

Bajaj Auto

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,858	BJA IN
	REUTERS CODE
S&P CNX: 3,711	BJAT.BO

18 October 2006

Buy

Previous Recommendation: Buy

Rs2,899

Equity Shares (m)	101.2
52-Week Range (Rs)	3,325/1,650
1,6,12 Rel.Perf.(%)	-3/-12/5
M.Cap. (Rs b)	293.3
M.Cap. (US\$ b)	6.5

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
3/06A	76,679	11,243	108.9	40.8	26.6	6.1	23.6	25.4	3.3	18.3
3/07E	97,514	13,285	131.3	20.6	22.1	5.2	23.8	27.1	2.6	16.1
3/08E	119,005	16,842	166.5	26.8	17.4	4.3	24.7	29.1	2.0	12.3

- 2QFY07 operating performance was below our expectation. The company recorded an EBITDA margin of 15% (our expectation: 17.6%). Success of entry level bikes, particularly Platina, came at a hefty price — competitive pressures and aggressive pricing squeezed margins — and a 310bp hike in the RM/sales ratio contributed to EBITDA margin decline by 190bp YoY and 140bp QoQ to 15%.
- Net sales recorded a 30.5% increase post strong 27.5% volume growth in 2QFY07 and 2.4% YoY increase in realizations.
- Other income and depreciation were in line with expectations. Adj. PAT was Rs3.3b increasing by merely 14% YoY compared with 30.5% YoY net sales growth. After adjusting for extraordinary expenses in the form of VRS and prior period items, BAL's reported PAT was Rs3.2b.
- Total volumes in the quarter rose by 27.5%, with motorcycles (+39.8% YoY) and three-wheelers (+17.8% YoY) being the major growth drivers. For FY07, we expect Bajaj to post volume growth of 21.6%.
- We are cutting our EPS estimate for FY07 and FY08 to account for competitive pressure in entry level bikes and management's guidance for lower margins. Our revised EPS estimates are Rs131.3 (+21% YoY) for FY07 and Rs166.5 for FY08 (+27% YoY). BAL trades at 22.1x FY07E EPS and 17.4x FY08E EPS. Maintain **Buy**.

QUARTERLY PERFORMANCE

(Rs Million)

	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Total Volumes (nos)	505,524	555,552	600,824	619,196	647,086	708,125	704,500	713,340	2,281,096	2,773,051
Change (%)	35.6	24.8	14.0	29.1	28.0	27.5	17.3	15.2	20.2	21.6
Net Sales	16,342	18,670	20,009	21,659	22,027	24,360	24,518	26,610	76,679	97,514
Change (%)	33.3	28.9	24.6	32.5	34.8	30.5	22.5	22.9	29.6	27.2
Total Cost	13,766	15,513	16,428	17,409	18,420	20,708	20,718	22,323	63,116	82,168
EBITDA	2,575	3,156	3,581	4,250	3,607	3,652	3,800	4,286	13,563	15,345
As % of Sales	15.8	16.9	17.9	19.6	16.4	15.0	15.5	16.1	17.7	15.7
Change (%)	39.6	31.8	48.5	71.2	40.1	15.7	6.1	0.9	48.5	13.1
Other Income	928	1,362	1,064	1,031	946	1,424	1,650	1,938	4,385	5,958
Interest	0.9	0.5	1.4	0.6	7.3	20.0	8.0	7.2	3.4	42.5
Depreciation	462	490	491	468	481	492	500	507	1,910	1,980
PBT	3,040	4,028	4,153	4,813	4,064	4,564	4,942	5,710	16,034	19,281
Tax	950	1,120	1,245	1,476	1,300	1,250	1,400	1,803	4,791	5,753
Effective Tax Rate (%)	31.3	27.8	30.0	30.7	32.0	27.4	28.3	31.6	29.9	29.8
Adj. PAT	2,090	2,908	2,908	3,337	2,764	3,314	3,542	3,907	11,243	13,528
Change (%)	28.2	62.0	59.8	30.3	32.2	14.0	21.8	17.1	40.8	20.3
Extraordinary Expenses	-	-	108	119	104	139	-	0	226	243
PAT	2,090	2,908	2,800	3,218	2,660	3,176	3,542	3,907	11,017	13,286
Change (%)	27.0	61.5	53.3	34.2	27.3	9.2	26.5	21.4	43.7	20.6

E: MOST Estimates

Motorcycles lead two-wheeler volume growth

In 2QFY07, Bajaj maintained its strong growth momentum led by motorcycles, which grew by 39.8% YoY. However, the mix in the motorcycle segment, which was improving in favor of the executive and premium segments until 1QFY07, tilted in favor of entry level bikes. In particular, Platina, registered stellar growth, capturing 34.4% share of the entry level segment in September 2006, as its sales during the month crossed 0.1m units.

Bajaj is also gaining significant share in the executive segment driven by successful new product launches — here, the Discover twins have been successful. Historically, Hero Honda too has been dominant in this segment with +70% share. BAL's strategy to focus on its 125cc offering within this segment, as competition is weaker in this category, is expected to pay off in the medium to long term. We have assumed 25% volume growth rate for motorcycles in FY07.

BAL plans to launch two new motorcycles and two ungeared scooters in 2HFY07. In the motorcycle segment the new launches would include Pulsar DTSI with electronic fuel injection and Sonic - 125cc motorcycle (executive segment to support the success of the Discover Twins); in the ungeared scooters segment two models — Kristal and Blade — will be launched in FY07.

Three-wheelers also going strong

Three wheeler volumes also increased by 17.8% 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. However, we believe 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. In FY07, we expect 24% growth in three-wheeler volumes.

VOLUME GROWTH MOMENTUM CONTINUES (UNITS NOS)

	2QFY07	2QFY06	% CHG.	1QFY07	% CHG.
Motorcycles	623,062	445,557	39.8	568,187	9.7
Scooters	4,380	41,510	-89.4	8,032	-45.5
2-wheelers	627,442	487,067	28.8	576,219	8.9
3-wheelers	80,683	68,485	17.8	70,875	13.8
Total	708,125	555,552	27.5	647,094	9.4

Source: Company / Motilal Oswal Securities

Strong motorcycle volume growth to sustain ahead

BAL reported 32% motorcycle volume growth in FY06; volumes grew 37% FY07 YTD. New product launches along with the right strategy should help sustain this growth. We expect 25% growth in FY07 and 20% in FY08. BAL will also benefit from strong economic growth and expected surge in rural demand. Its market share has improved to 30% in FY06 from 24% in FY04 and further to 34.5% in YTD FY07. Our expectation of residual growth for the next two quarters across segments is tabled below:

RESIDUAL GROWTH

	FY07	FY06	GR. (%)
YTD FY07 Sales (units)	1,355,211	1,061,076	27.7
FY07 Estimate (units)	2,773,051	2,281,096	21.6
<i>Residual Growth Req. (%)</i>	<i>16.2</i>		
YTD FY07 - Motorcycle Sales (units)	1,191,249	868,100	37.2
FY07 Estimate (units)	2,390,383	1,912,224	25.0
<i>Residual Growth Req.(%)</i>	<i>14.8</i>		
YTDFY07 - Three-wheelers (units)	151,550	121,796	24.4
FY07 Estimate (units)	312,547	252,006	24.0
<i>Residual Growth Req. (%)</i>	<i>23.6</i>		

Source: Company / Motilal Oswal Securities

DOMESTIC MARKET SHARE (%)

	FY05	FY06	1HFY06	1HFY07
Motorcycle	27.1	30.1	29.6	32.5
3W - Passenger	72.2	66.4	68.7	60.1
3W - Goods	23.8	24	22.9	27.1

Source: Company / Motilal Oswal Securities

Bajaj Auto has been seeing strong market share gains in the domestic motorcycles and three-wheeler goods vehicles segments. However, a decline in market share has been seen in the three-wheeler passenger vehicles segment,

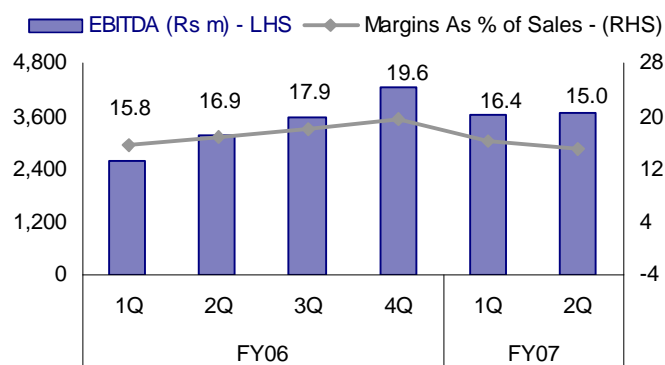
where competition from Piaggio, and higher focus on exports by BAL has seen its domestic market share decline over the past 18 months.

Operating margins plummet

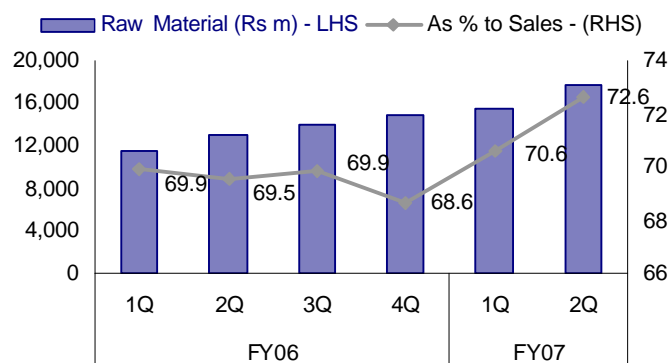
On the back of strong volume growth of 27.5% YoY in 2QFY07, net revenues registered healthy 30.5% YoY growth. Net realisations increased 2.4% YoY to Rs34,400. However, the success of Platina came at a hefty price, as competitive pressures and aggressive pricing contributed to lower EBITDA margins during the quarter. Coupled with a 310bp increase in the RM/sales ratio, the EBITDA margin declined 190bp YoY and 140bp QoQ to 15%.

Other expenses decreased as a percentage of net sales to 9.6% in 2QFY07 from 10.5% in 2QFY06. Further, the ratio of employee cost:sales also fell (3% in 2QFY07 v/s 3.5% in 2QFY06). However, overall this was not adequate to offset the RM increase in the quarter.

EBITDA MARGINS



RAW MATERIAL TO SALES



Source: Company / Motilal Oswal Securities

Net profit growth at 14% is lower than the 15.7% EBITDA growth

Adjusted net profit registered 14% growth to Rs3.3b, lower versus our expectations. Profitability was impacted by the dip in EBITDA margin. But other income, depreciation, and tax rate were in line with expectations. After accounting for extraordinary expenses of Rs139m (on account of VRS expenses and prior period items), the company reported PAT of Rs3.2b (+9% YoY).

We are cutting our EPS estimate for FY07 and FY08 to account for the competitive and margin pressure faced by the company in entry level bikes and the management’s guidance for lower margins. Our revised EPS estimates are Rs131.3 (+21% YoY) for FY07 and Rs166.5 for FY08 (+27% YoY).

REVISED ESTIMATES (RS M)

	FY07E			FY08E		
	OLD	REV.	% CHG	OLD	REV.	% CHG
Total Income	97,514	97,514	-	119,005	119,005	-
EBITDA	17,006	15,345	-9.8	20,748	19,079	-8.0
Margin (%)	17.4	15.7		17.4	16.0	
Adj. PAT	14,673	13,528	-7.8	18,034	16,842	-6.6
EPS (Rs)	144.0	131.3	-8.8	178.2	166.5	-6.6

Source: Motilal Oswal Securities

Export strategy well planned – BAL aims to achieve 10% global share in motorcycles

In 2QFY07, exports grew by 90% YoY volumewise and 88% YoY valuewise. Two-wheelers grew by 95%, while three-wheelers grew by 53.5%. Within two-wheelers, motorcycles account for most of the exports. Bajaj is the largest two- and three-wheeler exporter from India. BALs’ motorcycle exports constituted 52% of overall motorcycle exports from India in YTD FY07 (45% in FY06) and nearly 98% of three-wheeler exports in YTD FY07.

EXPORTS (UNITS)

	2QFY07	2QFY06	GR. (%)
Motorcycles	78,201	38,235	104.5
Total 2-wheelers	78,898	40,454	95.0
Total 3-wheelers	32,948	21,459	53.5
Total	190,047	100,148	89.8
Value (Rs m)	4,261	2,263	88.3

Source: Company / Motilal Oswal Securities

We expect overall exports to gather more momentum once local assembly in Indonesia begins in 3QFY07. Also, the company is in the process of setting up assembly lines in Nigeria. These markets are big enough (approx. size 100,000-150,000 units) to help Bajaj improve its market share going forward.

BAL has a global share of 4.5% in motorcycles (below 250cc), with the market size estimated to be 39m units in 2005. It is targeting a global market share of 10% in motorcycles by 2010, which indicates that its motorcycle sales will have to increase at 23% CAGR during this period, while its exports will have to increase at a CAGR exceeding 40%.

Indonesian market: In Indonesia, Bajaj has been working to enter into tie-ups for both distribution and financing (key drivers) and is now confident of winning a share of 5%-10% of this market.

Sri Lanka: Bajaj's largest export market is Sri Lanka. We expect this healthy demand growth from the country to sustain.

Central America: Bajaj is already a leader in Central America, which comprises countries such as Columbia , Peru etc. However, as it has no presence in the large market of Argentina, it is looking to tie up with a local partner in this country. As Bajaj has high brand equity in Central America, it can leverage this advantage to enter the Argentinian market. Export volumes reached 60,000 units in FY06 in Central America.

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

Subsidiaries

Plans to create a strong retail finance company: Bajaj Auto's finance subsidiary, Bajaj Auto Finance (BAF) is engaged in financing 2-wheelers and consumer durables. BAF has plans to infuse capital close to Rs9.5b. The higher

net worth will allow it to get aggressive in retail finance. Bajaj Auto plans to penetrate the rural markets along with BAF. Management is also open to the idea of hiving off its treasury portfolio into a separate company, where these funds could be used to generate higher yields for retail finance.

Subsidiaries performance in 2QFY07

Bajaj Auto Finance Ltd.

- ✍ The total disbursement increased by 27% to Rs5.6b in 2QFY07, while the stock of hire purchase finance receivables as of September 30, 2006 increased 53% to Rs23.2b
- ✍ PAT is Rs62m v/s Rs123m in 2QFY06.

Bajaj Allianz General Insurance Ltd.

- ✍ It has recorded gross premium of Rs3.9b in the quarter, growth of 28% YoY
- ✍ PAT is Rs84m v/s Rs95m in 2QFY06.
- ✍ The company has retained its second position among India's private insurers in terms of gross premiums. It has expanded its geographical reach to over 100 locations in the country.

Bajaj Allianz Life Insurance Ltd.

- ✍ Gross written premium for the quarter is Rs8.8b, growth of 64%
- ✍ Total number of policies issued in the quarter was 289,616 v/s 132,268 in 2QFY06
- ✍ It has expanded its geographical reach to nearly 900 locations across the country.

Valuation and view

We believe that Bajaj Auto is one of the best plays on consumerism and rural demand improvement. We are cutting our EPS estimate for FY07 and FY08 to account for the competitive and margin pressure faced by the company in entry level bikes and the management's guidance for lower margins. Our revised EPS estimates are Rs131.3 (+21% YoY) for FY07 and Rs166.5 for FY08 (+27% YoY). BAL trades at 22.1x FY07E EPS and 17.4x FY08E EPS. Our SOTP-based target price of Rs3,150 implies a 8.7% 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

- ✍ Any significant upmove in interest rates, leading to higher financing costs.
- ✍ Slowdown in three wheeler sales – BAL's cash cow business.
- ✍ Margin pressure due to competition and price wars in the entry segment might affect performance going forward.

Recent developments

- ✍ BAL is targeting global market share of 10% by 2010.
- ✍ Competitors have launched several bikes in the 150cc premium segment and 100cc entry-level segment, both of which BAL is strong in.
- ✍ BAL is setting up a greenfield project to manufacture three-wheelers and light four-wheelers at Chakan in Maharashtra, marking its foray into the LCV segment.

Valuation and view

- ✍ We expect BAL to witness a 25% volume growth in motorcycles in FY07 leading to a sales growth of 28%.
- ✍ We are cutting our EPS estimate for FY07 and FY08 to Rs131.3 and Rs166.5 respectively.
- ✍ BAL trades at 22.1x FY07E EPS and 17.4x FY08E EPS. Our SOTP-based target price of Rs3,150 implies a 8.7% upside. 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.

COMPARATIVE VALUATIONS

		BAJAJ AUTO	HERO HONDA	TVS MOTOR
P/E (x)	FY07E	22.1	14.7	18.4
	FY08E	17.4	12.9	15.6
EPS Gr (%)	FY07E	20.6	5.7	35.1
	FY08E	26.8	13.9	17.5
RoE (%)	FY07E	23.8	40.4	17.9
	FY08E	24.7	38.1	18.3
EV/EBITDA (x)	FY07E	16.1	9.0	11.0
	FY08E	12.3	7.7	9.4

SHAREHOLDING PATTERN (%)

	SEPO6	JUN.06	SEPO5
Promoter	29.8	29.8	29.8
Domestic Inst	8.3	8.7	7.4
Foreign	22.1	21.1	23.0
Others	39.8	40.4	39.8

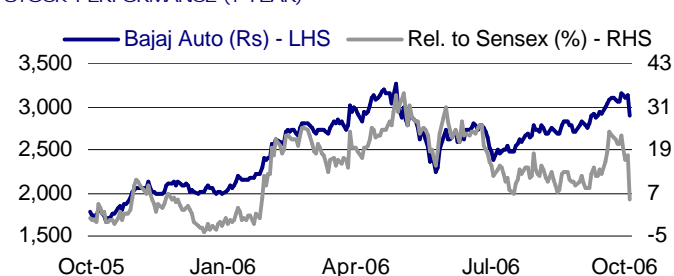
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	131.3	133.8	-1.9
FY08	166.5	160.6	3.7

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
2,899	3,150	8.7	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Net Sales	57,240	74,694	95,448	116,733	137,220	
Change (%)	20.4	30.5	27.8	22.3	17.6	
Operating Other Income	1,907	1,985	2,066	2,273	2,500	
Total Income	59,147	76,679	97,514	119,005	139,720	
Total Expenditure	50,013	63,116	82,168	99,926	116,954	
EBITDA	9,134	13,563	15,345	19,079	22,766	
Change (%)	7.1	48.5	13.1	24.3	19.3	
% of Net Sales	15.4	17.7	15.7	16.0	16.3	
Depreciation	1,854	1,910	1,980	2,055	2,115	
Interest & Finance Charges	7	3	43	41	41	
Other Income	4,081	4,385	5,958	7,077	8,049	
Non-recurring Expense	490	226	243	0	0	
PBT	10,865	15,808	19,038	24,060	28,660	
Tax	3,196	4,791	5,753	7,218	8,885	
Effective Rate (%)	29.4	30.3	30.2	30.0	31.0	
PAT	7,668	11,017	13,285	16,842	19,775	
Adj. PAT	7,987	11,243	13,528	16,842	19,775	
Change (%)	3.2	40.8	20.3	24.5	17.4	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Share Capital	1,012	1,012	1,012	1,012	1,012	
Reserves	40,332	46,696	55,824	67,277	80,526	
Net Worth	41,343	47,707	56,836	68,288	81,538	
Deferred Tax	1,399	876	876	876	876	
Loans	12,270	14,672	13,672	13,672	13,372	
Capital Employed	55,012	63,255	71,383	82,836	95,785	
Gross Fixed Assets	27,436	28,929	30,171	31,171	31,971	
Less: Depreciation	16,286	17,787	19,767	21,822	23,937	
Net Fixed Assets	11,150	11,142	10,404	9,349	8,033	
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	33,800	48,978	65,813	
Inventory	2,242	2,729	4,191	5,125	6,025	
Sundry Debtors	1,763	3,016	5,987	7,322	8,607	
Cash & Bank Balances	1,087	821	1,628	14,536	29,186	
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	31,579	34,249	36,819	
Sundry Creditors	7,351	11,802	11,973	14,643	17,213	
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	2,221	14,729	28,994	
Application of Funds	55,012	63,255	71,383	82,836	95,785	

E: MOST Estimates

RATIOS						
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Basic (Rs)						
EPS	75.8	108.9	131.3	166.5	195.4	
Cash EPS	94.1	127.8	150.9	186.8	216.3	
Book Value per Share	408.6	471.5	561.7	674.9	805.8	
DPS	25	40	42	53	64	
Payout (Incl. Div. Tax) %	33.0	36.7	32.3	32.0	33.0	
Valuation (x)						
P/E		26.6	22.1	17.4	14.8	
Cash P/E		22.7	19.2	15.5	13.4	
EV/EBITDA		18.3	16.1	12.3	9.6	
EV/Sales		3.3	2.6	2.0	1.6	
Price to Book Value		6.1	5.2	4.3	3.6	
Dividend Yield (%)		14	15	18	2.2	
Profitability Ratios (%)						
RoE	19.3	23.6	23.8	24.7	24.3	
RoCE	20.7	25.4	27.1	29.1	30.0	
Turnover Ratios						
Debtors (Days)	10	13	20	20	20	
Asset Turnover (x)	10	12	13	14	14	
Leverage Ratio						
Debt/Equity (x)	0.3	0.3	0.2	0.2	0.2	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
OP/(Loss) before Tax	7,280	11,653	13,365	17,024	20,651	
Interest/Div. Received	4,081	4,385	5,958	7,077	8,049	
Depreciation & Amort.	1,854	1,910	1,980	2,055	2,115	
Direct Taxes Paid	-3,026	-5,314	-5,753	-7,218	-8,885	
(Inc)/Dec in Working Capita	-395	4,579	-8,301	399	385	
CF from Oper. Activity	9,795	17,212	7,249	19,339	22,319	
Extra-ordinary Items	-490	-226	-243	0	0	
CF after EO Items	9,304	16,986	7,006	19,339	22,319	
(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	-605	139	0	0	
Inc/(Dec) in Debt	2,213	2,402	-1,000	0	-300	
Interest Paid	-7	-3	-43	-41	-41	
Dividends Paid	-2,530	-4,047	-4,296	-5,389	-6,526	
CF from Fin. Activity	-1,055	-2,255	-5,199	-5,430	-6,866	
Inc/(Dec) in Cash	293	-266	807	12,908	14,652	
Add: Beginning Balance	794	1,087	821	1,628	14,536	
Closing Balance	1,087	821	1,628	14,536	29,188	

N O T E S

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