

Bajaj Auto

STOCK INFO.	BLOOMBERG
BSE SENSEX: 10,293	BJA IN
	REUTERS CODE
S&P CNX: 3,008	BJAT.BO

17 July 2006

Buy
Previous Recommendation: Buy
Rs2,521

Equity Shares (m)	101.2
52-Week Range (Rs)	3,325/1,325
1,6,12 Rel.Perf.(%)	-9/16/37
M.Cap. (Rs b)	255.1
M.Cap. (US\$ b)	5.5

YEAR	NET SALES	Adj. PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/06A	76,679	11,243	108.9	40.8	23.2	5.3	23.6	25.4	2.8	15.5
3/07E	95,322	14,374	142.1	30.5	17.7	4.4	25.0	28.5	2.2	12.3
3/08E	116,343	17,709	175.0	23.2	14.4	3.7	25.5	30.1	1.7	9.4

- ⚡ Bajaj Auto (BAL) 1QFY07 operating performance inline with our expectations. Strong sales growth driven by strong volume growth and improved overall realization; EBITDA margin expansion by 60bp YoY. Lower other Income and higher tax outflow resulted in net profit growth of 27% YoY to Rs2.66b (below our expectation of Rs3.1b)
- ⚡ Sales grew 34.8% YoY at Rs22b on the back of 28% YoY volume growth and 5.3% YoY increase in realisation. Motorcycle volumes grew at 34% v/s industry growth of 24%. Within motorcycles, product mix improved with the economy segment contributing lower at 47.6% in 1QFY07 from 65.9% in 1QFY06. Three-wheeler volume growth improved to 33%.
- ⚡ Three-wheeler goods sales improved in 1QFY07 by posting 41% YoY (industry growth of 23%) growth after registering 9% YoY growth in FY06. This helped the company to improve share by 340bp to 27% in the quarter. Also, Bajaj is aggressively strengthening its position in the segment by rolling out exclusive new three-wheeler dealerships.
- ⚡ As a result of strong volume growth, improved product mix and falling employee cost to sales (3.9% in 1QFY07 v/s 4.5% in 1QFY06), EBITDA margins improved to 16.4%, an increase of 60bp YoY despite input cost pressure. Lower other income (2% YoY growth) at Rs946m and higher tax outflow resulted in lower-than-expected PAT at 27% to Rs2.7b.
- ⚡ We maintain our EPS estimate for FY07 at Rs142.4 (+30% YoY), and for FY08 at Rs175 (+22% YoY). BAL trades at 17.7x FY07E EPS and 14.4x FY08E EPS. We maintain **Buy** with our target price of Rs3,301 (upside 31%).

QUARTERLY PERFORMANCE

(Rs Million)

	FY06				FY07E				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Total Volumes (nos)	505,524	555,552	600,824	619,330	647,086	644,000	669,000	793,200	2,281,096	2,748,729
Change (%)	35.6	24.8	14.0	29.1	28.0	15.9	11.3	28.1	20.2	20.5
Net Sales	16,342	18,670	20,009	21,659	22,027	22,724	22,725	27,847	76,679	95,322
Change (%)	33.3	28.9	24.6	32.5	34.8	21.7	13.6	28.6	29.6	24.3
Total Cost	13,766	15,513	16,428	17,629	18,420	18,725	18,680	22,874	63,116	78,699
EBITDA	2,575	3,156	3,581	4,030	3,607	3,999	4,045	4,972	13,563	16,624
As % of Sales	15.8	16.9	17.9	18.6	16.4	17.6	17.8	17.9	17.7	17.4
Change (%)	39.6	31.8	48.5	62.3	40.1	26.7	13.0	23.4	48.5	22.6
Other Income	928	1,362	1,064	1,251	946	1,450	1,650	1,871	4,385	5,916
Interest	0.9	0.5	1.4	0.6	7.3	0.1	0.2	-4.0	3.4	3.6
Depreciation	462	490	491	468	481	495	500	526	1,910	2,003
Extraordinary Expenses (VRS)	-	-	108	119	-	-	-	-	226	-
PBT	3,040	4,028	4,045	4,694	3,960	4,954	5,195	6,321	15,808	20,534
Tax	950	1,120	1,245	1,476	1,300	1,500	1,500	1,860	4,791	6,160
Effective Tax Rate (%)	31.3	27.8	30.8	31.4	32.8	30.3	28.9	29.4	30.3	30.0
PAT	2,090	2,908	2,800	3,218	2,660	3,454	3,695	4,460	11,017	14,374
Adj. PAT	2,090	2,908	2,908	3,336	2,660	3,454	3,695	4,460	11,243	14,374
Change (%)	28.2	62.0	59.8	30.3	27.3	18.8	27.1	33.7	40.8	27.8

E: MOST Estimates

Volume growth led by motorcycles and 3- wheelers

In 1QFY07, Bajaj maintained its strong growth momentum led by motorcycles, which grew by 34% YoY. Also, product mix in the motorcycle segment improved in favor of the (executive + premium segments) contributing 52.4% in 1QFY07 v/s 34.1% in 1QFY06 and 54.7% in 4QFY06. Three-wheeler volumes also improved strongly to 35% YoY. Growth was derived from replacement sales of older petrol vehicles, which are being phased out in favor of LPG, CNG-powered vehicles. These environmental norms have been implemented in various cities such as Ahmedabad. Traditionally the three-wheeler market is a permit driven market, with sales being dependent on the new permits issued. However, this transition to alternate fuel vehicles due to regulatory norms will be the growth driver over the next 2-3 years.

VOLUME GROWTH MOMENTUM CONTINUES (UNITS NOS)

	1QFY07	1QFY06	% CH	4FY06	% CH
Motorcycles	568,187	422,543	34.5	533,018	6.6
Scooters	8,032	30,215	-73.4	13,540	-40.7
2-wheelers	576,219	452,758	27.3	546,558	5.4
3-wheelers	70,875	53,311	32.9	72,638	-2.4
Total	647,094	506,069	27.9	619,196	4.5

Source: Company / Motilal Oswal Securities

VOLUME BREAK-UP

	1QFY07	1QFY06	% CH
Motorcycle			
Domestic Sales	497,416	391,825	26.9
Exports	70,771	30,718	130.4
3-wheelers			
Passenger Carrier	33,834	29,272	15.6
Goods	9,955	7,058	41.0
Exports	27,086	16,981	59.5

Source: Company / Motilal Oswal Securities

Strong volume growth in motorcycles to sustain

BAL reported 32% volume growth in motorcycles in FY06; volumes grew 34% FY07YTD. New product launches along with the right strategy will help to sustain this growth. We hence expect 22% growth in FY07E and 20% in FY08E. BAL will also benefit from strong economic growth and expected surge in rural demand. Its market share has improved from 24% in FY04 to 31% in FY06 and we expect it to further increase in FY07. Our expected residual growth for 9MFY07 across the segment is:

RESIDUAL VOLUME GROWTH

	FY07	FY06	GR. (%)
YTD FY07 Total Volume	647,086	526,066	23.0
FY07 Estimates	2,748,729	2,281,096	20.5
Residual Growth Req. (%)			18.0
YTD FY07 - Motorcycles	568,187	422,543	34.5
FY07 Estimates	2,333,013	1,912,224	22.0
Residual Growth Req. (%)			18.0
YTD FY07 - Three wheelers	70,867	53,311	32.9
FY07 Estimates	284,821	252,006	13.0
Residual Growth Req. (%)			8.0

Source: Company / Motilal Oswal Securities

MARKET SHARE GAINS IN KEY SEGMENTS TO BE SUSTAINED (%)

	FY05	FY06	1QFY06	1QFY07
Motorcycle	27.1	30.1	30.0	30.9
3-Wheeler Passenger	72.2	66.4	68.7	62.4
3-Wheeler Goods	23.8	24.0	23.5	26.9

Source: Company / Motilal Oswal Securities

Net revenues up 35% YoY

On the back of strong volume growth of 28% YoY in 1QFY07, net revenues registered healthy 35% YoY growth. Revenue grew ahead of volume growth, mainly on account of richer product mix in the motorcycle segment and robust growth in 3-wheelers. Net realizations increased 5.3% YoY to Rs34,040.

PRODUCT MIX (%)

	1QFY07	1QFY06	DIFF.	4FY06	DIFF.
Entry-level	47.6	65.9	-18.3	45.2	2.4
Executive	33.3	12.9	20.4	35.3	-2.0
Premium	19.1	21.2	-2.1	19.4	-0.3

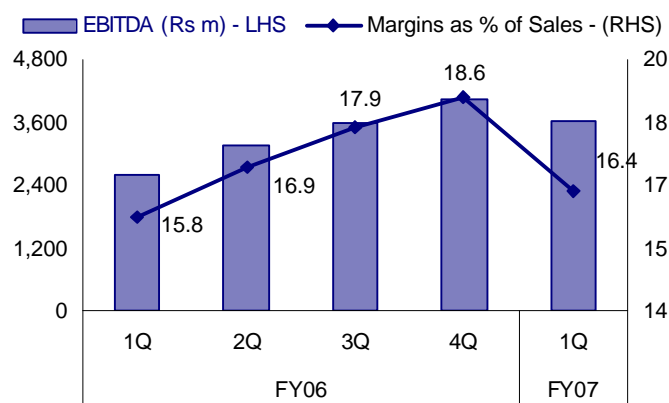
Source: Company / Motilal Oswal Securities

Operating performance in line with our expectation

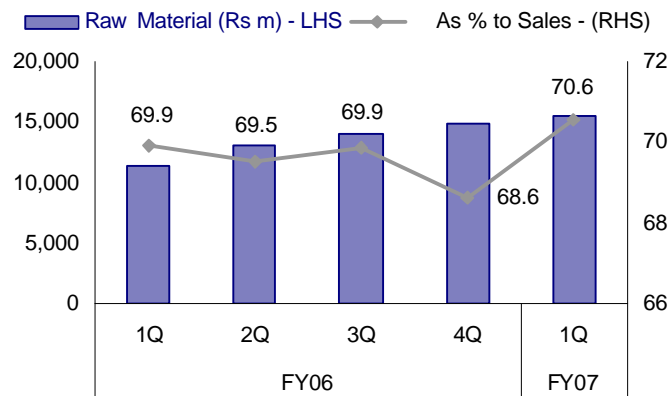
EBITDA margin at 16.4% improved by 60bp YoY and declined 220bp QoQ; this is in line with our expectations. Margin expansion is on account of improved product mix in the motorcycle segment in favor of high-end products as well as the strong volume growth in the 3-wheeler segment. The benefits of operating leverage and scale economics are clearly starting to benefit Bajaj now, particularly after its volumes have crossed the 2m mark. RM/sales increased to 70.6% in 1QFY07 from 69.9% in 1QFY06 and 68.6% in 4QFY06.

Other expenses decreased as a percentage of net sales to 9.5% in 1QFY07 from 10.2% in 1QFY06. Also, falling employee cost to sales (3.9% in 1QFY07 compared with 4.5% in 1QFY06) in the quarter helped the company offset raw material cost increases in the quarter.

EBITDA MARGINS



RAW MATERIAL TO SALES



Source: Company / Motilal Oswal Securities

Net profit growth at 27% is lower v/s EBITDA growth of 40%

Net profit registered growth of 27% to Rs2.7b, lower than our expectation of Rs3.1b for the quarter. The growth in the PAT is lower than EBITDA growth, mainly on account of lower other income at Rs946m (2% YoY growth) v/s our expectation of Rs1.2b and higher tax rate at 32.8% v/s our expectation of 28.1%.

Export strategy well planned –revenue guidance of 20% of sales over 3 years

In 1QFY07, exports grew by 95% YoY in volume terms and 100% YoY in value terms. Two-wheelers grew by 112%, while three-wheelers grew by 59%. Within two-wheelers, motorcycles account for over 95% of exports. Bajaj is the largest 2-wheeler and 3-wheeler exporters out of India.

EXPORT (UNITS)

	1QFY07	1QFY06	GR.(%)
Motorcycles	70,771	30,718	130
Total 2-W	71,177	33,512	112
Total 3-W	27,086	16,981	60
Total	169,034	81,211	108
Value (Rs m)	3,624	1,809	100

Source: Company/ Motilal Oswal Securities

We expect exports to gain momentum once its local assembly in Indonesia begins operations in 3QFY07. Also, the company is in process of setting up assembly lines in Nigeria. These markets would be large enough (approx. size 100,000-150,000 units) to aid Bajaj in improving its share going forward.

Bajaj’s largest export market is Sri Lanka — it has exported over 100,000 of its 2--wheeler and 3-wheeler products. We expect growth in this country to continue.

Bajaj is already a market leader in Central America, which comprises countries such as Columbia , Peru etc. Bajaj has a 50% share in this region. However, it does not have a presence in the large market of Argentina. It is considering a tie up with a local partner here. Bajaj has strong brand equity in Central America, which it will leverage to enter the Argentinian market. Export volumes reached 60,000 units in FY06 in Central America.

In Nigeria, Bajaj has already set up an assembly line to manufacture the Boxer 100cc bike. This bike will be used primarily for the taxi segment and will be more rugged than its Indian counterpart.

New product launches

The company plans to launch two new motorcycles and two ungeared scooters in 2HCY06. The new launch in motorcycle segment would include Pulsar DTSI with electronic fuel injection and Sonic-125cc motorcycle in the executive segment to support the success of Discover Twins. The strategy is well laid out to gain share in ungeared scooters with a couple of new model launches in the pipeline. Management does visualize good potential in the segment going forward. The two new scooters — Kristal and Blade would be launched in FY07. We do believe that its good products pipeline would supplement the success of its models in every segment of two-wheelers and help the company to improve its market to over 35% in the next few years.

Strong subsidiaries growth; outlook remains positive

Bajaj Auto Finance Limited

- ☞ The total disbursement increased by 48% to Rs5.7b in 1QFY07
- ☞ PAT is Rs34m versus Rs115m in 1QFY06. Lower on account of adjustment of prior period expenses and an additional tax provision.

Bajaj Allianz General Insurance Limited

- ☞ Recorded a gross premium of Rs4.5b in the quarter, growth of 42% YoY
- ☞ Net earned premium during the quarter is Rs1.9b, growth of 43%

Bajaj Allianz Life Insurance Limited

- ☞ Gross written premium for the quarter is Rs7.3b, growth of 205%
- ☞ Total number of policies issued during the quarter was 201,442 v/s 70,180 in 1QFY06

Valuation and view

We believe Bajaj Auto is one of the best plays on consumerism and improvement in rural demand. We maintain our EPS estimates for FY07 at Rs142.4 (+30% YoY), and for FY08 at Rs175 (+22% YoY). BAL trades at 17.7x FY07E EPS and 14.4x FY08E EPS. Our SOTP-based target price of Rs3,301 implies a 31% upside from the current levels. We maintain **Buy**.

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 increased its market share significantly in the motorcycle segment by 240bp in FY06.
- ✍ With a strong portfolio of motorcycles, we believe BAL will continue to benefit from the volume growth in the motorcycle industry.

Key investments risks

- ✍ Increasing competition in the executive segment where BAL is trying to gain a foothold with the 'Discover'.
- ✍ Any significant upmove in interest rates, leading to higher financing costs.
- ✍ Slowdown in three wheeler sales – BAL's cash cow business.

Recent developments

- ✍ BAL has launched a lower powered 110cc version of its 'Discover'.
- ✍ Competitors have launched several bikes in the 150cc premium segment and 100cc entry-level segment, both of which BAL is strong in.

Valuation and view

- ✍ We expect BAL to witness a 24% volume growth in motorcycles in FY07 leading to a sales growth of 24.9% at Rs93.3b.
- ✍ We maintain our FY07E EPS to Rs142.1 and FY08E EPS of Rs175.
- ✍ BAL trades at 17.7x FY07E EPS and 14.4x FY08E EPS. Our SOTP-based target price of Rs3,301 implies a 31% upside from the current levels. We maintain **Buy**.

Sector view

- ✍ Numerous motorcycle launches will lead to an increase in competition.
- ✍ Domestic two wheeler demand will continue to surpass estimates on the back of rural pull.
- ✍ Despite a large number of players, market share remains concentrated amongst the top two.
- ✍ We maintain an overweight stance on the sector.

COMPARATIVE VALUATIONS

		BAJAJ AUTO	HERO HONDA	TVS MOTOR
P/E (x)	FY07E	17.7	13.7	13.6
	FY07E	14.4	12.3	11.6
EPS Gr (%)	FY07E	30.5	6.4	30.1
	FY07E	23.2	11.2	17.7
RoE (%)	FY07E	25.0	39.2	17.7
	FY07E	25.5	35.0	18.5
EV/EBITDA (x)	FY07E	12.3	8.0	8.1
	FY07E	9.4	6.9	6.9

SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	29.8	29.8	29.8
Domestic Institutions	7.9	7.5	9.2
FII's/FDIs	22.3	22.7	20.4
Others	40.0	40.0	40.6

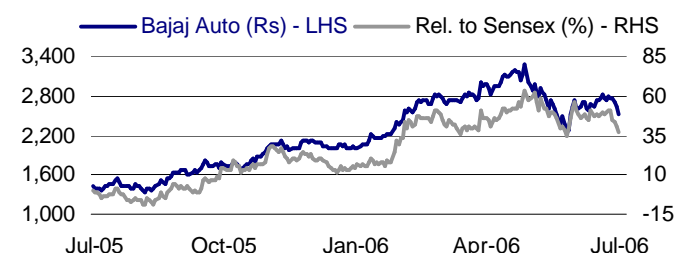
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	142.1	137.1	3.6
FY08	175.0	167.2	4.7

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
2,521	3,301	30.9	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Net Sales	47,552	57,240	74,694	93,256	114,070	
Change (%)	14.3	20.4	30.5	24.9	22.3	
Operating Other Income	1,616	1,907	1,985	2,066	2,273	
Total Income	49,168	59,147	76,679	95,322	116,343	
Total Expenditure	40,640	50,013	63,116	78,699	96,059	
Raw Material	31,992	40,897	53,246	65,433	79,831	
Employee Cost	2,405	2,491	2,741	3,009	3,671	
Other Mfg. Expenses	3,229	4,061	4,754	4,279	5,244	
Selling & Distribution	3,252	2,763	2,624	5,978	7,312	
EBITDA	8,528	9,134	13,563	16,624	20,284	
Change (%)	2.5	7.1	48.5	22.6	22.0	
% of Net Sales	17.3	15.4	17.7	17.4	17.4	
Depreciation	1,799	1,854	1,910	2,003	2,079	
Interest & Finance Charges	9	7	3	4	3	
Other Income	3,535	4,081	4,385	5,916	7,097	
Non-recurring Expense	650	490	226	0	0	
PBT	9,604	10,865	15,808	20,534	25,299	
Tax	2,289	3,196	4,791	6,160	7,590	
Effective Rate (%)	23.8	29.4	30.3	30.0	30.0	
PAT	7,315	7,668	11,017	14,374	17,709	
Adj. PAT	7,738	7,987	11,243	14,374	17,709	
Change (%)	43.8	3.2	40.8	27.8	23.2	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Share Capital	1,012	1,012	1,012	1,012	1,012	
Reserves	35,924	40,332	46,696	56,470	68,512	
Net Worth	36,936	41,343	47,707	57,481	69,524	
Deferred Tax	1,228	1,399	876	876	876	
Loans	10,057	12,270	14,672	13,672	13,672	
Capital Employed	48,222	55,012	63,255	72,029	84,071	
Gross Fixed Assets	27,030	27,436	28,929	30,171	31,171	
Less: Depreciation	14,967	16,286	17,787	19,790	21,868	
Net Fixed Assets	12,063	11,150	11,142	10,381	9,302	
Capital WIP	83	84	242	0	0	
Investments	38,554	45,606	58,570	58,570	58,570	
Curr. Assets, L & Adv.	20,530	25,897	28,561	38,241	53,973	
Inventory	2,026	2,242	2,729	4,094	5,008	
Sundry Debtors	1,339	1,763	3,016	5,849	7,155	
Cash & Bank Balances	794	1,087	821	6,303	19,815	
Loans & Advances	15,917	20,120	21,274	21,274	21,274	
Others	455	685	721	721	721	
Current Liab. & Prov.	23,261	27,940	35,448	35,351	37,962	
Sundry Creditors	6,232	7,351	11,802	11,698	14,309	
Other Liabilities	494	499	487	494	494	
Provisions	16,535	20,089	23,159	23,159	23,159	
Net Current Assets	-2,730	-2,042	-6,887	2,890	16,011	
Application of Funds	48,222	55,012	63,255	72,029	84,071	

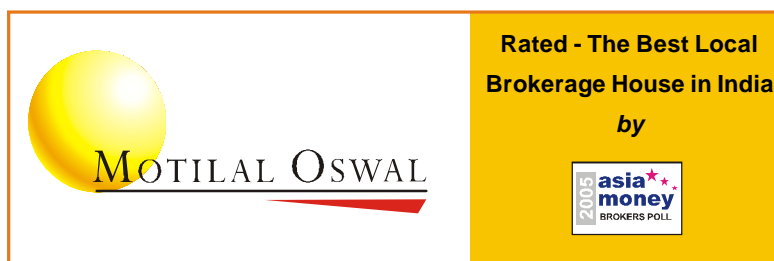
E: MOST Estimates

RATIOS						
Y/E MARCH	2004	2005	2006	2007E	2008E	
Basic (Rs)						
EPS	76.5	75.8	108.9	142.1	175.0	
Cash EPS	90.1	94.1	127.8	161.8	195.6	
Book Value per Share	365.0	408.6	471.5	568.1	687.1	
DPS	250	250	40	45	56	
Payout (Incl. Div. Tax) %	345.8	329.9	36.7	32.0	32.0	
Valuation (x)						
P/E		33.3	23.2	17.7	14.4	
Cash P/E		26.8	19.7	15.6	12.9	
EV/EBITDA		24.2	15.5	12.3	9.4	
EV/Sales		3.9	2.8	2.2	1.7	
Price to Book Value		6.2	5.3	4.4	3.7	
Dividend Yield (%)		9.9	16	18	2.2	
Profitability Ratios (%)						
RoE	20.9	19.3	23.6	25.0	25.5	
RoCE	21.3	20.7	25.4	28.5	30.1	
Turnover Ratios						
Debtors (Days)	9	10	13	20	20	
Inventory (Days)	18	16	16	19	19	
Creditors (Days)	71	66	81	65	65	
Asset Turnover (x)	10	10	12	13	14	
Leverage Ratio						
Debt/Equity (x)	0.3	0.3	0.3	0.2	0.2	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
OP/(Loss) before Tax	6,729	7,280	11,653	14,621	18,205	
Interest/Div. Received	3,535	4,081	4,385	5,916	7,097	
Depreciation & Amort.	1,799	1,854	1,910	2,003	2,079	
Direct Taxes Paid	-2,785	-3,026	-5,314	-6,160	-7,590	
(Inc)/Dec in Working Capita	5,368	-395	4,579	-4,295	392	
CF from Oper. Activity	14,646	9,795	17,212	12,085	20,185	
Extra-ordinary Items	-650	-490	-226	0	0	
CF after EO Items	13,996	9,304	16,986	12,085	20,185	
(Inc)/Dec in FA+CWIP	-1,107	-905	-2,033	-1,000	-1,000	
(Pur)/Sale of Invest.	-11,255	-7,051	-12,964	0	0	
CF from Inv. Activity	-12,363	-7,956	-14,997	-1,000	-1,000	
Inc./Dec. in Networth	22511	22035	-605	0	0	
Inc/(Dec) in Debt	1,655	2,213	2,402	-1,000	0	
Interest Paid	-9	-7	-3	-4	-3	
Dividends Paid	-25,296	-25,296	-4,047	-4,600	-5,667	
CF from Fin. Activity	-1,139	-1,055	-2,255	-5,603	-5,670	
Inc/(Dec) in Cash	493	293	-266	5,482	13,515	
Add: Beginning Balance	300	794	1,087	821	6,303	
Closing Balance	794	1,087	821	6,303	19,817	

E: MOST Estimates

N O T E S



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Bajaj Auto

- | | |
|---|----|
| 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 |

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.