

**Industrials**  
**Autos**  
 Equity – India

# Bajaj Auto (BJAUT IN)

## Neutral

Target price (INR)	1,700.00
Share price (INR)	1,575.35
Potential return (%)	7.9

Note: Potential return equals the percentage difference between the current share price and the target price

Performance	1M	3M	12M
Absolute (%)	-5.8	-12.7	20.2
Relative^ (%)	1.7	-0.6	35.7

Index^ BOMBAY SE IDX

RIC BAJA.BO  
 Bloomberg BJAUT IN

Market cap (USDm)	8,383
Market cap (INRm)	455,854
Enterprise value (INRm)	393,033
Free float (%)	45

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 with the disclosures and  
 the analyst certifications in  
 the Disclosure appendix,  
 and with the Disclaimer,  
 which forms part of it

## N: Growth in the slow lane

- ▶ **Weak market conditions coupled with market share losses affect growth**
- ▶ **Margins could come under pressure as well in FY13, owing to a weak outlook for three wheelers and premium bikes**
- ▶ **Maintain Neutral rating; cut TP to INR1,700 (from INR1,745)**

**Bajaj is battling headwinds on numerous fronts:** First, the industry is seeing two-wheeler (2W) buyers downgrading to the economy segment from the executive segment. This is adversely impacting the realization of 2W companies, particularly Bajaj. Second, scooters are growing faster than the overall 2W market, where Bajaj has no presence. And lastly, not only is the overall 2W market slowing down, but competitive intensity has resulted in Bajaj's market share decline in both the premium as well as executive segment (charts 6-9). Furthermore its exports business is impacted by the hike in import duty in Sri Lanka. There is minimal clarity on domestic demand of three wheelers as well.

**There are some greenshoots as well but not enough to offset the headwinds:** With the launch of the new Discover we expect some recovery in the market share of Bajaj in the executive segment. Remember Bajaj lost 4.2% market share in the executive segment in the past six months. The upcoming launch of Pulsar 200 NS is also likely to showcase Bajaj's R&D strength and improve brand perception. Additionally exports continue to grow stronger than the domestic demand and are expected to grow 15-20% y-o-y as per the management (including the SriLanka impact). A weaker INR may improve export realisations in FY13 and FY14 as well.

**EBITDA margins** for the quarter declined marginally to 20.7% from 21% in the 3Q12. Downward pressure on realisation due to unfavourable product mix and increase in raw material costs is the primary risks to margins in FY13. The currency depreciation benefit on exports is limited as well, as Bajaj has 85% of its exports covered for FY13 in the range of INR48-51 versus USD.

**Valuation:** Bajaj is currently trading at 14x our FY13 earnings. We expect 2W market to grow by 11% in FY13 (MotorCycle by c10% and scooters by c16%). We forecast Bajaj volumes to grow by c9.5% in FY13 and 11.5% in FY14. Benefit from better export realization and price increase to help maintain our top-line growth forecasts. We estimate a 50bps decline in margins for FY13 to 19.7% owing to the changing product mix, input cost headwinds offset by currency tailwinds. We cut our FY13 /FY14 earnings estimate marginally by 1% and 2% respectively. We value the company based on DCF to arrive at a target price of INR1,700 (from INR1,745) and remain Neutral on the stock. Our target price implies a PE multiple of 13x on our FY14 earnings.

## Financials & valuation

### Financial statements

Year to	03/2011a	03/2012e	03/2013e	03/2014e
<b>Profit &amp; loss summary (INRm)</b>				
Revenue	166,089	198,112	224,692	253,039
EBITDA	33,849	40,022	44,376	50,484
Depreciation & amortisation	-1,228	-1,456	-1,713	-2,024
Operating profit/EBIT	32,621	38,565	42,663	48,459
Net interest	-17	-222	-6	-13
PBT	43,507	40,262	46,623	52,746
HSBC PBT	36,262	41,602	46,623	52,746
Taxation	-10,110	-10,221	-13,054	-14,769
Net profit	33,397	30,041	33,569	37,977
HSBC net profit	26,152	31,381	33,569	37,977

### Cash flow summary (INRm)

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Cash flow from operations	30,018	33,605	35,406	40,895
Capex	-1,543	-1,164	-4,309	-4,852
Cash flow from investment	-9,280	-2,040	-4,309	-4,852
Dividends	-2,854	-2,884	-4,615	-4,735
Change in net debt	-14,685	-11,679	-10,784	-15,729
FCF equity	21,508	27,101	25,439	31,744

### Balance sheet summary (INRm)

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Intangible fixed assets	0	0	0	0
Tangible fixed assets	15,483	15,234	17,829	20,657
Current assets	28,726	46,749	63,771	81,653
Cash & others	5,565	16,538	27,322	43,051
Total assets	92,204	110,811	130,428	151,138
Operating liabilities	24,267	25,621	30,291	33,338
Gross debt	3,252	2,546	2,546	2,546
Net debt	-2,313	-13,993	-24,777	-40,506
Shareholders funds	49,102	60,411	73,666	91,329
Invested capital	14,377	19,823	23,987	25,921

### Ratio, growth and per share analysis

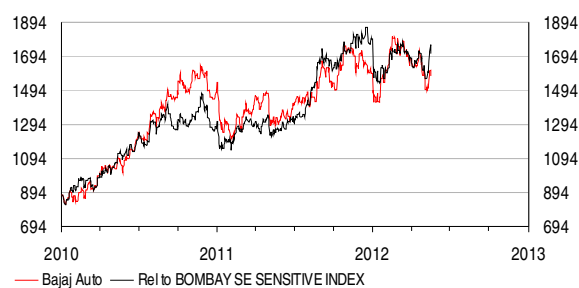
Year to	03/2011a	03/2012e	03/2013e	03/2014e
<b>Y-o-y % change</b>				
Revenue	39.3	19.3	13.4	12.6
EBITDA	30.5	18.2	10.9	13.8
Operating profit	32.7	18.2	10.6	13.6
PBT	80.7	-7.5	15.8	13.1
HSBC EPS	-29.9	20.0	7.0	13.1
<b>Ratios (%)</b>				
Revenue/IC (x)	8.7	11.6	10.3	10.1
ROIC	130.7	168.3	140.2	139.8
ROE	66.7	57.3	50.1	46.0
ROA	37.6	29.8	27.8	27.0
EBITDA margin	20.4	20.2	19.7	20.0
Operating profit margin	19.6	19.5	19.0	19.2
EBITDA/net interest (x)	2002.9	180.0	7578.3	3966.5
Net debt/equity	-4.7	-23.2	-33.6	-44.4
Net debt/EBITDA (x)	-0.1	-0.3	-0.6	-0.8
CF from operations/net debt				
<b>Per share data (INR)</b>				
EPS reported (fully diluted)	115.41	103.81	116.01	131.24
HSBC EPS (fully diluted)	90.37	108.44	116.01	131.24
DPS	40.00	55.00	60.00	60.00
Book value	169.69	208.77	254.57	315.61

### Valuation data

Year to	03/2011a	03/2012e	03/2013e	03/2014e
EV/sales	2.4	2.0	1.7	1.4
EV/EBITDA	12.0	9.8	8.6	7.3
EV/IC	28.2	19.8	15.9	14.1
PE*	17.4	14.5	13.6	12.0
P/Book value	9.3	7.5	6.2	5.0
FCF yield (%)	5.3	6.7	6.2	7.8
Dividend yield (%)	2.5	3.5	3.8	3.8

Note: \* = Based on HSBC EPS (fully diluted)

### Price relative

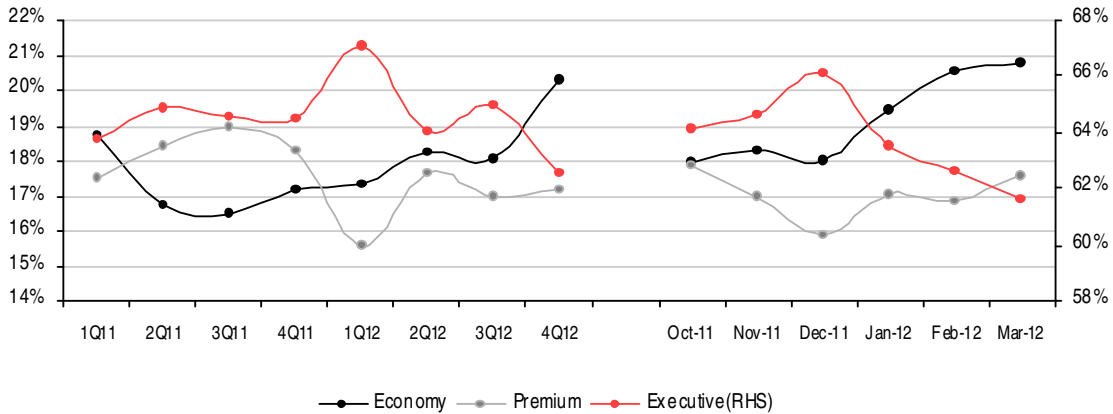


Source: HSBC

Note: price at close of 17 May 2012

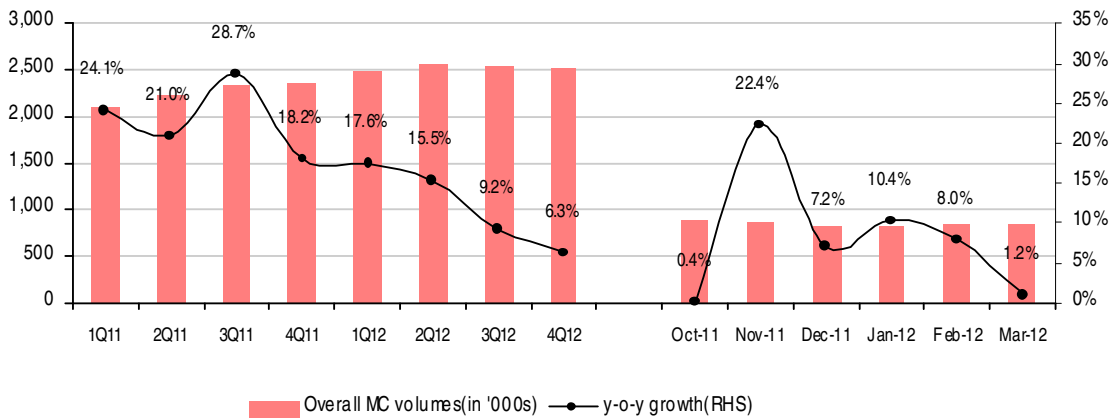
## 2W sector trends

Chart 1: Clear signs of down trading in overall 2W market from the executive segment to the economy segment



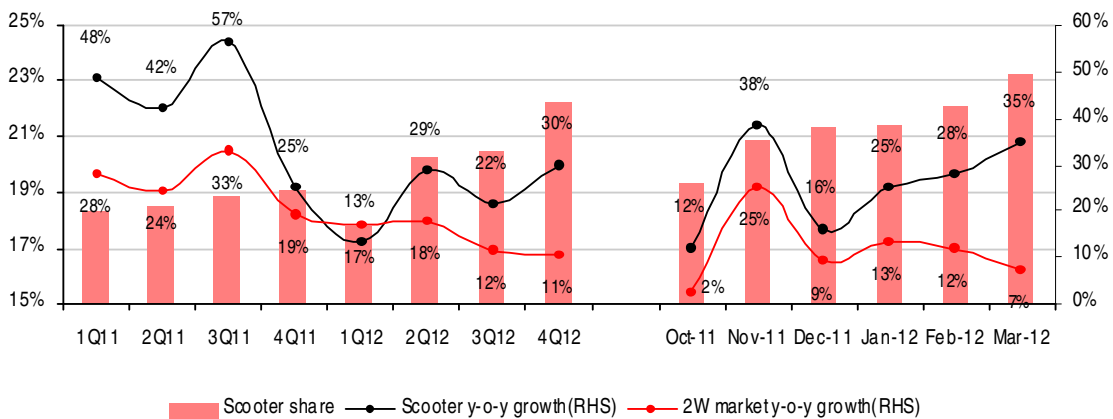
Source: SIAM, CRISIL, HSBC

Chart 2: Growth in the overall motorcycle is trending downward in past few quarters



Source: SIAM, CRISIL, HSBC

Chart 3: Growth in scooters have outpaced that of 2W market, leading to increase in overall share



Source: SIAM, CRISIL, HSBC

## 4Q12 Excerpts

Bajaj reported revenues of INR46.5b, 10.7% y-o-y, which is in line with our estimates of INR 47b if we include the operating income of INR0.52b that has been reclassified into other income. Average selling price per vehicles was down 1% q-o-q, in line with our estimates on account of weaker product mix and currency appreciation in the 4Q. As per the change in accounting the operating income includes only scrap sales, royalty and DEPB which accounted for 3% of net revenues. On a like to like basis the operational other income was 4.2% of net revenues compared to 4.6% in 3Q12 and 3.7% in 4Q11.

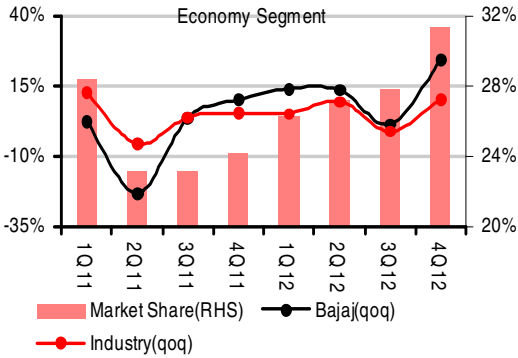
EBITDA margins for the quarter declined marginally to 20.7% from 21% in the 3Q12, mainly on account of increase in other expenditure. Raw material costs including inventory change was flat sequentially at 70.4%. The down trading of bikes is the primary margin risk to Bajaj going into FY13. The currency depreciation benefit on exports is limited as well, as Bajaj has 85% of its exports covered for FY13 in the range of INR48-51 versus USD.

The new Discover series is expected to push sales volume for the company in FY13, while we do not see the new Pulsar 200 NS (expected in the next couple of weeks) to add significantly to the volume growth. We believe the bike will be priced at the higher end of the premium category which is currently growing slower than the overall two wheeler market (please refer to chart 1).

### Conference call updates

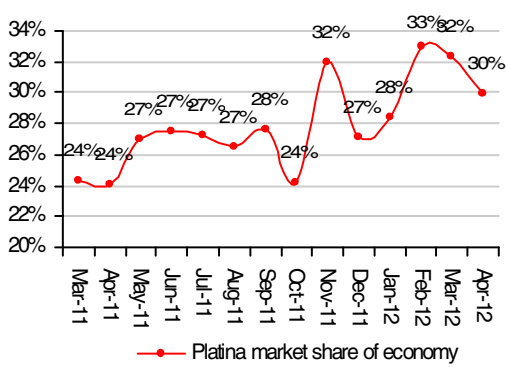
- ▶ The management is seeing a slowdown in the two wheeler market in the near term and expects the growth to be back ended for FY13. Further the delay in introduction of new three wheeler permits expected to strain domestic three wheeler sales as well. Nevertheless export volume growth (except Sri Lanka) continues to remain strong and is expected to grow 15-20% y-o-y in FY13.
- ▶ The duty increase in Sri Lanka has shot up retail prices of three wheelers by c32% and for two wheelers by c29%. The steep increase in price should impact the near term export volumes to Sri Lanka. Management expects a loss of 25,000 units of two wheelers and three wheelers each, in view of the duty hike in FY13.
- ▶ The new Discover series is expected to push sales volume for the company in FY13, while we do not see the new Pulsar 200 NS (expected in the next couple of weeks) to add significantly to the volume growth. We believe the bike will be priced at the higher end of the premium category which is currently growing slower than the two wheeler market (please refer to chart 1).
- ▶ The company invested INR 308.4m in Research and Development in FY12 and expects to launch one new Pulsar and one new Discover series from their latest platform in the coming years. The capital expenditure for FY12-14 is guided to be INR 5b.
- ▶ The Pantnagar plant is currently running at 60% utilization and has a capacity of producing 1.8m bikes per annum. The management is cautious on capacity expansion plans reflecting the weak demand outlook.
- ▶ Three wheelers domestic/export sales have margin of around 30% and 33% respectively. The lack of three wheeler demand visibility in our opinion could further hurt margins in the near term.

**Chart4: Economy segment growth trends:--** Bajaj has been gaining market share owing to strong sales in Platina



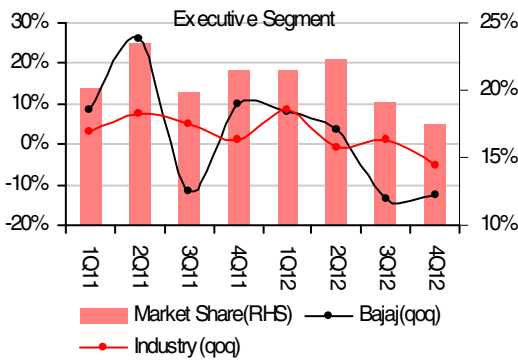
Source: Company data, HSBC

**Chart5: Economy segment - Market share trends of Platina**



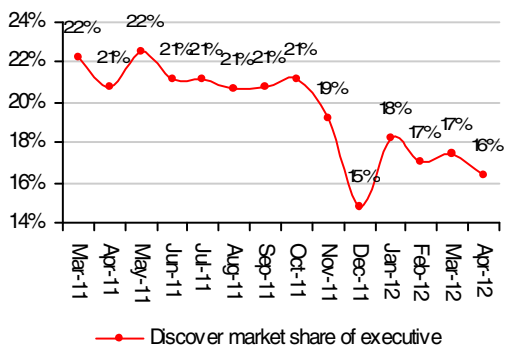
Source: Company data, HSBC

**Chart6: Executive segment growth trends: -** Success of new models in the Discover family key to recovery



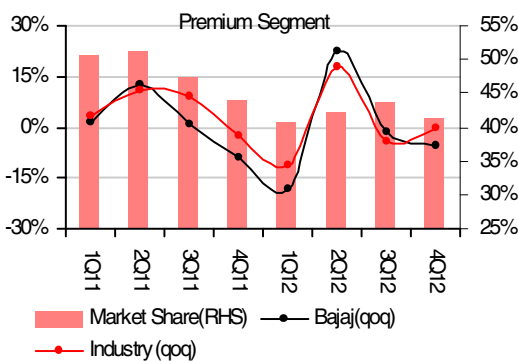
Source: Company data, HSBC

**Chart7: Executive segment - Market share trends of Discover**



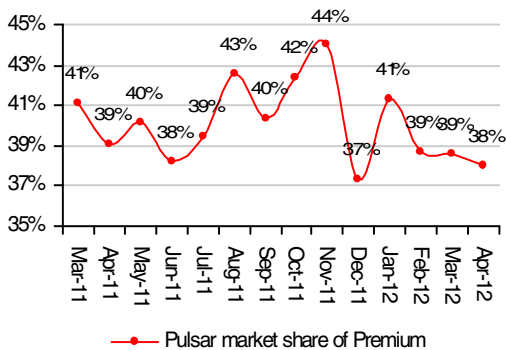
Source: Company data, HSBC

**Chart8: Premium segment growth trends:--** Market share drop of more than 10% since 2Q11



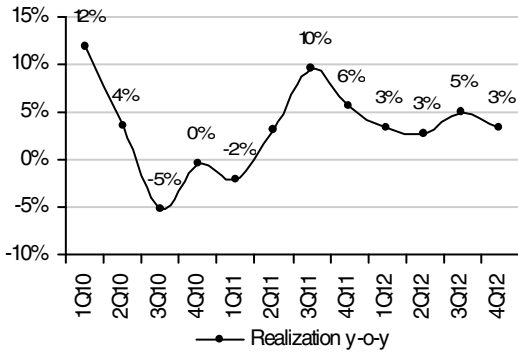
Source: Company data, HSBC

**Chart9: Premium segment - Market share trends of Pulsar**



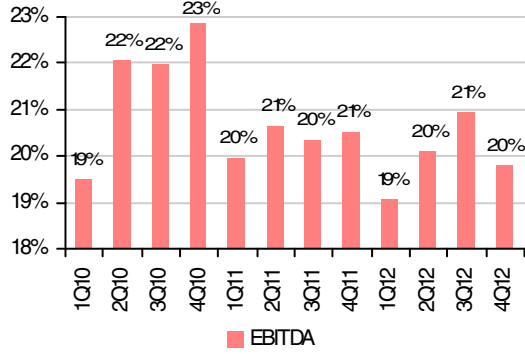
Source: Company data, HSBC

**Chart10: Quarterly trends in average realization**



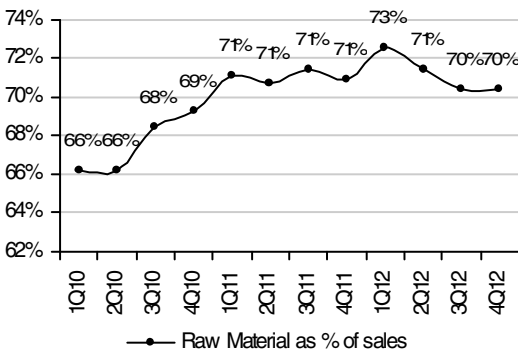
Source: Company data, HSBC

**Chart11: EBITDA margin trends**



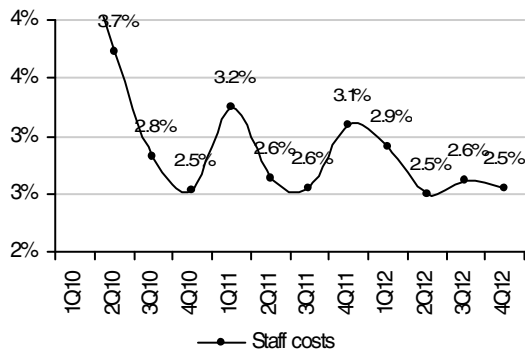
Source: Company data, HSBC

**Chart12: Raw Material costs trends as a % of Revenues**



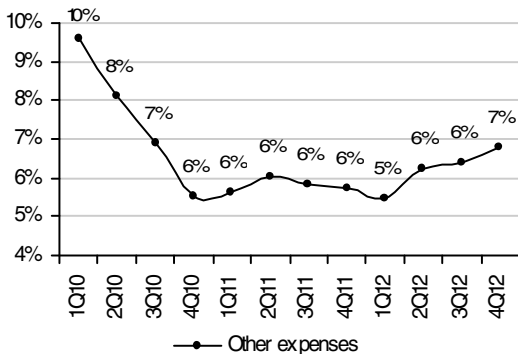
Source: Company data, HSBC

**Chart13: Staff costs as a % of Revenues**



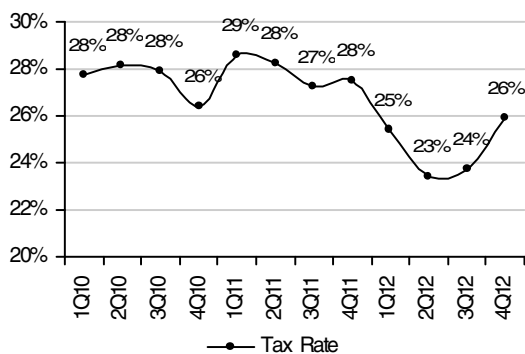
Source: Company data, HSBC

**Chart14: Quarterly trends in other expenses(% sales)**



Source: Company data, HSBC

**Chart15: Tax rate for FY13is guided to be near 29%**



Source: Company data, HSBC

## Valuation

Bajaj is currently trading at 14x our FY13 earnings. We expect 2W market to grow by 11% in FY13 (MC by c10% and scooters by c16%). We forecast Bajaj volumes to grow by c9% in FY13 and 11.5% in FY14. Benefit from better export realization and price increase to help maintain our top-line growth forecasts. We estimate a 50bps decline in margins for FY13 to 19.7% owing to the changing product mix, input cost headwinds offset by currency tailwinds. We cut our FY13 /FY14 earnings estimate marginally by 1% and 2% respectively. We value the company based on DCF methodology. We assume a risk free rate of 3.5%, cost of equity of 11% and cost of debt of 9.2% as per the HSBC method, and arrive at a WACC of 11% for Bajaj. Terminal growth rate is assumed to be 4.5%. Our DCF analysis values Bajaj at INR1,700 (from INR 1,745), implying a multiple of 13x on FY14e EPS.

Under our research model, for stocks without a volatility indicator, the Neutral band is 5ppts above and below the hurdle rate for Indian stocks of 11%. Our target price of INR1,700 implies a potential return of 7.9%, which is in the Neutral band; therefore, we rate the stock Neutral. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

## Risks

On the downside, increasing intensity of competition is a significant threat for Bajaj in both the premium and economy segment. Bajaj, due to its significant proportion of exports, is subject to changes in regulations (such as the hike in duty in SriLanka) which could have a material affect on earnings. On the upside, Bajaj with a history of new launches and quick technology adoption has often delivered vehicles that have boosted sales in the year of launch. The success of the new Discover series and Pulsar is the key upside risk to our estimates.

# Disclosure appendix

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This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at [www.hsbcnet.com/research](http://www.hsbcnet.com/research). Details of these short-term investment opportunities can be found under the Reports section of this website.

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HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile\*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile\*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.



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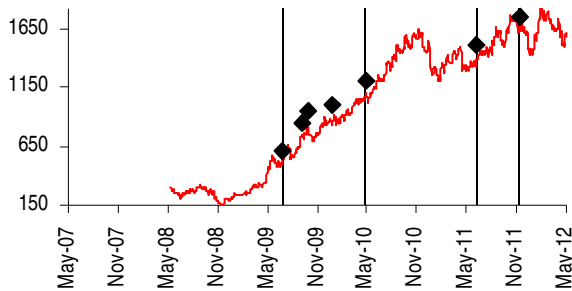
## Rating distribution for long-term investment opportunities

As of 18 May 2012, the distribution of all ratings published is as follows:

<b>Overweight (Buy)</b>	48%	(26% of these provided with Investment Banking Services)
<b>Neutral (Hold)</b>	38%	(25% of these provided with Investment Banking Services)
<b>Underweight (Sell)</b>	14%	(16% of these provided with Investment Banking Services)

## Share price and rating changes for long-term investment opportunities

Bajaj Auto (BAJA.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Underweight (V)	Overweight (V)	08 July 2009
Overweight (V)	Neutral (V)	12 May 2010
Neutral (V)	Neutral	20 June 2011
Neutral	N/A	21 June 2011
N/A	Neutral	28 November 2011
Target Price	Value	Date
Price 1	610.00	08 July 2009
Price 2	840.00	24 September 2009
Price 3	950.00	15 October 2009
Price 4	1000.00	12 January 2010
Price 5	1200.00	12 May 2010
Price 6	1506.00	20 June 2011
Price 7	N/A	21 June 2011
Price 8	1745.00	28 November 2011

Source: HSBC

## HSBC & Analyst disclosures

### Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
BAJAJ AUTO	BAJA.BO	1575.35	17-May-2012	7

Source: HSBC

- 1 HSBC\* has managed or co-managed a public offering of securities for this company within the past 12 months.
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### Additional disclosures

- 1 This report is dated as at 18 May 2012.
- 2 All market data included in this report are dated as at close 17 May 2012, unless otherwise indicated in the report.
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