Company Flash

30 January 2008 | 7 pages

Bajaj Auto (BJAT.BO)

Buy: 3QFY08 – Results Marginally Below Expectations

- **Recurring PAT +3% YoY** — PAT at Rs3.6bbn, marginally lower than estimates. Operating performance disappointed – EBITDA margins 1% below expectations (though margins rose 20bps Y/Y to 14.4%) as higher-margin 3-wheeler sales declined 13% Y/Y. Net profits buffered by higher-than-expected other income and lower tax rates.
- **EBITDA margins disappoint** — EBITDA margins at 14.4% (+20 bps Y/Y) were 1% below expectations. Margins were affected by a confluence of declining 3-wheeler sales (relatively high-margin products vs. 3 wheelers) and sticky input costs. Cost control on other expenses was encouraging, though, indicating lower intensity in discounts and subventions (vs. 3QFY07 which was the peak).
- **Demerger imminent** — Management stated that the High Court's approval for the demerger has been received - BJA should get the written order over the next few days, after which other formalities should be completed within 30-45 days. All 3 companies are expected to list by end March
- **Maintain Buy (1L)** — We believe the risk reward ratio at this juncture is favorable, and the sluggish outlook on the auto business is adequately priced in. Downside risks - A) delay in demerger, which is viewed as a near-term positive catalyst, B) increased material costs and attendant margin pressures, and C) decline in 3-wheeler sales.

Buy/Low Risk	1L
Price (30 Jan 08)	Rs2,246.05
Target price	Rs2,545.00
Expected share price return	13.3%
Expected dividend yield	2.2%
Expected total return	**15.5%**
Market Cap	Rs227,263M US$5,783M

Price Performance (RIC: BJAT.BO, BB: BJA IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	11,174	110.44	39.4	20.3	4.8	25.1	1.8
2007A	12,728	125.79	13.9	17.9	4.1	24.7	1.8
2008E	11,822	116.84	-7.1	19.2	3.7	20.2	2.0
2009E	13,364	132.08	13.0	17.0	3.3	20.4	2.2
2010E	14,841	146.68	11.1	15.3	2.9	20.2	2.4

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

[1]Citigroup Global Markets India Private Limited

Figure 1. 3QFY08 – Operational Results

	3Q FY07	3QFY08	% YoY Chg	CIR comments
Volumes (Nos)				
Scooters	173	4,400		
Motorcycles	652,406	634,624	-2.7	Impact of credit tightening by banks
3 wheelers	85,640	74,419	-13.1	Lower growth in exports (-14%y/y) which accounts for c.50% of overall 3w sales. Domestic environment remains challenging – BJA volumes declined 12% (higher than industry decline of 9%) as BJA accedes market share to Piaggio
Total	**738,219**	**713,443**	**-3.4**	
Product mix (%)				
Motorcycles	88.4	89.0		Significant shift towards >125cc bikes (59% of total sales vs. 37% of total sales in 3QFY07)
3 wheelers	11.6	10.4		
Market share (%)				
Motorcycles	34.6	34.7		
2 wheelers	29.2	29.0		
3 wheelers	59.2	57.6		Lost market share to Piaggio in passenger and goods segment

Source: Company, Citi Investment Research

Figure 2. 3QFY08 – Financial Results

	3Q FY07	3QFY08	% YoY Chg	CIR comments
Net sales	**25,682**	**25,297**	**-1.5**	Realizations impacted by lower 3w sales; excise duties decline due to Pantnagar benefits; revenues adjusted for Rs280m discount given to vendors
Decrease/(Increase) in Stocks	(47)	(68)		
Raw Materials	18,903	18,704	-1.0	Cost pressures ease – rising steel costs offset by declining aluminium and nickel costs
Staff costs	757	851	12.4	
Other Expenses	2,492	2,283	-8.4	Reflects sharp reduction in discounts and subventions
Expenditure capitalized	(59)	(111)	89.6	
Total Expenditure	22,046	21,660	-1.8	
EBITDA	**3,636**	**3,637**	**0.0**	90 bps below estimates
Interest	2	19	777.3	
Other income	1,610	1,787	11.0	19% above expectations
EBDT	5,244	5,404	3.1	
Depreciation	472	493	4.5	
PBT	4,771	4,911	2.9	
Exceptionals	(120)	(518)		Includes 512 million VRS expenses
Tax	1,200	1,125	-6.3	
PAT	3,452	3,268	-5.3	
PAT (pre exceptional)	**3,541**	**3,654**	**3.2**	3% below expectations
Profit Margins (%)				
EBITDA (%)	14.2	14.4		
EBIT (%)	16.3	17.4		
Tax / PBT (%)	25.8	25.6		
Cost ratios (%)				
Excise / sales	12.2	10.5		
Raw materials / sales	73.4	73.7		130 bps above estimates
Staff costs / sales	2.9	3.4		50 bps above estimates
Other expenses / sales	9.5	8.6		80 bps below estimates

Source: Company, Citi Investment Research

Bajaj Auto

Company description

Bajaj Auto (BAL) is India's leading manufacturer of two- and three-wheelers. Its product range includes scooters, motorcycles and three-wheelers. The company holds 26% and 50% equity stakes, respectively, in life and general insurance ventures in association with Allianz.

Investment strategy

We rate Bajaj Auto as Buy /Low Risk (1L). We believe that current valuations amply reflect concerns in the core auto business and provide reasonable upside from a risk-reward perspective. While the lack of adequate public transportation in India remains a structural growth driver, escalating competitive pressures and rising input costs are key concerns. Over the past three years, Bajaj has realigned its 2-wheeler product mix in-line with a market preference for motorcycles; its market share in motorcycles has risen from 24% (in FY03) to around 34% in FY07. But we expect competitive pressures to remain intense in the 2-wheeler space. Our estimates also reflect sedate growth prospects for the 3-wheeler sector.

Valuation

Our target price of Rs 2,545 is based on a sum-of-the-parts valuation that comprises: a) Bajaj Auto (core auto business) valued at Rs 997 at 13x FY09E EPS, b) Bajaj Finserve, which holds the financial services and insurance businesses at Rs 552/share, and c) Bajaj Holdings and Investments, which comprises cash and investments at Rs996/share. The stock has traded in the range of 13-21x with a mean of c.17x over the past one year. Our multiple of 13x is at a discount to this mean, but we think it is justified given rising competitive intensity in the industry. A 12% CAGR in core earnings for FY08E-10E should support these valuations, in our view.

Risks

We rate Bajaj Auto Low Risk based on our quantitative risk rating system, which tracks 260-day historical share price volatility. The key risk to Bajaj is a slowdown in sales and erosion in margins on any deterioration in macroeconomic variables (including growth, interest rates and fuel prices) or increase in competitive pressures. Competitive pressures in the 2-wheeler industry remain high and could likely accentuate given the aggressive product pipelines of key players. This, coupled with the rising trend in input costs, could mute margin expansion. Success in 3-wheelers is critical as it is the most profitable segment for the company and is a source of substantial cash flows. The predictability in this business remains relatively difficult, as performance is dependent on issuance of licenses by various government bodies. Upside risks include stronger-than-expected volume growth or a decline in material costs on a sustainable basis that would benefit margins.

Appendix A-1

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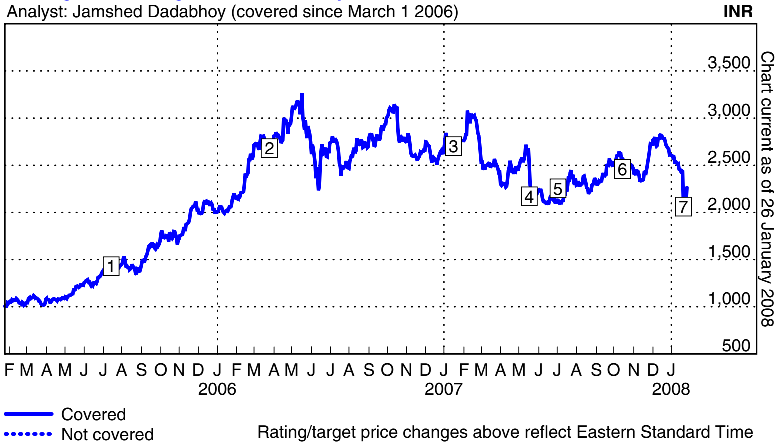
Bajaj Auto (BJAT.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Jamshed Dadabhoy (covered since March 1 2006)



#	Date	Rating	Target Price	Closing Price
1:	14 Jul 05	2L	*1,438.00	1,383.00
2:	26 Mar 06	2L	*2,956.00	2,732.80
3:	16 Jan 07	2L	*2,886.00	2,774.60
4:	17 May 07	2L	*2,600.00	2,500.30
5:	3 Jul 07	2L	*2,275.00	2,098.25
6:	15 Oct 07	2L	*2,671.00	2,579.95
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*Indicates change.

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