May 25, 2009

India: Automobiles

Initiate on Indian 2-wheelers; Sell Bajaj Auto, Neutral Hero Honda

Initiate coverage: Defensive exposure, but well priced in

We initiate coverage on the Indian 2-wheeler automobile industry with a Neutral sector stance and 2 stocks representing 30% of Indian auto industry's market cap. We like the structurally under-penetrated nature of Indian market and the strong brand franchise of companies under coverage. However, given that valuations have already moved higher (stocks are up 100% on average ytd), risk/reward appears fairly balanced, in our view. The sector is currently trading at an average of 16X FY10E P/E, and offers 20% CAGR earnings growth over FY09E-FY11E. Our positive outlook on the sector is offset by financial market weakness and competitive headwinds, particularly in the premium segment of the market.

Exploring global and Indian industry themes

Themes explored in this report are: (1) oligopolistic nature of the 2-wheeler industry globally – implications for India; (2) structural reasons behind superior earnings growth and returns of Indian 2-wheeler companies; (3) sustainability of Hero Honda's dominant franchise; and (4) the position of stocks on P/B, CROCI, and DCF-based valuation metrics.

Bajaj Auto – Growth interrupted, rich valuations, Sell

We initiate coverage on Bajaj Auto (BAJA.BO) with a Sell rating and a 12-month FY11E P/E-based target price of Rs705 implying 25% potential downside. We believe that currently the market is overestimating the impact of new model launches on Bajaj Auto's market share and profitability over FY09E-FY11E. Intensifying competition and macroeconomic demand headwinds in the premium segment of the market are the catalysts likely to drive stock-price underperformance, in our view.

Hero Honda – Structural leader, fairly valued, Neutral

We initiate coverage on Hero Honda (HROH.BO) with a Neutral rating and a 12-month FY11E P/E-based target price of Rs1,399 implying 10% potential upside. We believe that Hero Honda's market leading growth and returns are already priced in at current levels; as a consequence, we would wait for a more attractive opportunity to gain exposure to this stock.

Risks

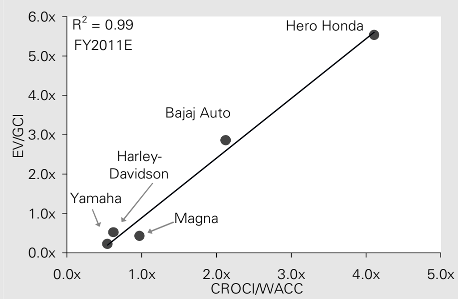
Key risks include: (1) Competitive pressure from operators such as Honda and Yamaha and (2) macroeconomic headwinds to demand growth.

SUMMARY RATINGS: INDIA 2-WHEELER AUTOMOBILE INDUSTRY

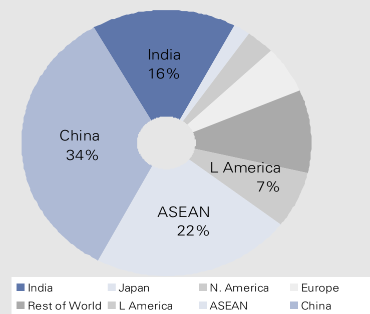
	Rating	Current Price (Rs)	12-month target price (Rs)	Potential upside / downside
Hero Honda	Neutral	1,268	1,399	10%
Bajaj Auto	Sell	934	705	-25%

Note: All target prices based on FY11E P/E.
Priced as at market close of May 21, 2009.

VALUATION VS RETURN MATRIX OF SELECT COMPARABLES



CHINA & INDIA ARE APPROX 50% OF GLOBAL 2-WHEELER MARKET (2007E)



Source: Company data, Datastream, Goldman Sachs Research estimates.

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The prices in the body of this report are based on the market close of May 21, 2009.

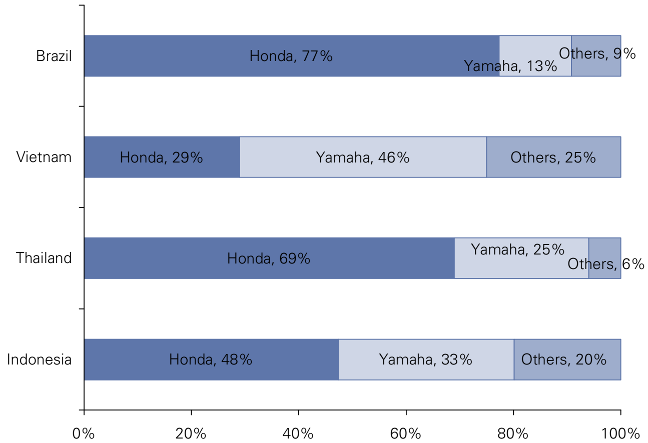
Oligopolistic competition and import barriers in India

The 2-wheeler industry operates as an oligopoly in most of the key emerging markets worldwide, including India. The Indian 2-wheeler market is also protected from imports by high tariffs and non-tariff barriers.

Most of the key 2-wheeler markets in emerging economies operate as an oligopoly with Honda and Yamaha being the dominant operators. We believe consumers in emerging markets tend to view a motorcycle as an asset rather than a consumption item. Dominant brands that command a higher resale value and offer consistently high fuel efficiency throughout the asset's operating life enjoy an advantage over smaller competitors and new entrants. This supports the oligopolistic nature of the industry, in our view.

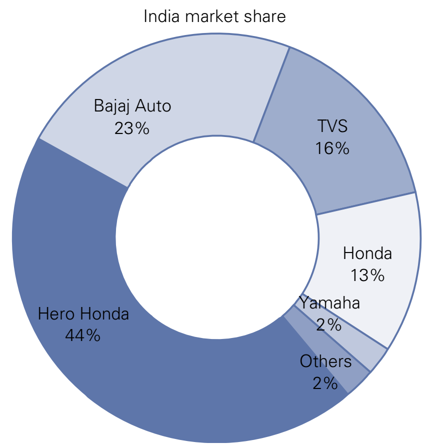
We believe India is no different in this regard, where Hero Honda and Bajaj Auto between them command 67% of the local 2-wheeler market, followed by limited market shares for TVS and Honda Motors. The Indian market is also protected to some extent by high tariffs (import duties exceeding 100%) and non-tariff barriers that restrict the supply of imported 2-wheelers into the country. Outdated documentation requirements and conditions such as imports being permitted only from the country of manufacture make it extremely difficult to legally import motorcycles into India.

Exhibit 1: Industry is an oligopoly in emerging markets
2007E market share in select 2-wheeler markets



Source: Bloomberg, ABRACICLO, Goldman Sachs Research estimates.

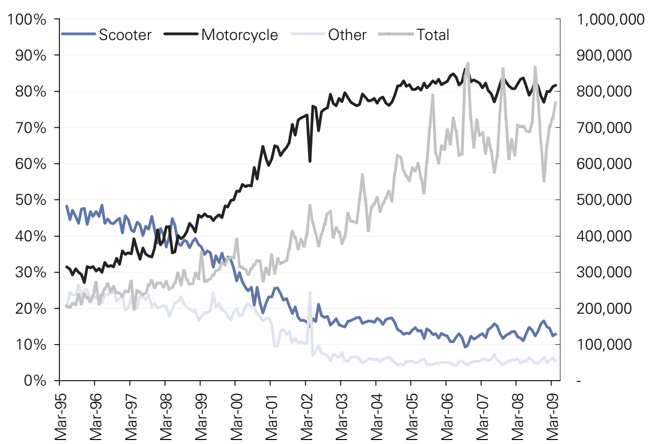
Exhibit 2: Similarly in India where incumbents dominate
FY09 market share in Indian 2-wheeler market



Source: Centre for Monitoring Indian Economy (CMIE).

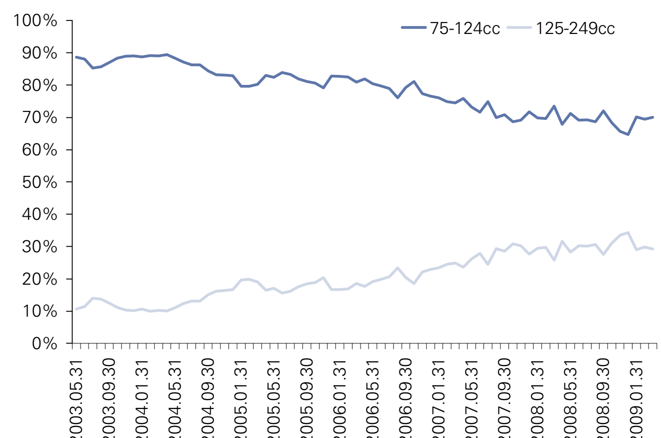
Much of the Indian 2-wheeler industry consists of motorcycles, which have gained market share over scooters during the past two decades primarily because of their relatively high fuel efficiency (Exhibit 3). Within motorcycles, the 75cc-125cc segment constitutes about 70% of the market (Exhibit 4), although the >125cc segment has been steadily gaining market share, which we believe was due to an aggressive focus by participants such as Bajaj Auto towards this segment. Participants commonly tend to segment the market in terms of price (Exhibit 5).

Exhibit 3: Motorcycles constitute most of the Indian 2-wheeler market
Volume share of motorcycles and scooters



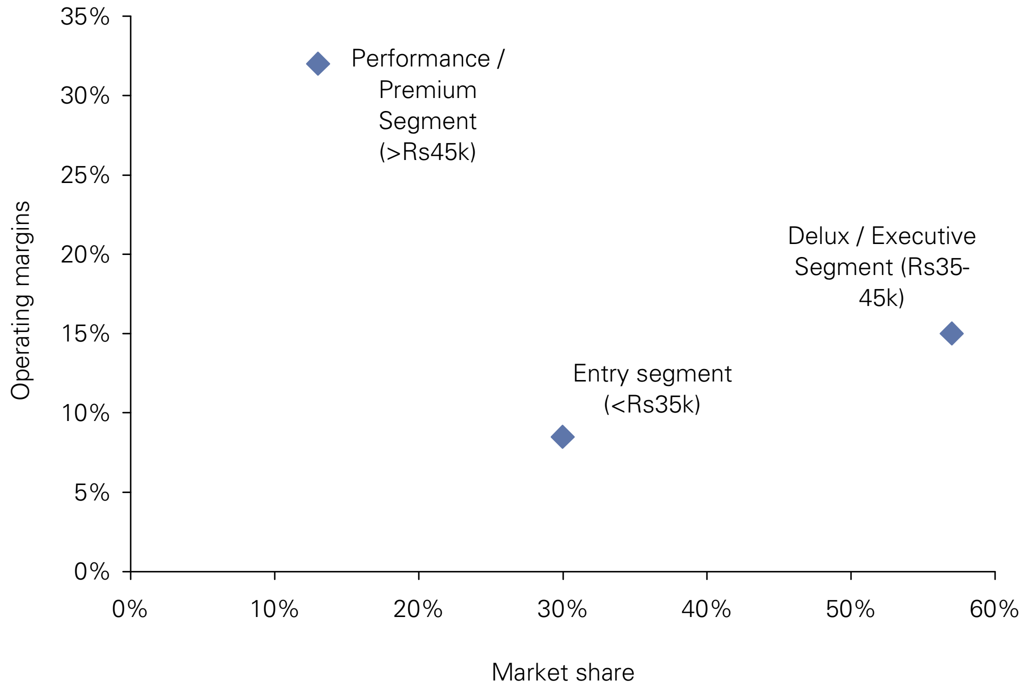
Source: CMIE, Society of Indian Automobile Manufacturers (SIAM).

Exhibit 4: <125cc segment constitutes most of the motorcycle market
Segment volume share in the motocycle market



Source: CMIE, SIAM.

Exhibit 5: Executive segment is the largest portion of the motorcycle market in India
Estimated market share of and operating margins in the three main price segments (indicative on-the-road price ranges)

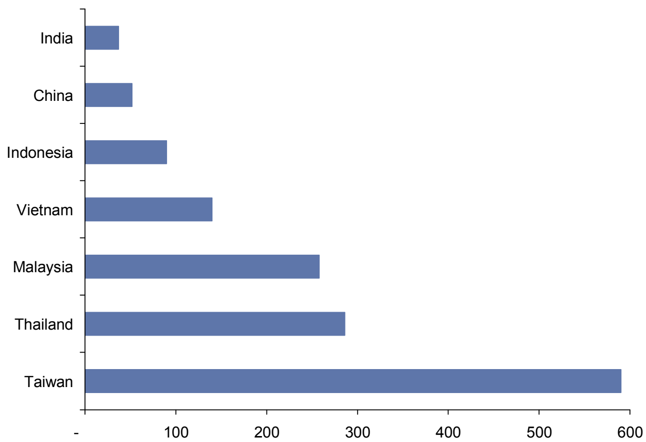


Source: Company data, Goldman Sachs Research estimates.

Low penetration rates may sustain growth over the long term

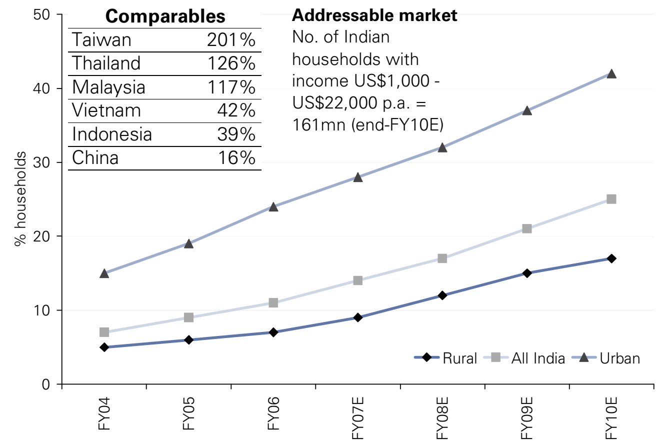
India has the lowest penetration rate of 2-wheelers among emerging economies on a per 1,000 inhabitants' basis. Even if we consider only the total addressable household market for 2-wheelers, the penetration level does not exceed 35%, which is among the lowest in Asian emerging economies. For this reason, we believe growth in the industry is likely to sustain its long-term growth trend rate of 10% CAGR. Over the medium term, however, we believe the industry is likely to grow at a slower rate due to macroeconomic headwinds and financial sector weakness.

Exhibit 6: India is among the most under-penetrated markets for 2-wheelers in Asian emerging markets
2-wheeler penetration per 1,000 inhabitants



Source: Company data, India Brand Equity Foundation (IBEF), Goldman Sachs Research.

Exhibit 7: 2-wheeler penetration in Indian households has the potential to rise further, in our view
Percentage of households with 2-wheeler ownership



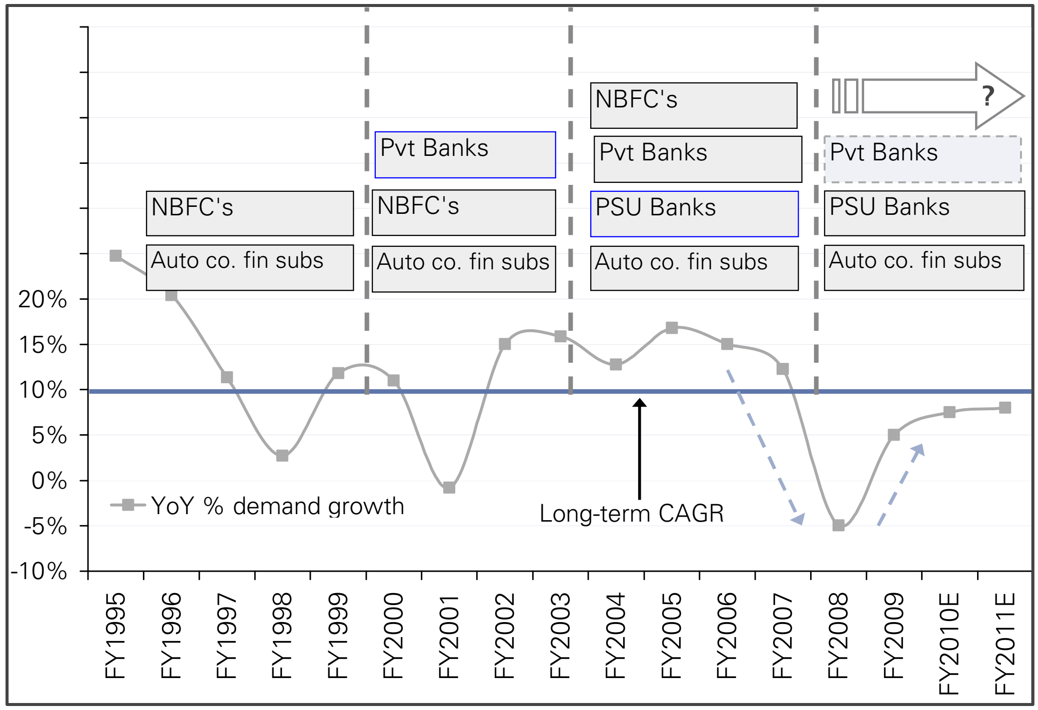
Source: Company data, National Council for Applied Economic Research (NCAER), India Brand Equity Foundation (IBEF), Goldman Sachs Research.

Trough in credit conditions – but improvement remains doubtful

We believe FY09 may have seen a cyclical trough in credit conditions with most categories of aggressive automotive financiers (such as ICICI Bank) already out of the market (Exhibit 8), and interest rates beginning to trend down during the year. Over the long run, we have observed a high inverse correlation between interest rates and 2-wheeler sales (Exhibits 9 and 10), and we believe it is only a matter of time before credit flows return to this sector. Over the near term, however, we believe there are a significant number of uncertainties in this regard, especially in relation to tighter credit standards and uncertainty over vehicle repossession procedures.

However, we believe that after -5% 2-wheeler demand growth in FY08, and a recovery in demand to +5% in FY09, we expect demand growth to pick up sequentially to 8% annual growth in FY10E-FY11E. This expectation hinges on: (1) The structurally under-penetrated nature of the Indian market and (2) our belief that credit conditions are not likely to worsen any further, as discussed above, and for natural demand growth to resume and sequentially improve over FY08-FY09.

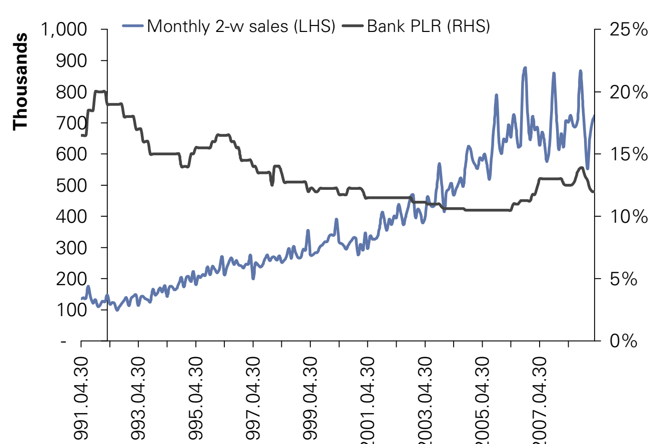
Exhibit 8: We believe credit conditions may have troughed in FY09, and growth is likely to pick up going forward over that experienced in FY08-FY09
Indian 2-wheeler demand growth, and evolution of the auto finance industry during this period



Note: We believe smaller NBFC's still finance 2-wheeler purchases but as a group they are not as aggressive as before. Private banks appear to have almost completely exited this business except for HDFC Bank, which still does financing for select brands, in our view.

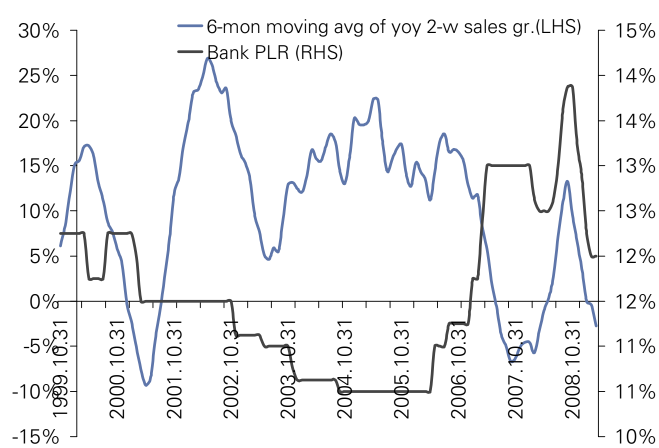
Source: SIAM, CMIE, Goldman Sachs Research estimates.

Exhibit 9: 2-wheeler sales are inversely correlated with interest rates over the long run...
Movement of monthly 2-wheeler sales and bank rates



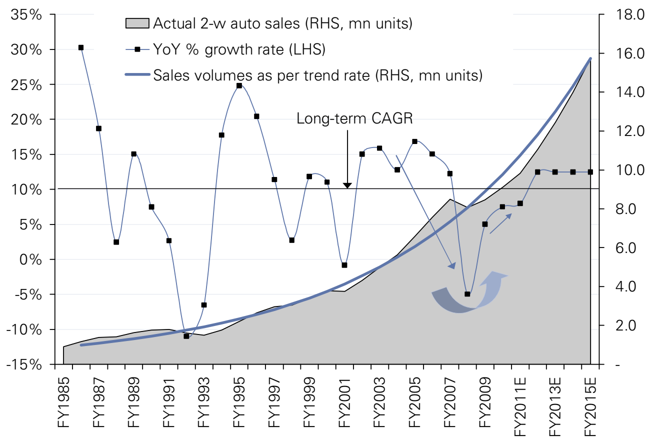
Source: CEIC, CMIE, SIAM.

Exhibit 10: ...similarly, over the medium term, 2-wheeler sales tend to rise with a fall in interest rates...
Movement of monthly 2-wheeler sales and bank rates



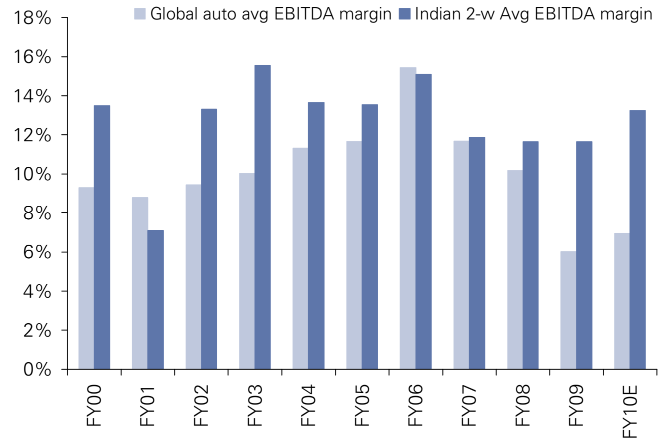
Source: CEIC, CMIE, SIAM.

Exhibit 11: …driving a modest pickup over FY09A-FY11E, and 10% long-term demand CAGR, in our view
2-wheeler demand growth rate



Source: CMIE, SIAM.

Exhibit 12: Operating margins have been higher relative to global comparables
EBITDA margins compared with global auto participants



Source: Company data, Goldman Sachs Research estimates.

Companies are well positioned for higher relative returns

Indian 2-wheeler auto companies have enjoyed superior earnings growth and cash returns on a historical and prospective basis relative to their global automotive peers (Exhibits 14 and 17) driven, in our view, by the following reasons:

(1) **Low market penetration** driving a long-term trend demand growth rate of 10% CAGR over the past 3 decades, as discussed in the previous section (Exhibits 7 and 11).

(2) **Pricing tends to be stickier** in the motorcycle business globally as compared with the broader automobile industry. This is exemplified by Yamaha's yoy pricing trend in developed markets, and by Hero Honda and Bajaj Auto's yoy pricing trends (net of excise) in India (Exhibit 13).

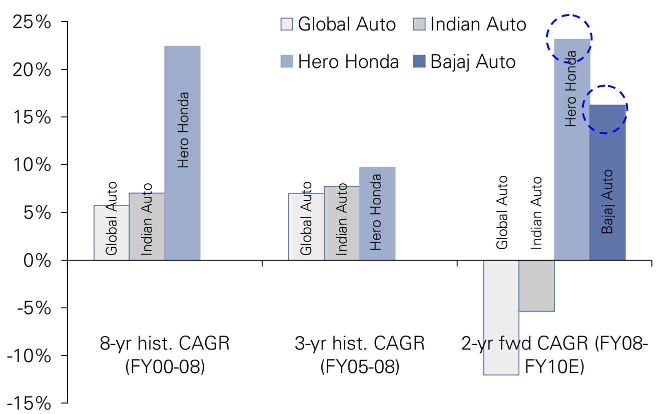
(3) **Indian 2-wheeler companies enjoy negative working capital** with sales to dealers on a cash basis, while vendors generally extend a 1-2 month credit period. As a result, on a relative basis, Indian 2-wheeler companies enjoy superior capital efficiencies than their global peers, in our view (Exhibits 15 and 16). This business model has come under pressure more recently due to current macroeconomic and financial sector weakness. Using their strong and cash-rich balance sheets, these operators have reportedly stepped in to support vendors under stress. However, we believe the practice of extending favorable credit terms to large 2-wheeler automotive manufacturers by vendors in India is unlikely to completely reverse over the long run, due to the fragmented nature and correspondingly low bargaining power enjoyed by the vendor base.

Exhibit 13: Pricing tends to be relatively stable in the motorcycle business
YoY change in realizations for Yamaha and Indian 2-wheeler manufacturers

Realizations (net) YoY	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Yamaha Japan	-19%	6%	4%	10%	-6%	-3%	9%	-3%	-5%	25%
Yamaha US	20%	6%	-3%	-7%	6%	9%	4%	11%	0%	2%
Yamaha EU	29%	9%	15%	4%	4%	2%	-4%	12%	-1%	-2%
Hero Honda India	0%	6%	4%	2%	-3%	-7%	0%	3%	2%	4%
Bajaj Auto India		5%	14%	6%	9%	9%	0%	4%	4%	4%

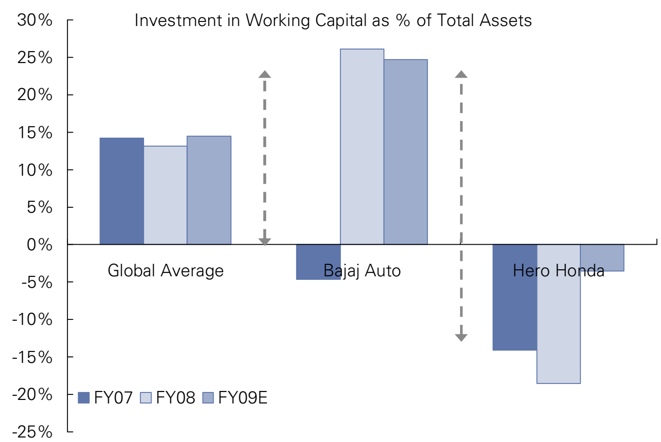
Source: Company data.

Exhibit 14: High earnings CAGR on a historical and prospective basis
EPS CAGR across time periods compared with the global average



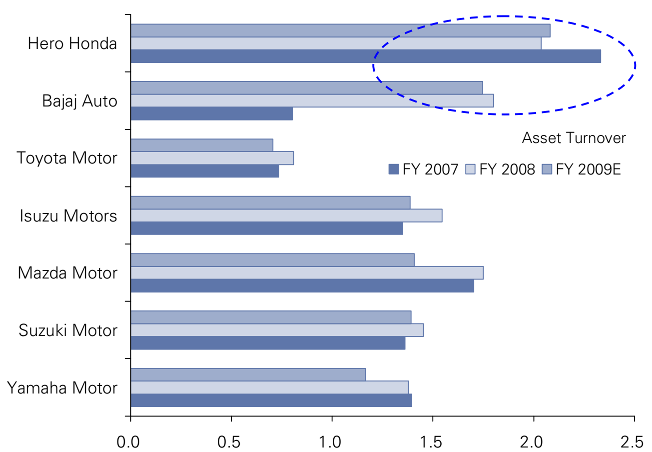
Source: Company data, Goldman Sachs Research estimates.

Exhibit 15: Negative working capital lowers investment in physical assets
Investment in working capital compared with the global average



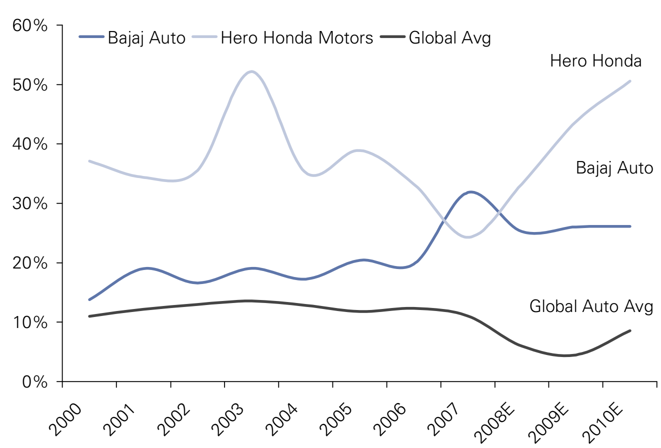
Source: Company data, Goldman Sachs Research estimates.

Exhibit 16: Asset light – high asset turnover helps generate higher returns
Asset turnover ratio compared with select global participants



Source: Company data, Goldman Sachs Research.

Exhibit 17: Higher cash returns relative to global comparables
Evolution of cash returns on capital invested (CROCI)

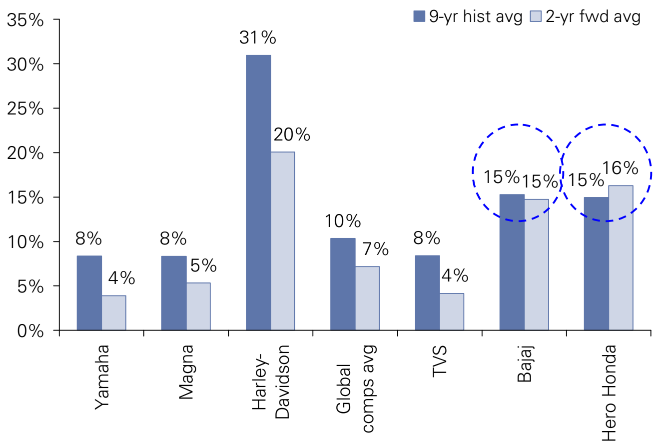


Source: Company data, Goldman Sachs Research.

Only a few 2-wheeler stocks in the global automotive industry

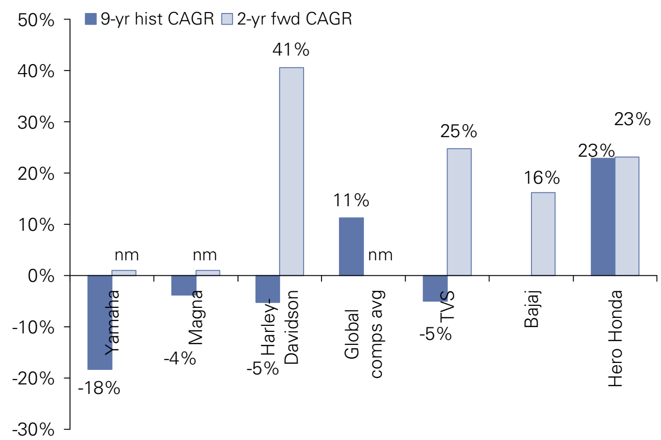
With the exception of Yamaha, Harley-Davidson, KTM Sports, Ducati, and TVS Motors, we believe there are only a few 2-wheeler comparables for stocks under our coverage. For the reasons discussed in the previous sections, Indian 2-wheeler companies have consistently enjoyed higher relative margins, earnings growth and returns on a historical and prospective basis even when compared with these direct comparables.

Exhibit 18: Hero Honda and Bajaj Auto have enjoyed consistently high margins…
EBITDA margins of select global comparables



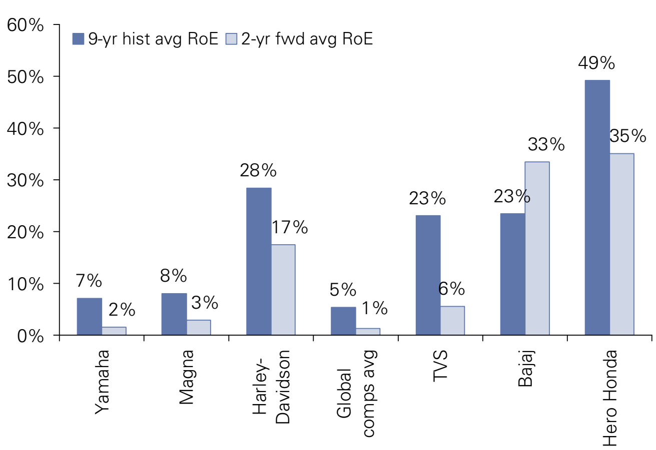
Source: Company data, Bloomberg, Goldman Sachs Research estimates.

Exhibit 19: …and a high earnings growth CAGR on a historical and forward looking basis…
Earnings CAGR of select global comparables



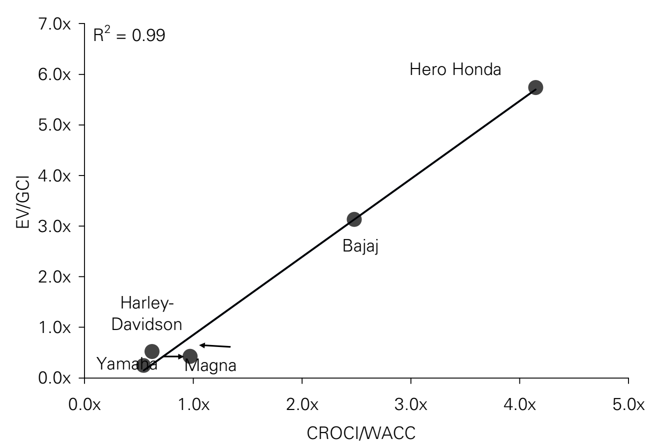
Source: Company data, Bloomberg, Goldman Sachs Research estimates.

Exhibit 20: …leading to consistently high returns over the long term
Average ROE of select global comparables



Source: Company data, Bloomberg, Goldman Sachs Research estimates.

Exhibit 21: Strong correlation with few direct comparables on a Director's Cut valuation
EV/GCI vs. CROCI/WACC for select comparables (FY10E)

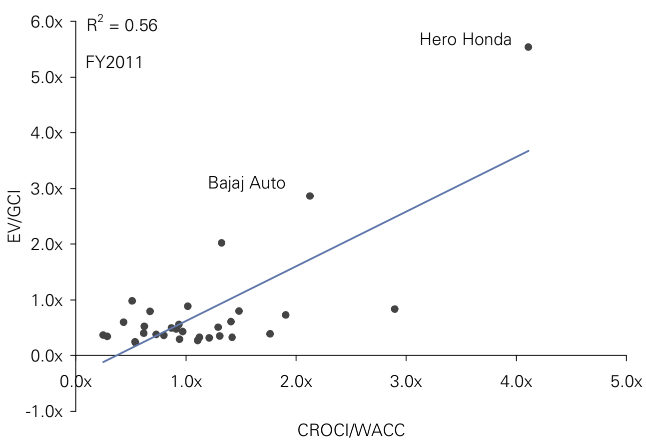


Source: Datastream, Goldman Sachs Research estimates.

Valuation premium vs. the broader automotive coverage group

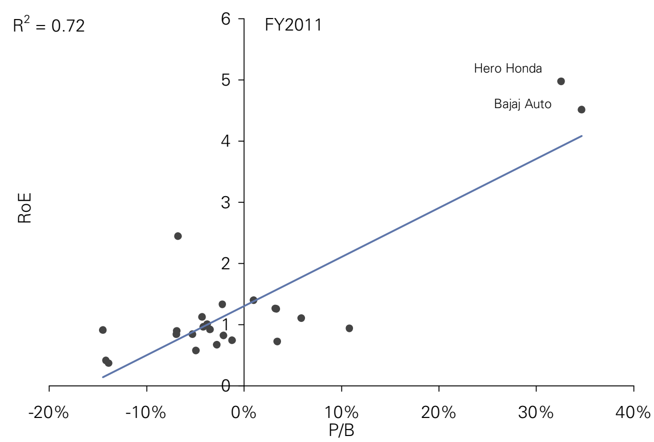
As a consequence of consistently high relative earnings growth and returns enjoyed by Indian 2-wheeler companies, these stocks have historically traded at a premium to global automotive comparables on a Director's Cut and P/B vs. ROE regression model basis.

Exhibit 22: Hero Honda and Bajaj Auto are trading at a premium to global automobile companies…
EV/GCI vs. CROCI/WACC chart for the global auto sector



Source: Datastream, Goldman Sachs Research estimates.

Exhibit 23: …similarly in the case of P/B vs. ROE regression
P/B vs. ROE chart for the global auto sector



Source: Datastream, Goldman Sachs Research estimates.

Exhibit 24: Global automobile sector comparables

Name	Ticker	GS Rating	Crncy	Price Date	Current Price	Mkt Cap (US $ Mn)	P/E (x) FY10E	P/E (x) FY11E	P/B (x) FY10E	P/B (x) FY11E	EV/EBITDA (x) FY10E	EV/EBITDA (x) FY11E	3-yr hist	ROE FY10E	ROE FY11E	EPS Growth FY10E	EPS Growth FY11E
Bajaj Auto	BAJA.BO	Sell	Rs	21-May-2009	934.2	2,846	17.2	15.3	5.9	5.0	10.4	9.3		38%	35%	20%	12%
Hero Honda Motors	HROH.BO	Neutral	Rs	21-May-2009	1,267.7	5,330	15.6	13.0	5.6	4.5	10.7	8.6	43%	39%	38%	26%	20%
India Regional Average						4,088	16.4	14.2	5.7	4.7	10.5	8.9	43%	38%	37%	23%	16%
Kia Motors	000270.KS	Sell	W	21-May-2009	12,450.0	3,455	79.7	22.8	0.8	0.7	10.8	10.3	1%	1%	3%	176%	250%
Hankook Tire	000240.KS	Neutral	W	21-May-2009	14,500.0	1,764	10.4	11.0	0.9	0.9	4.9	4.2	8%	10%	8%	3%	-6%
Hyundai Motor	005380.KS	Neutral	W	21-May-2009	66,700.0	11,612	14.5	12.4	0.7	0.7	8.8	8.3	8%	5%	5%	37%	16%
Hyundai Mobis	012330.KS	Neutral	W	21-May-2009	113,500.0	7,925	8.9	8.7	1.4	1.2	7.2	6.5	22%	17%	15%	16%	2%
Korean Sector Average						6,189	28.4	13.7	1.0	0.9	7.9	7.3	10%	8%	8%	58%	66%
UAZ	UAZAI.RTS	Neutral	$	20-May-2009	0.1	458	10.6	10.6	1.1	1.0	6.2	5.4	15%	11%	10%	45%	0%
Volvo	VOLVb.ST	Sell	Skr	20-May-2009	52.3	14,017	57.3	15.7	1.4	1.3	7.9	5.3	16%	2%	8%	135%	265%
Scania	SCVb.ST	Sell	Skr	20-May-2009	81.3	8,542	36.4	18.4	2.9	2.5	10.6	7.5	32%	8%	15%	-4%	98%
Renault	RENA.PA	Sell	€	20-May-2009	25.8	10,148			0.4	0.4	15.9	10.5	10%	-5%	-1%	53%	69%
BMW	BMWG.DE	Buy*	€	20-May-2009	26.0	22,752	21.9	9.5	0.8	0.8	2.8	2.0	11%	4%	8%	225%	129%
Porsche (pref)	PSHG_p.DE	Buy	€	20-May-2009	44.9	10,832	10.8	7.0	0.4	0.4	7.8	5.6	45%	4%	6%	-8%	56%
Peugeot	PEUP.PA	Sell	€	20-May-2009	18.7	6,060		15.1	0.4	0.4	3.7	2.6	2%	-6%	2%	44%	139%
MAN AG	MANG.DE	Sell	€	20-May-2009	46.4	9,405	34.3	16.3	1.2	1.2	12.6	7.6	23%	4%	7%	-44%	111%
Daimler AG	DAIGn.DE	Buy*	€	20-May-2009	26.6	37,506	20.4	8.9	0.8	0.8	4.7	3.2	9%	4%	9%	215%	129%
European Regional Average						13,291	33.0	13.0	1.0	1.0	7.6	5.3	18%	3%	7%	81%	137%
Yamaha Motor	7272.T	Sell	¥	21-May-2009	1,069.0	3,210		19.9	0.9	0.9	11.8	8.6	11%	-1%	4%	94%	516%
Toyota Motor	7203.T	Buy*	¥	21-May-2009	3,650.0	132,003	85.4	13.2	1.1	1.1	12.2	7.1	14%	1%	8%	131%	549%
Suzuki Motor	7269.T	Neutral	¥	21-May-2009	2,100.0	11,953	31.1	19.6	1.3	1.3	6.9	6.2	10%	4%	6%	10%	59%
Nissan Motor	7201.T	Neutral	¥	21-May-2009	559.0	26,506		39.9	0.9	0.9	11.6	6.8	15%	-4%	2%	46%	145%
Mazda Motor	7261.T	Neutral	¥	21-May-2009	241.0	3,586		52.7	0.8	0.8	16.9	12.1	18%	-8%	2%	56%	120%
Isuzu Motors	7202.T	Neutral	¥	21-May-2009	161.0	2,863		18.8	1.0	1.0	21.3	9.2	36%	-9%	5%	-2%	153%
Honda Motor	7267.T	Buy	¥	21-May-2009	2,645.0	50,903	8.0	35.0	1.2	1.1	8.4	4.0	14%	3%	11%	-20%	247%
Hino Motors	7205.T	Sell	¥	21-May-2009	294.0	1,769			1.0	1.0	10.4	7.3	9%	-10%	0%	70%	104%
Daihatsu Motor	7262.T	Buy*	¥	21-May-2009	921.0	4,126	18.4	12.7	1.1	1.1	4.4	3.9	11%	6%	8%	-4%	46%
Fuji Heavy Industries	7270.T	Neutral	¥	21-May-2009	365.0	2,997		89.5	0.8	0.8	21.4	8.5	5%	-11%	1%	42%	108%
Japan Regional Average						23,992	35.7	33.5	1.0	1.0	12.5	7.4	14%	-3%	5%	42%	205%
TRW Automotive Holding Corp.	TRW	Neutral	$	20-May-2009	8.5	858		10.8	1.2	1.2	4.6	3.7	10%	-1%	9%	96%	736%
The Goodyear Tire & Rubber Co.	GT	Neutral	$	20-May-2009	11.8	2,844	8.9	6.4	2.4	1.8	4.2	3.6		20%	22%	382%	40%
Magna International, Inc.	MGA	Sell	$	20-May-2009	32.1	3,589	40.0	11.9	0.5	0.5	2.6	1.7	8%	1%	4%	125%	236%
Harley-Davidson, Inc.	HOG	Sell	$	20-May-2009	17.5	4,074	9.3	7.3	1.5	1.3	9.2	7.1	34%	17%	20%	54%	29%
Johnson Controls, Inc.	JCI	Neutral	$	20-May-2009	19.9	11,803	25.5	15.4	1.5	1.4	9.8	7.5	16%	6%	9%	471%	66%
General Motors Corp.	GM	Rating Su:	$	20-May-2009	1.5	886					13.7	6.7		5%	1%	71%	78%
Ford Motor Company	F	Buy*	$	20-May-2009	5.4	12,968		6.8			3.8	2.9		1%	-10%	96%	947%
Federal Mogul Corp.	FDML	Buy	$	20-May-2009	8.6	852	13.4	7.8	1.0	0.9	4.7	3.9		8%	13%	266%	70%
Americas Regional Average						4,734	19.4	9.5	1.4	1.2	6.6	4.6	17%	7%	9%	180%	238%
Global Automobiles Sector Average						13,048	28.3	18.3	1.4	1.2	9.0	6.2	16%	5%	9%	90%	174%

*Denotes the stock is on our Conviction List. For important disclosures, please go to http://www.gs.com/research/hedge.html.

Source: Datastream, Goldman Sachs Research estimates.

Valuation methodology. We value Indian 2-wheeler stocks using FY11E P/E. Our target P/E multiple is arrived at using a 2-year EPS CAGR vs. P/E multiple model, as we have found a high historical correlation between P/E multiples and earnings growth for Hero Honda (for which reliable stock trading history is available). We cross-check our valuation using a Director's Cut, DCF and P/B valuation methodology. Our valuation methodology is explained in greater detail in the company valuation section on Hero Honda.

Hero Honda Motors (HROH.BO): Structural leader, fairly valued

Investment thesis: Neutral

We initiate coverage on Hero Honda Motors with a Neutral rating. Our 12-month FY11E P/E-based target price of Rs1,399 implies 10% potential upside.

We believe Hero Honda's market leadership and strong brand equity in the lower- to mid-price segment suggests:

(1) **A defensive market position** that could potentially withstand macroeconomic headwinds. Hero Honda enjoys a strong franchise in the lower- and mid-price segment, and has consistently gained market share from its competitors over the past decade.

(2) **Increase in market share in an under-penetrated market.** We believe that the 2-wheeler industry demand growth rate is likely to trend higher in FY10E at 8% vs. 5% demand growth in FY09. Hero Honda is likely to improve its market position further as it will face few challenges in the economy and executive segments of the market, in our view. We expect Hero Honda to deliver 15% volume growth in FY10E compared with the 11.5% it delivered in FY09.

(3) **Structural downward shift in raw material costs.** Is likely to be positive for Hero Honda owing to its relatively stable pricing in the motorcycle business, particularly considering the premium enjoyed by the company's products in the market. Excise duty and tax benefits on output from its Haridwar plant will further boost earnings in the medium term, in our view.

Our view on the stock is tempered by its valuations, which appear to price in most of these positives.

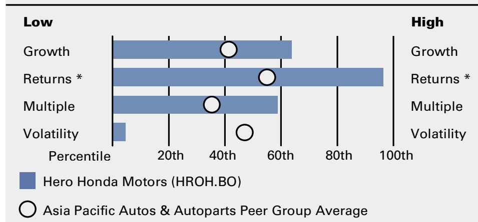
Valuation

The stock is currently trading at 15.6X FY10E P/E, which is between its mid- and peak-cycle valuations. We estimate 23% EPS CAGR over FY09E-FY11E, and an average ROE of 35% during FY10E-FY11E.

Key risks

The key upside risk to our target price and investment view includes stronger-than-expected pricing resilience leading to a higher-than-expected improvement in margins. Key downside risks include: (1) Higher-than-anticipated success of competitors in positioning a product in the economy and mid-price segments, particularly Bajaj Auto's new product launch in July; (2) financial sector weakness affecting vendors'/dealers' ability to extend favorable working capital terms; and (3) macroeconomic headwinds to demand.

Investment Profile

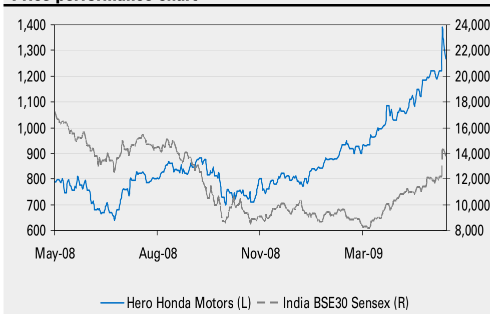


* Returns = Return on Capital. For a complete description of the investment profile measures please refer to the disclosure section of this document.

Key data	Current
Price (Rs)	1,267.70
12 month price target (Rs)	1,399.00
Market cap (Rs mn / US$ mn)	253,143.8 / 5,330.2
Foreign ownership (%)	30.6

	3/08	3/09E	3/10E	3/11E
EPS (Rs)	48.47	64.21	81.18	97.36
EPS growth (%)	12.8	32.5	26.4	19.9
EPS (diluted) (Rs)	48.47	64.21	81.18	97.36
EPS (basic pre-ex) (Rs)	48.47	64.21	81.18	97.36
P/E (X)	26.2	19.7	15.6	13.0
P/B (X)	8.5	6.9	5.6	4.5
EV/EBITDA (X)	10.0	14.0	10.7	8.6
Dividend yield (%)	1.5	2.0	2.5	3.0
ROE (%)	35.5	38.5	39.4	38.2

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	38.2	78.4	60.7
Rel. to India BSE30 Sensex	(11.0)	15.8	101.8

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 5/21/2009 close.

Exhibit 25: Hero Honda Motors: Summary financials

Profit model (Rs mn)	3/08	3/09E	3/10E	3/11E
Total revenue	**103,318.0**	**123,191.3**	**139,766.8**	**155,291.1**
Cost of goods sold	(77,258.9)	(90,754.3)	(101,170.0)	(109,078.8)
SG&A	(11,101.5)	(14,042.2)	(15,711.0)	(18,749.7)
R&D	0.0	0.0	0.0	0.0
Other operating profit/(expense)	(2,739.7)	(2,702.2)	(2,961.8)	(3,550.5)
EBITDA	**13,821.1**	**17,499.2**	**21,987.4**	**26,132.6**
Depreciation & amortization	(1,603.2)	(1,806.6)	(2,063.3)	(2,220.6)
EBIT	**12,217.9**	**15,692.6**	**19,924.1**	**23,912.0**
Interest income	358.1	316.8	721.7	721.7
Interest expense	--	--	--	--
Income/(loss) from uncons. subs.	0.0	0.0	0.0	0.0
Others	1,526.8	1,809.2	1,561.0	1,997.2
Pretax profits	**14,102.8**	**17,818.6**	**22,206.8**	**26,630.9**
Income tax	(4,424.0)	(4,997.0)	(5,995.8)	(7,190.4)
Minorities	0.0	0.0	0.0	0.0
Net income pre-preferred dividends	**9,678.8**	**12,821.6**	**16,211.0**	**19,440.6**
Preferred dividends	0.0	0.0	0.0	0.0
Net income (pre-exceptionals)	**9,678.8**	**12,821.6**	**16,211.0**	**19,440.6**
Post-tax exceptionals	0.0	0.0	0.0	0.0
Net income	**9,678.8**	**12,821.6**	**16,211.0**	**19,440.6**
EPS (basic, pre-except) (Rs)	48.47	64.21	81.18	97.36
EPS (basic, post-except) (Rs)	48.47	64.21	81.18	97.36
EPS (diluted, post-except) (Rs)	48.47	64.21	81.18	97.36
DPS (Rs)	19.00	25.17	31.82	38.16
Dividend payout ratio (%)	39.2	39.2	39.2	39.2
Free cash flow yield (%)	6.6	5.5	7.0	8.3

Growth & margins (%)	3/08	3/09E	3/10E	3/11E
Sales growth	4.4	19.2	13.5	11.1
EBITDA growth	14.2	26.6	25.6	18.9
EBIT growth	14.2	28.4	27.0	20.0
Net income growth	12.8	32.5	26.4	19.9
EPS growth	12.8	32.5	26.4	19.9
Gross margin	25.2	26.3	27.6	29.8
EBITDA margin	13.4	14.2	15.7	16.8
EBIT margin	11.8	12.7	14.3	15.4

Cash flow statement (Rs mn)	3/08	3/09E	3/10E	3/11E
Net income pre-preferred dividends	9,678.8	12,821.6	16,211.0	19,440.6
D&A add-back	1,603.2	1,806.6	2,063.3	2,220.6
Minorities interests add-back	0.0	0.0	0.0	0.0
Net (inc)/dec working capital	4,173.8	381.6	352.7	406.1
Other operating cash flow	(2,872.7)	0.0	0.0	0.0
Cash flow from operations	**12,583.1**	**15,009.7**	**18,627.1**	**22,067.3**
Capital expenditures	(3,738.9)	(1,418.7)	(1,500.0)	(1,700.0)
Acquisitions	0.0	0.0	0.0	0.0
Divestitures	0.0	0.0	0.0	0.0
Others	(4,556.5)	0.0	0.0	0.0
Cash flow from investments	**(8,295.4)**	**(1,418.7)**	**(1,500.0)**	**(1,700.0)**
Dividends paid (common & pref)	(3,394.7)	(5,880.2)	(7,434.7)	(8,915.9)
Inc/(dec) in debt	331.7	0.0	0.0	0.0
Common stock issuance (repurchase)	0.0	0.0	0.0	0.0
Other financing cash flows	(271.6)	0.0	0.0	0.0
Cash flow from financing	**(3,334.6)**	**(5,880.2)**	**(7,434.7)**	**(8,915.9)**
Total cash flow	**953.1**	**7,710.8**	**9,692.4**	**11,451.5**

Balance sheet (Rs mn)	3/08	3/09E	3/10E	3/11E
Cash & equivalents	1,310.9	9,021.7	18,714.1	30,165.5
Accounts receivable	2,974.4	3,546.5	4,023.7	4,470.6
Inventory	3,171.0	3,724.9	4,152.4	4,477.0
Other current assets	1,911.5	1,911.5	1,911.5	1,911.5
Total current assets	**9,367.8**	**18,204.6**	**28,801.7**	**41,024.7**
Net PP&E	15,487.0	15,099.1	14,535.7	14,015.1
Net intangibles	212.7	212.7	212.7	212.7
Total investments	25,668.2	25,668.2	25,668.2	25,668.2
Other long-term assets	0.0	0.0	0.0	0.0
Total assets	**50,735.7**	**59,184.6**	**69,218.3**	**80,920.7**
Accounts payable	7,837.7	9,345.3	10,602.7	11,780.4
Short-term debt	535.1	535.1	535.1	535.1
Other current liabilities	10,409.7	10,409.7	10,409.7	10,409.7
Total current liabilities	**18,782.5**	**20,290.1**	**21,547.5**	**22,725.2**
Long-term debt	784.9	784.9	784.9	784.9
Other long-term liabilities	1,305.9	1,305.9	1,305.9	1,305.9
Total long-term liabilities	2,090.8	2,090.8	2,090.8	2,090.8
Total liabilities	**20,873.3**	**22,380.9**	**23,638.3**	**24,816.0**
Preferred shares	**0.0**	**0.0**	**0.0**	**0.0**
Total common equity	**29,862.4**	**36,803.7**	**45,580.0**	**56,104.8**
Minority interest	0.0	0.0	0.0	0.0
Total liabilities & equity	**50,735.7**	**59,184.6**	**69,218.3**	**80,920.7**
BVPS (Rs)	**149.55**	**184.31**	**228.26**	**280.96**

Ratios	3/08	3/09E	3/10E	3/11E
ROE (%)	35.5	38.5	39.4	38.2
ROA (%)	20.8	23.3	25.3	25.9
ROACE (%)	33.8	42.7	54.8	68.2
Inventory days	14.0	13.9	14.2	14.4
Receivables days	11.2	9.7	9.9	10.0
Payable days	32.2	34.6	36.0	37.4
Net debt/equity (%)	0.0	(20.9)	(38.2)	(51.4)
Interest cover - EBIT (X)	NM	NM	NM	NM

Valuation	3/08	3/09E	3/10E	3/11E
P/E (analyst) (X)	26.2	19.7	15.6	13.0
P/B (X)	8.5	6.9	5.6	4.5
EV/EBITDA (X)	10.0	14.0	10.7	8.6
Dividend yield (%)	1.5	2.0	2.5	3.0

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

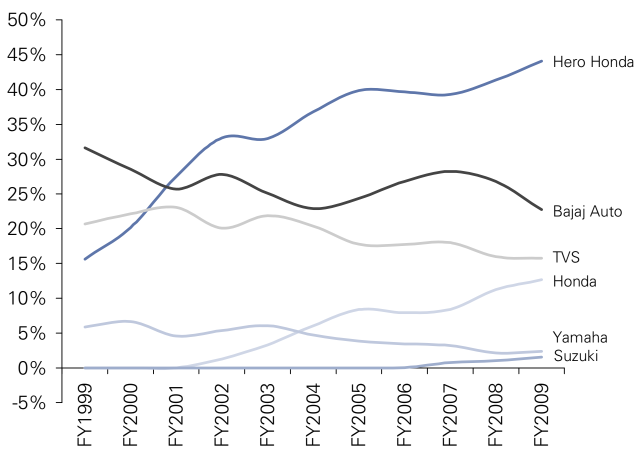
Strong market franchise: "Sustainable moat around the castle"?

Hero Honda has consistently enjoyed superior earnings growth, capital efficiencies and returns relative to its peers over the past two decades, based on our analysis. Hero Honda has continued to gain market share over its competitors since 2001, despite new model launches by its competitors and new entrants to the market every few years (Exhibit 26).

Hero Honda's brand name has grown stronger over the years. According to MRUC Hansa Research, in 2000 in the motorcycle space two of the top five brands belonged to Hero Honda in terms of household penetration. These were CD100 and Splendour. In 2005, Hero Honda increased this to three out of the top five brands, and these were Splendour, CD100/Dawn and Passion. Since 2005 (the last year for which Hansa Research data is available), Hero Honda has only managed to increase its market share by a further four percentage points (Exhibit 26).

Exhibit 26: Hero Honda continues to gain market share over time…

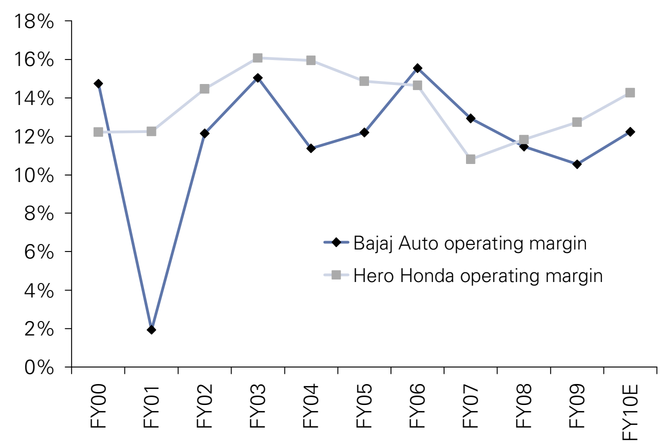
Annual market share in Indian 2-wheeler market



Source: SIAM, CMIE.

Exhibit 27: …even while improving margins relative to its peers

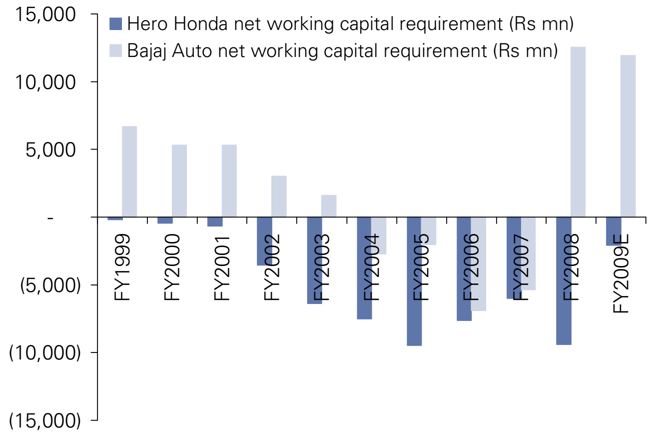
Hero Honda and Bajaj Auto EBITDA margin



Source: Company data, Goldman Sachs Research estimates.

Exhibit 28: Hero Honda's more favorable working capital terms

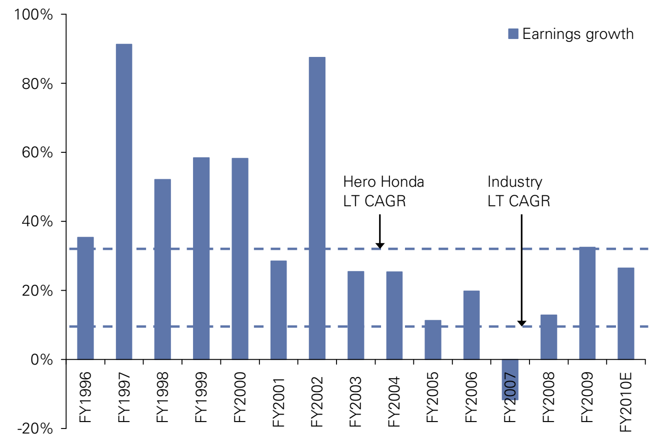
Hero Honda and Bajaj Auto net working capital requirement



Source: Company data, Goldman Sachs Research estimates.

Exhibit 29: Hero Honda's earnings have grown faster than the industry

Hero Honda's yoy % annual earnings growth



Source: Company data, Goldman Sachs Research estimates.

We believe there are structural reasons behind Hero Honda's sustained dominance in the Indian 2-wheeler market.

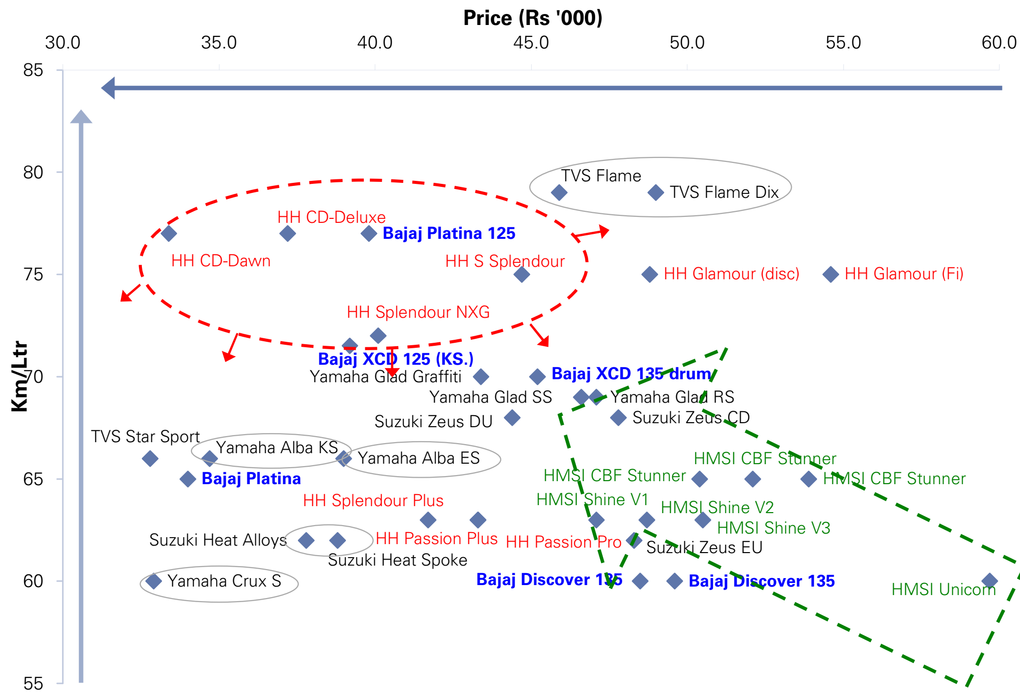
Hero Honda's products fare well on pricing and fuel efficiency parameters, in our view (Exhibit 30). These are perhaps the two most important variables consumers in emerging markets consider when making purchasing decisions, in our view. Consistent performance in relation to fuel efficiency over the years adds to the vehicle's resale value, leading to an increase in brand equity and greater pricing stability for the manufacturer.

The nature of this industry supports oligopolies, in our view. As discussed earlier in this report, we have observed that in key emerging markets in the world, early entrant motorcycle brands that offer consistently high fuel efficiency enjoy an advantage over smaller competitors and new entrants. This supports the oligopolistic nature of this industry, as it makes it difficult for newcomers to successfully challenge incumbents over the medium term, in our view.

New product launches by competitors in the economy and executive segments have so far been ineffective, in our view. While competitors have attempted to launch models in the economy and executive segments, we believe most have failed either because of pricing, fuel efficiency or promotional efforts during the marketing of the product. We believe that Bajaj Auto (the second-largest incumbent in this market) is the only competitor that has so far met with limited success in taking market share from Hero Honda in these segments, even though like other competitors, the company has reduced its focus on these segments due to insufficient demand for its products.

Hero Honda's management has been fairly successful on a range of softer business issues, in our view. It is widely acknowledged that Hero Honda has a strong relationship with its vendors, dealers and a successful customer relationship management program across its vast consumer base. This has resulted in a self-reinforcing loop that is difficult to replicate, in our view, with the high brand equity of its products and strong relationships feeding into each other (Exhibit 32).

Exhibit 30: What matters most to consumers is price, fuel efficiency, and resale value
Price vs. fuel efficiency matrix for Indian motorcycle brands



Note: HH denotes Hero Honda, while HMSI denotes Honda Motorcycles and Scooters India.
Prices are indicative only, and may vary based on region, variant and time period.

Source: Overdrive, Autocar, Bike India, Goldman Sachs Research.

Potential challenges to Hero Honda's strong market position

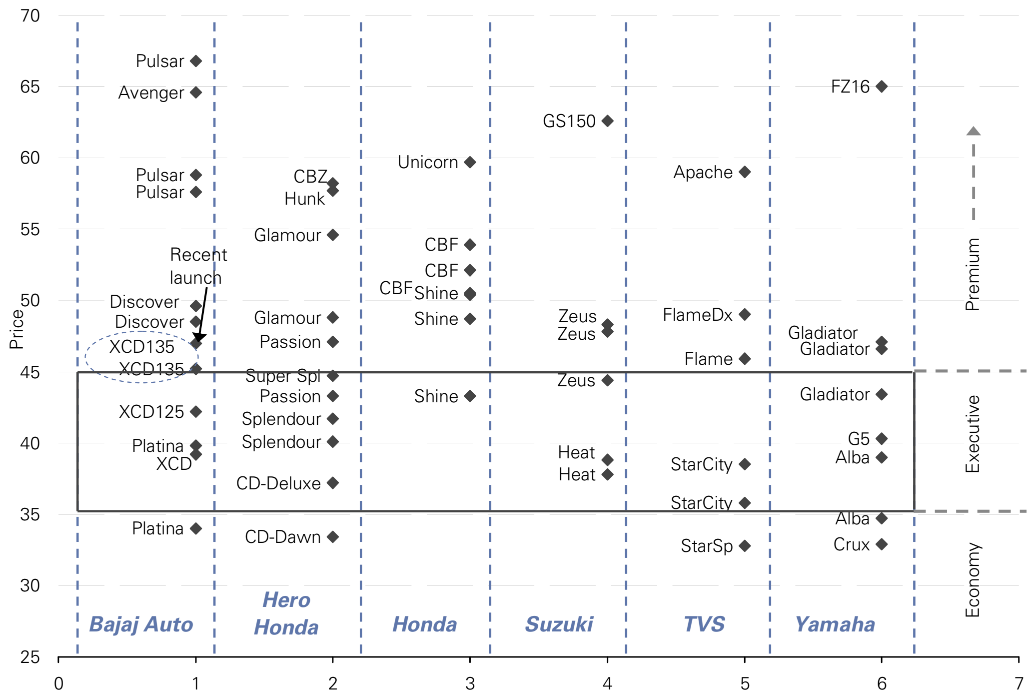
Most competitors have retreated from both the economy and executive segments of the market, in our view. We believe that most participants have actively reduced their focus on the economy and mid-range price segments where Hero Honda dominates, because of the relatively low margins and insufficient demand for their products. Prominent among these is Yamaha, who we believe now focuses most of its attention – in terms of new model launches – on the performance biking segment, given its success in gaining market share in the Vietnamese market by adopting this strategy.

We believe among the 5 largest competitors, Bajaj Auto has the greatest potential to emerge as a serious challenger to Hero Honda over the long run, given its previous track record of successful product launches, decades of experience in the Indian market, and economies of scale in terms of manufacturing. Over the near term, however, we believe Bajaj Auto is busy grappling with demand and competitive headwinds in its bread and butter premium performance segment, and dealing with challenges relating to, in our view, its less than optimal product portfolio. Our channel checks indicate that Hero Honda's products command a premium in the second-hand market, making it difficult for Bajaj Auto to attract a larger customer base in the lower- to mid-price segments.

Honda Motorcycles and Scooters India (HMSI or Honda) could also emerge as a serious challenger to Hero Honda in its dominant segments over the long run, in our view. As per Honda's publicly stated intentions (widely reported in popular business media such as Business Standard), the company plans to launch a 100cc sports motorcycle product that will not be in direct competition with any of Hero Honda's existing products. However, given Honda's dominance in key emerging markets, investors often perceive this as a threat to Hero Honda's dominance in the economy and executive segments that is characterized by 100cc motorcycles.

Exhibit 31: Hero Honda dominates the executive segment with the maximum number of brands

Indian motorcycle brands across different price segments (indicative price ranges in Rs '000)

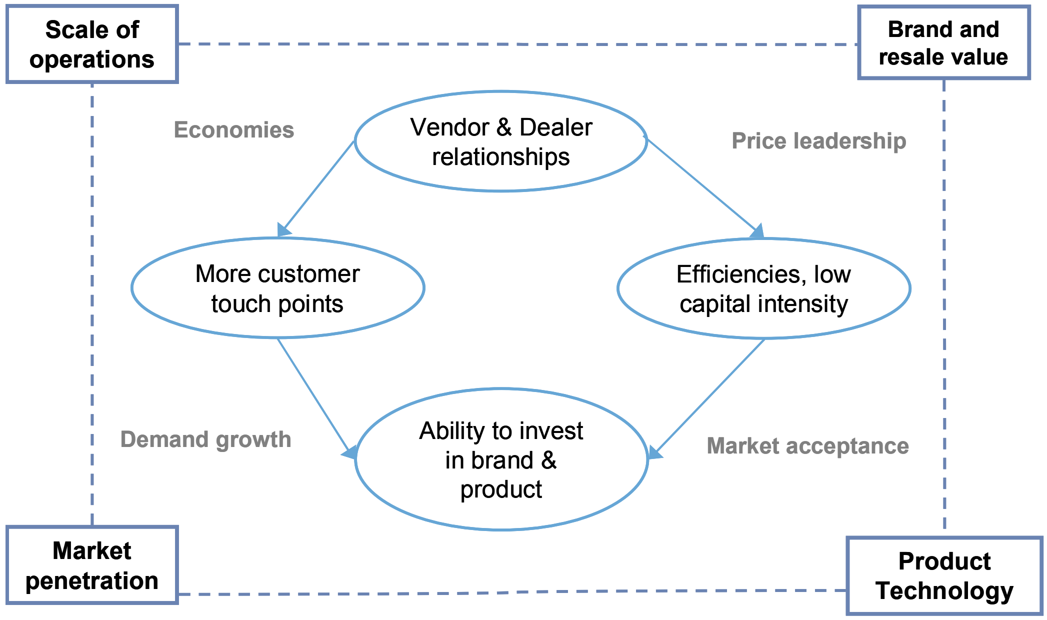


Note: We believe some industry executives also tend to classify the Rs45,000-Rs50,000 range under the Executive segment, so these price ranges should not be viewed as absolute.
Prices are indicative only, and may vary based on region, variant and time period.

Source: Overdrive, Autocar, Bike India, Goldman Sachs Research estimates.

But it could take several years for Honda to become a significant challenger to Hero Honda, in our view. We believe this issue needs to be seen from the context of the structural reasons behind Hero Honda's continued market share gains over time, as discussed in the previous section. We also believe that dislodging a dominant incumbent in a diverse and geographically widespread consumer market such as India is likely to involve years of hard work to gain market share. In a multi-industry consumer market study carried out by MRUC Hansa Research for the period 2000-2005, the No.1 brand in 18 out of the 20 product categories studied remained the same. Moreover, the top brand in 17 of the 20 product categories actually increased its user base during this period.

Exhibit 32: Hero Honda's dominance is the result of a self-reinforcing loop, in our view



Source: Goldman Sachs Research.

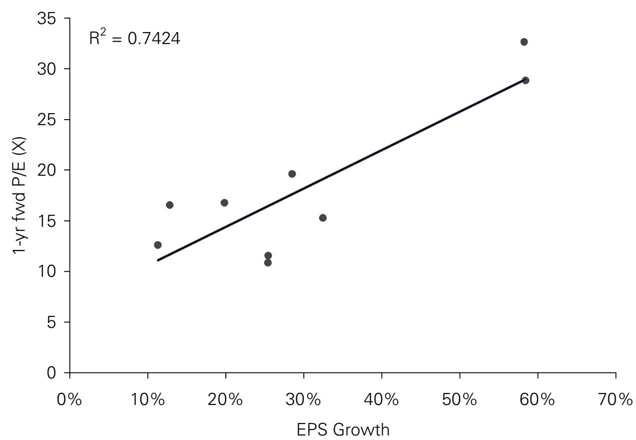
A case in point is the >125cc performance segment, where Honda has been competing with Bajaj Auto among other participants such as Yamaha, TVS, Hero Honda, and Suzuki. Bajaj Auto has been a dominant operator in this segment, with its extremely popular Pulsar brand of motorcycle. Between 2004 and 2009, Honda Motors has managed to gain 25% monthly market share in this segment (from 0% in 2004) much of which has come at the expense of TVS Motors. During this period, Bajaj Auto has managed to hold on to most of its market share and leading position in this segment, with its market share declining from 53% in Oct'04 to 47% in Feb'09. We believe Honda's market share gains in this segment were also given a boost over the past few months from the launch of its CBF Stunner brand of motorcycle in the Rs50,000-Rs55,000 segment, a price range where few competitor models exist (Exhibit 31 and 49).

As a consequence, we believe Honda will find it particularly challenging to sustain margins and generate volumes over the medium term if it decides to compete in the economy and executive segments of the market. These segments are crowded with strong brands from Hero Honda's product portfolio. Over the next decade though, while we believe it is likely that Honda will corner a meaningful share of India's motorcycle market, given its track record of success in other emerging economies, we think it is unlikely to significantly erode Hero Honda's growth prospects during this period.

For this reason we also believe that **Honda is likely to renew its technology licensing agreement with Hero Honda Motors in 2014.** This would enable Honda to retain an active stake and management influence over the largest participant in the fast growing Indian motorcycle market.

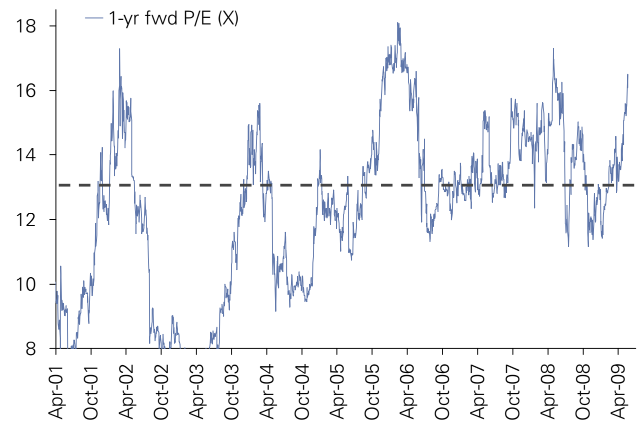
Valuations leave little room for further stock price appreciation, in our view

Exhibit 33: We observe a high correlation between EPS growth and P/E multiple for Hero Honda
EPS growth vs. P/E multiple across 1999-2008



Source: Datastream, Company data, Goldman Sachs Research estimates.

Exhibit 34: Hero Honda is currently trading between its peak and mid-cycle P/E multiple
Hero Honda's 1-year forward P/E trading pattern



Note: May 18 price movement is excluded from this chart.

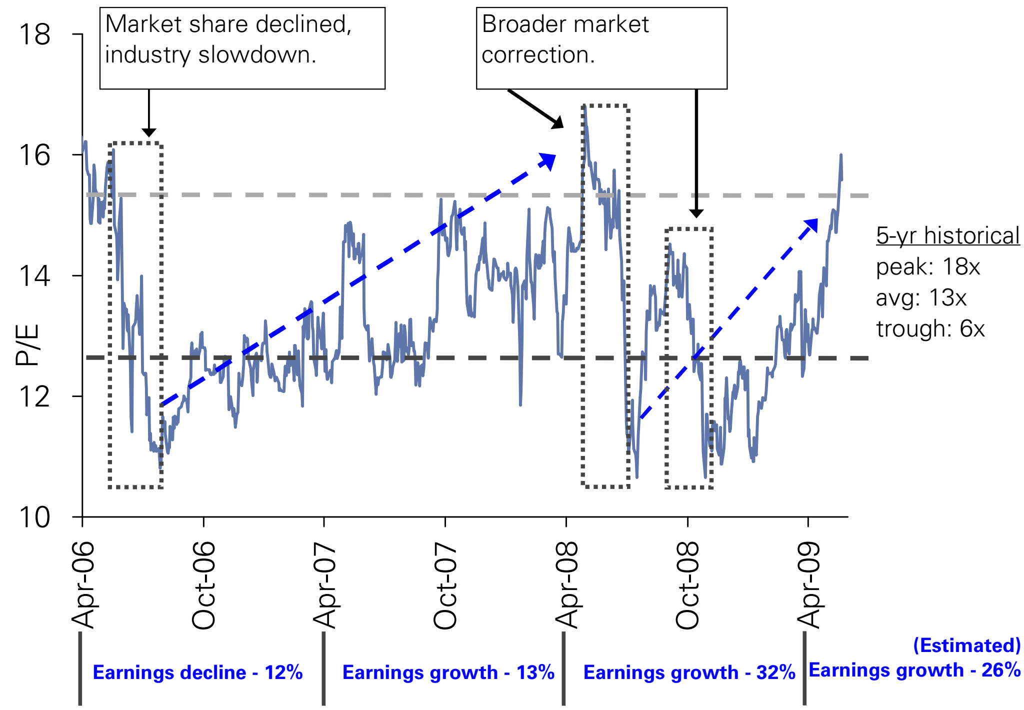
Source: Goldman Sachs Research estimates.

We believe current valuations leave little room for further appreciation in Hero Honda's stock price. The stock is trading at close to the mid-point between mid-cycle and peak multiples on its historical trading range.

We use a P/E vs. 2-year EPS CAGR regression model to arrive at our target multiple for Hero Honda (Exhibit 36). We have found a high correlation between Hero Honda's P/E multiples and earnings growth (exhibits 33 and 35), and our earnings estimates suggest a material acceleration in Hero Honda's earnings growth and cash returns over FY09E-FY11E, when compared with FY06-FY09A. Our FY09E-FY11E earnings estimates imply 2-year forward CAGR earnings growth of 23%, when compared with FY06-FY09A 3-year earnings CAGR of 10%. Our target price uses a multiple of 14.4X FY11E, compared with a 5-year average of 13X.

From our historical back-testing, we find that the stock has on average traded at a significant premium to cash returns based on a Director's Cut (EV/GCI vs. CROCI/WACC) valuation framework (Exhibit 40), and is also at a premium to its ROIC implied valuation. We believe this is because the market has consistently rewarded the company for its sustainable advantage, which has lead to 11 consecutive years of top quartile cash returns relative to the automobiles coverage group (Exhibit 42).

Exhibit 35: Empirically we observe that Hero Honda's P/E tends to react to earnings growth expectations
Hero Honda's P/E trading pattern over April 2006-2009



Note: May 18 price movement is excluded from this chart.

Source: Datastream, Goldman Sachs Research.

Exhibit 36: We estimate Hero Honda's 12-month target price at Rs1,399
Valuation table for Hero Honda

	FY2010E		FY2011E		FY09-11E CAGR	
	GS est.	Consensus	GS est.	Consensus	GS est.	
Regression coefficient	38.0	38.0	38.0	38.0	38.0	
Earnings growth assumption	26%	23%	20%	11%	23%	Valuation driver
Intercept	6.8	6.8	6.8	6.8	6.8	
Implied P/E	16.8	15.4	14.4	10.8	15.6	
EPS estimate	81.2	78.8	97.4	87.1	97.4	
Implied Valuation	**1,367**	**1,216**	**1,399**	**943**	**1,518**	Valuation output
Current price	1,268	1,268	1,268	1,268	1,268	
Implied up/downside	8%	-4%	10%	-26%	20%	

Source: Bloomberg consensus, Goldman Sachs Research estimates.

Exhibit 37: Implied DCF assumptions based on our target price appear reasonable, in our view
DCF-based valuation of Hero Honda

Hero Honda DCF (FY10E, in Rs mn)		
Second stage and terminal value drivers		
Second stage duration (years)	5	
Second stage revenue growth	13.1%	
Second stage margin	13.8%	Hero Honda's 10-year average
Second stage tax rate	27.0%	Lower owing to tax breaks in Haridwar.
Terminal growth rate	5.0%	Same as consumer companies
Terminal margin	10.0%	LT avg of Yamaha, Suzuki, Harley and Honda.
Terminal tax rate	30.0%	
Terminal net capex/sales	1.5%	
Present value of forecast period FCF	71,272	
Present value of second stage FCF	66,948	
Present value of terminal value	123,598	
Enterprise value	261,818	
Plus net cash (end FY10E)	17,394	
Pension liabilities	-	
Associates/minorities	-	
Equity value	279,212	
Shares outstanding (mn)	199.7	
Implied DCF NAV per share	1,398	

Source: Goldman Sachs Research estimates.

Exhibit 38: EPS estimate vs. P/E multiple sensitivity
Implied valuation on assuming different P/E multiples and FY11E EPS

EPS & P/E sensitivity	EPS				
P/E	64.9	87.6	97.4	107.1	128.5
17.4	1,128	1,522	1,691	1,860	2,232
16.4	1,063	1,434	1,594	1,753	2,103
15.4	998	1,347	1,496	1,646	1,975
14.4	933	1,259	1,399	1,539	1,846
13.4	868	1,171	1,301	1,432	1,718
12.4	803	1,084	1,204	1,325	1,589
11.4	738	996	1,107	1,217	1,461
10.4	673	908	1,009	1,110	1,332

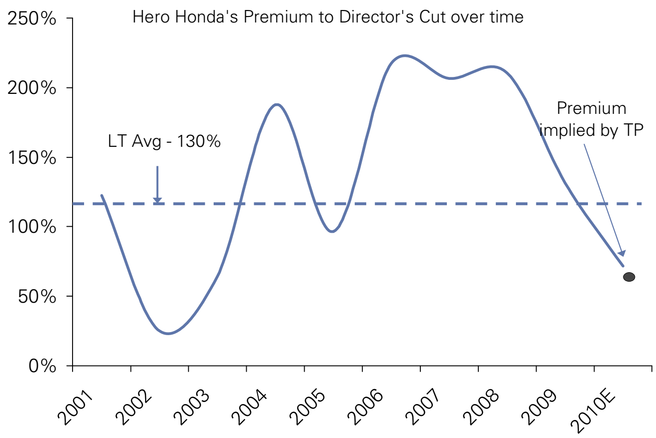
Source: Goldman Sachs Research estimates.

Exhibit 39: Returns on sensitivity-based scenarios
Implied upside/downside to sensitivity-based implied valuations

Implied upside / downside	EPS				
P/E	64.9	87.6	97.4	107.1	128.5
17.4	-11%	20%	33%	47%	76%
16.4	-16%	13%	26%	38%	66%
15.4	-21%	6%	18%	30%	56%
14.4	-26%	-1%	10%	21%	46%
13.4	-32%	-8%	3%	13%	36%
12.4	-37%	-15%	-5%	4%	25%
11.4	-42%	-21%	-13%	-4%	15%
10.4	-47%	-28%	-20%	-12%	5%

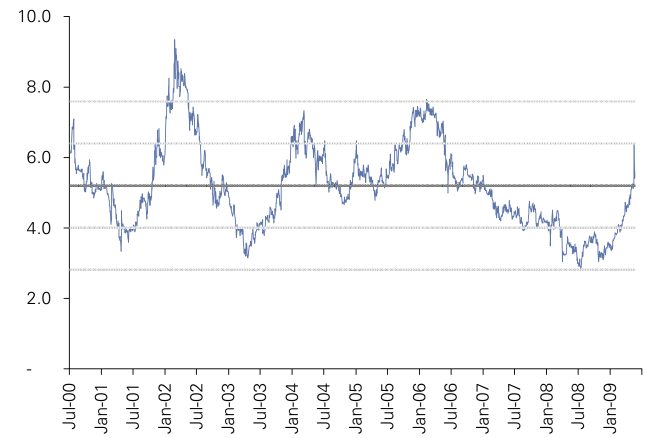
Source: Goldman Sachs Research estimates.

Exhibit 40: Hero Honda has historically traded at a premium to Director's Cut (EV/GCI vs. CROCI/WACC) valuation framework
Historical premium/discount over Director's Cut valuation



Source: Datastream, Company data, Goldman Sachs Research estimates.

Exhibit 41: Stock is trading above the mid-cycle P/B multiple
Hero Honda's 1-year forward P/B trading pattern



Source: Datastream, Company data, Goldman Sachs Research estimates.

Exhibit 42: Hero Honda has been a top quartile automobile company for nine consecutive years
Cash returns on capital invested (CROCI) for global automobile comparables across 2000-2010E

Name	CROCI										
	2000	2001	2002	2003	2004	2005	2006	2007	2008E	2009E	2010E
Bajaj Auto	14%	19%	17%	19%	17%	20%	20%	32%	25%	26%	26%
Hero Honda Motors	37%	34%	36%	52%	35%	39%	33%	24%	33%	44%	51%
Kia Motors	20%	24%	25%	22%	18%	9%	4%	2%	7%	4%	4%
Hankook Tire	-52%	16%	17%	17%	16%	16%	13%	16%	12%	17%	15%
Hyundai Mobis	20%	22%	18%	21%	14%	23%	19%	18%	19%	15%	14%
Hyundai Motor	23%	28%	28%	22%	17%	15%	17%	18%	8%	5%	9%
Volvo	10%	6%	11%	14%	18%	16%	17%	15%	11%	3%	7%
Scania	11%	6%	7%	8%	8%	8%	11%	14%	13%	6%	6%
Renault	12%	6%	10%	10%	12%	10%	8%	8%	5%	3%	4%
BMW	21%	21%	19%	16%	15%	15%	14%	15%	7%	8%	9%
Peugeot	11%	12%	13%	12%	10%	7%	6%	7%	4%	3%	4%
Daimler AG	15%	9%	13%	12%	11%	8%	8%	15%	11%	5%	8%
Yamaha Motor	6%	7%	10%	9%	9%	19%	12%	12%	4%	1%	5%
Toyota Motor	8%	7%	9%	9%	11%	12%	13%	11%	6%	6%	8%
Suzuki Motor	1%	1%	-1%	14%	13%	13%	14%	11%	6%	5%	6%
Nissan Motor	7%	7%	9%	9%	4%	5%	8%	8%	-9%	4%	8%
Mazda Motor	4%	3%	6%	6%	6%	6%	8%	6%	1%	1%	1%
Isuzu Motors	3%	1%	0%	6%	8%	7%	9%	9%	2%	-2%	1%
Honda Motor	10%	14%	14%	10%	11%	10%	12%	14%	9%	9%	12%
Hino Motors	10%	4%	4%	7%	6%	6%	6%	6%	1%	2%	5%
Daihatsu Motor	8%	5%	5%	7%	8%	6%	9%	9%	7%	6%	6%
Fuji Heavy Industries	9%	10%	8%	7%	4%	7%	6%	6%	4%	2%	4%
TRW Automotive Holding C					13%	13%	14%	15%	7%	5%	7%
The Goodyear Tire & Rubbe	5%	4%	5%	27%	12%	5%	3%	2%	-2%	5%	7%
Magna International, Inc.	17%	15%	17%	19%	19%	16%	14%	15%	9%	3%	7%
BorgWarner Inc.	9%	11%	14%	18%	13%	13%	16%	15%	8%	9%	13%
Johnson Controls, Inc.		14%	14%	14%	13%	10%	14%	12%	8%	4%	8%
General Motors Corp.	13%	1%	11%	-11%	1%	9%	40%	-5%	-15%	-28%	6%
Ford Motor Company	25%	8%	6%	2%	12%	8%	-8%	14%	-20%	-14%	10%
Harley-Davidson, Inc.	39%	56%	50%	38%	45%	13%	23%	10%	14%	-1%	7%
Average	11%	12%	13%	14%	13%	12%	12%	11%	6%	5%	9%

1st Qtle
3rd Qtle
4th Qtle

Source: Company data, Goldman Sachs Research estimates.

Bajaj Auto (HROH.BO): Growth interrupted, rich valuations

Investment thesis: Sell

We initiate coverage on Bajaj Auto with a Sell rating. Our 12-month FY11E P/E-based target price of Rs705 implies 25% potential downside.

Bajaj Auto's stock price has outperformed Hero Honda ytd by about 64%, and is now trading at 17.2X 1-year forward P/E vs. Hero Honda, which is trading at 15.6X. This is in spite of lower earnings growth and a cash return profile over FY09E-FY11E relative to Hero Honda.

Competition remains intense. We believe the market may be over-emphasizing the impact of new product launches on Bajaj Auto's market share and profitability in FY10E-FY11E. Competition is likely to intensify in the >125cc segment with most participants almost giving up on trying to gain market share from Hero Honda in the economy and executive segments, in our view.

Domestic sales decline, slowing export growth. We believe that although industrial and financial conditions have improved sequentially over the third and fourth quarters of FY09, Bajaj Auto will continue to face demand headwinds over the near term due to its exposure to the premium motorcycle segment. We expect domestic sales to decline by 11% in FY10E, compared with a 26% decline in FY09. We expect export sales to grow 20% in FY10E, compared with 35% growth in exports witnessed in FY09.

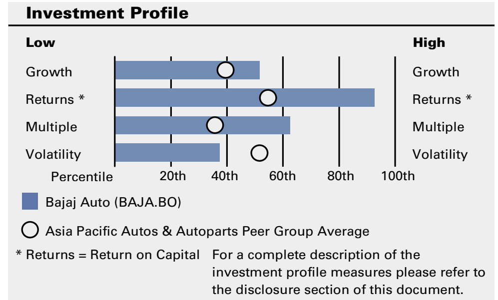
Although we like the long-run structural story of indigenous R&D and global market expansion unfolding at Bajaj Auto, we believe that the current stock price has run ahead of fundamentals over the short term. At current levels, we believe investors should take profit on this stock.

Valuation

The stock is currently trading at 17.2X FY10E P/E. We use a P/E vs. 2-year EPS CAGR regression model to arrive at our target multiple for Bajaj Auto. We estimate 16% EPS CAGR over FY09E-FY11E, and our target price uses a multiple of 11.5X FY11E. Bajaj Auto does not have stock price trading history that can be referred to for valuing its core business, but we have found a high correlation between Hero Honda's P/E multiples and earnings growth.

Key risks

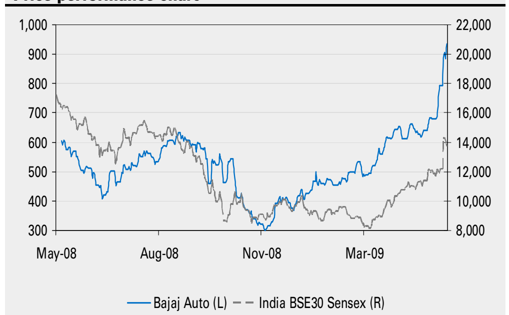
Key upside risks (positive for stock price) to our target price and investment view include: (1) Greater-than-expected success of Bajaj Auto's new product launches and marketing programs and (2) stronger-than-expected pricing resilience leading to higher-than-expected improvement in margins. Key downside risks include: (1) financial sector weakness affecting vendors'/dealers' ability to extend favorable working capital terms; (2) uncertainties and risks to cash flow arising from Bajaj Auto's foray into passenger cars and 4-wheeler commercial vehicles business; and (3) higher-than-expected slowdown in export markets.



Key data	Current
Price (Rs)	934.20
12 month price target (Rs)	705.00
Market cap (Rs mn / US$ mn)	135,163.3 / 2,846.0
Foreign ownership (%)	30.6

	3/08	3/09E	3/10E	3/11E
EPS (Rs)	54.19	45.24	54.35	61.13
EPS growth (%)	--	(16.5)	20.1	12.5
EPS (diluted) (Rs)	54.19	45.24	54.35	61.13
EPS (basic pre-ex) (Rs)	54.19	46.75	54.35	61.13
P/E (X)	17.2	20.7	17.2	15.3
P/B (X)	8.5	7.1	5.9	5.0
EV/EBITDA (X)	NM	13.4	10.4	9.3
Dividend yield (%)	2.2	2.1	2.6	2.9
ROE (%)	NM	37.5	37.5	35.4

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	87.0	174.7	--
Rel. to India BSE30 Sensex	20.4	78.3	--

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 5/21/2009 close.

Exhibit 43: Bajaj Auto: Summary financials

Profit model (Rs mn)	3/08	3/09E	3/10E	3/11E
Total revenue	**86,632.9**	**84,369.7**	**83,760.6**	**96,607.4**
Cost of goods sold	(69,382.0)	(67,332.1)	(65,107.7)	(76,222.5)
SG&A	(7,301.5)	(8,395.3)	(8,642.7)	(8,281.9)
R&D	0.0	0.0	0.0	0.0
Other operating profit/(expense)	(17.8)	250.4	236.1	(447.3)
EBITDA	**11,671.2**	**10,190.6**	**12,775.8**	**13,752.5**
Depreciation & amortization	(1,739.6)	(1,297.9)	(2,529.5)	(2,096.8)
EBIT	**9,931.6**	**8,892.7**	**10,246.3**	**11,655.7**
Interest income	0.0	0.0	0.0	0.0
Interest expense	(51.6)	(210.1)	(200.2)	(200.2)
Income/(loss) from uncons. subs.	0.0	0.0	0.0	0.0
Others	1,467.3	1,096.9	1,269.3	1,269.3
Pretax profits	**11,347.3**	**9,779.5**	**11,315.5**	**12,724.9**
Income tax	(3,787.8)	(3,016.1)	(3,451.2)	(3,881.1)
Minorities	0.0	0.0	0.0	0.0
Net income pre-preferred dividends	**7,559.5**	**6,763.4**	**7,864.3**	**8,843.8**
Preferred dividends	0.0	0.0	0.0	0.0
Net income (pre-exceptionals)	**7,559.5**	**6,763.4**	**7,864.3**	**8,843.8**
Post-tax exceptionals	0.0	(218.0)	0.0	0.0
Net income	**7,559.5**	**6,545.4**	**7,864.3**	**8,843.8**
EPS (basic, pre-except) (Rs)	54.19	46.75	54.35	61.13
EPS (basic, post-except) (Rs)	54.19	45.24	54.35	61.13
EPS (diluted, post-except) (Rs)	54.19	45.24	54.35	61.13
DPS (Rs)	20.74	19.91	23.92	26.90
Dividend payout ratio (%)	38.3	44.0	44.0	44.0
Free cash flow yield (%)	NM	0.9	5.9	6.5

Growth & margins (%)	3/08	3/09E	3/10E	3/11E
Sales growth	--	(2.6)	(0.7)	15.3
EBITDA growth	--	(12.7)	25.4	7.6
EBIT growth	--	(10.5)	15.2	13.8
Net income growth	--	(13.4)	20.1	12.5
EPS growth	--	(16.5)	20.1	12.5
Gross margin	19.9	20.2	22.3	21.1
EBITDA margin	13.5	12.1	15.3	14.2
EBIT margin	11.5	10.5	12.2	12.1

Cash flow statement (Rs mn)	3/08	3/09E	3/10E	3/11E
Net income pre-preferred dividends	7,559.5	6,763.4	7,864.3	8,843.8
D&A add-back	1,739.6	1,297.9	2,529.5	2,096.8
Minorities interests add-back	0.0	0.0	0.0	0.0
Net (inc)/dec working capital	2,836.5	(2,706.0)	93.0	26.6
Other operating cash flow	(5,943.4)	0.0	0.0	0.0
Cash flow from operations	**6,192.2**	**5,355.3**	**10,486.8**	**10,967.2**
Capital expenditures	(3,265.9)	(3,930.0)	(2,364.0)	(1,987.5)
Acquisitions	0.0	(1,380.0)	0.0	0.0
Divestitures	0.0	0.0	0.0	0.0
Others	17,997.7	0.0	0.0	0.0
Cash flow from investments	**14,731.8**	**(5,310.0)**	**(2,364.0)**	**(1,987.5)**
Dividends paid (common & pref)	(3,385.5)	(3,369.5)	(4,048.4)	(4,552.6)
Inc/(dec) in debt	(2,910.9)	0.0	0.0	0.0
Common stock issuance (repurchase)	0.0	0.0	0.0	0.0
Other financing cash flows	0.0	0.0	0.0	0.0
Cash flow from financing	**(6,296.4)**	**(3,369.5)**	**(4,048.4)**	**(4,552.6)**
Total cash flow	**14,627.6**	**(3,324.2)**	**4,074.4**	**4,427.1**

Balance sheet (Rs mn)	3/08	3/09E	3/10E	3/11E
Cash & equivalents	15,462.4	12,138.2	16,212.7	20,639.8
Accounts receivable	2,753.1	2,242.2	2,226.0	2,567.4
Inventory	3,496.1	3,740.7	3,617.1	4,234.6
Other current assets	9,687.2	9,687.2	9,687.2	9,687.2
Total current assets	**31,398.8**	**27,808.3**	**31,742.9**	**37,128.9**
Net PP&E	12,928.2	15,560.3	15,394.8	15,285.5
Net intangibles	105.3	105.3	105.3	105.3
Total investments	3,669.7	4,831.7	4,831.7	4,831.7
Other long-term assets	0.0	0.0	0.0	0.0
Total assets	**48,102.0**	**48,305.6**	**52,074.7**	**57,351.4**
Accounts payable	9,444.6	6,472.2	6,425.5	7,411.0
Short-term debt	69.5	69.5	69.5	69.5
Other current liabilities	9,328.3	9,328.3	9,328.3	9,328.3
Total current liabilities	**18,842.4**	**15,870.0**	**15,823.3**	**16,808.8**
Long-term debt	13,273.9	13,273.9	13,273.9	13,273.9
Other long-term liabilities	109.8	109.8	109.8	109.8
Total long-term liabilities	13,383.7	13,383.7	13,383.7	13,383.7
Total liabilities	**32,226.1**	**29,253.7**	**29,207.0**	**30,192.5**
Preferred shares	**0.0**	**0.0**	**0.0**	**0.0**
Total common equity	**15,875.9**	**19,051.9**	**22,867.8**	**27,159.0**
Minority interest	0.0	0.0	0.0	0.0
Total liabilities & equity	**48,102.0**	**48,305.6**	**52,074.7**	**57,351.4**
BVPS (Rs)	**109.73**	**131.68**	**158.05**	**187.71**

Ratios	3/08	3/09E	3/10E	3/11E
ROE (%)	NM	37.5	37.5	35.4
ROA (%)	NM	13.6	15.7	16.2
ROACE (%)	NM	40.6	39.8	45.1
Inventory days	--	19.6	20.6	18.8
Receivables days	--	10.8	9.7	9.1
Payable days	--	43.1	36.2	33.1
Net debt/equity (%)	(13.3)	6.3	(12.5)	(26.9)
Interest cover - EBIT (X)	192.5	42.3	51.2	58.2

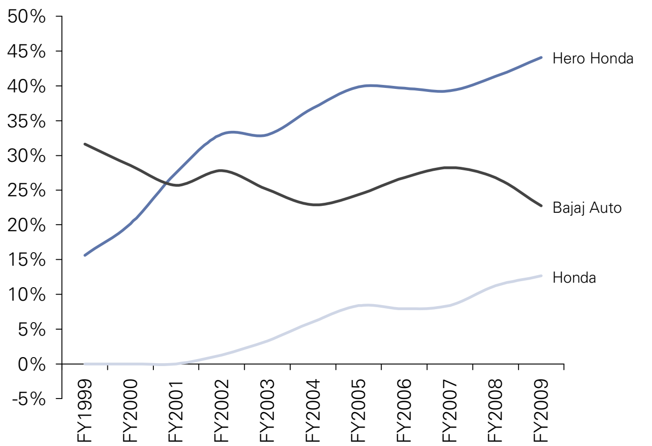
Valuation	3/08	3/09E	3/10E	3/11E
P/E (analyst) (X)	17.2	20.7	17.2	15.3
P/B (X)	8.5	7.1	5.9	5.0
EV/EBITDA (X)	NM	13.4	10.4	9.3
Dividend yield (%)	2.2	2.1	2.6	2.9

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

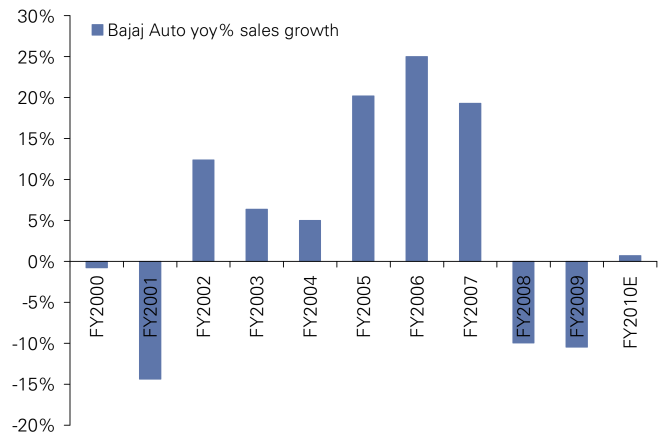
Growth interrupted, rich valuations, initiate with Sell rating

Exhibit 44: Bajaj Auto has been losing market share for the past 2 years
Indian 2-wheeler market share on select companies



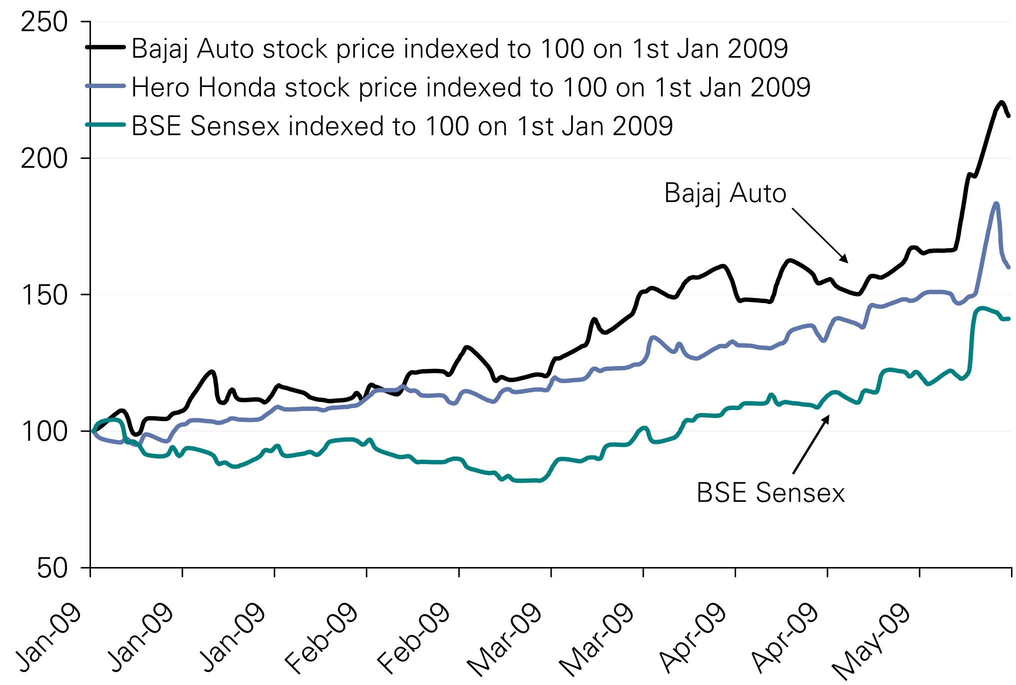
Source: CMIE, SIAM.

Exhibit 45: We believe Bajaj Auto's sales volume will remain flat in FY10E, on a low base in FY09
Sales volume growth (yoy, %)



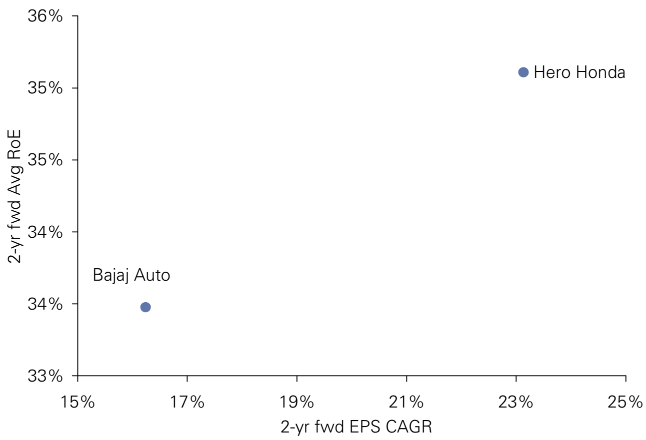
Source: Company data, Goldman Sachs Research estimates.

Exhibit 46: Bajaj Auto stock price has more than doubled since the beginning of the year
Relative stock price performance



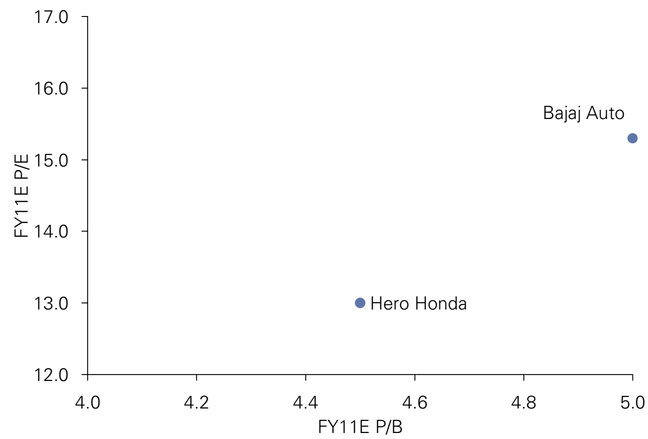
Source: Datastream.

Exhibit 47: Bajaj Auto will lag Hero Honda in returns and growth during FY09-FY11E, in our view
ROE and EPS CAGR matrix for Hero Honda and Bajaj Auto



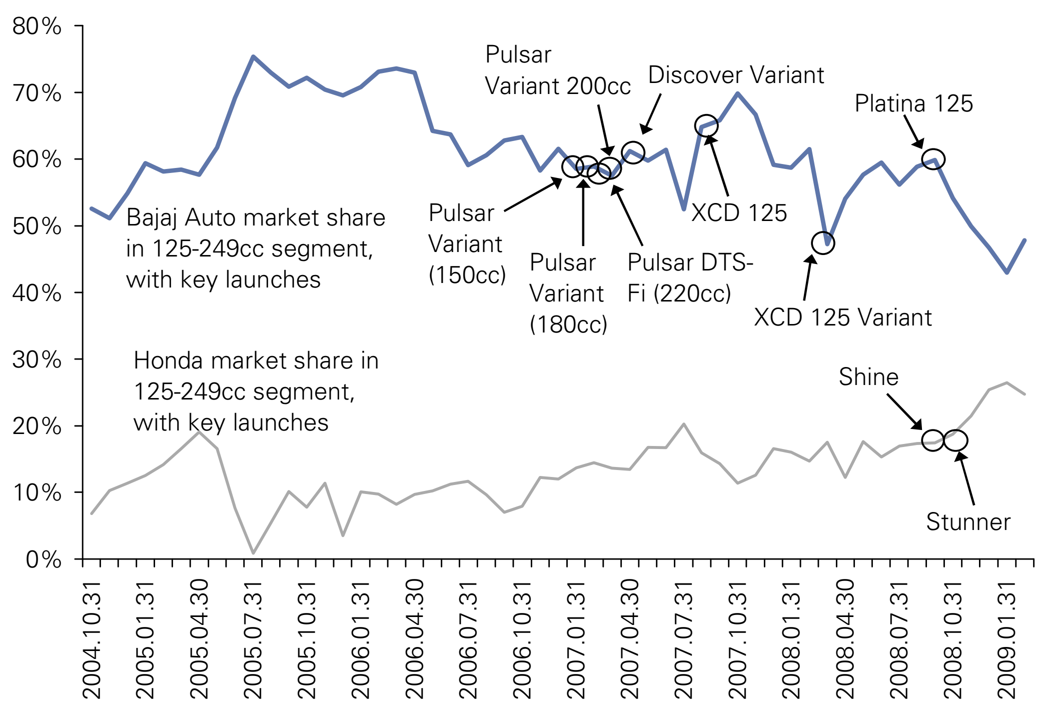
Source: Datastream.

Exhibit 48: However, Bajaj Auto's current valuations appear to be rich relative to Hero Honda's, in our view
P/B and P/E matrix for Hero Honda and Bajaj Auto



Source: Company data, Goldman Sachs Research estimates.

Exhibit 49: We believe it is difficult to assess the market share impact of forthcoming product launches, and the market may be currently overestimating the impact of forthcoming launches from Bajaj Auto
Bajaj Auto's and Honda's market share in the 125cc-249cc segment



Source: Company data, CMIE, SIAM.

Exhibit 50: We estimate Bajaj Auto's 12-month target price at Rs705

	FY2010E		FY2011E		FY09-11E CAGR
	GS est.	Consensus	GS est.	Consensus	GS est.
Regression coefficient	38.0	38.0	38.0	38.0	38.0
Earnings growth assumption	**20%**	**35%**	**12%**	**16%**	**16%** ← **Valuation driver**
Intercept	6.8	6.8	6.8	6.8	6.8
Implied P/E	14.5	20.0	11.5	13.0	13.0
EPS estimate	54.4	61.0	61.1	71.0	61.1
Implied Valuation	**786**	**1,222**	**705**	**925**	**793** ← **Valuation output**
Current price	934	934	934	934	934
Implied up/downside	**-16%**	**31%**	**-25%**	**-1%**	**-15%**

Source: Bloomberg consensus, Goldman Sachs Research estimates.

Exhibit 51: Implied DCF assumptions based on our target price appear reasonable, in our view

DCF-based valuation of Bajaj Auto

Bajaj Auto DCF (FY10E, in Rs mn)		
Second stage and terminal value drivers		
Second stage duration (years)	5	
Second stage revenue growth	10.0%	
Second stage margin	12.8%	Bajaj Auto 10-year average
Second stage tax rate	27.0%	
Terminal growth rate	5.0%	Same as consumer companies
Terminal margin	10.0%	LT avg of Yamaha, Suzuki, Harley and Honda.
Terminal tax rate	30.0%	
Terminal net capex/sales	1.5%	
Present value of forecast period FCF	29,062	
Present value of second stage FCF	33,316	
Present value of terminal value	43,296	
Enterprise value	105,673	
Plus net cash (end FY10E)	(1,205)	
Pension liabilities		
Associates/minorities		
Equity value	104,468	
Shares outstanding (mn)	144.7	
Implied DCF NAV per share	722	

Source: Goldman Sachs Research estimates.

Exhibit 52: EPS estimate vs. P/E multiple sensitivity
Implied valuation on assuming different P/E multiples and FY11E EPS

EPS & P/E sensitivity

P/E \ EPS	43.5	48.9	54.4	59.8	71.7
16.0	694	781	868	955	1,146
15.0	651	732	814	895	1,074
14.0	607	683	759	835	1,002
13.0	564	634	705	775	931
12.0	520	586	651	716	859
11.0	477	537	596	656	787
10.0	434	488	542	596	715
9.0	390	439	488	536	644

Source: Goldman Sachs Research estimates.

Exhibit 53: Returns on sensitivity-based scenarios
Implied upside/downside to sensitivity-based implied valuations

Implied upside / downside

P/E \ EPS	43.5	48.9	54.4	59.8	65.2
16.0	-26%	-16%	-7%	2%	23%
15.0	-30%	-22%	-13%	-4%	15%
14.0	-35%	-27%	-19%	-11%	7%
13.0	-40%	-32%	-25%	-17%	0%
12.0	-44%	-37%	-30%	-23%	-8%
11.0	-49%	-43%	-36%	-30%	-16%
10.0	-54%	-48%	-42%	-36%	-23%
9.0	-58%	-53%	-48%	-43%	-31%

Source: Goldman Sachs Research estimates.

Reg AC

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