India I Equities

Automobiles

Sector Report

25 February 2009

Indian Auto Sector

Quality survivors: Buy Hero Honda, Bajaj Auto and Maruti Suzuki

Neutral

Nifty/Sensex: 2736/8843

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- **Qualitative improvement.** We expect the plunge in commodity prices since 1HFY09 to raise auto sector margins from 4QFY09 and the 200bps lower auto-loan rates to increase demand. We recommend choosing stocks with healthy cash flows and sound business fundamentals.

- **Better margins.** Lower commodity prices should reduce raw material costs and result in an improvement in EBITDA margins from 4QFY09, in our view.

- **Stimuli to help.** Measures such as lower interest rates and excise duties should spur month-on-month growth in auto volumes, in our view. We, however, are concerned about the economic slowdown and credit availability. Rural-focused and low-price-point products are best positioned to grow through this downturn.

- **Focus on cash flow and dominant market position.** Our stock picks are those companies with strong cash flows, good return ratios, dominant market shares, and with capacity expansion completed or nearing there (operating/financial leverage).

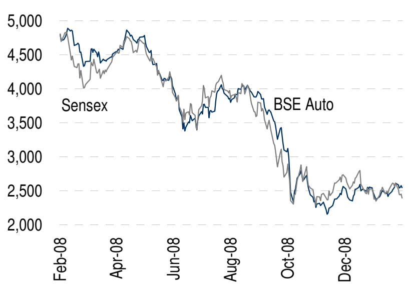
- **Buy Hero Honda, Bajaj Auto and Maruti Suzuki.** Bajaj Auto will see market share gains and margin improvement. Hero Honda is best positioned in the rural segment. Maruti's leadership in low-price-point products would sustain its dominance. We recommend a Sell on Tata Motors, Ashok Leyland and TVS Motors, and a Hold on Mahindra & Mahindra.

Indian Auto Sector – Valuation matrix (FY10e)

	Ashok Leyland	Bajaj Auto	Hero Honda	M&M*	Maruti Suzuki	Tata Motors*	TVS
Rating	Sell	Buy	Buy	Hold	Buy	Sell	Sell
Price (Rs)	15	500	917	281	633	134	19
Target Price (Rs)	13	610	1,022	318	760	123	11
Upside (%)	-15	22	11	13	20	-8	-40
Market cap (US$bn)	0.4	1.5	3.7	1.4	3.7	1.4	0.1
EPS (Rs)	1.6	63.1	73.0	52.9	56.3	15.3	1.4
PE (x)	9.4	7.9	12.6	5.3	11.3	8.7	13.4
EV/EBITDA (x)	5.3	4.5	7.8	4.4	5.2	5.5	6.0
EV/Sales (x)	0.5	0.6	1.1	0.4	0.6	0.5	0.2
RoE (%)	9.1	34.9	30.2	14.1	14.7	5.8	4.0

*Source: Anand Rathi Research. Note: Prices as of 20 February 2009; * Consolidated EPS*

Indian Auto Sector vs Sensex



Source: Anand Rathi Research