**
Staff cost (% of sales at Gujarat plant)	4.7	3.5
Staff cost (% of sales at Haryana plant)	3.6	3.7

Source: Company, MOSL

Exhibit 19: Minimum daily wages are lower in Gujarat by 15%



Source: Company, MOSL

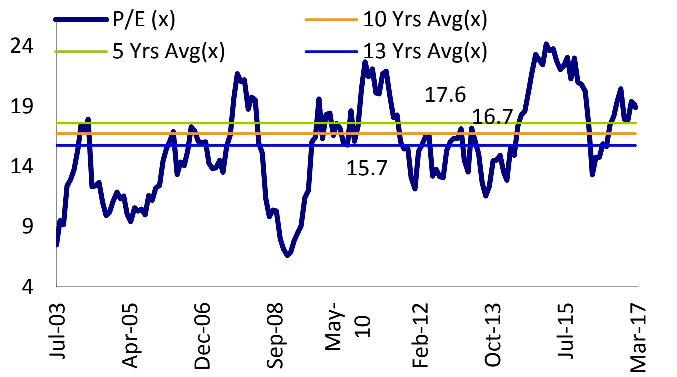
- **Production optimization to derive full benefit of locational and sales tax advantage**: In our estimates we are not optimizing sales tax refund (by maximizing sales to Gujarat from Gujarat plant) and lead distance (maximizing sales to West and South from Gujarat) due to limited understanding of model wise production strategy and model wise volumes for key market. We believe management would try to optimize benefit of both sales tax incentive and freight cost, thereby improving realizations and margins.

Valuation and view

- **1st year of PV industry recovery and multi-year favorable product lifecycle for MSIL:** We believe MSIL could emerge as the biggest beneficiary of impending demand recovery, considering its stronghold in the worst-impacted entry-level segment as well as favorable product lifecycle. MSIL's new launches targeted toward filling gaps in its portfolio are likely to improve its overall product mix. We estimate MSIL would gain market share further, driven by 13.5% volumes CAGR over FY17-19E. This, coupled with improvement in mix and reduction in discounts, would drive revenue CAGR of ~18.3% over FY17-19E.

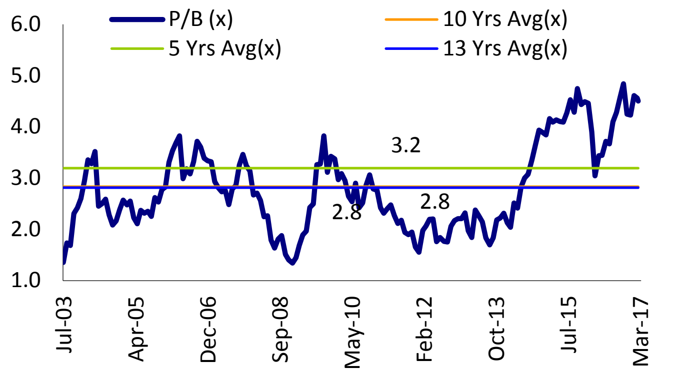
- **EBITD margins to moderate from recent highs but remain healthy:** MSIL's EBIT margins are estimated to decline from peak of 13.5% in 2QFY17 to ~12.5% in FY18 and 13.2% in FY19 due to impact of Gujarat plant and recovery in commodity prices. We believe EBIT margins will remain healthy at 12-13%, driven by a) discounts reduction with demand revival, b) mix improvement, c) benefits of operating leverage and d) reducing exposure to JPY due to exports to Japan and royalty based on INR for new products.
- **Strong margins, asset-light model to result in strong FCF generation and RoE improvement:** The Gujarat plant arrangement with its parent Suzuki will make MSIL's business asset-light, thereby allowing management to focus more on marketing. We expect strong cumulative FCF generation of ~INR277.6b over FY17-19E, despite factoring in for capex of ~INR105b. RoE is estimated to improve 100bp to ~23.3%, while RoIC is likely to improve by 34.9pp to ~89.3% by FY19E.
- **Structural improvement in business to drive further re-rating**: All business/financial parameters have substantially improved over last few years and are expected to strengthen further (refer Exhibit 55). Business parameters such as industry consolidation, market share improvement, rising rural contribution, reduced JPY exposure and improving share of premium products have improved MSIL's positioning considerably. Consequently, we expect financial parameters to exhibit improvements over next five years. In summary, the moat for MSIL is expected to strengthen further, which should led to further re-rating of the stock.
- **Buy with TP of ~INR7,443:** We remain positive on MSIL, considering a) 1st year of recovery, b) multi-year favorable product lifecycle, c) improvement in product mix (increasing share of premium products) aiding realizations and consequently margins, d) reducing JPY exposure, e) improvement in FCF conversion and f) high FCF generation and sharp improvement in RoIC as capex intensity reduces. Our EPS are 15-20% higher than the consensus numbers, driven by stronger revenue growth and higher margins. The stock trades at 19x/15.6x FY18E/19E EPS. As a result, we value MSIL at 20x Mar-19 core EPS (~20% premium to 5 year average core EPS). We have increased premium to LPA from 10% to 20% as we have got more comfort on quantum and longevity of impact of Gujarat plant and have cushion to estimates (Our JPYINR assumption adverse by 14% than the spot rate).

Exhibit 20: MSIL 1 year forward PE (x) near LPA



Source: MOSL

Exhibit 21: MSIL 1 year forward PB (x) at premium to LPA



Source: MOSL

Exhibit 22: Comparative valuation

	CMP	Rating	TP	P/E (x)		EV/EBITDA (x)		RoE (%)		RoCE (%)		EPS CAGR (%)
Auto OEM's	**(INR)***		**(INR)**	**FY17E**	**FY18E**	**FY17E**	**FY18E**	**FY17E**	**FY18E**	**FY17E**	**FY18E**	**FY16E-18E**
Bajaj Auto	2,821	Buy	3,414	21.0	17.7	14.8	12.3	29.7	31.0	28.9	30.1	10.1
Hero MotoCorp	3,232	Neutral	3,543	18.7	17.1	12.3	11.2	39.6	36.7	38.6	35.9	9.2
TVS Motor	435	Buy	456	38.8	28.7	23.5	17.9	25.1	27.8	25.9	30.3	29.0
M&M	1,280	Buy	1,562	20.9	17.0	15.7	14.0	14.5	13.7	12.1	11.6	7.8
Maruti Suzuki	5,954	Buy	7,443	23.6	19.0	15.3	12.0	22.3	23.4	30.6	31.4	31.8
Tata Motors	468	Buy	658	35.8	13.1	5.9	4.2	5.4	13.4	4.9	10.7	-1.4
Ashok Leyland	83	Buy	111	18.6	13.4	9.6	7.4	21.6	25.9	15.7	20.2	25.9
Eicher Motors	25,638	Buy	27,439	41.0	29.5	31.9	24.2	41.2	41.2	27.6	30.9	32.7
Auto Ancillaries												
Bharat Forge	1,027	Buy	1,105	40.5	27.5	18.9	15.0	15.7	20.5	10.8	14.7	15.1
Exide Industries	220	Buy	236	26.5	22.5	16.7	14.3	14.3	15.1	14.8	15.7	15.3
Amara Raja Batteries	871	Buy	1,142	29.7	23.0	16.9	13.5	21.7	23.2	20.6	22.2	15.1
BOSCH	22,607	Neutral	21,940	50.1	35.5	38.0	26.1	17.4	23.6	24.5	32.7	14.8

Source: MOSL

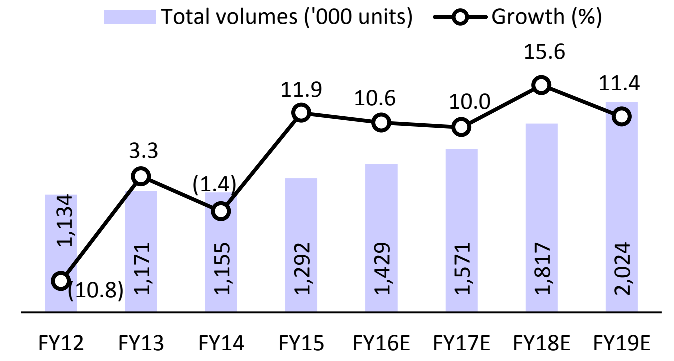
Story in charts: Expect EPS CAGR of ~23% over FY17-19E

Exhibit 23: Market leader most segments

	FY13	FY14	FY15	FY16	FY17E
Mini	75.4	76.7	81.4	79.8	68.4
Compact	34.2	37.6	43.1	42.0	44.8
Compact-Sedan	80.6	63.8	53.7	58.1	58.0
Mid-Size	2.7	2.2	15.4	25.2	33.4
UV1	27.4	21.1	21.4	25.6	37.1
Domestic PV	**39.4**	**42.1**	**45.0**	**46.8**	**47.6**

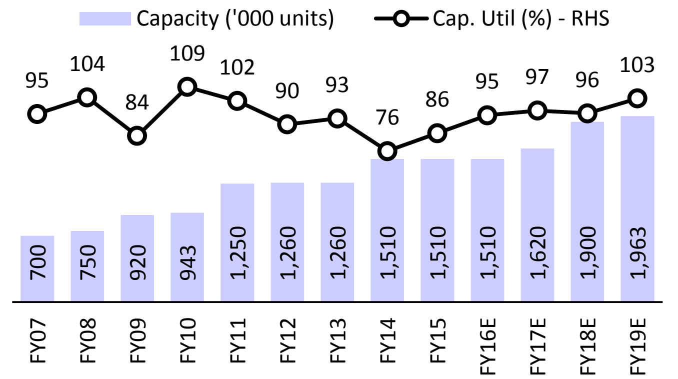
Source: Company, MOSL

Exhibit 24: Expect ~13% volume CAGR FY16-19E on demand recovery, new launches in new segments



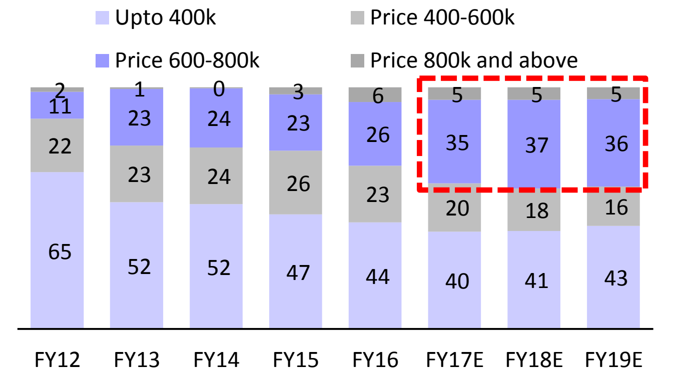
Source: Company, MOSL

Exhibit 25: MSIL to operate at peak utilization



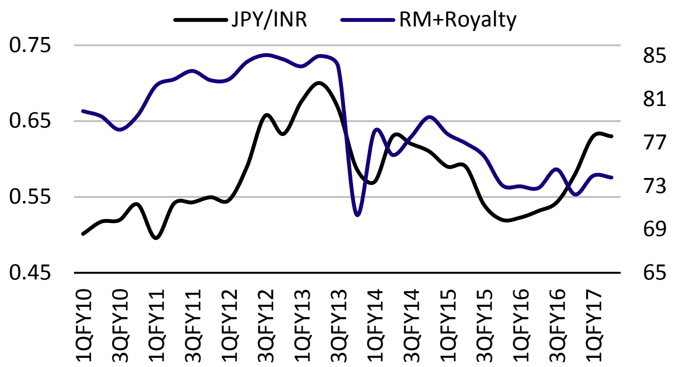
Source: Company, MOSL

Exhibit 26: Mix to improve in favor of premium products over next couple of years



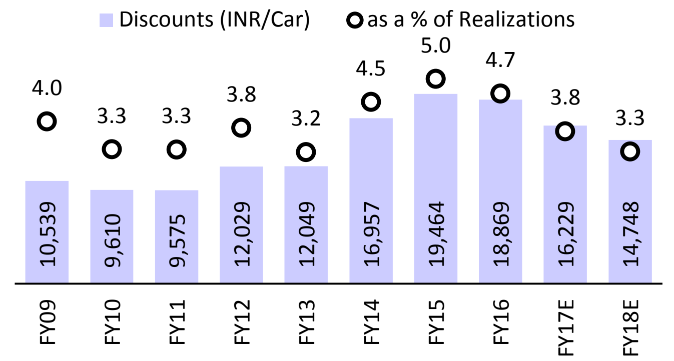
Source: Company, MOSL

Exhibit 27: JPY/INR influences variable cost meaningfully



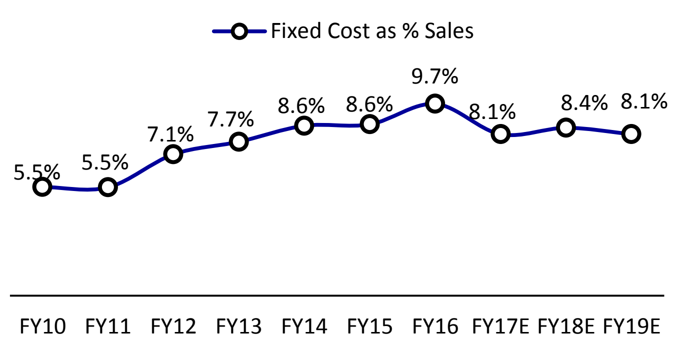
Source: Company, MOSL

Exhibit 28: Discounts to moderate the over the next 2 year



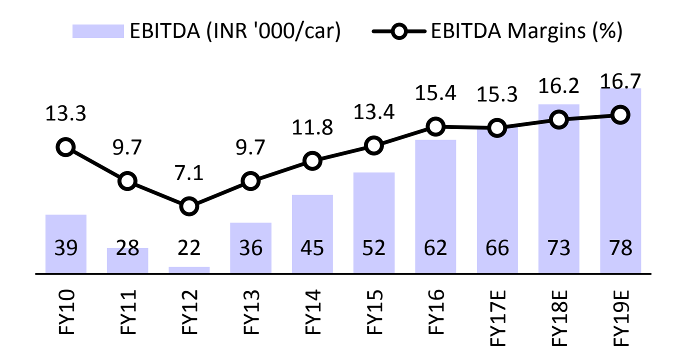
Source: Company, MOSL

Exhibit 29: ***Fixed cost as % of Sales***



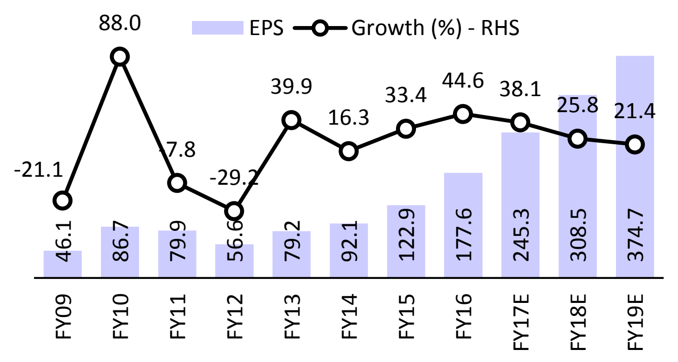
Source: Company, MOSL

Exhibit 30: ***EBITDA margins and EBITDA per car***



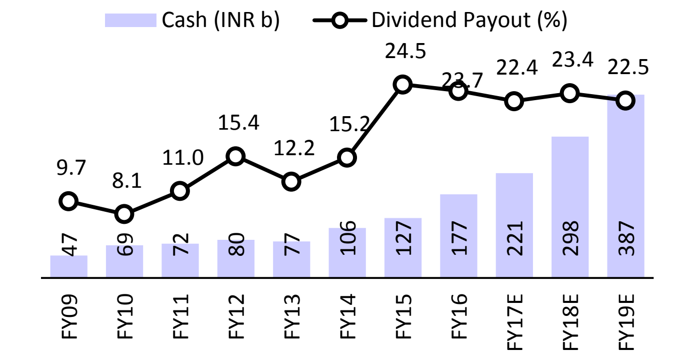
Source: Company, MOSL

Exhibit 31: EPS (INR) and Growth in EPS



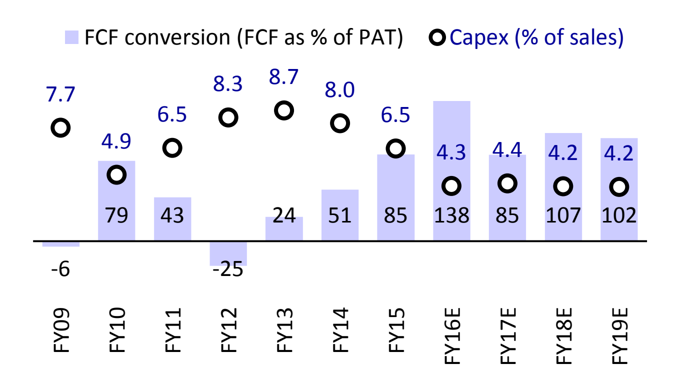
Source: MOSL, Company

Exhibit 32: Dividend Payout (%) and Cash Balance (INR b)



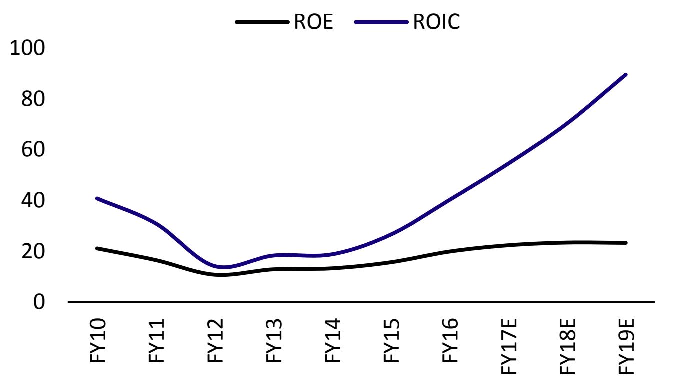
Source: MOSL, Company

Exhibit 33: Despite significant capex, FCF to remain strong (INR b)



Source: Company, MOSL

Exhibit 34: ROE v/s ROIC (%)



Source: Company, MOSL

Exhibit 35: Key assumptions | Snapshot of revenue model

000 units	FY13	FY14	FY15	FY16	FY17E	FY18E	FY19E
A1 (M800)	18	17	0	0	0	0	0
Growth (%)	-23.1	-5.2	-100.0				
% of Dom vols	1.7	1.6	0.0	0.0	0.0	0.0	0.0
MPV (Vans)	111	102	129	143	150	162	170
Growth (%)	-23.3	-7.6	26.3	11.2	4.6	8.0	5.0
% of Dom vols	10.5	9.7	11.0	11.0	10.4	9.7	9.1
A2 (other hatchbacks)	667	672	730	779	835	884	1,009
Growth (%)	-5.2	0.7	8.6	6.8	7.2	5.8	14.2
% of Dom vols	63.5	63.8	62.3	59.7	57.7	52.7	54.0
A3 (Dzire, Ciaz)	176	202	244	288	261	283	296
Growth (%)	37.6	14.4	20.9	18.3	-9.5	8.5	4.6
% of Dom vols	16.8	19.1	20.8	22.1	18.0	16.9	15.8
Uvs (Ertiga, Compact SUV)	79	61	68	94	202	347	395
Growth (%)	1,113.7	-22.8	11.6	38.4	113.5	72.2	13.6
% of Dom vols	7.5	5.8	5.8	7.2	13.9	20.7	21.1
Total Domestic	**1,051**	**1,054**	**1,171**	**1,305**	**1,448**	**1,676**	**1,870**
Growth (%)	4.4	0.2	11.1	11.5	10.9	15.8	11.6
% of Total vols	89.7	91.2	90.6	91.3	92.2	92.3	92.4
Exports	120	101	122	124	123	141	153
Growth (%)	-5	-16	20	2	0	14	9
% of Total vols	10	9	9	9	8	8	8
Total Volumes	**1,171**	**1,155**	**1,292**	**1,429**	**1,571**	**1,817**	**2,024**
Growth (%)	3.3	-1.4	11.9	10.6	10.0	15.6	11.4
ASP (INR 000/unit)	**372**	**379**	**387**	**403**	**433**	**454**	**471**
Growth (%)	18.5	1.9	2.0	4.3	7.3	4.9	3.7
Net Sales (INR b)	**436**	**438**	**500**	**577**	**680**	**824**	**952**
Growth (%)	22	0	14	15	18	21	15

Financials and valuations

Income Statement							(INR Million)
Y/E March	**2015**	**2016**	**2017E**	**2018E**	**2019E**	**2020E**	**2021E**
Net Op Income	**499,706**	**576,530**	**680,071**	**824,476**	**952,255**	**1,107,108**	**1,201,438**
Change (%)	14.1	15.4	18.0	21.2	15.5	16.3	8.5
Total Cost	432,577	487,568	576,024	691,152	793,580	929,541	1,021,275
EBITDA	**67,129**	**88,962**	**104,047**	**133,323**	**158,675**	**177,567**	**180,162**
Change (%)	29.4	32.5	17.0	28.1	19.0	11.9	1.5
EBITDA Margins (%)	13.4	15.4	15.3	16.2	16.7	16.0	15.0
Depreciation	24,703	28,239	25,967	30,112	33,371	36,668	40,167
EBIT	**42,426**	**60,723**	**78,080**	**103,212**	**125,304**	**140,899**	**139,995**
Interest	2,060	815	875	850	800	800	800
Other Income	8,316	14,610	23,958	24,012	26,397	33,207	33,218
PBT	**48,682**	**74,518**	**99,679**	**126,374**	**150,901**	**173,306**	**172,413**
Tax	11,570	20,864	26,664	33,173	37,725	43,327	43,103
Effective tax Rate (%)	23.8	28.0	26.8	26.3	25.0	25.0	25.0
PAT	**37,112**	**53,654**	**73,015**	**93,201**	**113,176**	**129,980**	**129,310**
Change (%)	33.4	44.6	36.1	27.6	21.4	14.8	-0.5
% of Net Sales	7.6	9.5	10.9	11.5	12.1	11.9	10.9
Adj. PAT	**37,112**	**53,654**	**74,102**	**93,201**	**113,176**	**129,980**	**129,310**
Change (%)	33.4	44.6	38.1	25.8	21.4	14.8	-0.5

Balance Sheet							(INR Million)
Y/E March	**2015**	**2016**	**2017E**	**2018E**	**2019E**	**2020E**	**2021E**
Sources of Funds							
Share Capital	1,510	1,510	1,510	1,510	1,510	1,510	1,510
Reserves	235,532	268,561	325,237	396,652	484,411	583,527	681,974
Net Worth	**237,043**	**270,071**	**326,747**	**398,162**	**485,921**	**585,037**	**683,484**
Loans	5,156	2,309	2,309	2,309	2,309	2,309	2,309
Deferred Tax Liability	4,810	4,741	4,741	4,741	4,741	4,741	4,741
Capital Employed	**247,009**	**277,121**	**333,797**	**405,212**	**492,971**	**592,087**	**690,534**
Application of Funds							
Gross Fixed Assets	264,617	294,092	324,161	359,161	399,161	439,161	479,161
Less: Depreciation	142,024	166,414	192,381	222,492	255,863	292,531	332,699
Net Fixed Assets	**122,593**	**127,678**	**131,780**	**136,669**	**143,298**	**146,630**	**146,462**
Capital WIP	18,828	10,069	10,000	10,000	10,000	10,000	10,000
Investments	128,140	177,857	177,857	177,857	177,857	177,857	177,857
Curr.Assets, Loans	**65,932**	**76,352**	**126,776**	**214,406**	**312,780**	**430,525**	**538,472**
Inventory	26,859	31,321	29,811	36,141	41,743	48,531	52,666
Sundry Debtors	10,698	12,986	20,495	24,847	28,698	33,365	36,208
Cash & Bank Balances	183	391	44,815	121,763	210,685	316,975	417,944
Loans & Advances	25,221	29,062	29,062	29,062	29,062	29,062	29,062
Others	2,971	2,592	2,592	2,592	2,592	2,592	2,592
Current Liab. & Prov.	**88,484**	**114,835**	**112,616**	**133,720**	**150,964**	**172,925**	**182,257**
Sundry Creditors	71,954	93,470	84,823	97,879	109,431	123,432	131,960
Provisions	16,530	21,365	27,793	35,841	41,532	49,493	50,297
Net Current Assets	**-22,553**	**-38,483**	**14,160**	**80,686**	**161,816**	**257,601**	**356,215**
Appl. of Funds	**247,009**	**277,121**	**333,797**	**405,212**	**492,971**	**592,087**	**690,534**

Financials and valuations

Ratios							
Y/E March	**2015**	**2016**	**2017E**	**2018E**	**2019E**	**2020E**	**2021E**
Basic (INR)							
Adjusted EPS	**122.9**	**177.6**	**245.3**	**308.5**	**374.7**	**430.3**	**428.1**
EPS Growth (%)	33.4	44.6	38.1	25.8	21.4	14.8	(0.5)
Consol EPS	**126.0**	**155.5**	**251.8**	**314.1**	**380.7**	**436.8**	**435.0**
Cash EPS	207.8	249.0	337.8	413.8	491.1	558.1	568.0
Book Value per Share	785	894	1,082	1,318	1,609	1,937	2,263
DPS	25.0	35.0	45.0	60.0	70.0	85.0	85.0
Div. payout (%)	24.5	23.7	22.4	23.4	22.5	23.7	23.9
Valuation (x)							
Consol. P/E	47.5	38.5	23.8	19.1	15.7	13.7	13.8
Cash P/E	28.8	24.0	17.7	14.5	12.2	10.7	10.5
EV/EBITDA	25.1	18.3	15.3	11.3	9.0	7.4	6.7
EV/Sales	3.5	2.9	2.4	1.9	1.5	1.2	1.0
P/BV	7.6	6.7	5.5	4.5	3.7	3.1	2.6
Dividend Yield (%)	0.4	0.6	0.8	1.0	1.2	1.4	1.4
FCF Yield (%)		4.1	3.5	5.5	6.4	7.6	7.3
Profitability Ratios (%)							
RoIC	26.5	40.2	54.5	70.2	89.5	104.8	109.4
RoE	15.7	19.9	22.3	23.4	23.3	22.2	18.9
RoCE	20.5	27.2	30.6	31.4	30.8	29.4	25.1
Turnover Ratios							
Debtors (Days)	7	7	10	10	10	10	10
Inventory (Days)	23	23	19	19	19	19	19
Creditors (Days)	75	88	67	64	62	60	58
Work. Cap. (Days)	-45	-57	-38	-35	-33	-31	-29
Asset Turnover (x)	2.0	2.0	2.0	2.0	1.9	1.8	1.7
Leverage Ratio							
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Cash Flow Statement							(INR Million)
Y/E March	**2015**	**2016**	**2017E**	**2018E**	**2019E**	**2020E**	**2021E**
OP/(Loss) before Tax	48,682	60,723	78,080	103,212	125,304	140,899	139,995
Int./Div. Received	-7,228	14,610	23,958	24,012	26,397	33,207	33,218
Depreciation	24,703	28,239	25,967	30,112	33,371	36,668	40,167
Direct Taxes Paid	-10,407	-20,933	-26,664	-33,173	-37,725	-43,327	-43,103
(Inc)/Dec in WC	8,356	16,139	-8,219	10,422	7,792	10,506	2,355
Other Items							
CF from Oper.Activity	**64,106**	**98,777**	**93,122**	**134,584**	**155,139**	**177,954**	**172,632**
Extra-ordinary Items	0	0	-1,484	0	0	0	0
Other Items	0	0	0	0	0	0	0
CF after EO Items	**64,106**	**98,777**	**91,638**	**134,584**	**155,139**	**177,954**	**172,632**
(Inc)/Dec in FA	-32,386	-24,565	-30,000	-35,000	-40,000	-40,000	-40,000
Free Cash Flow	**31,720**	**74,212**	**63,122**	**99,584**	**115,139**	**137,954**	**132,632**
(Pur)/Sale of Invest.	-12,613	-49,717	0	0	0	0	0
CF from Inv. Activity	**-44,999**	**-74,282**	**-30,000**	**-35,000**	**-40,000**	**-40,000**	**-40,000**
Change in Networth	0	-7,917	0	0	0	0	0
Inc/(Dec) in Debt	-13,898	-2,847	0	0	0	0	0
Interest Paid	-2,098	-815	-875	-850	-800	-800	-800
Dividends Paid	-3,625	-12,709	-16,340	-21,786	-25,417	-30,864	-30,864
CF from Fin. Activity	**-19,621**	**-24,287**	**-17,215**	**-22,636**	**-26,217**	**-31,664**	**-31,664**
Inc/(Dec) in Cash	**-514**	**208**	**44,424**	**76,948**	**88,922**	**106,290**	**100,969**
Add: Op. Balance	6,298	183	391	44,815	121,763	210,685	316,975
Closing Balance	**5,784**	**391**	**44,815**	**121,763**	**210,685**	**316,975**	**417,944**
Closing Balance	**12,081**	**574**	**45,206**	**166,578**	**332,448**	**527,660**	**734,920**

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