

## Upgrade to Buy with new TP of INR1809

# New launches and weak INR to aid growth

May 10, 2012

<b>Rating</b>	<b>Buy</b>
Up from Neutral	
<b>Target price</b>	INR 1809
Increased from 1588	
<b>Closing price</b>	INR 1489
May 8, 2012	
<b>Potential upside</b>	+21.5%

### Action: Upgrade to Buy, and TP revised to INR1,809

BJAUT stock has corrected by 14% in the last six months due to concerns over slowing domestic volume growth and intensifying competition. We believe the new launches due over the next 1-2 months should lead to improvement in domestic volumes going forward. We expect 7% volume growth in FY13F. Further, as BJAUT derives 35% of its revenues from exports, the weaker INR (down 20% y-y) bodes well for the company. If the INR remains around current levels or weakens further, this will give the company strategic advantage, especially over Chinese competitors, in our view. At 11.6x FY14F EPS, valuations are compelling and provide a good entry point, in our view. Upgrade to BUY.

### Catalysts:

- Success of new launches: BJAUT is likely to launch the all-new Pulsar and Discover in 1QFY13. We have not built in any volume upside from the new Discover and RE-60 four-wheeler platform. Success of these launches may lead to upsides to our estimates.
- Benefits from a weaker INR: We are building in average export realization at INR 50 for FY13F and INR51 for FY14F. If the INR remains around current levels or weakens further, there could be upside to our estimates.
- Competitors have introduced price increases over the last 1-2 months; if BJAUT does the same, there could be upside risks to our estimates.

### Valuation: DCF-based TP of INR1,809, implying 21% potential upside

We value BJAUT based on DCF at INR1,809. The implied target multiple at 14x FY14F EPS (INR131.1) is lower than the average multiple of 15x.

31 Mar	FY11	FY12F		FY13F		FY14F	
Currency (INR)	Actual	Old	New	Old	New	Old	New
<b>Revenue (mn)</b>	165,782	197,788	198,491	222,897	216,048	250,821	242,165
<b>Reported net profit (mn)</b>	33,397	29,258	29,652	31,161	32,757	35,734	37,930
<b>Normalised net profit (mn)</b>	26,152	29,258	31,194	31,161	32,757	35,734	37,930
<b>Normalised EPS</b>	90.37	101.11	107.80	107.68	113.20	123.49	131.08
<b>Norm. EPS growth (%)</b>	41.3	11.9	19.3	6.5	5.0	14.7	15.8
<b>Norm. P/E (x)</b>	16.8	N/A	14.1	N/A	13.4	N/A	11.6
<b>EV/EBITDA (x)</b>	11.9	10.1	9.6	8.8	8.6	7.4	7.1
<b>Price/book (x)</b>	8.9	N/A	6.8	N/A	5.3	N/A	4.3
<b>Dividend yield (%)</b>	2.6	N/A	2.7	N/A	3.0	N/A	3.5
<b>ROE (%)</b>	85.2	51.4	52.0	42.7	44.4	39.3	41.0
<b>Net debt/equity (%)</b>	net cash	net cash	net cash	net cash	net cash	net cash	net cash

Source: Company data, Nomura estimates

**Key company data:** See page 2 for company data and detailed price/index chart.

### Anchor themes

We expect domestic volume growth to slow to around 8% over the next two years. Amidst growth slowdown and increased competition from Honda, we prefer BJAUT over HMCL, due to 1) relatively low exposure to the domestic two-wheeler business; 2) strong export growth potential; and 3) benefits of INR depreciation.

### Nomura vs consensus

Our estimates are largely in line with consensus.

### Research analysts

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

# Key data on Bajaj Auto

## Income statement (INRmn)

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
<b>Revenue</b>	<b>119,295</b>	<b>165,782</b>	<b>198,491</b>	<b>216,048</b>	<b>242,165</b>
Cost of goods sold	-82,069	-119,217	-142,820	-154,790	-173,295
<b>Gross profit</b>	<b>37,226</b>	<b>46,565</b>	<b>55,671</b>	<b>61,258</b>	<b>68,870</b>
SG&A	-8,585	-9,484	-11,987	-14,521	-16,190
Employee share expense	-3,995	-4,768	-5,333	-5,973	-6,570
<b>Operating profit</b>	<b>24,646</b>	<b>32,313</b>	<b>38,352</b>	<b>40,764</b>	<b>46,110</b>
<b>EBITDA</b>	<b>26,011</b>	<b>33,541</b>	<b>39,698</b>	<b>42,215</b>	<b>47,658</b>
Depreciation	-1,365	-1,228	-1,346	-1,451	-1,548
Amortisation					
EBIT	24,646	32,313	38,352	40,764	46,110
Net interest expense	-60	-17	-200	0	0
Associates & JCEs					
Other income	1,465	3,966	3,297	5,502	7,530
<b>Earnings before tax</b>	<b>26,052</b>	<b>36,262</b>	<b>41,449</b>	<b>46,267</b>	<b>53,640</b>
Income tax	-7,543	-10,110	-10,255	-13,510	-15,711
<b>Net profit after tax</b>	<b>18,509</b>	<b>26,152</b>	<b>31,194</b>	<b>32,757</b>	<b>37,930</b>
Minority interests					
Other items					
Preferred dividends					
<b>Normalised NPAT</b>	<b>18,509</b>	<b>26,152</b>	<b>31,194</b>	<b>32,757</b>	<b>37,930</b>
Extraordinary items	-1,147	7,246	-1,543	0	0
<b>Reported NPAT</b>	<b>17,362</b>	<b>33,397</b>	<b>29,652</b>	<b>32,757</b>	<b>37,930</b>
Dividends	-5,787	-11,568	-11,861	-13,103	-15,172
<b>Transfer to reserves</b>	<b>11,574</b>	<b>21,829</b>	<b>17,791</b>	<b>19,654</b>	<b>22,758</b>

## Valuation and ratio analysis

FD normalised P/E (x)	23.7	16.8	14.1	13.4	11.6
FD normalised P/E at price target (x)	28.3	20.0	16.8	16.0	13.8
Reported P/E (x)	25.3	13.2	14.8	13.4	11.6
Dividend yield (%)	1.3	2.6	2.7	3.0	3.5
Price/cashflow (x)	14.6	14.6	12.0	12.2	10.3
Price/book (x)	15.0	8.9	6.8	5.3	4.3
EV/EBITDA (x)	16.1	11.9	9.6	8.6	7.1
EV/EBIT (x)	17.0	12.4	9.9	8.9	7.4
Gross margin (%)	31.2	28.1	28.0	28.4	28.4
EBITDA margin (%)	21.8	20.2	20.0	19.5	19.7
EBIT margin (%)	20.7	19.5	19.3	18.9	19.0
Net margin (%)	14.6	20.1	14.9	15.2	15.7
Effective tax rate (%)	29.0	27.9	24.7	29.2	29.3
Dividend payout (%)	33.3	34.6	40.0	40.0	40.0
Capex to sales (%)	0.5	0.3	1.5	1.2	1.1
Capex to depreciation (x)	0.5	0.4	2.2	1.7	1.7
ROE (%)	72.4	85.2	52.0	44.4	41.0
ROA (pretax %)	49.4	63.4	76.0	76.4	80.7

## Growth (%)

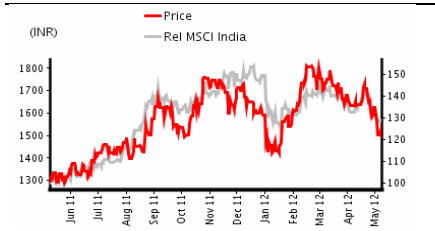
Revenue	35.5	39.0	19.7	8.8	12.1
EBITDA	118.9	29.0	18.4	6.3	12.9
EBIT	132.9	31.1	18.7	6.3	13.1
Normalised EPS	135.3	41.3	19.3	5.0	15.8
Normalised FDEPS	135.3	41.3	19.3	5.0	15.8

## Per share

Reported EPS (INR)	60.00	115.41	102.47	113.20	131.08
Norm EPS (INR)	63.97	90.37	107.80	113.20	131.08
Fully diluted norm EPS (INR)	63.97	90.37	107.80	113.20	131.08
Book value per share (INR)	101.20	169.69	224.49	285.03	355.14
DPS (INR)	20.00	39.98	40.99	45.28	52.43

Source: Company data, Nomura estimates

## Relative performance chart (one year)



Source: ThomsonReuters, Nomura research

(%)	1M	3M	12M
Absolute (INR)	-7.1	-7.3	15.1
Absolute (USD)	-10.2	-13.7	-2.6
Relative to index	-2.9	-3.4	24.2
Market cap (USDmn)	8,302.4		
Estimated free float (%)	43.5		
52-week range (INR)	1843.35/1260.3		
3-mth avg daily turnover (USDmn)	13.84		
Major shareholders (%)			
Bajaj Holdings and Investments	30.7		
Jamnalal Sons Pvt. Ltd.	9.0		

Source: Thomson Reuters, Nomura research

## Notes

EBITDA margins to remain strong on higher export realizations resulting from rupee depreciation

**Cashflow (INRmn)**

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
EBITDA	26,011	33,541	39,698	42,215	47,658
Change in working capital	11,263	2,638	4,167	1,918	3,088
Other operating cashflow	-7,285	-6,161	-7,157	-8,007	-8,180
<b>Cashflow from operations</b>	<b>29,989</b>	<b>30,018</b>	<b>36,708</b>	<b>36,126</b>	<b>42,565</b>
Capital expenditure	-648	-443	-3,000	-2,500	-2,625
<b>Free cashflow</b>	<b>29,341</b>	<b>29,575</b>	<b>33,708</b>	<b>33,626</b>	<b>39,940</b>
Reduction in investments	-827	-2,084	0	0	0
Net acquisitions					
Reduction in other LT assets	1,996	-43	0	0	0
Addition in other LT liabilities	-25	280	0	0	0
Adjustments					
<b>Cashflow after investing acts</b>	<b>30,484</b>	<b>27,729</b>	<b>33,708</b>	<b>33,626</b>	<b>39,940</b>
Cash dividends	-6,749	-13,488	-13,794	-15,239	-17,645
Equity issue					
Debt issue	-2,315	-10,134	0	0	0
Convertible debt issue					
Others	-473	6,098	-1,543		
<b>Cashflow from financial acts</b>	<b>-9,536</b>	<b>-17,525</b>	<b>-15,337</b>	<b>-15,239</b>	<b>-17,645</b>
<b>Net cashflow</b>	<b>20,948</b>	<b>10,204</b>	<b>18,371</b>	<b>18,387</b>	<b>22,295</b>
Beginning cash	11,800	32,748	42,952	61,322	79,709
Ending cash	32,748	42,952	61,322	79,709	102,005
Ending net debt	-19,362	-39,700	-58,071	-76,458	-98,753

Source: Company data, Nomura estimates

**Notes**

We expect strong free cashflow generation over FY12-14F

**Balance sheet (INRmn)**

As at 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Cash & equivalents	32,748	42,952	61,322	79,709	102,005
Marketable securities	0	0	0	0	0
Accounts receivable	2,728	3,628	4,321	4,731	5,307
Inventories	4,462	5,473	6,570	7,192	8,047
Other current assets	21,805	14,061	13,052	14,292	16,030
<b>Total current assets</b>	<b>61,743</b>	<b>66,113</b>	<b>85,266</b>	<b>105,924</b>	<b>131,388</b>
LT investments	8,482	10,565	10,565	10,565	10,565
Fixed assets	15,211	15,483	17,137	18,186	19,264
Goodwill					
Other intangible assets					
Other LT assets	0	43	43	43	43
<b>Total assets</b>	<b>85,436</b>	<b>92,204</b>	<b>113,011</b>	<b>134,719</b>	<b>161,260</b>
Short-term debt					
Accounts payable	20,263	24,267	28,905	31,650	35,499
Other current liabilities	22,487	15,286	15,598	17,042	19,449
<b>Total current liabilities</b>	<b>42,750</b>	<b>39,553</b>	<b>44,502</b>	<b>48,692</b>	<b>54,948</b>
Long-term debt	13,386	3,252	3,252	3,252	3,252
Convertible debt					
Other LT liabilities	17	297	297	297	297
<b>Total liabilities</b>	<b>56,152</b>	<b>43,101</b>	<b>48,051</b>	<b>52,241</b>	<b>58,497</b>
Minority interest					
Preferred stock	0	0	0	0	0
Common stock	1,447	2,894	2,894	2,894	2,894
Retained earnings	27,837	46,209	62,066	79,585	99,870
Proposed dividends					
Other equity and reserves					
<b>Total shareholders' equity</b>	<b>29,283</b>	<b>49,102</b>	<b>64,960</b>	<b>82,478</b>	<b>102,763</b>
<b>Total equity &amp; liabilities</b>	<b>85,436</b>	<b>92,204</b>	<b>113,011</b>	<b>134,719</b>	<b>161,260</b>

**Notes**

Higher cash balance could lead to higher payouts

**Liquidity (x)**

Current ratio	1.44	1.67	1.92	2.18	2.39
Interest cover	412.1	1,912.0	191.8	na	na

**Leverage**

Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash

**Activity (days)**

Days receivable	9.7	7.0	7.3	7.6	7.6
Days inventory	17.5	15.2	15.4	16.2	16.0
Days payable	72.0	68.2	68.1	71.4	70.7
Cash cycle	-44.9	-46.0	-45.4	-47.5	-47.1

Source: Company data, Nomura estimates

## Exports remain the driver

*BJAUT's volumes have slowed down in the domestic market but we expect exports to remain firm. BJAUT is much less exposed to the domestic motorcycle market than competitor, Hero Motor Corp (HMCL IN, Neutral, TP: INR2,237)*

*We believe BJAUT will gain further from a weaker INR, which has been down 20% y-y against the USD. If the currency stays weak, we believe it will improve BJAUT's ability to gain market share against its Chinese and Japanese peers. Also, if any of BJAUT's new launches succeed, there will be potential upside to our volume estimates.*

## New launches planned to recover market share in FY13F

BJAUT will be launching the all-new Pulsar in end-May and new Discover in June-12, which should in our view support volume growth. The company targets to gain back market share with new launches of Pulsar and Discover models. However, we are more conservative and build in slower growth due to our expectations of industry slowdown and increased competitive intensity from Honda. We are building in 3.5% growth in the domestic motorcycles segment for FY13F and 6.8% for FY14F versus our expectations of around 8% growth in industry volumes.

**Fig. 1: New Pulsar 200NS expected to be available from end May-12**



Source: Company data

**Fig. 2: Existing Bajaj Pulsar 180**

Source: Company data

### **Competitive intensity is likely to increase in entry and mid-segment motorcycles ...**

Post separation from HMCL, Honda has highlighted aggressive expansion plans to increase its market share in India. Honda plans to enter the mass segment quite significantly to compete with current market leaders HMCL and BJAUT. Honda is already in the process of setting up two plants to increase its capacity to 4mn units by mid-CY13 from 1.6mn units in FY11.

Honda launched Dream Yuga (110 cc), its first bike in the executive segment at the 2012 *Auto Expo*. The model, priced competitively at an ex-showroom price of INR45,000-50,000, will compete with Hero's Passion and Splendor models and Bajaj Discover. Honda has already finalized plans for more launches in the lower-priced segment as well, as per our interactions with industry experts. Further, Suzuki has announced new launches in the 110cc-motorcycle segment

With all the new launches, we believe, competition is set to increase significantly in the two-wheeler space (primarily entry and mid segments) over the next 12-18 months.

### **... we believe BJAUT is better placed than HMCL if Honda becomes more aggressive**

We believe that due to a relatively weaker franchise (compared to HMCL's), the entry- and mid-segment motorcycles of BJAUT can be affected more by increased competition from Honda over the next 2-3 years. However, due to its presence in the 3-wheeler segment and higher exports contribution, only around 50% of revenues and 40% of EBITDA come from the domestic motorcycle business, as per our calculations. Therefore, we believe BJAUT is relatively better placed than HMCL if Honda becomes more aggressive. Further, even within the domestic motorcycle space, BJAUT has a higher market share in the premium segment, which we believe will be least impacted by higher competition. The premium segment accounts for around 30% of BJAUT's domestic 2-wheeler volumes compared with only 5% of volume for HMCL.

Fig. 3: Revenue and EBITDA breakdown of BJAUT

Revenue breakdown (%)	FY11	FY12F	FY13F	FY14F
Domestic 2-w heelers	55.7	50.5	48.3	47.5
Domestic 3-w heelers	7.2	7.1	6.5	6.3
Exports	30.4	35.3	38.3	39.5
Others	6.6	7.1	6.9	6.8
Total	100.0	100.0	100.0	100.0
<b>EBITDA breakdown (%)</b>				
Domestic 2-w heelers	49.7	41.6	37.4	37.2
Domestic 3-w heelers	10.6	9.8	9.6	9.1
Exports	26.9	35.2	41.4	42.3
Others	12.7	13.4	11.6	11.4
Total	100.0	100.0	100.0	100.0

Source: Company data, Nomura estimates

Fig. 4: Market share across different segments

BJAUT	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12	3QFY12	4QFY12
Economy	33.4	26.5	29.8	31.2	27.8	22.9	22.6	24.1	26.2	27.2	29.7	31.3
Executive	9.4	14.2	21.0	19.7	20.3	23.7	20.1	21.7	21.5	21.9	19.1	17.6
Premium	40.1	43.3	47.7	52.0	50.6	51.3	47.4	44.1	40.6	42.3	43.6	41.3
Overall	19.6	20.4	26.8	27.6	27.0	28.6	25.7	26.3	25.3	26.5	25.1	24.4
<b>HMCL</b>	<b>1QFY10</b>	<b>2QFY10</b>	<b>3QFY10</b>	<b>4QFY10</b>	<b>1QFY11</b>	<b>2QFY11</b>	<b>3QFY11</b>	<b>4QFY11</b>	<b>1QFY12</b>	<b>2QFY12</b>	<b>3QFY12</b>	<b>4QFY12</b>
Economy	39.5	46.8	45.2	43.4	44.6	46.8	46.2	46.6	44.7	43.0	45.6	45.4
Executive	80.2	76.3	70.4	68.1	66.8	64.6	69.1	68.2	67.7	68.2	69.5	69.8
Premium	22.1	21.3	16.7	19.2	19.2	18.6	19.9	23.7	21.4	20.6	16.1	17.2
Overall	62.1	63.9	57.3	54.9	54.2	53.1	55.8	56.3	56.5	55.2	56.1	55.8
<b>Honda</b>	<b>1QFY10</b>	<b>2QFY10</b>	<b>3QFY10</b>	<b>4QFY10</b>	<b>1QFY11</b>	<b>2QFY11</b>	<b>3QFY11</b>	<b>4QFY11</b>	<b>1QFY12</b>	<b>2QFY12</b>	<b>3QFY12</b>	<b>4QFY12</b>
Economy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Executive	8.3	6.3	6.2	9.1	10.8	9.1	8.8	8.6	8.7	7.8	9.7	11.2
Premium	10.1	8.2	7.2	7.5	8.0	7.6	7.7	7.0	8.1	7.3	9.3	9.0
Overall	6.7	5.8	5.2	7.3	8.3	7.3	7.1	6.8	7.1	6.3	7.9	8.6

Source: Crisil, Nomura research

Fig. 5: Domestic 2-wheeler volume mix

BJAUT	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12	3QFY12	4QFY12
Economy	38.8	16.4	20.9	19.5	19.3	13.5	14.8	15.8	17.9	18.8	21.4	26.0
Executive	29.7	49.8	51.3	46.1	47.7	53.5	50.0	53.2	57.0	52.9	49.3	45.0
Premium	31.5	33.8	27.8	34.5	33.0	33.0	35.1	30.9	25.1	28.3	29.4	29.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<b>HMCL</b>	<b>1QFY10</b>	<b>2QFY10</b>	<b>3QFY10</b>	<b>4QFY10</b>	<b>1QFY11</b>	<b>2QFY11</b>	<b>3QFY11</b>	<b>4QFY11</b>	<b>1QFY12</b>	<b>2QFY12</b>	<b>3QFY12</b>	<b>4QFY12</b>
Economy	14.5	9.2	14.9	13.6	15.5	16.2	14.0	14.3	13.9	14.3	14.7	16.5
Executive	80.1	85.5	80.5	80.0	78.3	77.8	79.2	77.9	80.5	79.1	80.5	78.2
Premium	5.5	5.3	4.6	6.4	6.2	5.9	6.8	7.8	5.6	6.6	4.8	5.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<b>Honda</b>	<b>1QFY10</b>	<b>2QFY10</b>	<b>3QFY10</b>	<b>4QFY10</b>	<b>1QFY11</b>	<b>2QFY11</b>	<b>3QFY11</b>	<b>4QFY11</b>	<b>1QFY12</b>	<b>2QFY12</b>	<b>3QFY12</b>	<b>4QFY12</b>
Economy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Executive	76.7	77.5	78.3	81.2	83.1	80.8	79.4	80.9	82.2	79.5	80.1	82.0
Premium	23.3	22.5	21.7	18.8	16.9	19.2	20.6	19.1	17.8	20.5	19.9	18.0
Overall	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Crisil, Nomura research

## Exports to remain the key volume growth driver; rupee depreciation to give competitive advantage, especially in Africa, in our view

In FY11, exports contributed around 33% of total sales for Bajaj Auto. After having expanded its exposure into many markets in the past, the company is now reaping the fruits of its efforts. Bajaj Auto's export revenues saw a CAGR of nearly 30% over the past three years. Bajaj Auto sells around 48% of volumes in Africa and continues to see high potential there. We expect export volumes to achieve a 14% CAGR over the next two years.

As per our discussions with the company, management remains confident of achieving strong volume growth in the motorcycles space in FY13F. Further, Nigeria (the largest market in Africa for motorcycles) and a few other markets in Africa have implemented a ban on 2-stroke bikes this year. Thus, we believe the Chinese players, who have a combined 30% market share, will likely find it tough to maintain their advantage of selling their bikes at USD450 each. In our opinion, this should help Bajaj Auto even in the wake of competition from Honda's USD650-priced bikes. Further, we believe that INR depreciation vis-a-vis all major currencies over the last one year (see fig 6) will give BJAUT a competitive advantage especially in price-sensitive markets such as Africa.

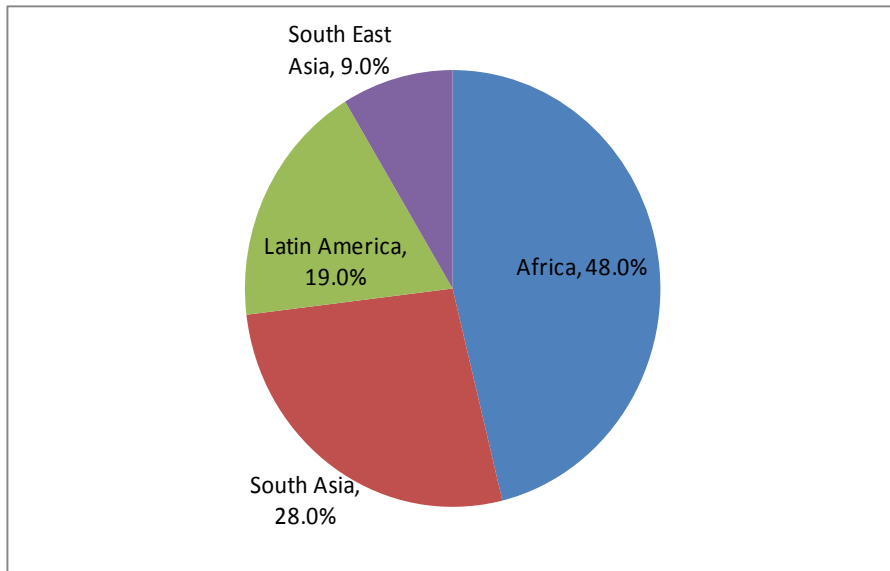
**Fig. 6: INR depreciation vis-a-vis other currencies**

Currencies	Exchange rate			INR dep. vs FY11 (%)	
	FY11 Avg	FY12 Avg	Current	FY12	Current
Nigeria	0.30	0.30	0.34	1%	12%
China	6.79	7.49	8.41	10%	24%
Sri Lanka	0.41	0.42	0.41	4%	2%
Colombia	0.02	0.03	0.03	8%	25%
Japan	0.55	0.65	0.66	18%	21%
USD	45.6	48.0	52.8	5%	16%

Source: Bloomberg, Nomura research

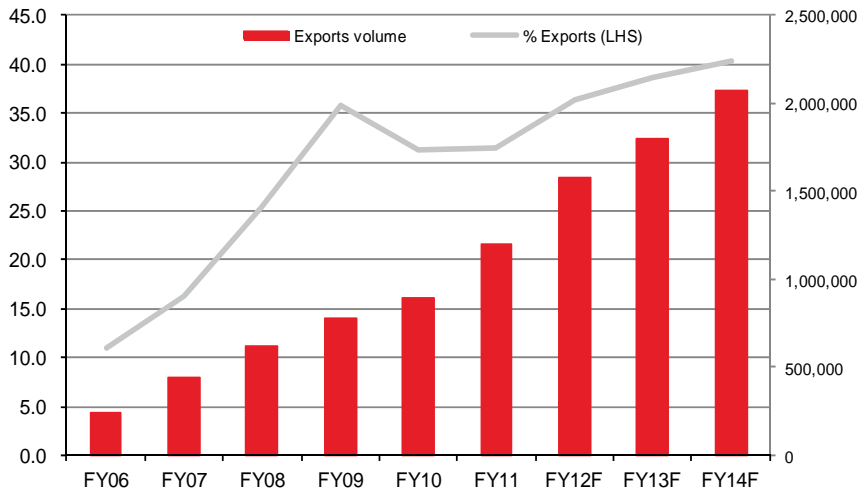
As per our interaction with industry consultants on the African markets, there is significant growth potential in the 3-wheeler segment in Africa; volumes could double in the next 2-3 years. Bajaj Auto also expects strong growth for 3-wheeler vehicles in the export markets, with the company forecasting growth in Africa could be as high as 50%. We note that the 3-wheeler vehicle segment is the most profitable segment for Bajaj Auto.

**Fig. 7: Regional distribution of exports (FY11)**



Source: Company data

**Fig. 8: Export contribution to volumes on the rise**



Source: Company data, Nomura estimates

**Increasing FY13F-14F EPS estimates by 5-6%; cutting volume estimates but we expect rupee depreciation to help margins**

We believe that competitive intensity in the domestic industry is set to increase significantly over the next two years. Coupled with our expectations of a slowdown in industry growth, we believe this will impact BJAUT’s domestic 2-wheeler volume growth. Therefore, we are cutting down our domestic volume estimates by around 7-8% for FY13-14F. We now build in only 3.5% volume growth for FY13F and 6.8% for FY14F for the domestic motorcycle business.

Post the imposition of additional import duties in Sri Lanka, we have cut down our export volume growth estimates, particularly for 3-wheeler vehicles. We believe 3-wheeler sales volume in Sri Lanka, which accounts for around 40% of BJAUT’s total 3-wheeler exports, will be significantly impacted in the next 3-6 months before stabilizing in 2HFY13F. We now expect 3-wheeler export growth of only 5% (~22% earlier) in FY13F and 15% in FY14F. We expect around 15% growth in 2-wheeler exports, driven by strong growth in



Africa and expansion into other newer markets. Overall, we have reduced our volume growth estimates by ~7% for FY13F and 8% for FY14F.

We have increased our EBITDA margin assumptions by around 150 bps for FY13-14F, particularly to factor in rupee depreciation. As per our discussions with the management, BJAUT has hedged around 80% of FY13 exports (through range forwards) at the upper band of 47-51 range. Therefore, average export realization could be around INR50 for FY13F, in our view. We have built in EBITDA margin of 19.5% for FY13F and 19.7% for FY14F. Overall, we have upped our EPS estimates by 5% for FY13F and 6% for FY14F.

Fig. 9: Changes to our assumptions

	New Estimates			Old Estimates			% change		
	FY12F	FY13F	FY14F	FY12F	FY13F	FY14F	FY12F	FY13F	FY14F
Volumes (units)									
<b>Two Wheelers</b>									
Domestic	2,566,374	2,656,806	2,836,971	2,656,063	2,868,548	3,098,032	-3.4	-7.4	-8.4
YoY	6.3	3.5	6.8	10.0	8.0	8.0			
Exports	1,268,031	1,458,236	1,676,971	1,312,790	1,509,708	1,811,650	-3.4	-3.4	-7.4
YoY	30.4	15.0	15.0	35.0	15.0	20.0			
<b>Total</b>	<b>3,834,405</b>	<b>4,115,042</b>	<b>4,513,942</b>	<b>3,968,853</b>	<b>4,378,257</b>	<b>4,909,682</b>	<b>-3.4</b>	<b>-6.0</b>	<b>-8.1</b>
<b>YoY</b>	<b>13.2</b>	<b>7.3</b>	<b>9.7</b>	<b>17.2</b>	<b>10.3</b>	<b>12.1</b>			
<b>Three Wheelers</b>									
Domestic	203,362	203,362	213,530	205,603	215,883	226,677	-1.1	-5.8	-5.8
YoY	(1.1)	-	5.0	-	5.0	5.0			
Exports	311,793	327,383	376,490	318,557	386,901	406,246	-2.1	-15.4	-7.3
YoY	34.8	5.0	15.0	37.7	21.5	5.0			
<b>Total</b>	<b>515,155</b>	<b>530,745</b>	<b>590,020</b>	<b>524,160</b>	<b>602,784</b>	<b>632,923</b>	<b>-1.7</b>	<b>-12.0</b>	<b>-6.8</b>
<b>YoY</b>	<b>17.9</b>	<b>3.0</b>	<b>11.2</b>	<b>20.0</b>	<b>15.0</b>	<b>5.0</b>			
<b>Total Volumes</b>	<b>4,349,560</b>	<b>4,645,786</b>	<b>5,103,962</b>	<b>4,493,013</b>	<b>4,981,041</b>	<b>5,542,606</b>	<b>-3.2</b>	<b>-6.7</b>	<b>-7.9</b>
<b>YoY</b>	<b>13.7</b>	<b>6.8</b>	<b>9.9</b>	<b>17.5</b>	<b>10.9</b>	<b>11.3</b>			
<b>Realization/Unit (INR)</b>	<b>45,635</b>	<b>46,504</b>	<b>47,447</b>	<b>44,021</b>	<b>44,749</b>	<b>45,253</b>	<b>3.7</b>	<b>3.9</b>	<b>4.8</b>
EBITDA	39,698	42,215	47,658	36,808	40,472	45,303	7.9	4.3	5.2
EBITDA margin (%)	20.0%	19.5%	19.7%	18.6%	18.2%	18.1%	1.4	1.4	1.6
EPS (INR)	107.8	113.2	131.1	101.1	107.7	123.5	6.6	5.1	6.1

Source: Nomura estimates

Fig. 10: Nomura vs. Consensus

INR m n	Nomura			Consensus			% difference		
	FY12F	FY13F	FY14F	FY12F	FY13F	FY14F	FY12F	FY13F	FY14F
Sales	198,491	216,048	242,165	198,034	226,395	256,012	0.2	(4.6)	(5.4)
EBITDA	39,698	42,215	47,658	39,924	45,161	50,241	(0.6)	(6.5)	(5.1)
EBITDA margin (%)	20.0	19.5	19.7	20.2	19.9	19.6	(0.2)	(0.4)	0.1
Net profit	29,652	32,757	37,930	31,187	34,800	39,100	(4.9)	(5.9)	(3.0)
EPS (INR)	107.8	113.2	131.1	107.8	120.3	135.1	0.0	(5.9)	(3.0)

Source: Bloomberg, Nomura estimates

## Rupee depreciation could lead to further upside risks

Exports account for around 35% of BJAUT's total revenue. As such, a weaker INR bodes well for the company's profitability. Our sensitivity analysis suggests that every INR1 depreciation could lead to a 60bp increase in our estimated EBITDA margins and around 3% increase in our EPS estimates. We are currently building in USD/INR of 51.0 (compared with current levels of around 53 for FY14F). If INR stays at current levels of 53.0, this would increase our FY14F EPS estimates by around 5.5% to INR138. At 14x

FY14 PE, this would imply a target price of INR1,936, suggesting potential upside of 30% from current levels.

**Fig. 11: FY14 EPS sensitivity to INR depreciation**

	USD/INR exchange rate					
	49.0	51.0	53.0	55.0	57.0	60.0
Impact on OPM (bps)	(120)	-	120	240	360	540
Impact on EPS	-5.5%	-	5.5%	11.0%	16.5%	24.8%
FY 14F EPS	124	131	138	146	153	164
TP @ 14x FY14F EPS	1,734	1,835	1,936	2,037	2,138	2,289

Note: Our base case exchange rate assumption is 50.5 for FY13F and 51.0 for FY14F

Source: Nomura estimates

## Valuations look reasonable after recent under-performance ...

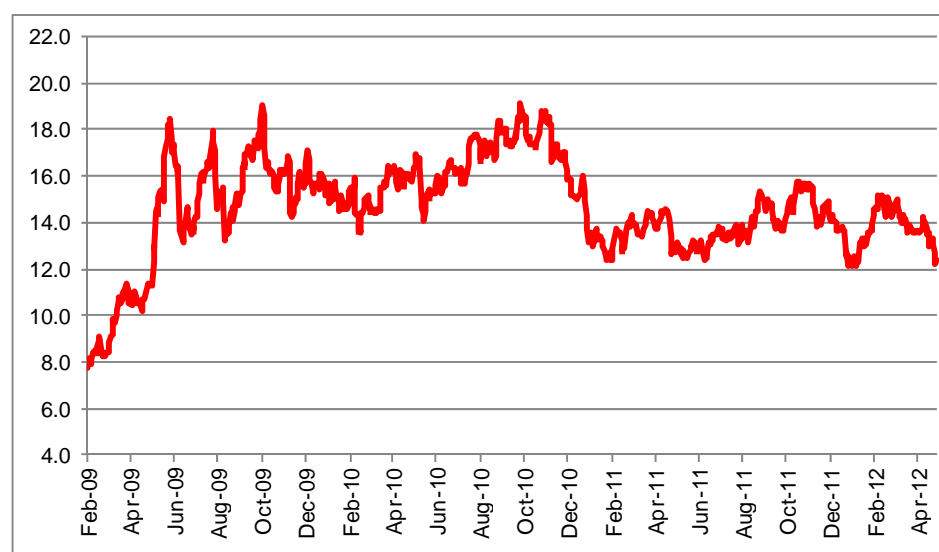
BJAUT has under-performed the Sensex by around 8% over the last six months. After the recent correction, the stock is trading at 12.5x one-year forward consensus EPS. We note that this is lower than the long-term average of around 15.0x.

**Fig. 12: Stock price performance**

Company	B'berg Ticker	Rating	Price	Stock performance			
				1M	3M	6M	1Y
BSE SENSEX	SENSEX		16,546	(3.9)	(6.1)	(5.8)	(10.7)
Tata Motors	TTMT IN	Buy	296	7.5	18.4	56.2	25.9
Ashok Leyland	AL IN	Buy	29	(5.1)	11.5	4.6	17.8
Maruti Suzuki	MSIL IN	Neutral	1,306	1.8	4.7	16.2	4.9
<b>Bajaj Auto</b>	<b>BJAUT IN</b>	<b>Buy</b>	<b>1,489</b>	<b>(9.7)</b>	<b>(9.0)</b>	<b>(13.6)</b>	<b>15.0</b>
Mahindra & Mahindra	MM IN	Buy	677	(1.0)	(1.9)	(19.0)	(4.7)
TVS	TVSL IN	Buy	38	(8.3)	(23.7)	(43.4)	(30.4)
Hero MotoCorp	HMCL IN	Neutral	1,899	(3.8)	(2.6)	(10.4)	9.0
Exide Industries	EXID IN	Neutral	125	(11.7)	(8.4)	1.2	(18.6)
Bharat Forge	BHFC IN	Buy	336	7.3	10.6	15.8	(2.3)

Source: Bloomberg, Nomura research

**Fig. 13: PE based on 1-yr forward consensus earnings**



Source: Thomson Reuters DataStream, Nomura research

Fig. 14: Two-wheeler cos: Relationship between P/E and volumes and earnings growth

One Year forward P/E (avg)			
Period	BJAUT	HMCL	TVSL
6 Months	13.9	14.7	7.6
1 Year	13.9	15.5	8.6
2 Years	14.8	15.0	11.3
3 Years	15.0	15.5	13.2
5 Years	NA	14.9	13.3
One Year forward P/E (avg)			
Period	BJAUT	HMCL	TVSL
FY12	13.9	15.4	9.0
FY11	15.9	14.8	14.7
FY10	15.0	16.3	16.4
FY09	NA	13.4	11.4
FY08	NA	14.4	15.6
FY07	NA	13.5	14.7
Volume Growth			
Period	BJAUT	HMCL	TVSL
FY12	13.7	15.4	7.4
FY11	34.0	17.4	33.5
FY10	30.0	23.6	14.6
FY09	(10.5)	11.5	3.1
FY08	(9.9)	-0.3	-15.7
FY07	19.3	14.5	13.9
Earnings Growth			
Period	BJAUT	HMCL	TVSL
FY12F	17.8	23.4	19.9
FY11	41.3	-9.5	131.7
FY10	15.8	74.1	183.2
FY09	-3.3	32.4	-2.2
FY08	-36	12.8	-52.3
FY07	14.5	-11.7	-43.1

Source: Thomson Reuters DataStream, Nomura research

### ... upgrade to Buy with a new TP of INR1,809

We value BJAUT based on a DCF methodology (unchanged). We have assumed 5% terminal growth and 13% cost of equity. We are building in slower volume growth in domestic market but expect export volumes to remain strong over the next two years. Overall, we have increased our EPS estimates by 5% for FY13F and 6% for FY14F. Further, we have rolled forward our target price to Apr-13 from Aug-12 previously, which has impacted our target price by around 9%. As a result, we revise our target price to INR1,809 (INR1,588 earlier), implying 21% potential upside from current levels.

Our target price implies 13.8x FY14F EPS compared with an average one-year forward multiple of around 15x.

Fig. 15: DCF based valuation

INR m	FY13F	FY14F	FY15F	FY16F	FY17F	FY18F	FY19F	FY20F
Total Revenues	216,048	242,165	270,711	297,839	326,442	358,217	385,833	410,502
YoY Growth	8.8	12.1	11.8	10.0	9.6	9.7	7.7	6.4
Operating Profit	42,215	47,658	53,484	58,867	63,994	69,568	74,716	79,490
OPM (%)	19.5%	19.7%	19.8%	19.8%	19.6%	19.4%	19.4%	19.4%
Interest	0	0	0	0	0	0	0	0
Depreciation	1,451	1,548	1,650	1,758	1,870	1,989	2,113	2,244
PBT	40,764	46,110	51,834	57,109	62,124	67,580	72,603	77,247
Extraordinary income/(loss)	0	0	0	0	0	0	0	0
Tax	11,903	13,505	15,214	16,865	18,434	20,950	22,507	23,946
Tax Rate (%)	29.2	29.3	29.4	29.5	29.7	31.0	31.0	31.0
PAT	28,861	32,605	36,619	40,245	43,690	46,630	50,096	53,300
YoY Growth	6.1	13.0	12.3	9.9	8.6	6.7	7.4	6.4
Depreciation	1,451	1,548	1,650	1,758	1,870	1,989	2,113	2,244
Increase in WC and other adj	156	202	225	224	260	293	249	221
Capex	2,500	2,625	2,756	2,894	3,039	3,191	3,350	3,518
Debt raised-Debt repaid	0	0	0	0	0	0	0	0
Equity raised	0	0	0	0	0	0	0	0
<b>Free cash flow</b>	<b>27,656</b>	<b>31,326</b>	<b>35,288</b>	<b>38,884</b>	<b>42,261</b>	<b>45,135</b>	<b>48,610</b>	<b>51,805</b>
<b>NPV of FCFE</b>	<b>385,420</b>	<b>Terminal</b>	<b>Terminal</b>	<b>Cost of</b>	<b>Terminal</b>			
<b>No of Shares(m)</b>	<b>289.4</b>	<b>ROE (%)</b>	<b>Growth (%)</b>	<b>Equity (%)</b>	<b>Value (INR m)</b>			
		22.00	5.00	13.0	540,573			
<b>Price</b>	<b>1,332</b>							
<b>Investments/share</b>	<b>253</b>							
<b>Total</b>	<b>1,585</b>							
<b>Target Price [INR, Apr 13]</b>	<b>1,809</b>							

Source: Company data, Nomura estimates

## Key risks

- **Aggressive competition from Honda:** Honda, post its separation from HMCL, is expanding its capacity from 1.6mn in FY11 to 4mn by end-FY13, as per management. Consequently, we expect Honda to become more aggressive in the lower-end space. Higher-than-expected increase in competitive intensity especially new model launches and aggressive pricing by Honda may impact volume growth and margins for BJAUT's domestic business, in our view.
- **Lower than expected exports growth:** We have assumed exports volume growth of around 15% over the next two years. If volume growth is weaker than expected, there could be downside risks to our estimates.
- **INR appreciation:** We have assumed a USD:INR rate of 51.0 for FY14F compared with current levels of 53.0. However, if INR appreciates sharply and goes back to 48 levels, there could be downside risks to our estimates.
- **Slowdown in economic growth:** In case India's GDP growth slows below Nomura's expectations of 7.4% for FY13F, there could be downside risks to our estimates.

## Business Update

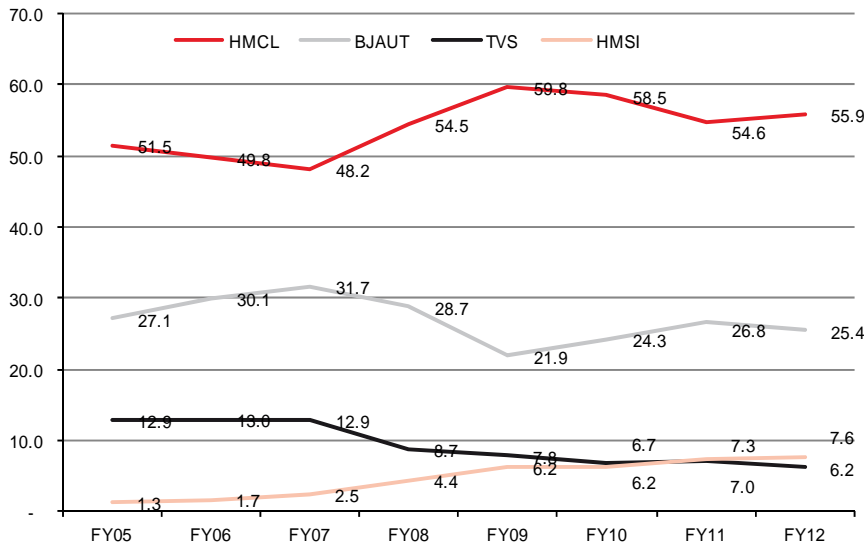
### Market share declined marginally in FY12

BJAUT's domestic motorcycle volumes increased by around 6% y-y in FY12 compared to 12% growth in industry volumes. Overall, the market share of BJAUT declined by 140bp to 25.4% in FY12; in 4QFY12, the market share declined even lower to around 24.5%. This is due to 1) growth slowdown in the premium segment where BJAUT has a

higher market share and 2) loss of market share in the executive and premium segments.

Volumes in the premium segment increased only 3% in FY12 while the economy segment grew 19%. This is the first time that the premium segment has under-performed the overall industry growth in the last 6-7 years due to sharp increases in petrol prices. BJAUT was impacted the most due to slower growth in the premium segment as it has higher market share in this segment. Further, the market share of BJAUT in this segment declined by 600 bps to 42% in FY12. This was possibly due to the lack of new launches by Pulsar. Yamaha gained around 4% market share in this segment, driven by the successful launch of the Sz model.

**Fig. 16: Domestic motorcycles market share (%)**



Source: Crisil, Nomura research

**Fig. 17: Segmental growth in motorcycles**

Volumes	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	CAGR		
										3 Year	5 Year	10 Year
Industry	4,170,445	4,963,498	5,810,533	6,557,405	5,768,881	5,835,169	7,341,139	9,019,090	10,094,338			
Economy	1,188,577	1,647,881	2,417,182	2,491,814	1,903,731	1,625,491	1,409,499	1,566,509	1,865,884			
Executive	2,502,267	2,799,413	2,789,056	3,278,703	3,115,196	3,397,322	4,713,011	5,801,111	6,528,019			
Premium	479,601	516,204	604,295	786,889	749,955	812,356	1,218,629	1,651,473	1,700,435			
YoY growth												
Industry	13.4%	19.0%	17.1%	12.9%	-12.0%	1.1%	25.8%	22.9%	11.9%	20%	9%	13%
Economy	15.2%	38.6%	46.7%	3.1%	-23.6%	-14.6%	-13.3%	11.1%	19.1%	5%	-6%	6%
Executive	12.2%	11.9%	-0.4%	17.6%	-5.0%	9.1%	38.7%	23.1%	12.5%	24%	15%	14%
Premium	15.4%	7.6%	17.1%	30.2%	-4.7%	8.3%	50.0%	35.5%	3.0%	28%	17%	24%

Source: Crisil, Nomura research

**KTM – Expects strong volume growth driven by new launches**

KTM Power Sports AG successfully launched KTM Duke 125 in 1HCY11, which was aimed primarily for the European markets. The product was jointly developed by Bajaj Auto and KTM’s R&D teams. Further, KTM launched the KTM Duke 200 in India in Jan-12, targeting annual sales of around 20,000 bikes. According to Bajaj, the product has received strong initial response from customers, with the company selling about 1,400 bikes in Mar-12. Both the products are manufactured in BJAUT’s Chakan plant which has an annual capacity of 30,000 units.

In CY11, KTM exported 11,000 units to markets like Europe and America from India. KTM expects the export volumes to increase to around 150,000 units in the next three years.

BJAUT has increased its stake in KTM to 47.2% in Apr-12 from around 40% earlier.

**Fig. 18: KTM – Key Financials**

EUR mn	CY10	CY11	YoY
Volumes	66,327	81,200	22%
Revenues	464	527	13%
ASP (EUR)	7,002	6,488	-7%
EBITDA	61	64	6%
Margin (%)	13.0%	12.2%	
Net profit	16	21	31%

Source: Company data, Nomura research

# Appendix A-1

## Analyst Certification

We, Kapil Singh and Nishit Jalan, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

## Issuer Specific Regulatory Disclosures

The term "Nomura Group Company" used herein refers to Nomura Holdings, Inc. or any affiliate or subsidiary of Nomura Holdings, Inc. Nomura Group Companies involved in the production of Research are detailed in the disclaimer below.

Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Ashok Leyland	AL IN	INR 28	08-5-2012	Buy	Not rated	
Bharat Forge	BHFC IN	INR 336	08-5-2012	Buy	Not rated	
Bajaj Auto	BJAUT IN	INR 1489	08-5-2012	Buy	Not rated	
Exide Industries	EXID IN	INR 125	08-5-2012	Neutral	Not rated	
Hero MotoCorp	HMCL IN	INR 1899	08-5-2012	Neutral	Not rated	
Mahindra and Mahindra	MM IN	INR 676	08-5-2012	Buy	Not rated	
Maruti Suzuki	MSIL IN	INR 1306	08-5-2012	Neutral	Not rated	
Tata Motors	TTMT IN	INR 296	08-5-2012	Buy	Not rated	
TVS Motor	TVSL IN	INR 37	08-5-2012	Buy	Not rated	

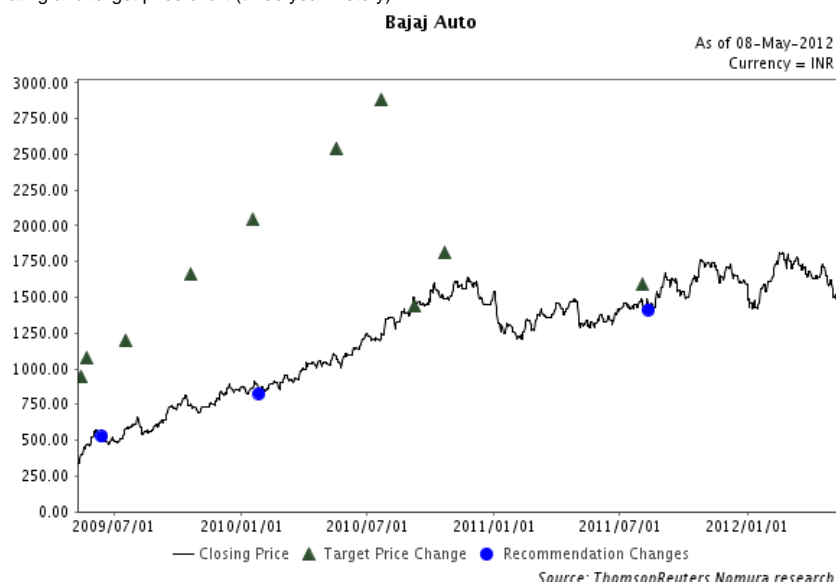
## Previous Rating

Issuer name	Previous Rating	Date of change
Ashok Leyland	Reduce	09-11-2009
Bharat Forge	Not Rated	30-3-2010
Bajaj Auto	Neutral	10-5-2012
Exide Industries	Buy	22-7-2011
Hero MotoCorp	Buy	20-4-2009
Mahindra and Mahindra	Not Rated	27-3-2009
Maruti Suzuki	Buy	02-11-2011
Tata Motors	Neutral	21-9-2011
TVS Motor	Neutral	24-8-2009

**Bajaj Auto (BJAUT IN)**

**INR 1489 (08-5-2012)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
03-Aug-11	Neutral		1,454.65
03-Aug-11		1,588.00	1,454.65
21-Oct-10		1,810.00	1,490.20
08-Sep-10		1,441.50	1,480.60
22-Jul-10		2,883.00	1,245.25
17-May-10		2,541.00	1,083.47
18-Jan-10	Buy		867.85
18-Jan-10		2,041.00	867.85
20-Oct-09		1,659.00	750.80
17-Jul-09		1,201.00	576.80
05-Jun-09	Neutral		566.70
22-May-09		1,076.00	470.50
14-May-09		949.00	397.38

For explanation of ratings refer to the stock rating keys located after chart(s)

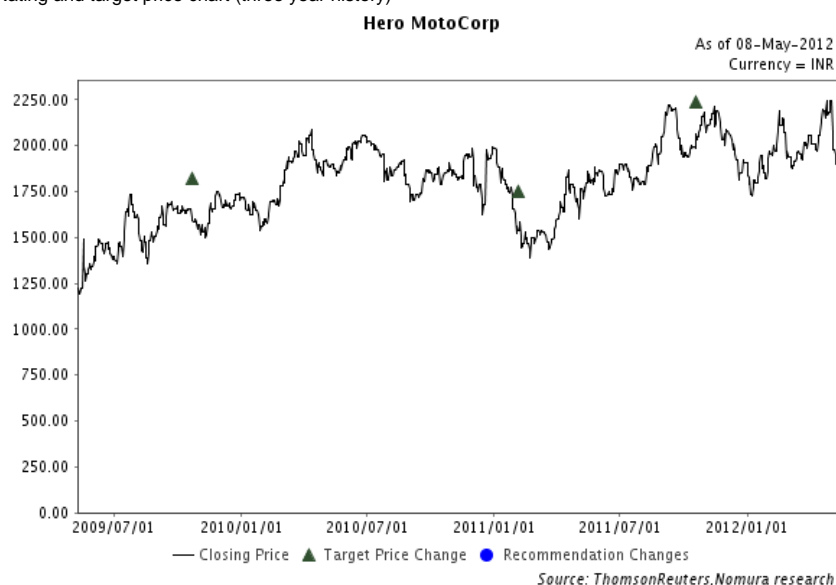
**Valuation Methodology** We use DCF to value Bajaj Auto. We have discounted our cashflows to Apr-13 to arrive at our 1-yr price target of INR1,809/sh. We have assumed 5% terminal growth and 13% cost of equity. The implied target multiple at 14x FY14F EPS of INR131.1 is lower than the average multiple of 15x one-year forward EPS over the last three years as we build in slower domestic volume growth.

**Risks that may impede the achievement of the target price** Key risks • Aggressive competition from Honda: Honda, post its separation from HMCL, is expanding its capacity from 1.6mn in FY11 to 4mn by end-FY13, as per management. Consequently, we expect Honda to become more aggressive in the lower-end space. Higher than expected increase in competitive intensity especially new model launches and aggressive pricing by Honda may impact volume growth and margins for BJAUT's domestic business, in our view. • Lower than expected exports growth: We have assumed exports volume growth of around 15% over the next 2 years. If volume growth is weaker than expected, there could be downside risks to our estimates. • INR appreciation: We have assumed USD:INR rate of 51.0 for FY14F as compared to current levels of 53.0. However, if INR appreciates sharply and goes back to 48 levels, there could be downside risks to our estimates. • Slowdown in economic growth: In case India's GDP growth slows below Nomura's expectations of 7.4% for FY13F, there could be downside risks to our estimates.

**Hero MotoCorp (HMCL IN)**

**INR 1899 (08-5-2012)** Neutral (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
19-Oct-11		2,237.00	2,066.55
04-Feb-11		1,753.00	1,537.20
22-Oct-09		1,818.00	1,595.00

For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** We value HMCL based on DCF. We have discounted our cashflows to Sep-12 to arrive at our 1-yr price target of INR2,237/sh. We have assumed terminal growth of 5% and cost of equity of 13%.

**Risks that may impede the achievement of the target price** Downside • HMCL does not have R&D capabilities to design its own motorcycles at present. We believe the company will be able to develop this over the next few years. If the company is



unable to set up a successful R&D facility by June 2014, there could be downside risks to our estimates. • We have assumed a decline in RM/sales due to decline in commodity prices, in case, commodity prices do not decline, there will be downside risk to our operating margin estimates • Macro risks: We have assumed stable macro conditions with GDP growth averaging around 8% over the next few years. In case there is a slowdown leading to lower GDP growth, there will be downside risks to our estimates. Upside • We have assumed that Hero MotoCorp will take around four to five years to establish itself in new export markets. If the company is able to do so faster there may be upside risks to our estimates. • HMCL has booked mark to market losses on license fee payable due to yen appreciation against rupee in 2QFY12. If going ahead, rupee appreciates against yen, then there would be mark to market gains leading to lower outgo on quarterly payments towards license fee; this would pose upside risks to our estimates.

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### SECTORS

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Benchmarks are as follows: **United States**: S&P 500; **Europe**: Dow Jones STOXX 600; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia.

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#### STOCKS

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