

BAJAJ AUTO

INR 2,775

Margins bottoming out

BUY



January 16, 2007

Ashutosh Goel
+91-22-2286 4287
ashutosh.goel@edelcap.com

Bajaj Auto (BAL) announced its Q3FY07 results. Adjusted net profit, at INR 3.57 bn, up 22.8% Y-o-Y from INR 2.91 bn, was above our and consensus estimates. This was primarily because of higher-than-expected income from treasury, which partly offset the lower-than-expected operating margins. EBITDA margin was at 14.2%, down significantly by 370bps Y-o-Y and 80bps Q-o-Q to 14.2%. We believe that margins have bottomed out and expect them to improve sequentially from Q4FY07 onwards, as a result of the two price hikes in the past two months and most of the expensive sales promotion schemes being withdrawn. We reiterate our 'BUY' recommendation on Bajaj Auto as the top pick in the two-wheeler segment on back of strong continued volume growth, robust product pipeline, stable to upward margins, and value in the balance sheet.

Result highlights

* Higher than expected results in Q3FY07 propped up by other income

Net sales in Q3FY07 were at INR 25.68 bn, up 28.4% Y-o-Y. This was driven by a 22.9% Y-o-Y increase in volumes and a 4.5% increase in realizations. Net profit (adjusted for VRS compensation) for Q3FY07 grew 22.8% Y-o-Y to INR 3.57 bn, compared with our estimate of INR 3.16 bn. Other income was higher at INR 1.61 bn compared with INR 1.06 bn in Q3FY06 on profit on sale of non-core equity holdings.

* EBITDA margin continue to be subdued

Pressure on input costs, which increased by 360bps Y-o-Y, and other expenses (primarily selling costs) increased by 60bps Y-o-Y, resulting in EBITDA margin declining 370bps Y-o-Y and 80bps Q-o-Q to 14.2%. EBITDA margin is at its lowest in the past 13 quarters (since Q1FY04). We believe that margins have bottomed out and expect them to improve from Q4FY07 onwards. This judgment is based on the recent price hikes, withdrawal of sales incentives, and subventions on all except the entry level models, continued robust growth in the three-wheeler business, exports, and higher-end models.

* New product launches

Bajaj Auto plans to launch the Kristal scooter and Pulsar 220cc bike in the next few weeks. Further, it will launch three new models in the entry segment based on a new platform by July 2007. These new models are expected to be part of the company's strategy to move away from the low-margin entry level segment by upgrading customers to a higher value product.

* Valuation

We continue to like BAL on its continued robust growth, strong product pipeline, stable to improving margins and value in the balance sheet. We have recalibrated our estimates for FY07E and FY08E. Excluding the value of its investments (INR 1,144 per share), it is trading at 14.3x FY08E and 12.5x FY09E core EPS. We reiterate 'BUY'.

Reuters : BJAT.BO
Bloomberg : BJA IN

Market Data

52-week range (INR) : 3, 325 / 1,974
Share in issue (mn) : 101.2
M cap (INR bn/USD mn) : 280.7 / 6,341.4
Avg. Daily Vol. BSE/NSE ('000) : 290.5

Share Holding Pattern (%)

Promoters : 30.4
MFs, FIs & Banks : 8.5
FII's : 19.9
Others : 41.2

Financials

Year to March	Q3FY07E	Q2FY07	QoQ (%)	Q3FY06	YoY (%)	FY07E	FY08E
Net revenues (INR mn)	25,682	24,360	5.4	20,009	28.4	98,712	124,051
EBITDA (INR mn)	3,636	3,652	(0.4)	3,581	1.5	15,096	19,305
Net profit (INR mn)	3,571	3,314	7.8	2,908	22.8	12,848	16,060
EPS (INR)	35.3	32.8	7.8	28.7	22.8	127.0	158.7
P/E (x)						21.9	17.5
EV/EBITDA (x)						16.3	12.8
ROE (%)						23.3	24.8

* Other highlights

Bajaj Auto expects to increase its motorcycle capacity to 300,000 units per month by April 2007, compared with 250,000 units per month at present, partly through expansion and partly at the new plant at Pantnagar in Uttaranchal. We expect the current product mix of models (entry level 35%, executive segment 45%, and premium segment 20%) to move marginally in favour of the premium segment over the next 1-3 quarters.

* Revision in estimates

We have recalibrated our FY07 and FY08 estimates marginally on back of lower operating margins. Our revised estimate for FY07 EPS is INR 127 compared with INR 131.4 earlier. For FY08, our revised estimate stands at INR 158.7 compared with INR 160.1 earlier. This is based on lower margins of 15.3% for FY07E and 15.6% for FY08E compared with 16.8% and 16.3%, respectively, earlier. We continue to maintain our volume estimates at 2.48 mn motorcycles and 2.84 mn for total sales for FY07E and 3.03 mn motorcycles and 3.5 mn total sales for FY08.

Company description

Bajaj Auto Ltd. is the second largest two-wheeler manufacturer in India with a market share of 35%. It offers products in all motorcycle segments—*Platina* (entry), *Discover* (executive), and *Pulsar* (premium). It is also the largest three-wheeler manufacturer in India. In addition, it has presence in the life and general insurance businesses, in joint venture with Allianz AG of Germany, in which it has 74% stake each.

Investment thesis

Bajaj Auto is our best pick in the two-wheelers space as we see greater visibility on strong volume growth, both in domestic and export markets. It has a wide product portfolio and new model line up based on its in-house research and development capability. We expect margins to remain stable to improving slightly over the next two years. Further, there is a potential for significant value unlocking from the demerger of its investment portfolio including its stake in the insurance businesses, which the company has indicated it is in the process of evaluating.

Risks to the recommendation

Increasing input costs and higher selling costs due to intense competition can continue to keep margins under pressure. Further, given a slew of new model introductions planned over the next few quarters, non-performance of one or more key models could affect volume growth.

Financials snapshot							(INR mn)	
Year to March	Q3FY07	Q3FY06	YoY%	Q2FY07	QoQ%	FY06	FY07E	FY08E
Volumes								
Motorcycles	652,406	511,106	27.6	623,062	4.7	1,912,306	2,485,998	3,032,917
Scooters-Geared	0	16,518	(100.0)	696	(100.0)	63,384	0	0
Scooters-ungeared	173	15,628	(98.9)	3,684	(95.3)	52,611	36,828	101,276
Stepthrus	0	0		0		864	0	0
Total 2 Wheelers	652,579	543,252	20.1	627,442	4.0	2,029,165	2,522,826	3,134,193
Three Wheelers	85,640	57,572	48.8	80,683	6.1	252,054	315,068	362,328
Total Units sold (nos)	738,219	600,824	22.9	708,125	4.2	2,281,219	2,837,893	3,496,521
Exports(of the above)	115,619	64,359	79.6	111,847	3.4	250,204	425,347	595,486
Realisation (INR)	34,790	33,303	4.5	34,400	1.1	33,613	34,783	35,478
Revenues (gross)	29,267	22,847		27,751		87,484	110,291	136,579
Less: Excise	3,585	2,838		3,392		10,805	13,938	15,171
Income from services								
Revenues (net)	25,682	20,009	28.4	24,360	5.4	76,679	98,712	124,051
Other operating income								
Total revenues	25,682	20,009	28.4	24,360	5.4	76,679	98,712	124,051
Dec/(inc) in stock	(47)	(50)		68		-490		
Raw material	18,903	14,029	34.7	17,623	7.3	53,736	71,737	90,815
Staff costs	757	676	12.1	726	4.3	2,741	3,085	3,504
Other expenses	2,492	1,823	36.7	2,345	6.2	7,377	9,054	10,701
Expenses capitalised	(59)	(49)		(55)		(248.1)	(260.5)	(273.5)
Total expenditure	22,046	16,428	34.2	20,708	6.5	63,116	83,616	104,746
EBITDA	3,636	3,581	1.5	3,652	(0.4)	13,563	15,096	19,305
Interest	2	1	57.1	20	(89.0)	3	4	4
Depreciation	472	491	(3.8)	492	(4.0)	1,910	2,087	2,350
Other income	1,610	1,064	51.3	1,424	13.0	4,385	5,616	5,829
PBT	4,771	4,153	14.9	4,564	4.5	16,034	18,620	22,780
Tax	1,200	1,245	(3.6)	1,250	(4.0)	4,791	5,772	6,720
Adj. net profit	3,571	2,908	22.8	3,314	7.8	11,243	12,848	16,060
period items/ write-down/ VRS	120	118	1.0	139	(13.8)	10	(378)	0
Net profit	3,452	2,790	23.7	3,176	8.7	11,233	13,226	16,060
Equity capital (FV INR 10)	1,012	1,012	0.0	1,012	-	1,012	1,012	1,013
Number of shares (mn)	101	101	0.0	101	-	101	101	101
Adj. EPS (INR)	35.3	28.7	22.8	32.8	7.8	111.1	127.0	158.5
EPS	34.1	27.6	23.7	31.4	8.7	111.0	130.7	158.5
PE (x)						25.0	21.2	17.5
EV/EBITDA (x)						26.0	23.8	19.3
As % of net revenues								
Raw material	73.4	69.9	3.6	72.6	0.8	69.4	72.7	73.2
Staff costs	2.9	3.4	(0.4)	3.0	0.0	3.6	3.1	2.8
Other expenses	9.5	8.9	0.6	9.4	0.1	9.6	9.2	8.6
EBITDA	14.2	17.9	(3.7)	15.0	(0.8)	17.7	15.3	15.6
Adj. net profit	13.9	14.5	(0.6)	13.0	0.9	14.7	13.0	12.9
Tax rate	25.1	30.0	(4.8)	27.4	(2.2)	29.9	31.0	29.5

Financial Statements

Income statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Total volume (nos)	1,824,699	2,281,219	2,837,893	3,496,521	4,171,903
% Growth	20.2	25.0	24.4	23.2	19.3
Income from operations	58,878	76,285	98,712	124,051	149,242
Materials costs	40,897	53,246	71,737	90,815	109,832
Stores and tools	630	742	867	1,093	1,243
Staff costs	2,491	2,741	3,085	3,504	4,106
S G & A expenses	5,945	6,435	8,187	9,608	10,973
Less: Expenses capitalised	198	248	261	274	287
Total operating expenses	49,763	62,917	83,616	104,746	125,867
EBITDA	9,114	13,368	15,096	19,305	23,375
Non-operational income	4,101	4,580	5,616	5,829	6,377
PBDIT	13,215	17,947	20,712	25,134	29,752
Interest	7	3	4	4	5
Depreciation and amortisation	1,854	1,910	2,087	2,350	2,587
Provisions/ VRS	490	226	-	-	-
Profit before tax	10,864	15,808	18,620	22,780	27,160
Prior period adjustments (net)	(18)	217	-	-	-
Extraordinary income/ (loss)	-	-	(378)	-	-
Provision for tax	3,196	4,791	5,772	6,720	7,876
Adjusted profit after tax	7,668	11,017	12,848	16,060	19,283
Reported profit after tax	7,650	11,234	12,470	16,060	19,283
Shares outstanding	101	101	101	101	101
Dividend per share	28.5	45.6	49.3	63.5	76.2
Dividend payout (%)	37.6	41.9	38.8	40.0	40.0

Common size metrics- as % of net revenues

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Operating expenses	84.5	82.5	84.7	84.4	84.3
Materials costs	69.5	69.8	72.7	73.2	73.6
Staff costs	4.2	3.6	3.1	2.8	2.8
S G & A expenses	10.1	8.4	8.3	7.7	7.4
Depreciation	3.1	2.5	2.1	1.9	1.7
Interest expenditure	0.0	0.0	0.0	0.0	0.0
EBITDA margins	15.5	17.5	15.3	15.6	15.7
Net profit margins	12.2	13.6	12.3	12.4	12.4

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Revenues	20.4	30.5	29.0	26.0	20.5
EBITDA	7.5	46.7	12.9	27.9	21.1
PBT	13.1	45.5	17.8	22.3	19.2
Net profit	4.8	43.7	16.6	25.0	20.1
EPS	4.8	43.7	16.6	25.0	20.1

Balance sheet					(INR mn)
As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Equity capital	1,012	1,012	1,012	1,012	1,012
Reserves & surplus	40,332	46,696	54,177	63,813	75,383
Shareholders funds	41,343	47,707	55,189	64,825	76,395
Unsecured loans	12,270	14,671	16,671	18,671	20,671
Borrowings	12,270	14,672	16,672	18,672	20,672
Deferred tax (Net)	1,399	876	876	876	876
Deferred Tax liability	2,128	1,902	1,902	1,902	1,902
Deferred Tax Assests	729	1,026	1,026	1,026	1,026
Sources of funds	55,012	63,255	72,737	84,372	97,943
Gross block	27,436	28,929	32,671	36,671	39,671
Depreciation	16,286	17,787	19,875	22,224	24,811
Net block	11,150	11,142	12,796	14,446	14,859
Lease Adj. Account-Plant & M/c	175	175	175	175	175
Capital work in progress	84	242	0	0	0
Technical know-how	41	13	13	13	13
Investments	45,606	58,570	64,076	74,284	86,833
Inventories	2,242	2,729	3,960	4,989	6,012
Sundry debtors	1,763	3,016	3,168	3,992	4,809
Cash and bank balance	1,087	821	1,700	2,142	2,580
Loans and advances	20,120	21,274	21,274	21,274	21,274
Other current assets	685	721	721	721	721
Total current assets	25,897	28,561	30,822	33,118	35,396
Sundry creditors and others	7,851	12,289	11,046	12,129	12,510
Provisions	20,089	23,159	24,099	25,535	26,825
Total current liab. & provisions	27,940	35,448	35,146	37,664	39,335
Net current assets	(2,042)	(6,887)	(4,323)	(4,547)	(3,939)
Uses of funds	55,012	63,255	72,737	84,372	97,943
Book value per share (BV) (INR)	409	471	545	641	755

Cash flow statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
PBIT	7,471	11,837	13,236	17,210	21,073
Less: Actual tax paid	3,384	5,186	5,772	6,720	7,876
Less: Tax shield on interest	2	1	1	1	1
Add: Tax on int. & invt. income	1,212	1,378	1,670	1,645	1,766
NOPLAT	5,297	8,028	9,133	12,133	14,962
Add: Depreciation	1,854	1,910	2,087	2,350	2,587
Gross cash flow	7,150	9,938	11,220	14,483	17,549
Less: Capital expenditure	905	2,033	3,500	4,000	3,000
Less: Working capital investment	(480)	(1,020)	935	771	1,459
Less: Increase in other assets	4,434	1,190	-	-	-
Add: Increase in other liabilities/provis	3,559	3,058	941	1,436	1,289
Add: Fresh cash from equity	-	-	-	-	-
Free cash flow	5,850	10,794	7,726	11,148	14,380

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROE (%)	18.5	23.1	23.3	24.8	25.2
ROCE (%)	20.7	25.4	25.6	27.0	27.7
Inventory days	14	14	15	15	15
Debtors days	11	11	12	12	12
Fixed asset turnover (x)	2.1	2.6	3.0	3.4	3.8
Debt/Equity	0.3	0.3	0.3	0.3	0.3

Valuations parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (INR)	75.8	108.9	127.0	158.7	190.6
<i>Y-o-Y growth (%)</i>	<i>4.8</i>	<i>43.7</i>	<i>16.6</i>	<i>25.0</i>	<i>20.1</i>
CEPS (INR)	94.1	127.8	147.6	181.9	216.1
PE (x)	36.6	25.5	21.9	17.5	14.6
Price/BV (x)	6.8	5.9	5.1	4.3	3.7
EV/Sales (x)	4.2	3.2	2.5	2.0	1.7
EV/EBITDA (x)	27.0	18.4	16.3	12.8	10.5

Edelweiss Securities

14th Floor, Express Towers,
Nariman Point, Mumbai – 400 021
Board: (91-22) 2286 4400
Email: research@edelcap.com



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Head, Institutional Equities

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			Dipesh Shah	- 2286 4434

Email addresses: firstname.lastname@edelcap.come.g. naresh.kothari@edelcap.com

unless otherwise specified

RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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