



Bajaj Auto

STOCK INFO.	BLOOMBERG
BSE SENSEX: 15,092	BJA IN
	REUTERS CODE
S&P CNX: 4,446	BJAT.BO

12 July 2007

Sell

Previous Recommendation: Sell

Rs2,195

Equity Shares (m)	101.2
52-Week Range (Rs)	3,175/2,063
1,6,12 Rel.Perf.(%)	-3/-28/-58
M.Cap. (Rs b)	222.1
M.Cap. (US\$ b)	5.5

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	95,204	12,857	127.1	14.5	17.3	4.0	22.9	24.9	1.9	12.5
3/08E	105,639	13,186	130.3	2.6	16.8	3.4	20.4	23.1	1.6	11.6
3/09E	117,107	14,562	143.9	10.4	15.3	3.0	19.6	22.8	1.4	9.7

- ✗ Bajaj Auto reported 4.2% decline in revenues in 1QFY08, while EBITDA declined 23.7% YoY and PAT declined 14.9% YoY.
- ✗ Total volumes have declined by 11.7% in 1QFY08, making it the second successive weak quarter in terms of volume growth for Bajaj Auto. However, realizations surprised positively, increasing 8.5% YoY, causing net sales to decline by only 4.2% to Rs21.1b.
- ✗ EBITDA margins declined 330bp YoY and 100bp QoQ to 13.1% (lower v/s expectation), as EBITDA declined 23.7% YoY to Rs2.8b. Adj. PAT decreased by 18.1% YoY to Rs2.3b (in line with expectation).
- ✗ The new plant at Pantnagar in Uttarakhand has commenced commercial production in April 2007. Progress on the new motorcycle platform is on course and launch is scheduled for September 2007. The initial volume target for this new motorcycle is 15,000, and to be scaled up to 50,000 units per month by January 2008.
- ✗ We have cut our EBITDA margin estimate for FY08 by 50bp to 13.6%. We expect margin pressure to continue due to new launches that would entail higher adspend and due to higher raw material cost.
- ✗ Without considering impact of the demerger, we expect Bajaj Auto to report EPS of Rs130.3 in FY08 (2.6%) and Rs143.9 in FY09 (+10.4%). The stock trades at 16.8x FY08E EPS and 15.3x FY09E EPS. Maintain **Sell**.

QUARTERLY PERFORMANCE

(Rs Million)

	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Total Volumes (nos)	647,086	708,125	738,219	625,346	571,113	689,900	832,950	776,620	2,718,776	2,870,583
Net Sales	22,027	24,360	25,682	23,136	21,091	24,682	30,137	29,729	95,204	105,639
Change (%)	34.8	30.5	28.4	6.8	-4.2	1.3	17.3	28.5	24.2	11.0
Total Cost	18,420	20,708	22,046	19,873	18,338	21,419	25,963	25,584	81,046	91,304
EBITDA	3,607	3,652	3,636	3,263	2,754	3,263	4,174	4,144	14,158	14,335
As % of Sales	16.4	15.0	14.2	14.1	13.1	13.2	13.8	13.9	14.9	13.6
Change (%)	40.1	15.7	1.5	-23.2	-23.7	-10.6	14.8	27.0	4.4	1.3
Other Income	946	1,424	1,609	1,577	1,027	1,709	1,770	1,710	5,556	6,216
Interest	7	20	2	24	1	18	10	25	53	53
Depreciation	481	492	472	458	490	500	520	545	1,903	2,055
PBT	4,064	4,564	4,771	4,358	3,290	4,455	5,414	5,284	17,758	18,442
Tax	1,300	1,250	1,200	1,151	1,025	1,247	1,516	1,468	4,901	5,256
Effective Tax Rate (%)	32.0	27.4	25.2	26.4	31.2	28.0	28.0	27.8	27.6	28.5
Adj. PAT	2,764	3,314	3,571	3,208	2,265	3,207	3,898	3,816	12,857	13,186
Change (%)	32.2	14.0	22.8	-3.9	-18.1	-3.2	9.2	19.0	14.4	2.6
PAT	2,660	3,176	3,452	3,083	2,265	3,207	3,898	3,816	12,371	13,186
Change (%)	27.3	9.2	23.3	-4.2	-14.9	1.0	12.9	23.8	12.3	6.6

E: MOST Estimates

Motorcycle volume slowdown continues

In 1QFY08, the slowdown in Bajaj Auto's motorcycle sales continued. Retail sales, particularly in the 100cc segment, were impacted by lower demand due to higher interest rates and stringent financing norms being followed by banks. Its despatches to dealers were lower on these counts, as well as due to initiation of structural changes to the distribution and logistics channel. This resulted in inventory at the dealership level reducing by nearly 45,000 motorcycles.

Industrywise, domestic sales in the up to 125cc segment motorcycles, have declined by 20.8% YoY in 1QFY08, while the 125cc-250cc segment has witnessed domestic volume growth of 13.2%. Bajaj Auto's domestic motorcycle volumes have registered 39.7% YoY decline in 1Q in the up to 125cc segment, while volumes in the 125cc-250cc segment have increased by 1.5%.

Total volumes of Bajaj Auto have declined by 11.7% in 1QFY08, making it the second successive weak quarter in terms of volume growth for the company.

Betting on new motorcycle launch

The new plant at Pantnagar in Uttarakhand, wherein BAL is able to avail of excise duty and other tax benefits, has commenced commercial production in April 2007. As a result of production of Platina at this plant, the company is being able to make profits on this model, whereas earlier it was merely breaking-even.

Progress of the new motorcycle platform is on course and is scheduled for launch in September 2007. The initial volumes target is 15,000, with an objective to scale this up to 50,000 units per month by January 2008.

This new platform is expected to offer the fuel efficiency of a 100cc bike and performance equivalent to that of a premium bike. Management expects the launch of this bike to result in improvement of margins. While some cannibalization of the Platina and Discover will take place due to this launch, the company will benefit from improved profitability as a result. Management expects similar operating profits from the new bike as well as Discover.

BAL's management remains optimistic of forcing a shift away from 100cc motorcycles post launch of this new product.

Three-wheelers sales flat

Three wheeler volumes disappointed, increasing by a mere 0.7% during the quarter. This segment derives its growth from replacement sales of older petrol vehicles, which are being phased out in favour of LPG, CNG powered vehicles (in cities such as Ahmedabad, Chennai, Delhi, and Kolkata), as well as the robust demand in the exports market. Traditionally the three wheeler market is permit driven, with sales dependent on the new permits issued. The transition to alternate fuel vehicles owing to implementation of fuel emission regulatory norms will be the growth driver over next 2-3 years.

The company has developed new three-wheeler models scheduled for launch over the next few quarters to counter competition. We believe some of these products will also find a reasonable level of acceptance in export markets. However, due to the high base effect, in FY08, we expect flat three-wheeler volumes.

The management has guided that it is building a portfolio of light goods carrying vehicles, of which three-wheelers will be a constituent. However, in the interim, for the next 2 years, while this portfolio is being developed, sales will not show rapid growth.

LOWER VOLUME GROWTH (UNITS NOS)

	1QFY08	1QFY07	YOY CHG (%)	4QFY07	QOQ CHG (%)
Volume (units)					
Motorcycles	493,565	568,187	-13.1	532,853	-7.4
Other Two-wheelers	6,212	8,032	-22.7	7,895	-21.3
Total Two-wheelers	499,777	576,219	-13.3	540,748	-7.6
Three-wheelers	71,336	70,867	0.7	84,598	-15.7
Total Sales	571,113	647,086	-11.7	625,346	-8.7
of Which Exports	149,804	98,263	52.5	113,703	31.8

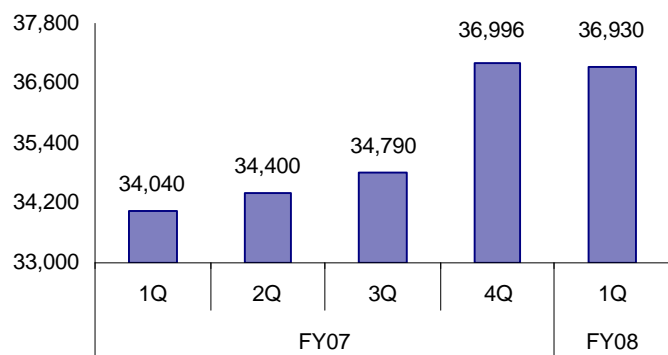
Source: Company/Motilal Oswal Securities

Operating margins plummet

Bajaj Auto reported 4.2% decline in revenues in 1QFY08, while EBITDA declined 23.7% YoY and PAT declined 14.9% YoY.

Motorcycles have registered 13.1% YoY decline in volumes during 1Q, while three-wheelers volumes have increased by merely 0.7%. However, there was a positive surprise on realizations, which increased 8.5% YoY, leading to net sales to decline by only 4.2% to Rs21.1b. The increase in realizations can be attributed to the change in product mix in favor of the premium segment, and excise duty reduction benefits from the new plant not being passed on to customers as expected.

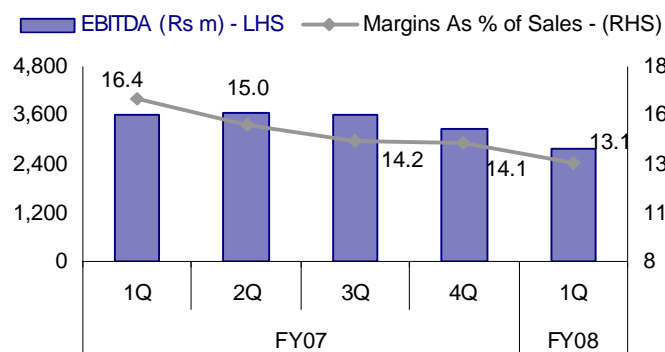
INCREASED REALIZATION PER VEHICLE (RS)



Source: Company/Motilal Oswal Securities

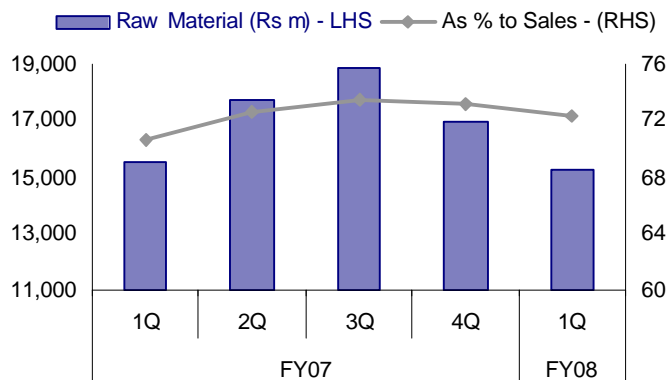
EBITDA margins declined 330bp YoY and 100bp QoQ to 13.1% (lower than expectation). Margins were adversely impacted due to higher staff costs (4.7% of sales v/s 3.9% in 1QFY07 and 3% in 4QFY07) due to commencement of the new plant. Continued high raw material costs (72.4% of net sales v/s 70.6% in 1QFY07) and higher advertising expenses impacted EBITDA margin negatively as well. This resulted in EBITDA declining 23.7% YoY to Rs2.8b. Adj. PAT decreased by 18.1% YoY to Rs2.3b (in line with expectation).

LOWER EBITDA MARGINS



Source: Company/Motilal Oswal Securities

RAW MATERIAL TO SALES REMAINS HIGH



Source: Company/Motilal Oswal Securities

Export strategy well planned – BAL targets 10% global share in motorcycles

In FY07, exports volume grew by 77% YoY and by 88% in terms of value. Two-wheeler exports increased by 73%, while three-wheeler exports increased by 87%. This strong trend was maintained in 1QFY08, as motorcycle exports increased 62%, while three-wheeler exports increased 30%. The sales value of exports increased 42% to Rs5.1b.

EXPORTS GROWTH MOMENTUM MAINTAIN (UNITS)

	1Q FY08	1Q FY07	GR.(%)
Motorcycles	114,551	70,771	62
Total 2-wheelers	114,555	71,177	61
Total 3-wheelers	35,249	27,086	30
Total	149,804	98,263	52
Value (Rs m)	5,141	3,624	42

Source: Company/Motilal Oswal Securities

Demerger of businesses

The demerger procedure to be followed by BAL, as per the scheme announced in May 2007, will result in the existing company become a holding company, while two new subsidiaries have been formed to carry out the auto business and the financial services/wind energy/consumer services businesses. However, nearly two-thirds of the cash and cash equivalents are expected to be retained by the holding company, which may result in lower value unlocking.

The economic interest of BAL in the life insurance business has been disclosed at 26%, and not 50% as initially factored

in our assumptions earlier. This has reduced the value of the insurance business in BAL's SOTP.

Subsidiaries performance in 1QFY08

Retail Finance

- ⌘ The total disbursement increased by 30% to Rs7.4b, while the stock of hire purchase finance receivables as of June 30, 2007 increased 32% to Rs29b
- ⌘ PAT is Rs472m v/s Rs377m in FY07.

Bajaj Allianz General Insurance

- ⌘ It has recorded gross premium of Rs5.7b in the quarter, growth of 27% YoY.
- ⌘ PAT for 1QFY08 is Rs354m v/s Rs305m in 1QFY07.

Bajaj Allianz Life Insurance

- ⌘ Gross written premium for the 1QFY08 is Rs10.6b, growth of 45%.
- ⌘ The company has now the largest distribution network

in the private sector. It has expanded its geographical reach to nearly 900 locations across the country.

Valuation and view

The company has guided for 10% volume growth in FY08. We expect two-wheeler growth of 6.3% in FY08 and 10.1% in FY09, while we expect flat three-wheeler sales in FY08 and 4% growth in FY09.

We have cut our EBITDA margin estimate for FY08 by 50bp to 13.6%. We expect margin pressure to continue due to new launches resulting in higher adspend and the intense competition versus Hero Honda continuing.

Without considering impact of the demerger, we expect Bajaj Auto to report EPS of Rs130.3 in FY08 (2.6%) and Rs143.9 in FY09 (+10.4%). The stock trades at 16.8x FY08E EPS and 15.3x FY09E EPS. Maintain Sell with a target price of Rs2,110.

Bajaj Auto: an investment profile

Company description

Bajaj Auto is the second largest two-wheeler manufacturer in India. An erstwhile scooter company, Bajaj has reinvented itself by re-innovating its product portfolio to become the second largest motorcycle manufacturer in India. With the opening of the insurance sector, the company has entered into joint venture agreements with Allianz AG, Germany.

Key investment arguments

- ✎ The company has significantly increased its market share in the motorcycle segment in FY06 and FY07.
- ✎ The introduction of the new motorcycle in September 2007 may see a revival in the fortunes of the two-wheeler industry.

Key investments risks

- ✎ Intense competition, higher input costs resulting in margin pressures in the motorcycles business, particularly the entry level segment.
- ✎ Further upmove in interest rates, leading to higher financing costs and lower demand.
- ✎ Slowdown in three wheeler sales – BAL's cash cow.

Recent developments

- ✎ BAL has launched its upgrades of Pulsar, which the management expects to drive motorcycle sales.
- ✎ The demerger procedure to be followed by BAL will result in the existing company become a holding company, while two new subsidiaries have been formed to carry out the auto business and the financial services/wind energy/consumer services businesses.

Valuation and view

- ✎ We expect BAL to witness a 5.6% volume growth in FY08 and 9.4% in FY09.
- ✎ We maintain **Sell** with a revised price target of Rs2,110.

Sector view

- ✎ Numerous motorcycle launches will lead to an increase in competition.
- ✎ Despite a large number of players, market share remains concentrated amongst the top two.
- ✎ We maintain a Neutral stance on the sector.

COMPARATIVE VALUATIONS

		BAJAJ AUTO	HERO HONDA	TVS MOTOR
P/E (x)	FY08E	16.8	14.3	23.1
	FY09E	15.3	12.6	21.2
EPS Gr (%)	FY08E	2.6	8.8	1.1
	FY09E	10.4	13.1	8.9
RoE (%)	FY08E	20.4	33.6	7.9
	FY09E	19.6	31.5	8.1
EV/EBITDA (x)	FY08E	11.6	8.7	11.2
	FY09E	9.7	7.4	8.9

SHAREHOLDING PATTERN (%)

	MAR.07	DEC.06	MAR.06
Promoter	29.9	29.9	29.8
Domestic Inst	7.6	8.3	7.9
Foreign	22.1	21.4	22.3
Others	40.4	40.4	40.0

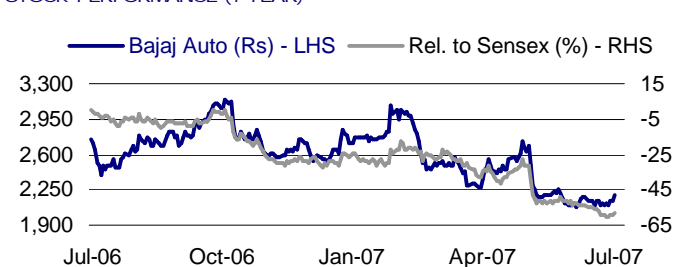
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VIATION (%)
FY08	130.3	138.2	-5.7
FY09	143.9	160.6	-10.4

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
2,195	2,110	-	Sell

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT						(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E						
Net Sales	57,240	74,694	93,138	103,366	114,607						
Change (%)	20.4	30.5	24.7	11.0	10.9						
Operating Other Income	1,907	1,985	2,066	2,273	2,500						
Total Income	59,147	76,679	95,204	105,639	117,107						
Total Expenditure	50,013	63,116	81,046	91,304	101,120						
EBITDA	9,134	13,563	14,158	14,335	15,987						
Change (%)	7.1	48.5	4.4	1.3	11.5						
% of Net Sales	15.4	17.7	14.9	13.6	13.7						
Depreciation	1,854	1,910	1,903	2,055	2,115						
Interest & Finance Charges	7	3	53	53	53						
Other Income	4,081	4,385	5,556	6,216	6,547						
Non-recurring Expense	490	226	478	0	0						
Non-recurring Income	0	216	-9	0	0						
PBT	10,865	16,024	17,272	18,442	20,366						
Tax	3,196	4,791	4,901	5,256	5,804						
Effective Rate (%)	29.4	29.9	28.4	28.5	28.5						
PAT	7,668	11,233	12,371	13,186	14,562						
Adj. PAT	7,987	11,243	12,857	13,186	14,562						
Change (%)	3.2	40.8	14.4	2.6	10.4						

BALANCE SHEET						(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E						
Share Capital	1,012	1,012	1,012	1,012	1,012						
Reserves	40,332	46,696	55,019	63,652	73,154						
Net Worth	41,343	47,707	56,031	64,664	74,166						
Deferred Tax	1,399	876	876	876	876						
Loans	12,270	14,672	14,672	14,672	14,672						
Capital Employed	55,012	63,255	71,578	80,211	89,714						
Gross Fixed Assets	27,436	28,929	30,171	31,171	31,971						
Less: Depreciation	16,286	17,787	19,690	21,745	23,860						
Net Fixed Assets	11,150	11,142	10,481	9,426	8,111						
Capital WIP	84	242	0	0	0						
Investments	45,606	58,570	58,570	58,570	58,570						
Curr.Assets, L & Adv.	25,897	28,561	33,505	44,325	56,523						
Inventory	2,242	2,729	4,046	4,442	4,925						
Sundry Debtors	1,763	3,016	5,780	6,346	7,036						
Cash & Bank Balances	1,087	821	1,684	11,542	22,566						
Loans & Advances	20,120	21,274	21,274	21,274	21,274						
Others	685	721	721	721	721						
Current Liab. & Prov.	27,940	35,448	31,166	32,298	33,678						
Sundry Creditors	7,351	11,802	11,560	12,692	14,072						
Other Liabilities	499	487	494	494	494						
Provisions	20,089	23,159	19,112	19,112	19,112						
Net Current Assets	-2,042	-6,887	2,339	12,027	22,845						
Application of Funds	55,012	63,255	71,578	80,211	89,714						

E: Most Estimates

RATIOS					
Y/E MARCH	2005	2006	2007	2008E	2009E
Basic (Rs)					
EPS	75.8	111.0	127.1	130.3	143.9
EPS growth (%)	-0.9	46.5	14.5	2.6	10.4
Cash EPS	94.1	129.9	141.1	150.6	164.8
Book Value per Share	408.6	471.5	553.8	639.1	733.0
DPS	25	40	40	45	50
Payout (Incl. Div. Tax) %	33.0	40.5	36.8	39.7	40.0
Valuation (x)					
P/E		19.8	17.3	16.8	15.3
Cash P/E		16.9	15.6	14.6	13.3
EV/EBITDA		13.1	12.5	11.6	9.7
EV/Sales		2.4	1.9	1.6	1.4
Price to Book Value		4.7	4.0	3.4	3.0
Dividend Yield (%)		1.8	1.8	2.1	2.3
Profitability Ratios (%)					
RoE	19.3	23.6	22.9	20.4	19.6
RoCE	20.7	25.4	24.9	23.1	22.8
Leverage Ratio					
Debt/Equity (x)	0.3	0.3	0.3	0.2	0.2

CASH FLOW STATEMENT						(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E						
OP/(Loss) before Tax	7,280	11,653	12,255	12,280	13,872						
Interest/Div. Received	4,081	4,385	5,556	6,216	6,547						
Depreciation & Amort.	1,854	1,910	1,903	2,055	2,115						
Direct Taxes Paid	-3,026	-5,314	-4,901	-5,256	-5,804						
(Inc)/Dec in Working Capita	-395	4,579	-8,363	168	207						
CF from Oper. Activity	9,795	17,212	6,450	15,464	16,939						
Extra-ordinary Items	-490	-10	-486	0	0						
CF after EO Items	9,304	17,202	5,964	15,464	16,939						
(Inc)/Dec in FA+CWIP	-905	-2,033	-1,000	-1,000	-800						
(Pur)/Sale of Invest.	-7,051	-12,964	0	0	0						
CF from Inv. Activity	-7,956	-14,997	-1,000	-1,000	-800						
Inc. / Dec.in Networth	-731	-316	506	0	0						
Inc/(Dec) in Debt	2,213	2,402	0	0	0						
Interest Paid	-7	-3	-53	-53	-53						
Dividends Paid	-2,530	-4,553	-4,553	-4,553	-5,818						
CF from Fin. Activity	-1,055	-2,471	-4,101	-4,607	-5,871						
Inc/(Dec) in Cash	293	-266	863	9,858	10,268						
Add: Beginning Balance	794	1,087	821	1,684	11,542						
Closing Balance	1,087	821	1,684	11,542	21,810						

N O T E S



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Bajaj Auto

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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