

INITIATING COVERAGE

Share Data

Market Cap	Rs. 215.4 bn
Price	Rs. 2128.85
BSE Sensex	14650.51
Reuters	BJAT.BO
Bloomberg	BJA.IN
Avg. Volume (52 Week)	0.08 mn
52-Week High/Low	Rs. 3175/2063
Shares Outstanding	101.18 mn

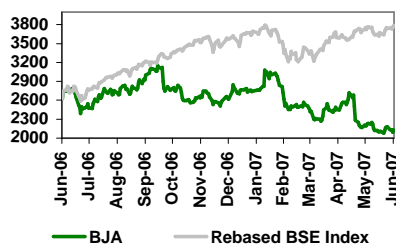
Valuation Ratios

Year to 31 March	2008E	2009E
EPS (Rs.)	112.8	122.1
+/- (%)	-7.7%	8.3%
PER (x)	18.9x	17.4x
EV/ Sales (x)	2.8x	2.5x
EV/ EBITDA (x)	20.9x	19.5x

Shareholding Pattern (%)

Promoters	30
FII's	20
Institutions	8
Public & Others	42

Relative Performance



Bajaj Auto Limited

Hold

Uncertainties ahead

Bajaj Auto Limited recently announced the demerger of its existing businesses into three different companies: BAL, Bajaj Finserve Ltd and a holding company, Bajaj Holdings and Investments Ltd. The existing shareholders will be issued shares in the new companies in the ratio 1:1. Further, the company also disclosed that its foreign partner (Allianz) in its insurance JV enjoys a call option to increase its stake from the current 26% to 74% in the life insurance JV and up to 49% in the general insurance business at a nominal price. BAL's stock has since taken a beating due to the uncertainty over the utilization of the cash and investments on BAL's balance sheet and a lower implied stake of BAL in the insurance business.

Key Figures

Year to March	FY05	FY06	FY07	FY08E	FY09E	CAGR (%)
(Figures in Rs mn, except per share data) (FY07-09E)						
Net Sales	57,240	76,679	95,204	95,204	109,485	7.2%
EBITDA	7,227	13,563	14,170	12,889	13,747	-1.5%
Net Profit	7,650	11,233	12,371	11,416	12,360	0.0%
Margins(%)						
EBITDA	12.6%	17.7%	14.9%	13.5%	12.6%	
NPM	12.1%	13.9%	12.3%	11.3%	10.7%	
Per Share Data (Rs.)						
EPS	75.6	111.0	122.2	112.8	122.1	0.0%
PER (x)	28.2x	19.2x	17.4x	18.9x	17.4x	

- We expect BAL to record a sales growth of 7.2% over 2007-2009E on the back of muted growth in 2008 and an improved performance in 2009.
- The EBITDA and net profit margins are expected to decline by 230bps and 160 bps over 2007-09E owing to the current weakness in the two-wheeler industry, high interest rates and rise in raw material prices
- On a stand alone basis we have valued BAL at Rs 1,467. However, based on the sum of the parts valuation we have arrived at a valuation of Rs 302 for its insurance business and Rs 548 for its investments and holdings in Maharashtra Scooters and Bajaj Auto Finance Limited, thereby giving us a one year target price of Rs. 2,317. We initiate this coverage with a hold rating on BAL.

Rationale

Demerger issue: Uncertainty ahead

Bajaj Auto Limited recently announced the demerger of its existing businesses into three different companies: BAL, Bajaj Finserve Ltd and a holding company Bajaj Holdings and Investments Ltd. The existing shareholders will be issued shares in the new companies in the ratio 1:1. Prima facie, the demerger proposal is expected to unlock shareholder value by splitting the manufacturing and financial assets of Bajaj Auto into two separate companies. However, the decision of transferring marginal cash to the manufacturing and financial services companies and holding back a large chunk of the cash and investments, currently over Rs 60bn, in an altogether separate holding company (BHIL) leaves uncertainty over the likely utilization of funds.

Concern over Bajaj's stake in the Insurance JVs

Apart from the valuation of its core business and investments, Bajaj Auto Limited (BAL) derived a significant chunk of value from its insurance joint ventures (life and non-life) with Allianz, Germany. At present, FDI holding in insurance ventures is capped at 26 per cent. Consequently, BAL held 74% and Allianz held 26% each in both the JVs. However, the company recently disclosed that the foreign partner (Allianz) enjoys a call option of increase in its stake from the current 26% to 74% in the life insurance JV and up to 49% in the general insurance business at a nominal price.

Currently, the exercise price for the Life Insurance business works out to Rs 13.4 per share and for the General Insurance business to Rs 24.4 per share. This implies a reduced effective stake of BAL in the insurance business. Taking these developments into account we have valued the combined insurance business at Rs 302 per share.

Spiraling interest rates to have an adverse impact on sales

The combination of high interest rates and inflation has impacted the demand of motorcycles. The central bank has raised interest rates five times in the last year. In addition to raising its key interest rate, the Reserve Bank also raised the cash reserve ratio three times since December. This has had an

adverse impact on the sales of two-wheelers and May has been one of the worst months for motorcycle makers. Sales dipped by a massive 16 per cent. However, consumers would not only have to bear the brunt of increased interest rates, they would also not enjoy the kind of hefty discounts that were common last year. While the parameters for providing loans have become stricter, the down payment amount has increased, hitting the entry-level buyer the hardest. We expect sales growth to be flat for the current year and improve marginally over the next year.

Slowdown in the motorcycles sales; niche models likely to grow

Sales are down 17% for April - May 2007. Going by the latest numbers, it is likely that the industry will experience a slowdown in FY08 for the first time in six years. The niche segments seem to be the only area within the two-wheeler market that will continue to grow this year. During April-May 2007, growth was visible in motorcycles with engine capacities between 125 cc and 250 cc. This segment, which includes Bajaj Pulsar and Discover and Hero Honda CBZ, grew 13% to reach 2.18 lakh units. But this segment accounts for just 20% of the market and a growth here will not be enough to keep the industry in the growth track in the long term.

Price Wars in the Entry segment

A fresh round of price war in the low-end motorcycle segment may well be on the cards. Bajaj Auto (BAL) recently lowered the price of its 100-cc Bajaj Platina by Rs 3,000, taking advantage of the tax sops for its new plant at Pantnagar (Uttaranchal). Bajaj Platina will now be available at Rs 33,000 (ex-showroom). With this price cut, it would be taking rival Hero Honda head on. With the ensuing price wars, we expect the Company's margins to take a beating in the near term.

High input costs affecting margins

Prices of steel and aluminum are on an upward trend. Raw material costs have increased from 70% of net sales in FY06 to 72% in FY07. Strong competition would make it difficult to pass-on further cost increases and margins are therefore likely to be adversely affected

Entry of global majors

Global majors such as Honda, Suzuki have recently entered the executive segment. Honda has Unicorn and Shine while Suzuki is present with its Zeus. HMSI plans to ramp up production to 2mn units in 2008.

Key Risks

Uncertainties related to exports

There are still uncertainties regarding the level of the investments that would be required and what kind of returns will BAL be able to derive out of its overseas forays. Its plans for its overseas market share in early stages yet. It is yet to create significant presence in those markets particularly with respect to manufacturing and distribution.

Price Cuts/ Special offers by competition

The two wheeler industry is characterized by intense competition resulting in price wars and existence of a large number of brands in the market. The sales of BAL's products could be adversely affected due to unanticipated price cuts/ discounts/ special offers made by competitors.

Outlook

The two wheeler industry in India has shown a shift from scooters to motorcycles in the last decade. Growing at a CAGR of 21% in the last 11 yrs, the two wheeler market still accounts for barely 2% of the Indian population. Though the industry is expected to grow in double digits in medium to long term, due to intense competition margins are expected to remain under pressure.

We expect BAL to record a sales growth of 7.2% over 2007-2009E on the back of muted growth in 2008 and an improved performance in 2009. The EBITDA and net profit margins are expected to decline by 230bps and 160 bps over 2007-09E owing to the current weakness in the two-wheeler industry, high interest rates and rise in raw material prices

On a stand alone basis we have valued BAL at Rs 1467. However, based on the sum of the parts valuation we have arrived at a valuation of Rs 302 for its insurance business and Rs 548 for its investments and holdings in Maharashtra Scooters and Bajaj Auto Finance Limited, thereby giving us a one year target price of 2317. We initiate this coverage with a hold rating on BAL.

Company Background

The Bajaj Group is amongst the top 10 business houses in India. Its footprint stretches over a wide range of industries, spanning automobiles (two-wheelers and three-wheelers), insurance, and finance.

The group's flagship company, Bajaj Auto Limited (BAL), is ranked as the world's fourth largest two and three wheeler manufacturer and the Bajaj brand is well-known in over a dozen countries in Europe, Latin America, the US and Asia. Founded in 1948, BAL had been synonymous with scooters in India till the 1990s (when India was predominantly a scooter market), BAL commenced operations as an importing agent for Vespa scooters of Piaggio in 1948. The tie-up with Piaggio wended in 1975 and the brand name was changed from Vespa to Bajaj.

An erstwhile scooter company, BAL has significantly altered its product portfolio to become the second largest motor cycle manufacturer in India. BAL entered the motorcycle market in 1986 in technical collaboration with Kawasaki. BAL is the second largest two wheeler manufacturer in India. In motor cycles, it is the market leader in the entry and premium segments. The company also has its presence in the auto finance and life as well as non-life insurance business. It has a JV with Allianz, Germany in the insurance sector.

BAL straddles all the segments in the Indian motorcycle space with its six models. It has recently made its foray into the ungeared scooters segment with the newly launched Wave.

- **Economy:** CT100 accounts for around 40-50% of BAL's sales volumes. It is the dominant player in this segment with a 40% market share. Recently BAL launched Platina in this segment
- **Executive:** BAL's presence in this segment is through the Discover twins. BAL has been a distant second in this segment behind Hero Honda with a 25% share. This segment is expected to see intense competition as global majors Honda and Suzuki make further inroads.
- **Premium:** BAL has 50-60% share with the Pulsar twins and the Avenger.

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