

Bajaj Auto

STOCK INFO. BLOOMBERG
 BSE Sensex: 9,374 BJA IN
 REUTERS CODE
 S&P CNX: 2,851 BJAT.BO

13 January 2006

Buy

Previous Recommendation: Buy

Rs2,013

		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
Equity Shares (m)	101.2	3/05A	59,271	7,668	75.8	4.8	26.6	4.9	18.5	20.7	3.0	18.5
52-Week Range (Rs)	2,158/966	3/06E	76,663	10,763	106.4	43.2	18.9	4.2	22.5	25.8	2.2	12.4
1,6,12 Rel.Perf.(%)	-6/15/36	3/07E	92,071	13,609	134.5	26.4	15.0	3.5	23.4	28.2	1.7	9.6
M.Cap. (Rs b)	203.7											
M.Cap. (US\$ b)	4.6											

Bajaj Auto (BAL) 3QFY06 results were very impressive across parameters. Strong sales growth driven by improved overall realisations, EBITDA margin expansion and higher other income led to a strong PAT growth of 53% YoY.

✍ BAL witnessed a sales growth of 25% YoY at Rs20b on the back of a 14% YoY volume growth and a 9.3% YoY increase in realisations. Motorcycle volumes of BAL grew at 15.8% in 3QFY06. In 9MFY06, motorcycle volumes of BAL grew by 30% against industry growth of 18%, resulting in a market share gain of 240bp to 30.2%. Within motorcycles, product mix improved with economy segment contribution getting lowered to 60% in 9MFY06 from 70% in FY05. Three wheeler volume growth improved to 16.3% in 3QFY06 from 2.6% in 1HFY06.

✍ As a result of strong volume growth, improved product mix and falling employee cost to sales (3.4% in 3QFY06 compared to 3.8% in 3QFY05), EBITDA margins improved to 17.9%, highest in the past 8 quarters. We expect BAL to continue to report strong volume growth on the back of good monsoons. We expect motorcycle volumes to grow 31% in FY06 and 17% in FY07.

✍ We are upgrading FY07 EPS estimates to Rs134.5 and introducing FY08 EPS estimate at Rs159.3. BAL quotes at an FY07 PE of 15x and FY08 PE of 12.6x. We estimate the value of insurance business at Rs189 per share and value of investments and cash as of Mar-06 at Rs546 per share. We recommend **Buy** with an upgraded target price of Rs2,507 (upside of 25%) based on SOTP.

QUARTERLY PERFORMANCE

	(Rs Million)									
	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Total Volumes (nos)	372,912	445,192	526,983	479,612	505,524	555,552	600,824	629,463	1,824,699	2,291,363
Net Sales	12,261	14,483	16,057	16,470	16,342	18,670	20,009	21,643	59,271	76,663
Change (%)	14.2	16.0	22.6	28.3	33.3	28.9	24.6	31.4	20.5	29.3
Total Expenses	10,417	12,088	13,645	13,987	13,766	15,513	16,428	17,955	50,137	63,662
EBITDA	1,845	2,395	2,412	2,483	2,575	3,156	3,581	3,688	9,134	13,001
As % of Sales	15.0	16.5	15.0	15.1	15.8	16.9	17.9	17.0	15.4	17.0
Change (%)	24.8	5.5	-4.3	9.9	39.6	31.8	48.5	48.5	7.1	42.3
Other Income	1,064	882	869	1,266	928	1,362	1,064	1,148	4,081	4,502
Interest	1.7	-0.6	2.7	1.7	0.9	0.5	1.4	3.9	6.7	6.7
Depreciation	462	464	468	460	462	490	491	462	1,854	1,904
Extraordinary Expenses (VRS)	-	163	163	163	-	-	108	108	490	216
PBT	2,446	2,650	2,647	3,123	3,040	4,028	4,045	4,263	10,864	15,376
Tax	800	850	820	726	950	1,120	1,245	1,298	3,196	4,613
Effective Tax Rate (%)	32.7	32.1	31.0	23.2	31.3	27.8	30.8	30.4	29.4	30.0
PAT	1,646	1,800	1,827	2,397	2,090	2,908	2,800	2,965	7,668	10,763
Change (%)	3.3	-6.9	0.8	22.4	27.0	61.5	53.3	23.7	4.8	40.4

E: MOSt Estimates

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Strong sales growth

BAL reported a net sales growth of 25% YoY at Rs20b on the back of a 14% YoY volume growth and a 9.3% YoY increase in realisations. The improvement in realisation has come on the back of improved product mix in the motorcycle segment as well as 16% growth witnessed in the three-wheeler category as compared to slow growth in the first two quarters of FY06. In 3QFY06, BAL sold 101,000 units and 126,000 units of Pulsar and Discover, respectively. The contribution of higher end motorcycles to overall motorcycle volumes during the quarter stands at 43% (compared to less than 30% a year ago).

Motorcycles accounted for 83% of BAL's product mix in 9MFY06 as compared to 78% in 9MFY05. This segment has grown at 30.9%, which is almost twice the industry growth rate.

VOLUME BREAK -UP (NOS)

	3QFY06	3QFY05	% CH	FY06 YTD	FY05 YTD	% CH
Motorcycles	511,106	441,355	15.8	1,379,206	1,053,566	30.9
Scooters-G	16,518	24,291	-32.0	55,853	82,344	-32.2
Scooters-U	15,628	7,661	104.0	46,603	26,113	78.5
Step Thru's	0	4,175	N.A.	870	14,804	-94.1
2 Wheelers	543,252	477,482	13.8	1,482,532	1,176,827	26.0
3 Wheelers	57,572	49,501	16.3	179,368	168,260	6.6
Total	600,824	526,983	14.0	1,661,900	1,345,087	23.6

Source: Company/Motilal Oswal Securities

Exports to drive growth further

Exports have witnessed strong growth, 53% up in 3QFY06 at 64,359 units. On a YTD basis, BAL clocked a volume of 176,765 units, a growth of 28% YoY. Growth was driven by motorcycles, which grew at 56% followed by three wheelers which grew at 30%. Export revenue increased 60% YoY in 3QFY06 to Rs2.4b whereas for 9MFY06 it grew 28% to Rs6.4b.

BAL is addressing the emerging opportunities in the Asean region through assemblies set up in Indonesia and the

Phillipines along with Kawasaki. We forecast a 26% growth in total exports over FY05-08E for BAL. Among the Indian two-wheeler companies, we attach the highest probability of success for BAL in the global market.

EXPORT VOLUME (NOS.)

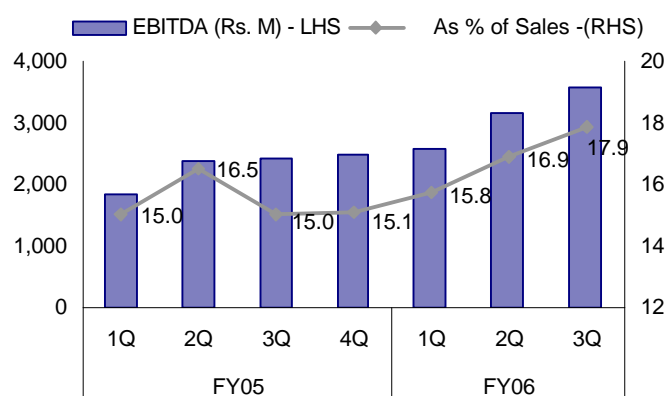
	3QFY06	3QFY05	GR.(%)	YTD 06	YTD 05	GR.(%)
Motorcycles	43,826	28,086	56	112,779	82,896	36
2 wheelers	47,040	28,786	63	121,006	87,221	39
3 wheelers	17,319	13,355	30	55,759	50,933	9
Total	64,359	42,141	53	176,765	138,154	28
Value-Rs.M	2,359	1,474	60	6,431	5,005	28

Source: Company/Motilal Oswal Securities

Impressive operating performance

BAL's EBITDA margin at 17.9% improved by 290bp YoY and 100bp QoQ and was the highest in the last eight quarters. Margin expansion was on account of an improved product mix in the motorcycle segment towards high-end products as well as the strong volume growth in three wheelers. Margin expansion on a YoY basis was mainly on account of a sharp drop in raw material and other expenses.

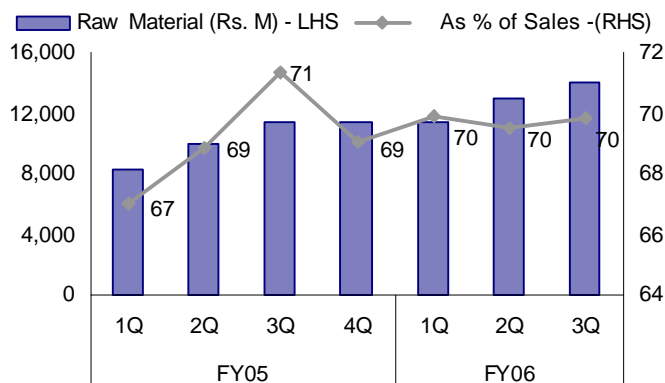
EBITDA MARGINS: HIGHEST IN PAST EIGHT QUARTERS



Source: Company / Motilal Oswal Securities

Other expenses to net sales decreased to 9.1% in 3QFY06 from 10.2% in 3QFY03 and 10.5% in 2QFY06. Raw material cost in 3QFY06 stood at 69.9% of sales, a decrease of 150bp YoY and increased 50bp QoQ.

RAW MATERIAL AS % OF SALES: STABLE IN FY06



Source: Company / Motilal Oswal Securities

New product launch

BAL has launched a stripped down version of its Discover brand – ‘the Discover 110cc’ in December 2005. The bike will be without the DTS-I engine and is only available in kick start version. However, it will be available in alloy wheels and offer the other facilities of the Discover. The bike is priced as Rs45,892 on road, Mumbai.

PRICES OF BAL'S PRODUCTS (RS)

MODEL	ON ROAD PRICE (MUMBAI)
CT100 DX	38,375
Discover 110cc	45,892
Discover 125cc	49,082
Pulsar 150cc	62,312

Prices as of 19 December 2005

Source: Company

BAL has launched the bike at a discount of Rs3,000 to the 125cc version. BAL hopes to ramp up volumes of the Discover to 60,000 units with this new variant. The Discover has not been able to create a significant dent in the executive segment with volumes at around 35,000–40,000 units/month. In comparison, Hero Honda's Splendor and Passion sell c.150,000 units/month in the executive segment.

BAL is also offering a discount on its entry level bike CT100 of Rs1,500-Rs2,000. BAL has stated that it intends to launch a new entry level bike in the fourth quarter. We believe that the discounts will be offered in order to offer an entry to the new bike. BAL has stated that with several new launches in the 100cc segment such as the TVS Star and the LML CRD100, the CT100 would find it difficult to maintain its product lead, hence it plans to launch a new product in this segment.

PAT growth of 53% YoY

On the back of strong volume growth of 14% coupled with improved realisations in the quarter (9.3% increase YoY), sales growth of 25% and EBITDA growth of 49%, PAT growth was 53% at Rs2.8b. Other income in 3QFY06 stood at Rs1.1b compared to Rs869m in 3QFY05.

Insurance business is growing

BAL continues to be the second largest player in the private insurance segment in both the life and general insurance business. The gross written premium in Bajaj Allianz General Insurance was Rs3.3b against Rs2.0b in 3QFY05, a growth of 63%. PAT for the quarter was Rs38m as against Rs37m in 3QFY05. The company commands a market share of 24% among private insurers.

Life insurance premium rose 343% at Rs8.1b.

Valuation and view

We expect BAL to continue to report strong volume growth on the back of good monsoons. We expect motorcycle volumes to grow 31% in 4QFY06 and 17% in FY07. Three-wheeler volumes are expected to grow 7% in 4QFY06 and 13% in FY07.

We are also upgrading FY07E EPS to Rs134.5 (+18% YoY) and introducing FY08E EPS at Rs159.3. BAL quotes at an FY07E PE of 15x and FY08E PE of 12.6x. We estimate the value of the insurance business at Rs189/share. The value of investments and cash as of March 2006 is expected to be Rs546/share. We recommend **Buy** with a target price of Rs2,507 (an upside of 25%) based on SOTP.

REVISED ESTIMATE (RS M)

	FY06E			FY07E		
	OLD	NEW	% CH.	OLD	NEW	% CH.
Total Income	72,376	76,663	5.9	83,670	92,071	10.0
EBITDA	11,838	13,001	9.8	13,713	15,919	16.1
<i>Margin (%)</i>	<i>16.4</i>	<i>17.0</i>		<i>16.4</i>	<i>17.3</i>	
Adj. PAT	9,862	10,763	9.1	11,554	13,609	17.8
EPS (Rs)	97.5	106.4		114.2	134.5	

Source: Motilal Oswal Securities

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

- ✍ Increasing competition in the executive segment where BAL is trying to gain a foothold with the 'Discover'.
- ✍ Any significant upmove in interest rates, leading to higher financing costs.
- ✍ Slowdown in three wheeler sales – BAL's cash cow business.

Recent developments

- ✍ BAL has launched a lower powered 110cc version of its 'Discover'.
- ✍ Competitors have launched several bikes in the 150cc premium segment and 100cc entry-level segment, both of which BAL is strong in.

Valuation and view

- ✍ We expect BAL to witness a 26% volume growth in motorcycles in FY06 leading to a sales growth of 30% at Rs74.5b.
- ✍ We have upgraded our FY06E EPS to Rs106.4 (+9%); FY07E EPS to Rs134.5 (+18%) and introduced FY08E EPS of Rs159.3.
- ✍ We maintain **Buy** with a revised target price of Rs2,507 (an upside of 25%).

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.
- ✍ We maintain an overweight stance on the sector.

COMPARATIVE VALUATIONS

		BAJAJ AUTO	HERO HONDA	TVS MOTOR
P/E (x)	FY06E	18.9	17.5	16.9
	FY07E	15.0	14.8	14.6
EPS Gr (%)	FY06E	42.2	18.4	11.9
	FY07E	26.4	18.2	15.9
ROE (%)	FY06E	22.5	49.4	19.6
	FY07E	23.4	46.2	19.8
EV/EBITDA (x)	FY06E	12.4	11.0	10.6
	FY07E	9.6	8.9	8.8

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	29.8	29.8	29.8
Domestic Institutions	7.5	7.4	8.4
FII's/FDIs	22.7	23.0	21.1
Others	40.0	39.8	40.7

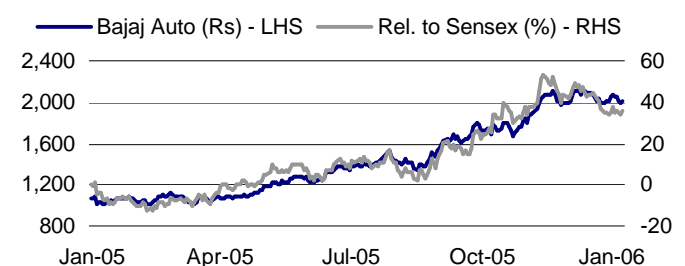
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	106.4	101.9	4.4
FY07	134.5	116.7	15.3

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
2,013	2,507	24.5	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Net Sales	47,552	57,364	74,470	89,549	105,141
Change (%)	14.3	20.6	29.8	20.2	17.4
Operating Other Income	1,616	1,907	2,193	2,522	2,774
Total Income	49,168	59,271	76,663	92,071	107,915
Raw Material	31,992	41,021	53,377	63,239	74,147
Employee Cost	2,405	2,491	2,730	3,000	3,624
Other Mfg. Expenses	3,229	3,183	3,446	4,136	4,921
Selling & Distribution	3,252	3,641	4,307	5,776	6,841
EBITDA	8,528	9,134	13,001	15,919	18,382
Change (%)	2.5	7.1	42.3	22.4	15.5
% of Net Sales	17.3	15.41	17.0	17.3	17.0
Depreciation	1,799	1,854	1,904	1,975	2,043
Interest & Finance Charges	9	7	7	6	6
Other Income	3,535	4,081	4,502	5,503	6,694
Non-recurring Expense	650	490	216	0	0
PBT	9,604	10,864	15,376	19,442	23,027
Tax	2,289	3,196	4,613	5,833	6,908
Effective Rate (%)	23.8	29.4	30.0	30.0	30.0
PAT	7,315	7,668	10,763	13,609	16,119
Change (%)	36.0	4.8	40.4	26.4	18.4
% of Net Sales	14.9	12.9	14.0	14.8	14.9

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Share Capital	1,012	1,012	1,012	1,012	1,012
Reserves	35,924	40,332	47,758	57,216	68,177
Net Worth	36,936	41,343	48,770	58,228	69,189
Deferred Tax	1,228	1,399	1,399	1,399	1,399
Loans	10,057	12,270	10,270	9,270	9,270
Capital Employed	48,222	55,012	60,439	68,897	79,858
Gross Fixed Assets	27,030	27,436	28,520	29,520	30,520
Less: Depreciation	14,967	16,286	18,191	20,166	22,209
Net Fixed Assets	12,063	11,150	10,329	9,354	8,310
Capital WIP	83	84	0	0	0
Investments	38,554	45,606	45,606	45,606	45,606
Curr. Assets, L & Adv.	20,530	25,897	34,887	45,508	59,463
Inventory	2,026	2,242	3,494	3,921	4,604
Sundry Debtors	1,339	1,763	3,494	5,601	6,577
Cash & Bank Balances	794	1,087	7,094	15,180	27,477
Loans & Advances	15,917	20,120	20,120	20,120	20,120
Others	455	685	685	685	685
Current Liab. & Prov.	23,261	27,940	30,598	31,786	33,737
Sundry Creditors	6,232	7,351	10,015	11,203	13,153
Other Liabilities	494	499	494	494	494
Provisions	16,535	20,089	20,089	20,089	20,089
Net Current Assets	-2,730	-2,042	4,288	13,722	25,726
Application of Funds	48,222	55,012	60,439	68,897	79,858

E: M O S t Estimates

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
EPS	72.3	75.8	106.4	134.5	159.3
Cash EPS	90.1	94.1	125.2	154.0	179.5
Book Value per Share	365.0	408.6	482.0	575.5	683.8
DPS	25	25	33	41	51
Payout (Incl. Div. Tax) %	34.6	33.0	31.0	30.5	32.0
Valuation (x)					
P/E	27.8	26.6	18.9	15.0	12.6
Cash P/E	22.3	21.4	16.1	13.1	11.2
EV/EBITDA	20.4	18.5	12.4	9.6	7.6
EV/Sales	3.7	3.0	2.2	1.7	1.3
Price to Book Value	5.5	4.9	4.2	3.5	2.9
Dividend Yield (%)	12	12	16	2.0	2.5
Profitability Ratios (%)					
RoE	19.8	18.5	22.5	23.4	23.3
RoCE	21.3	20.7	25.8	28.2	28.8
Turnover Ratios					
Debtors (Days)	9	10	15	20	20
Inventory (Days)	18	16	20	19	19
Creditors (Days)	71	65	68	65	65
Asset Turnover (x)	1.0	1.0	1.2	1.3	1.3
Leverage Ratio					
Debt/Equity (x)	0.3	0.3	0.2	0.2	0.1

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
OP/(Loss) before Tax	6,729	7,280	11,097	13,944	16,339
Interest/Div. Received	3,535	4,081	4,502	5,503	6,694
Depreciation & Amort.	1,799	1,854	1,904	1,975	2,043
Direct Taxes Paid	-2,785	-3,026	-4,613	-5,833	-6,908
(Inc)/Dec in Working Capita	5,368	-395	-323	-1,347	293
CF from Oper. Activity	14,646	9,795	12,567	14,243	18,462
Extra-ordinary Items	-650	-490	-216	0	0
CF after EO Items	13,996	9,304	12,351	14,243	18,462
(Inc)/Dec in FA+CWIP	-1,107	-905	-1,000	-1,000	-1,000
(Pur)/Sale of Invest.	-11,255	-7,051	0	0	0
CF from Inv. Activity	-12,363	-7,956	-1,000	-1,000	-1,000
Inc. / Dec. in Networth	-255	-731	0	0	0
Inc/(Dec) in Debt	1,655	2,213	-2,000	-1,000	0
Interest Paid	-9	-7	-7	-6	-6
Dividends Paid	-2,530	-2,530	-3,336	-4,151	-5,158
CF from Fin. Activity	-1,139	-1,055	-5,343	-5,157	-5,164
Inc/(Dec) in Cash	493	293	6,007	8,086	12,299
Add: Beginning Balance	300	794	1,087	7,094	15,180
Closing Balance	794	1,087	7,094	15,180	27,479

E: M O S t Estimates

N O T E S



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Bajaj Auto

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|--|----|
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| 3. Broking relationship with company covered | No |

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