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Every week, the ICICIdirect research team selects a stock based on fundamental and/or technical parameters, which is likely to give a return of 20% or more over a 3-6 month perspective.

Bajaj Auto(BAJAUT)

Current Price: Rs 2,240

Target Price: Rs 2690

Potential upside: 20%

Time Frame: 3-6 mths

Company Background

Bajaj Auto Ltd (BAL), the flagship of the Bajaj group, manufactures and markets Bajaj scooters, motorcycles, three-wheelers and spare parts. The company was incorporated in 1945 as a private limited company and went public in 1960. Currently, the company has four plants at Akurdi, Waluj, Chakan (all in Maharashtra) and Uttaranchal with a combined installed capacity to produce 4,180,000 units of two and three-wheelers. BAL also has a 74% stake each in Bajaj Allianz General Insurance Company and Allianz Bajaj Life Insurance Company.

Investment Rationale

Automobile segment geared for high growth

BAL is set to reclaim the *numero uno* position in the auto space with its multi-pronged strategy of a richer product mix which is more focused towards high-end motorcycles and renewed focus on its high-margin three-wheeler segment. New product offerings in higher cc segment with new technology and little price differentiation would further help shift customers from low-end motorbikes offered by its competitors to its portfolio, enhancing volume and value growth.

Capex to ramp-up volumes

The company's capacity is set to increase to 5.5 million units in FY09 from 4.2 million units in FY07. We see significant volume growth coming from the increased capacities in both two- and three-wheelers aiding top line growth.

Operational efficiency to stabilize EBITDA margins

Productivity and efficiency gains should aid the company counter the impact of high input costs and maintain its margins at 15%. A remarkable improvement in output per employee, vendor consolidation and declining warranty costs would aid the EBITDA margins.

Value creation opportunity in insurance biz

BAL has 74% stake each in Bajaj Allianz Life Insurance and Bajaj Allianz General Insurance and currently enjoys the number 2 position in both segments among private sector players. We value the life insurance business on the basis of new business-achieved profit (NBAP) and the general insurance on the basis of book value. The de-merger of the insurance and finance businesses would enable the management focus on two key businesses and deploy money in high return avenues. The only concern is the call option available to the joint venture partner to increase its stake up to 74% in the life insurance and 50% in general insurance business.

Risks & Concerns

Rising interest costs and higher petrol prices could lower demand for two-wheelers, while rising material costs would continue to pressurize EBITDA margins.

Financials

On a stand-alone basis, the company reported net sales of Rs 9,415 crore, registering a growth of 24.3% for the year ended March 31, 2007. EBITDA grew by 4.7%, though EBITDA margins declined 260 basis points to 14.2%. Net profit grew 10.1% to Rs 1,237.1 crore. On a consolidated basis, the company reported net sales of Rs 10,118.7 crore and net profit of Rs 1,249.4 crore.

For Q1FY08, BAL reported a 4.2% decline in net sales mainly impacted by 11.7% de-growth in volumes. EBITDA margins declined 330 bps to 13.1%, while EBITDA declined 23.7% to Rs 275.4 crore. Higher non-operating income mainly from treasury helped restrict the fall in bottom line to 14.9%. Net profit was Rs 226.5 crore against Rs 266 crore in the corresponding quarter the previous year. On a consolidated basis, net sales were down 3.8% to Rs 2,206.4 crore and net profit declined 24.4% to Rs 201.2 crore. EBITDA margins declined 340 bps to 16.3%.

Going forward, on standalone basis we expect net sales to grow at a CAGR of 17.4% over FY07-09E and net profit at 5.8% to Rs 12,973.7 crore and Rs 1,384.8 crore respectively.

Key Financial Ratios					
	2006/03	2005/03	2004/03	2003/03	2002/03
EPS	108.87	72.06	72.98	53.21	51.5
CEPS	128.15	90.78	91.16	70.53	70.49
Book Value	546.96	471.49	408.6	365.04	320.27
Dividend/Share	40	25	25	14	14
OPM	16.9	14.91	16.92	18.92	15.84
RONW	20.44	15.98	18.41	17.08	14.37
Debt/Equity	0.3	0.29	0.27	0.25	0.21
Ratio	0.81	0.88	0.84	1.02	1.08
Interest Cover	4,852.44	1,752.05	1,169.98	876.83	233.93

Valuation

At the current price of Rs 2,240, the stock trades at 17.3x and 16.4x its FY08E and FY09E EPS respectively and 8.3x and 7.6x its core FY08E and FY09E EPS respectively. We expect the company's strategy to focus more on high-end bikes and high-margin three-wheelers would pay off in the coming years. The stock is available at attractive valuations and we expect it to gain 20% to Rs 2,690 within a 3-6 month timeframe.

Technical Outlook

On the charts, the stock made a bottom at Rs 2,080 from where it rallied to its 200 DMA at Rs 2,450. It has thereafter consolidated and is now finding good support at around Rs 2,250. The daily RSI indicator and MACD indicators have found support and are on the verge of a positive crossover.



ICICIdirect Research Desk

ICICI Securities Limited,
2nd Floor, Stanrose House,
Appasaheb Marathe Road,
Prabhadevi, Mumbai - 400 025
research@icicidirect.com

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