Bajaj Auto

Robust business outlook already priced in; downgrade to REDUCE

India Equity Research I Auto & Auto Ancillaries | September 16, 2011 | Company Update

- **With limited scope of appreciation from current levels, we downgrade our rating to REDUCE (from Accumulate) but raise our PT to Rs1,659 (from Rs1,528).**
- **We model in a revenue CAGR of 18% over FY11-13E, led by volume CAGR of 16% for motorcycles (MC) and 18% for three-wheelers (3-W). We estimate an EBITDA margin of 19.3% in FY13E, leading to a 14% earnings CAGR during FY11-13E.**
- **We expect cash on books to inflate to ~Rs65 bn by FY13E, reducing ROCE to ~62% vs ~80% for Hero Motocorp (HMCL IN), thereby reducing the possibility of a re-rating from current levels led by the shrinking of valuation gap with HMCL.**

Exports drive 17% YTD volume growth; domestic MC market share drops by ~170bp to ~26% y-y: Domestic MC volume of BJAUT is up ~9% YTD vs industry growth of ~16%, losing share by ~170bp to 26% y-y. Export MC volume is up 32% YTD, which we believe is not sustainable in the longer run. We model in volume CAGR of 9.5% and 31.0% for MC in the domestic and export markets, respectively in FY11-13E. 3-W volume is up 23% YTD, led by exports volume growth of 43% and domestic volume contraction of 3%. We model in an overall 3-W volume CAGR of 18% over FY11-13E, led by a volume CAGR of 5% and 28% in the domestic and export markets, respectively. We estimate volume at 4.6 mn and 5.1 mn in FY12 and FY13 (against 4.4 mn and 4.9 mn earlier), respectively, leading to a revenue CAGR of 18% over FY11-13E to Rs230 bn in FY13E.

Negative drivers of margin outweigh positive drivers; model in a 19% EBITDA margin in FY13E: We expect negative margin drivers such as weaker product mix, the reduction in export benefits and the need for higher sales expenditure led by rising competition to outweigh positive margin drivers like a potential fall in raw material costs, a depreciating rupee and better operating leverage. We believe revenue contribution of the *Pulsar* brand is gradually dropping, being substituted by new lower margin models/variants like *Discover* and *Boxer.* Additionally, we expect 3-W volume growth to peak in FY12, thereby worsening product mix. We have factored in benefits of 6% of export value against existing ~10%. We are increasing our EBITDA margin estimates for FY12/13E by 10/50bp respectively led by swift weakening in INR thus increasing our earning estimates by 7.6%/8.2% for FY12/13E respectively.

Lower capex need & ~40-50% dividend payout to lead to rising cash on hand, reducing scope of re-rating: We expect cash on books to reach Rs65 bn by FY13E after factoring in capex of Rs7.5 bn and a dividend payout of ~60% over FY12-13E, leading to ROCE dropping to ~62% in FY13E from ~68% in FY11. We believe BJAUT can deliver a ~80% ROCE comparable with industry leader HMCL, by increasing dividend payout to ~80%-plus levels. We think this can a possible trigger for incremental re-rating of BJAUT, shrinking the EV/EBITDA gap with HMCL further from the mean levels of 25%.

Valuation: We downgrade BJAUT to REDUCE from Accumulate with a revised 12-month PT of Rs1,659 (from Rs1,528) based on 13.5x FY13E core earnings (from 9x FY13E EV/EBITDA) and a Rs36/share value of its stake in KTM AV. We have chosen core earnings multiple to calculate our PT to keep parity with HMCL. At our revised price target, BJAUT would be trading at ~9.5x FY13E EV/EVITDA.

Risks: No reduction in export benefits, the continuation of 30%-plus in export volume, recovery in domestic three-wheelers sales growth to 10-12% levels, a sharp fall in input commodity costs and a depreciating rupee are key risks to our call.

REDUCE Rs1,629

Reuters: BAJA.BO; Bloomberg: BJAUT IN

12-month price target Rs1,659

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Market cap:	Rs471 bn (US$9.8 bn)
52-week high/low:	Rs1,695/Rs1,190
Share o/s:	289 mn
Share o/s (fully diluted):	289 mn
Avg daily trading vol (3m):	447 ('000)
Avg daily trading val (3m):	Rs661 mn (US$13.8 mn)

Source: Bloomberg

Quant vs Consensus (Rs)

	PT	EPS (FY13E)
Mean	1,578	106.1
High	1,850	118.5
Low	968	89.4
Quant	1,659	119.2

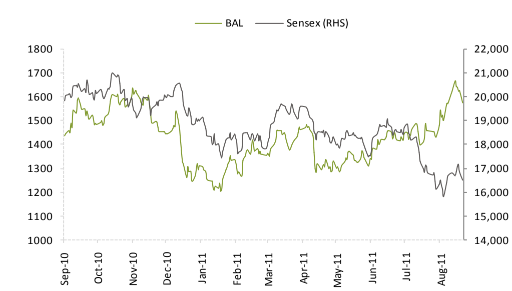
	Buy(s)	Hold(s)	Sell(s)
Nos	41	14	6

Shareholding pattern (%)

	Jun 11	Mar 11	Dec 10
Promoter	50.0	50.2	49.7
FII	15.8	16.0	17.8
MF/FI/Bank	8.1	7.9	6.2
Other	26.1	26.1	26.3

Source: BSE

Price performance (Rs) vs the Sensex



Source: Bloomberg

Exhibit 1: Financial and valuation (YE March)

	Revenue		EBITDA		Adjusted net income		EPS	PE	EV/EBITDA	ROCE	ROE
	(Rs mn)	Growth(%)	(Rs mn)	Margin (%)	(Rs mn)	Growth(%)	(Rs/share)	(x)	(x)	(%)	(%)
FY10	119,210	35.3	25,926	21.7	18,652	112.3	64.5	25.2	16.9	63.9	77.7
FY11	166,089	39.3	33,849	20.4	26,152	40.2	90.4	18.0	12.6	68.4	66.7
FY12E	204,531	23.1	39,492	19.3	31,084	18.9	107.4	15.2	10.5	65.3	55.9
FY13E	230,905	12.9	43,875	19.0	34,503	11.0	119.2	13.7	9.3	61.6	51.2

Note: Pricing as on 15 September 2011; Source: Company data, Quant Global Research estimates

Export driven growth; losing share in domestic market

We model in a revenue CAGR of 18% over FY11-13E

We are modelling in an overall volume of 4.65 mn and 5.18 mn for MC and 3-W, respectively, at a CAGR of 16.4% over FY11-13E. We are modelling in a revenue CAGR of 18% during FY11-13E with revenue of Rs231 bn in FY13E

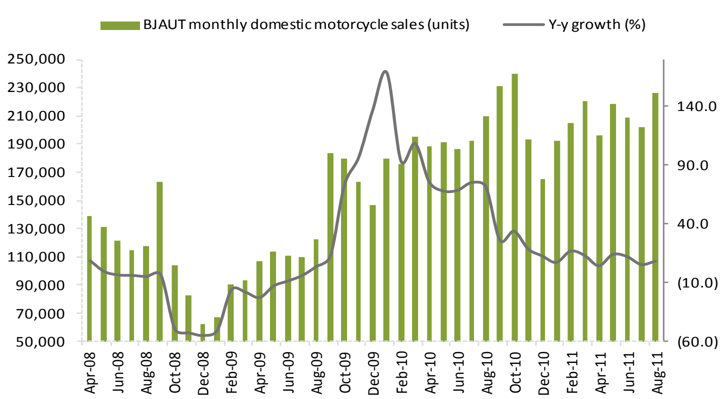
BJAUT's domestic motorcycle volume has grown by 8.8% YTD vs industry growth of 15.5% YTD, signifying a market share erosion of 170bp during the same period last year to the present level of 25.7%. We are factoring in 12% volume growth for the industry in FY13E, with BJAUT's share at current levels of ~26%. Management is targeting monthly volume at 30,000 units from the newly launched Boxer 150cc, thereby adding to the stable ~85,000 per month rate of Pulsar and 140,000 pm rate of Discover. MC volume growth of 16.5% YTD is primarily driven by 32% YTD growth in export volume, which we believe is not sustainable. We estimate 20% export volume growth in FY13E. We model in MC volume at 4.1 mn units and 4.6 mn units in FY12E and FY13E, respectively.

Domestic 3-W volume down 3% YTD for BJAUT

Volume is down by ~3% YTD at 74,982 units in the domestic passenger 3-W segment, with the market share unchanged around 48%. Export volume is up ~43% YTD to 142,445 units, leading to overall 3-W volume growth of 23% YTD. With export volume contributing around 65% of total 3-W sales, we expect BJAUT overall 3-W volume growth to have peaked out in past few months. We believe domestic 3-W demand is lumpy in nature as it is dependent on opening of permits across new states, thereby affecting demand. We are factoring in a volume CAGR of 5% and 28% in FY11-13E for domestic and export 3-W, respectively, leading to total 3-W sales of 0.56 mn and 0.61 mn in FY12E and FY13E, respectively, resulting in a CAGR of 18% during FY11-13E.

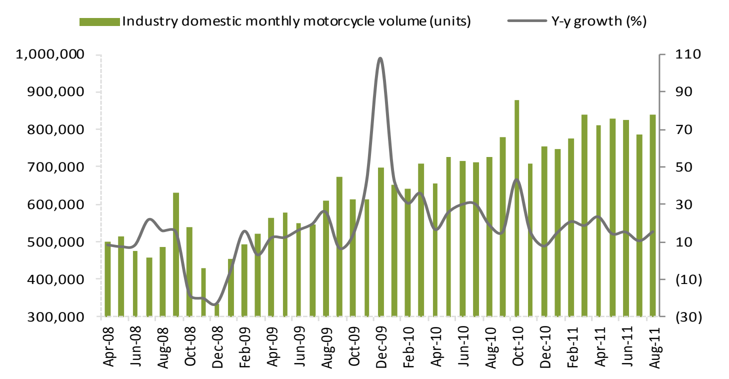
We are modelling in an overall volume of 4.65 mn and 5.18 mn for MC and 3-W, respectively, at a CAGR of 16.4% over FY11-13E. We are modelling in a revenue CAGR of 18% during FY11-13E with revenue of Rs231 bn in FY13E.

Exhibit 2: Domestic MC volume up ~9% YTD



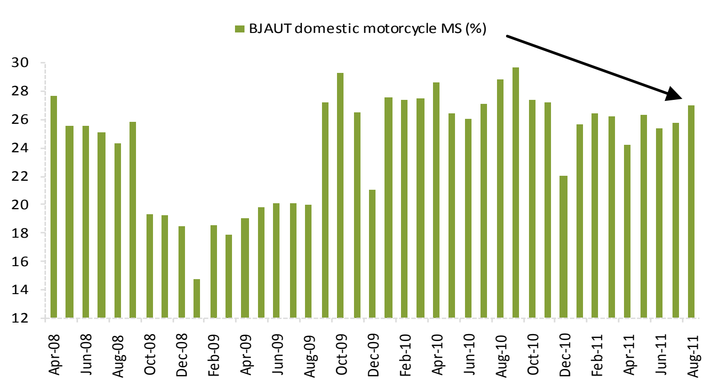
Source: SIAM, Quant Global Research

Exhibit 3: We expect an industry volume CAGR of 12% over FY11-13E



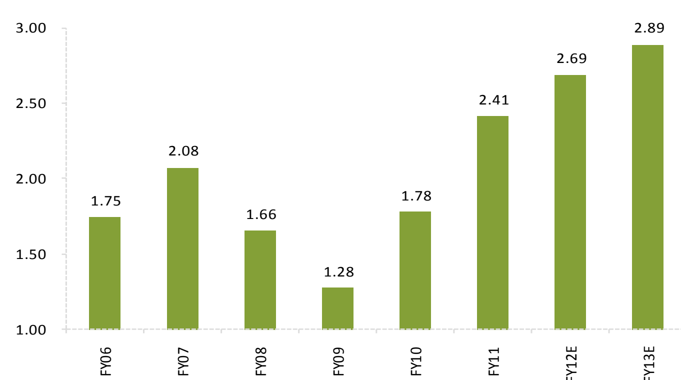
Source: SIAM, Quant Global Research

Exhibit 4: Losing domestic share despite multiple variant launches



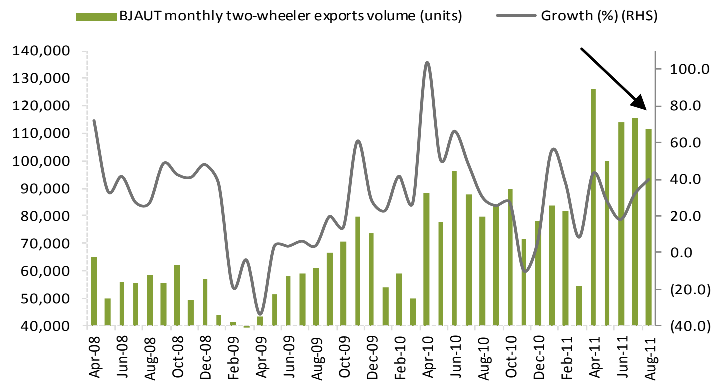
Source: SIAM, Quant Global Research

Exhibit 5: Model in domestic MC volume of 2.9 mn in FY13E



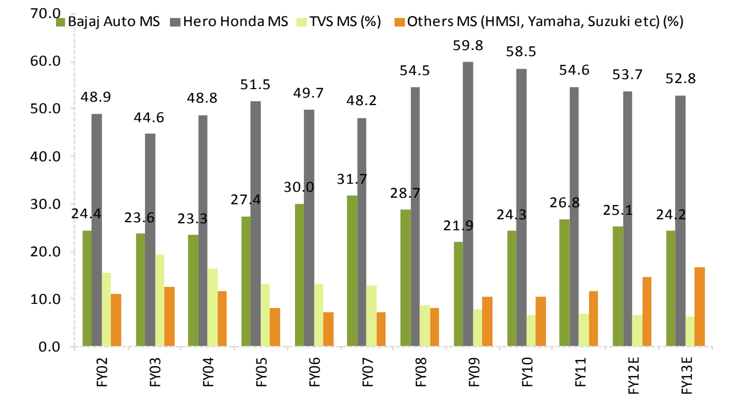
Source: SIAM, Quant Global Research estimates

Exhibit 6: MC export growth of 32% YTD is not sustainable



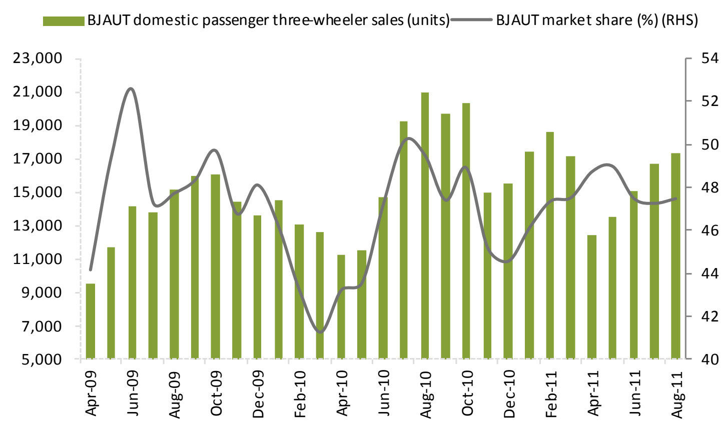
Source: SIAM, Quant Global Research

Exhibit 7: Market share expected to consolidate ~26% over FY12-13E



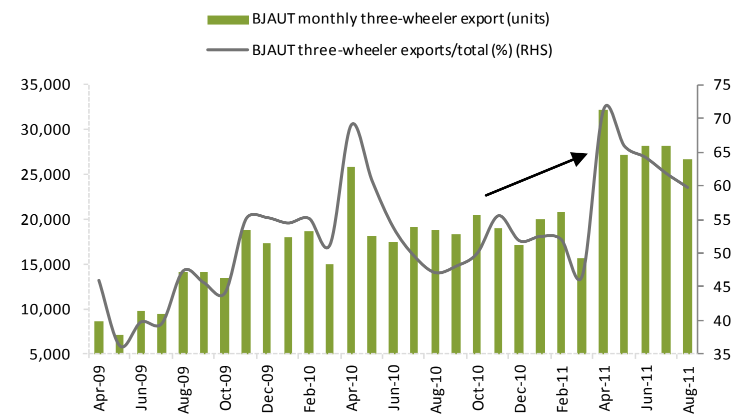
Source: SIAM, Quant Global Research estimates

Exhibit 8: Domestic passenger three-wheelers' share stable ~47%



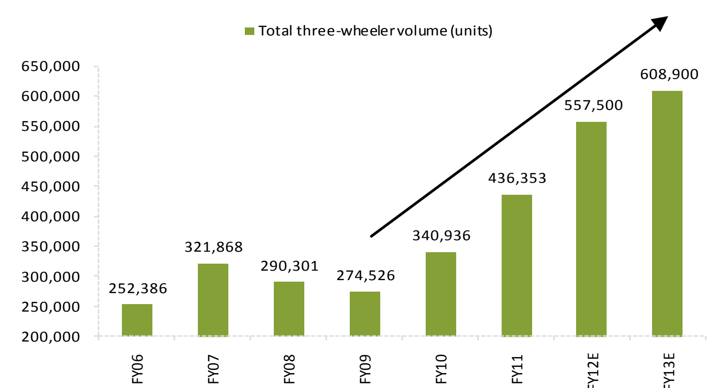
Source: SIAM, Quant Global Research

Exhibit 9: Three-wheelers export rebasing to new levels from FY12



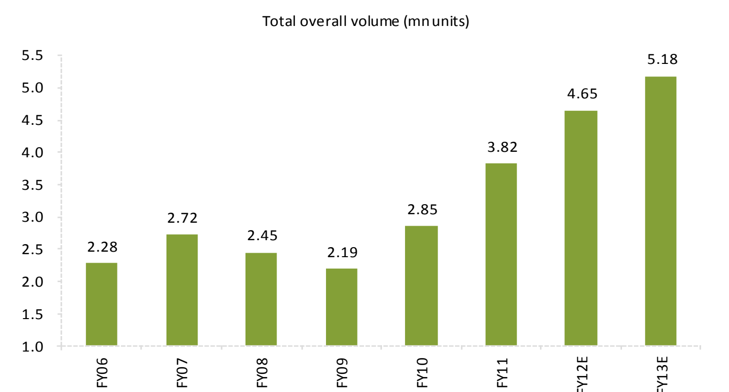
Source: SIAM, Quant Global Research

Exhibit 10: Export-led growth in three-wheelers sales



Source: SIAM, Quant Global Research estimates

Exhibit 11: Model in an overall volume of 5.18 mn in FY13E



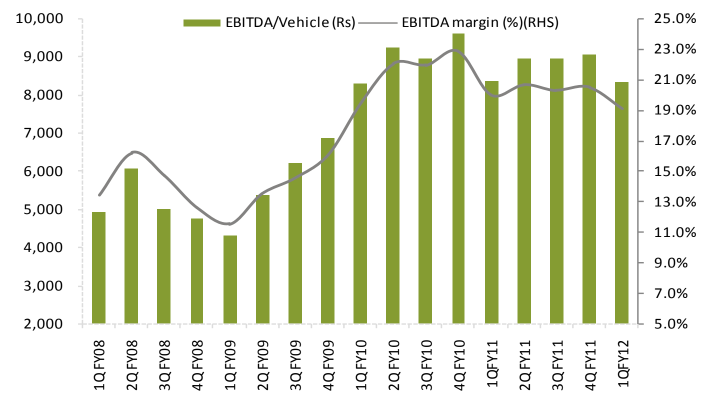
Source: SIAM, Quant Global Research estimates

We expect EBITDA margin to stabilize around 19%

Raising dividend payout to ~80% can result in an ROCE of ~80%

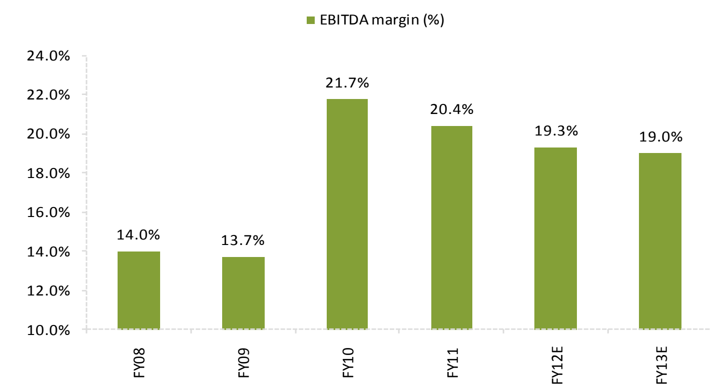
We are modeling in an EBITDA margin of 19% in FY13E after factoring lower raw material costs, a depreciating rupee and improving operating leverage against negative factors like weaker product mix, the need for higher sales & marketing expenditure and export benefit withdrawal. We have factored in export benefits of 6% in FY13E against existing levels of ~10%. After incorporating revenue and margin estimates, we expect a PAT CAGR of 15% over FY11-13E. Management has hedged 90% and 70% of estimated exports value in FY12E and FY13E at an US$/INR rate of ~47, thereby leaving behind a small window in benefitting from the current depreciating rupee.

Exhibit 12: We expect margin to consolidate around 19% levels



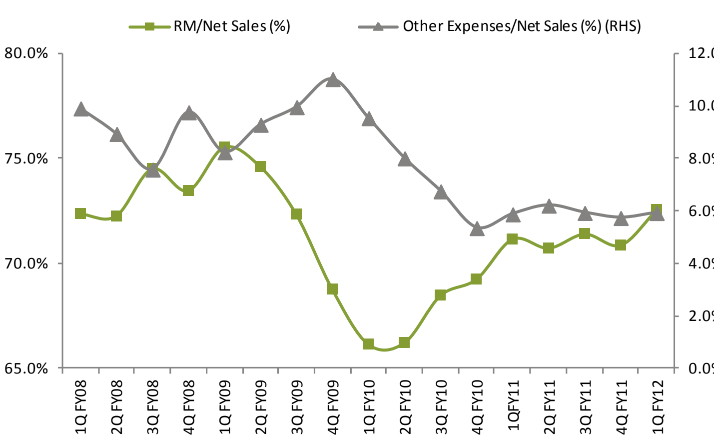
Source: Company data, Quant Global Research estimates

Exhibit 13: Peaking of growth in three-wheelers/ *Pulsar* to cap margin



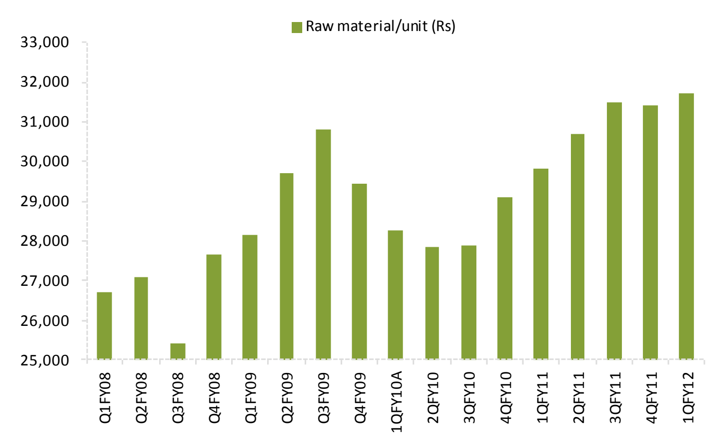
Source: Company data, Quant Global Research estimates

Exhibit 14: RM/sales at almost two-year highs; DEPB uncertainty continues



Source: Company data, Quant Global Research

Exhibit 15: RM/vehicle can contract ahead led by slower growth in three-wheelers



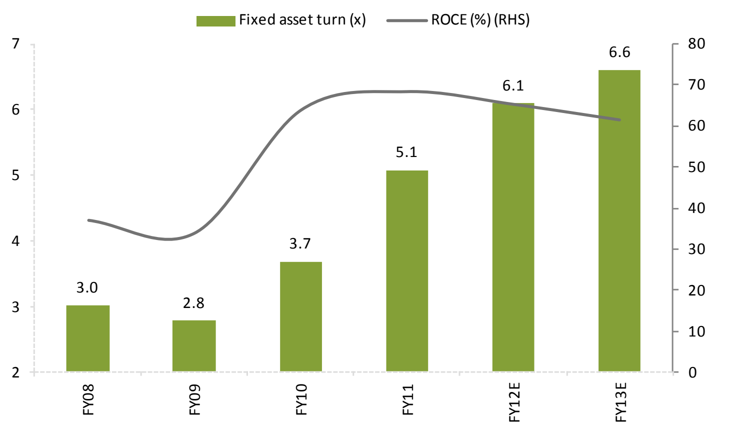
Source: Company data, Quant Global Research

Rising cash chest to dent capital efficiency with no plans of raising dividend payout

Management has guided for capex of Rs7.5 bn over FY12-13E to expand existing capacity from 5.0 mn units to 6.2 mn units along with maintenance capex. We expect BJAUT to generate operating cashflow of Rs40 bn, ie, ~8x that of capex requirement in FY13E, leading to liquid investment book inflating to ~Rs65 bn. We model in a dividend payout of 50% and 60% in FY12E and FY13E, respectively. We expect BJAUT to operate at an ROE in the range of 50-55% during FY12-13E. In the past month, BJAUT has received Rs8 bn out of the pending receivables of Rs11 bn from the Maharashtra government in the form of VAT refund, thereby freeing working capital and adding to income-generating investment book.

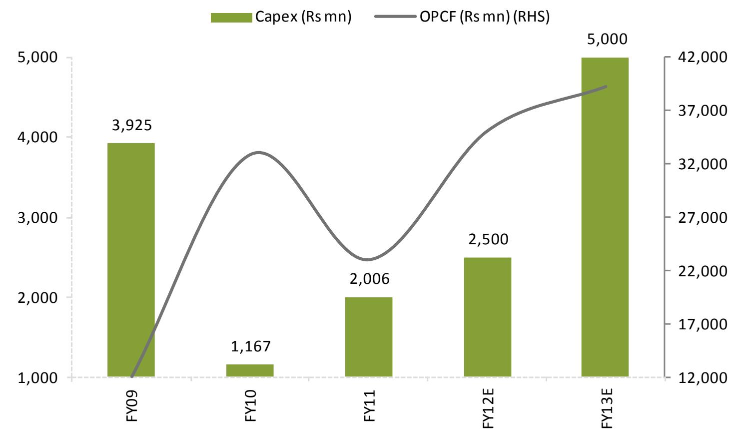
We believe with liquid cash/equivalents contributing ~50% of the balance sheet size, BJAUT can improve its capital efficiency to ~80% from the exisiting 65% levels, by increasing its dividend payout to ~80% in both FY12E and FY13E against 40% in FY11 while maintaining its operational efficiency as per our estimates.

Exhibit 16: We expect ROCE to stabilize ~60-65% over FY12-13E



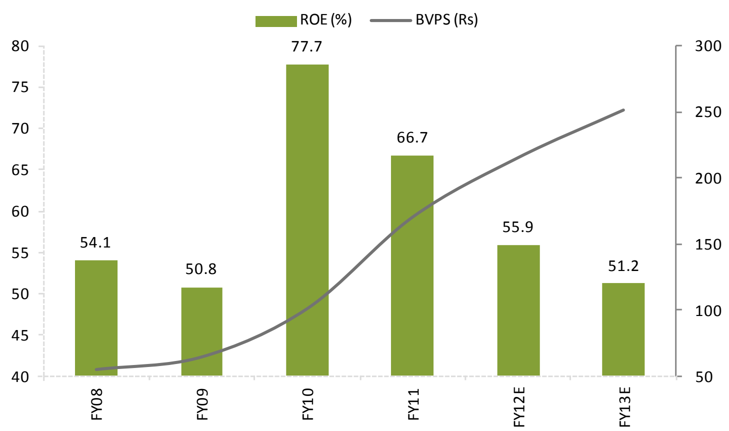
Source: Company data, Quant Global Research estimates

Exhibit 17: We expect BJAUT to generate OPCF of 8x capex needs in FY13E



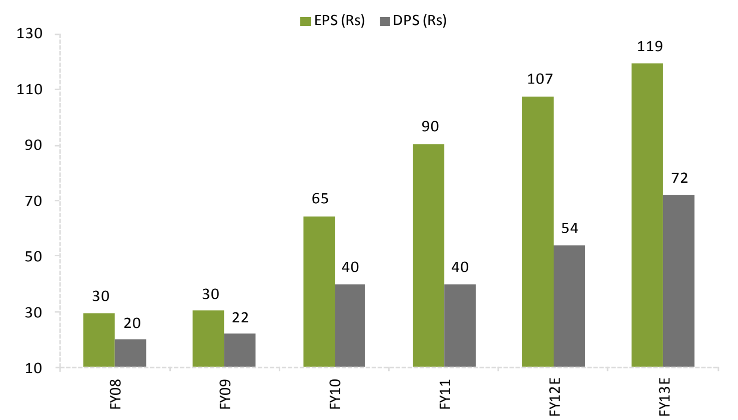
Source: Company data, Quant Global Research estimates

Exhibit 18: ROE falling from peak of 78% in FY10 on an expanding book



Source: Company data, Quant Global Research estimates

Exhibit 19: Model in a 60% dividend payout in FY13E against ~45% in FY11



Source: Company data, Quant Global Research estimates

Exhibit 20: Revision in estimates

	Previous estimates		Revised estimates	
	FY12E	FY13E	FY12E	FY13E
Volume (mn units)	4.4	4.9	4.6	5.1
Revenue (Rs mn)	195,406	217,836	204,531	230,905
Operating profit (Rs mn)	37,582	40,283	39,492	43,875
OPM (%)	19.2	18.5	19.3	19.0
Net profit (Rs mn)	28,882	31,862	31,084	34,503
EPS (Rs)	99.8	110.1	107.4	119.2
Price target (Rs)	1,528		1,659	
Rating	ACCUMULATE		REDUCE	

Source: Company data, Quant Global Research estimates

Exhibit 21: Outperforming the Sensex though BJAUT lags HMCL

Return (%)	1-mth	3-mth	6-mth	1-yr
BJAUT	11.6	18.5	17.6	10.7
HMCL	16.4	26.8	43.8	27.9
BSE Auto	0.7	(0.5)	(2.7)	(7.4)
BSE Sensex	(0.8)	(8.7)	(9.4)	(13.6)
BJAUT outperforming Sensex	**12.4**	**27.2**	**27.0**	**24.3**

Source: Bloomberg, Quant Global Research

Valuation

Factoring target P/E of 13.5x vs 15% earnings CAGR over FY11-13E

We downgrade BJAUT to REDUCE from Accumulate but raise our 12-month PT to Rs1,659 (from Rs1,528) based on 13.5x FY13E core earnings along with Rs36/share value of our stake in KTM.

We factor in a target earnings multiple of 13.5x, which we believe is highly unlikely to be breached on the upside considering a 15% earnings CAGR over FY11-13E and consensus target earnings multiple of ~15-16x for the industry leader HMCL. Historically, HMCL has traded at premium of 20-30% in terms of EV/EBITDA and 20% in terms of P/E compared to BJAUT, barring few outlier periods. We expect valuation premium of HMCL over BJAUT to persist ahead led by sustainability of the difference in capital efficiency and market leadership. At our target multiple, HMCL P/E premium would be around ~18% and we expect this gap to narrow in case there is an improvement in capital efficiency in BJAUT through a higher dividend payout.

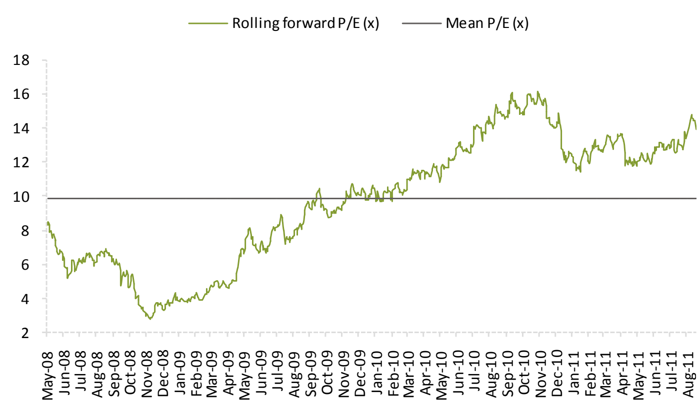
Downgrade to REDUCE with a revised PT of Rs1,659

We downgrade BJAUT to REDUCE from Accumulate but raise our 12-month PT to Rs1,659 (from Rs1,528) based on 13.5x FY13E core earnings along with Rs36/share value of our stake in KTM and the Indonesian unit. We are using an earnings multiple instead of EV/EBITDA to arrive at our price target to keep parity with the valuation methodology we used for HMCL. Compared to our target EV/EBITDA of 9x as per our previous report, BJAUT would be trading at ~9.5x FY13E EV/EBITDA.

Exhibit 22: EV/EBITDA premium of 30% for HMCL vs BJAUT

Source: Bloomberg, Quant Global Research estimates

Exhibit 23: We factor in a target P/E of 13.5x



Source: Bloomberg, Quant Global Research estimates

Exhibit 24: SOTP valuation; the stock would trade at ~9.5x FY13E EV/EBITDA at our price target

SOTP - BAJAJ AUTO (FY13E)					(Rs mn)
Automotive					
Core EPS (Rs)					107
Target P/E (x)					**13.5**
Target value /share of core business (Rs mn)					1,444
Cash/share (Rs)					179
Standalone business/ share value (A)(Rs)					1,623
Investments	**BAL holding**	**Metric**	**Value of metric (Rs mn)**	**Share of BAL (Rs mn)**	**Per share (Rs)**
B.KTM Power Sports	39%	Market cap	26,676	10,483	36
Total value per share of Bajaj Auto (A+B)(Rs.)					**1,659**

Source: Quant Global Research estimates

Key financials

Exhibit 25: Financial statements (YE March)

Income Statement (Rs mn)	FY10	FY11	FY12E	FY13E
Net revenue	119,210	166,089	204,531	230,905
Expenditure	93,284	132,240	165,039	187,030
Raw materials	81,384	118,838	148,064	167,297
Employee expenses	3,995	4,768	5,748	6,530
Other expenditure	7,906	8,635	11,226	13,203
EBITDA	25,926	33,849	39,492	43,875
Non-operating income	1,225	3,658	3,800	4,500
Depreciation	1,365	1,228	1,276	1,422
EBIT	25,787	36,279	42,016	46,953
Net interest expense	60	17	10	10
Adjusted pre-tax profit	25,727	36,262	42,006	46,943
Unusual or infrequent items				
Reported pre-tax profit	25,727	36,262	42,006	46,943
Less: taxes	7,075	10,110	10,921	12,440
Reported net profit	18,652	26,152	31,084	34,503
Add: extraordinary items (post-tax basis)	(1,615)	7,246	0	0
Less: minority/associate earnings				
Reported net profit for shareholders	17,037	33,397	31,084	34,503
Adjusted net profit for shareholders	18,652	26,152	31,084	34,503
EPS (Rs), based on wtd avg shares	64.5	90.4	107.4	119.2
EPS (Rs), based on fully diluted shares	64.5	90.4	107.4	119.2
Year-end shares outstanding (mn)	145	289	289	289
Weighted average shares outstanding (mn)	145	289	289	289
Fully diluted shares outstanding (mn)	289	289	289	289

Growth ratio (%)				
Net revenue	35.3	39.3	23.1	12.9
EBITDA	114.4	30.6	16.7	11.1
Adjusted net profit	112.3	40.2	18.9	11.0

Ratios (%)	FY10	FY11	FY12E	FY13E
Effective tax rate	27.5	27.9	26.0	26.5
EBITDA margin	21.7	20.4	19.3	19.0
Adjusted net income margin	15.6	15.7	15.2	14.9
Net debt/equity	(0.6)	(0.8)	(0.9)	(0.9)
ROaCE	63.9	68.4	65.3	61.6
ROaE	77.7	66.7	55.9	51.2
Total asset turnover ratio (x)	3.7	5.1	6.1	6.6
Inventory days	13.7	12.0	12.6	13.7
Debtor days	7.3	8.0	8.7	9.8

Per share numbers (Rs)	FY10	FY11	FY12E	FY13E
Diluted earnings	64.5	90.4	107.4	119.2
Cash earnings	69.3	94.6	111.8	124.2
Free cash	219.4	72.7	112.7	118.4
Book value	101.3	169.7	214.7	250.8

Valuations (x)	FY10	FY11	FY12E	FY13E
Price to diluted earnings	25.2	18.0	15.2	13.7
EV/EBITDA	16.9	12.6	10.5	9.3
Price to book	16.1	9.5	7.6	6.5

Balance Sheet (Rs mn)	FY10	FY11	FY12E	FY13E
Equity capital	1,447	2,894	2,894	2,894
Reserves and surplus	27,837	46,209	59,229	69,672
Deferred tax liability (net)	16	297	297	297
Total equity	29,300	49,399	62,420	72,863
Secured loans	130	237	0	0
Unsecured loans	13,256	3,016	1,893	770
Minority interest				
Total borrowings	13,386	3,254	1,893	770
Current liabilities	28,579	39,553	48,930	57,560
Total liabilities	71,264	92,206	113,243	131,193
Cash	1,014	5,565	5,868	2,457
Inventory	4,462	5,473	7,060	8,636
Debtors	2,395	3,628	4,887	6,169
Other current assets	7,968	14,103	18,267	20,693
Total current assets	15,838	28,769	36,082	37,955
Gross block	33,793	33,909	37,007	42,007
Less: depreciation and amortisation	(18,997)	(19,125)	(20,401)	(21,823)
Add: capital work-in-process	415	698	100	100
Total fixed assets	15,211	15,482	16,706	20,284
Investments	40,215	47,955	60,455	72,955
of which, liquid investment	31,079	38,319	50,319	62,319
Other assets				
Total assets	71,264	92,206	113,243	131,193
Net working capital	(13,754)	(16,392)	(19,143)	(22,490)

Cash flow statement (Rs mn)	FY10	FY11	FY12E	FY13E
Operating cashflow				
Pre-tax income	27,342	29,016	42,006	46,943
Add: depreciation and amortisation	1,365	1,228	1,276	1,422
Less: interest expense (net)	60			
Less: other adjustments				
Less: taxes paid	(7,126)	(9,830)	(10,921)	(12,440)
Add: working capital changes	11,263	2,638	2,752	3,347
Total operating cashflow	32,903	23,052	35,112	39,272
Investing cashflow				
Capital expenditure	(1,167)	(2,006)	(2,500)	(5,000)
Investments	(22,130)	(7,740)	(12,500)	(12,500)
Others				
Total investing cashflow	(23,297)	(9,746)	(15,000)	(17,500)
Financing cashflow				
Share issuances		1,447		
Loans	(2,035)	(10,134)	(1,358)	(1,123)
Less: Others	(9,480)	(67)	(18,451)	(24,060)
Total financing cashflow	(11,514)	(8,755)	(19,810)	(25,183)
Net change in cash	(1,908)	4,551	303	(3,411)
Opening cash	2,922	1,014	5,565	5,868
Add: other adjustments				
Closing cash	1,014	5,565	5,868	2,457

Source: Company data, Quant Global Research estimates

Ratings and other definitions

Stock rating system

BUY. We expect the stock to deliver >15% absolute returns.

ACCUMULATE. We expect the stock to deliver 6-15% absolute returns.

REDUCE. We expect the stock to deliver +5% to -5% absolute returns.

SELL. We expect the stock to deliver negative absolute returns of >5%.

Not Rated (NR). We have no investment opinion on the stock.

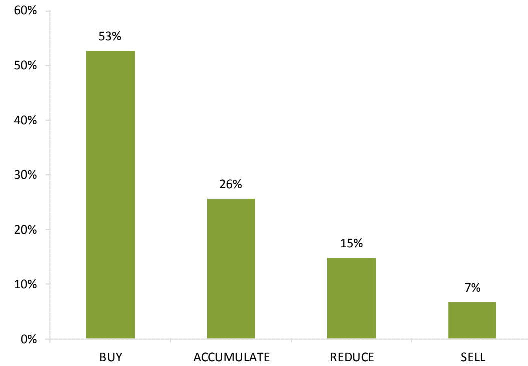
Sector rating system

Overweight. We expect the sector to relatively outperform the Sensex.

Underweight. We expect the sector to relatively underperform the Sensex.

Neutral. We expect the sector to relatively perform in line with the Sensex.

Institutional Equities Research coverage universe – distribution of ratings



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