4 February 2013 │ 21 pages

Motorcycle Manufacturers (GICS) │ Auto Manufacturers (Citi)
Asia Pacific │ India

Bajaj Auto (BAJA.BO)

Downgrade to Neutral: Brake for a Breather After the Sprint

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

- **Downgrade** — We downgrade Bajaj Auto to Neutral following the stock's sharp run-up (~33%) since July. The stock currently trades at ~16x FY14E consensus EPS. We think it will continue to trade in its current band of ~15-17x given a lack of meaningful fundamental catalysts over the next 12 months. Our revised target price of Rs2,189 (previously Rs1,835) is based on 16x Mar14E P/E. We hike our multiple from 14x to 16x (c10% premium to the average of the past 2 years) to reflect the better outlook for 3-wheelers and a sedate recovery in exports, both of which should support margins.
- **EPS revised up 4.4%/9.4% over FY14/FY15** — To reflect better pricing/realizations on account of a depreciating currency (locked in at ~Rs54/$ on the downside in FY14). We cut export volumes (both 2&3w) sharply – around 8-15%, to reflect a lower than expected FY13 and also a more muted growth outlook (10-12%) than previously envisaged (15-20%). Domestic 3w volumes have been revised up sharply (+10%/5% in FY14/15 respectively); 2w volumes are broadly unchanged.
- **Stable market share forecast across segments** — We expect a slight (~100bps) compression in market share in the executive segment as we expect the space to become more competitive with Honda's new launches (anticipate 2 bikes). Bajaj's strategy of segmenting the market and launching new variants will have limited appeal in the short run (given significant cannibalization with other models), though it could improve over the longer term. Within the premium/economy segments we expect Bajaj to be able to retain its current market share.
- **Bajaj better positioned than peers in the sector** — We are now neutral on the sector, with a slight negative bias, given share price performance in the past few months. Volumes must keep pace with share price performance or else the sector will see a fairly sharp sell-off. Tata Motors is now our preferred pick. We also prefer Bajaj to Maruti / Mahindra & Mahindra given its relatively low volatility of earnings, dividend yield of ~3% and very strong free cash flow generation.

Neutral	**2**
from Buy	
Price (01 Feb 13)	Rs2,053.45
Target price	Rs2,189.00
from Rs1,835.00	
Expected share price return	6.6%
Expected dividend yield	3.2%
Expected total return	**9.8%**
Market Cap	Rs594,201M
	US$11,153M

Price Performance
(RIC: BAJA.BO, BB: BJAUT IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2011A	27,835	96.19	53.2	21.3	12.1	71.0	1.9
2012A	31,040	107.27	11.5	19.1	9.8	56.7	2.2
2013E	31,544	109.01	1.6	18.8	7.4	44.8	2.4
2014E	39,597	136.84	25.5	15.0	6.0	44.3	3.2
2015E	45,716	157.99	15.5	13.0	5.0	42.1	3.7

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

BAJA.BO: Fiscal year end 31-Mar

Price: Rs2,053.45; TP: Rs2,189.00; Market Cap: Rs594,201m; Recomm: Neutral

Profit & Loss (Rsm)	2011	2012	2013E	2014E	2015E
Sales revenue	165,768	196,077	203,474	235,245	271,349
Cost of sales	-119,217	-142,605	-146,312	-164,295	-189,812
Gross profit	46,551	53,473	57,162	70,951	81,537
Gross Margin (%)	28.1	27.3	28.1	30.2	30.0
EBITDA (Adj)	**33,528**	**37,988**	**40,161**	**50,987**	**58,407**
EBITDA Margin (Adj) (%)	20.2	19.4	19.7	21.7	21.5
Depreciation	-1,228	-1,456	-1,605	-1,794	-2,079
Amortisation	0	0	0	0	0
EBIT (Adj)	**32,299**	**36,531**	**38,556**	**49,193**	**56,328**
EBIT Margin (Adj) (%)	19.5	18.6	18.9	20.9	20.8
Net interest	-17	-222	-150	-150	-150
Associates	0	0	0	0	0
Non-op/Except	3,980	5,293	6,336	7,525	9,131
Pre-tax profit	**36,262**	**41,602**	**44,743**	**56,568**	**65,309**
Tax	-10,110	-10,221	-13,199	-16,970	-19,593
Extraord./Min.Int./Pref.div.	7,246	-1,340	0	0	0
Reported net profit	**33,397**	**30,041**	**31,544**	**39,597**	**45,716**
Net Margin (%)	20.1	15.3	15.5	16.8	16.8
Core NPAT	27,835	31,040	31,544	39,597	45,716

Per share data	2011	2012	2013E	2014E	2015E
Reported EPS (Rs)	115.41	103.81	109.01	136.84	157.99
Core EPS (Rs)	96.19	107.27	109.01	136.84	157.99
DPS (Rs)	40.00	45.00	50.00	65.00	75.00
CFPS (Rs)	128.77	127.72	120.68	160.34	178.49
FCFPS (Rs)	123.59	123.55	108.51	151.63	168.02
BVPS (Rs)	169.69	208.77	278.29	339.59	410.41
Wtd avg ord shares (m)	289	289	289	289	289
Wtd avg diluted shares (m)	289	289	289	289	289

Growth rates	2011	2012	2013E	2014E	2015E
Sales revenue (%)	39.3	18.3	3.8	15.6	15.3
EBIT (Adj) (%)	32.8	13.1	5.5	27.6	14.5
Core NPAT (%)	53.2	11.5	1.6	25.5	15.5
Core EPS (%)	53.2	11.5	1.6	25.5	15.5

Balance Sheet (Rsm)	2011	2012	2013E	2014E	2015E
Cash & cash equiv.	5,565	16,538	16,737	18,366	23,972
Accounts receivables	3,628	4,228	4,589	5,453	6,287
Inventory	5,473	6,785	7,410	8,640	10,136
Net fixed & other tangibles	15,483	15,234	17,149	17,875	18,826
Goodwill & intangibles	43	14	20	20	20
Financial & other assets	62,013	68,011	89,549	112,537	133,229
Total assets	**92,204**	**110,811**	**135,453**	**162,891**	**192,470**
Accounts payable	21,578	22,071	24,609	27,765	32,087
Short-term debt	0	0	0	0	0
Long-term debt	3,252	975	1,000	1,200	1,500
Provisions & other liab	18,272	27,354	29,316	35,660	40,123
Total liabilities	**43,101**	**50,400**	**54,924**	**64,625**	**73,711**
Shareholders' equity	49,102	60,411	80,529	98,266	118,759
Minority interests	0	0	0	0	0
Total equity	**49,102**	**60,411**	**80,529**	**98,266**	**118,759**
Net debt	**-2,313**	**-15,564**	**-15,737**	**-17,166**	**-22,472**
Net debt to equity (%)	-4.7	-25.8	-19.5	-17.5	-18.9

Valuation ratios	2011	2012	2013E	2014E	2015E
PE (x)	21.3	19.1	18.8	15.0	13.0
PB (x)	12.1	9.8	7.4	6.0	5.0
EV/EBITDA (x)	17.1	14.5	13.4	10.2	8.6
FCF yield (%)	6.0	6.0	5.3	7.4	8.2
Dividend yield (%)	1.9	2.2	2.4	3.2	3.7
Payout ratio (%)	42	42	46	48	47
ROE (%)	85.2	54.9	44.8	44.3	42.1

Cashflow (Rsm)	2011	2012	2013E	2014E	2015E
EBITDA	33,528	37,988	40,161	50,987	58,407
Working capital	2,638	5,463	1,771	5,005	3,856
Other	1,098	-6,491	-7,013	-9,596	-10,612
Operating cashflow	**37,263**	**36,959**	**34,920**	**46,397**	**51,651**
Capex	-1,500	-1,207	-3,520	-2,520	-3,030
Net acq/disposals	-7,737	-876	-17,721	-18,988	-16,692
Other	0	0	0	0	0
Investing cashflow	**-9,237**	**-2,083**	**-21,241**	**-21,508**	**-19,722**
Dividends paid	-13,452	-15,134	-16,816	-21,860	-25,223
Financing cashflow	**-22,140**	**-17,411**	**-16,790**	**-21,660**	**-24,923**
Net change in cash	**5,886**	**17,466**	**-3,111**	**3,229**	**7,006**
Free cashflow to s/holders	**35,763**	**35,752**	**31,400**	**43,877**	**48,621**

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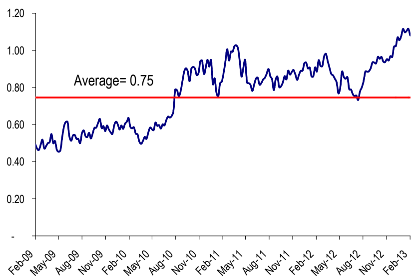
For definitions of the items in this table, please click here.

Powered by: dataCentral

Valuation Speed Breaker: Time for a Breather

We continue to wield the axe on our auto sector recommendations. Following our downgrade on Maruti Suzuki (Maruti Suzuki India (MRTI.BO) - The Macro Micro Disconnect – Downgrade to Neutral) we now downgrade Bajaj Auto to Neutral with a target price of Rs2,189 at 16x FY14E P/E. Bajaj Auto's stock price has risen almost 33% since July. and while we remain fairly constructive on the business outlook over the next 12-24 months, we do think the valuation hurdle is a bit steep at this juncture. Given both stocks have rallied sharply in the past 6 months (Bajaj/ Maruti up 27%/43% respectively), we think a pullback in both stocks is possible. Logically though, it should be a bit less in Bajaj (vs. MSIL), as Bajaj's cash flow stream is far more defensive, and conversion of PAT into free cash is very high (>90%).

Figure 1. Bajaj Auto: PE relative to Hero MotoCorp



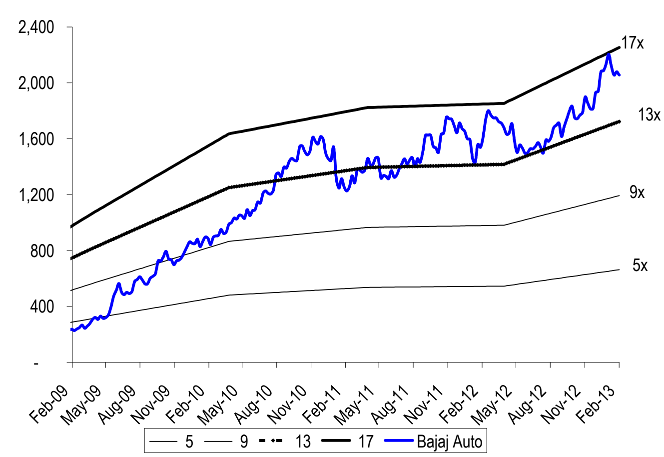
Source: Company, dataCentral, Citi Research

Our 16x multiple is slightly on the higher side, and it is at a 10% premium to the average of the past two years. We think that it should be well supported by earnings growth of around 20% CAGR over FY13-FY15E. We expect the re-rating should sustain, provided Bajaj a) doesn't cede too much market share in the domestic market to Hero, b) maintains its margins at around 18-20%, c) continues to grow market share in the export markets and thrust into new markets (Indonesia for 2 wheelers with Kawasaki and then Brazil – with KTM and Kawasaki). At our target price, the stock would trade at a multiple of around 6.5x, which is fairly substantial but supported by the 44-45% RoE that we forecast going forward.

Our downgrade is predicated on the following aspects:

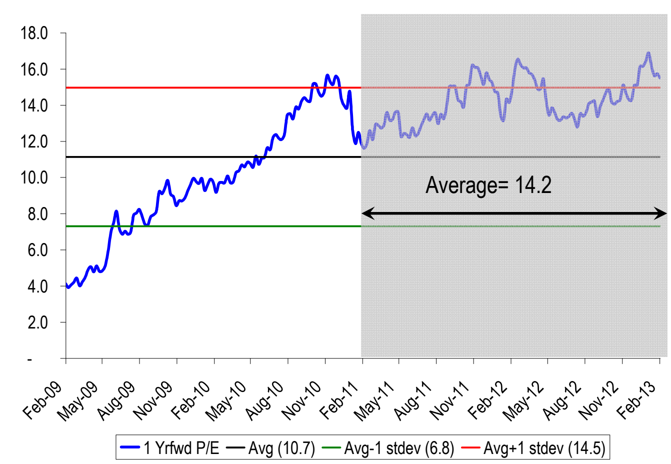
1 – Valuations – we think Bajaj's valuations at current levels reflect its strong franchise in 3-wheelers, exports and the premium 2-wheeler space. As the charts below depict, absolute P/E at nearly 17x is almost at an all-time high. Valuations are also above 1SD. We think there should be a slight upward bias given the relatively short trading history – Bajaj restructured in 2007 and re-listed in 2008 – around the time of the financial crisis. However, even vis-à-vis an average P/E of say 12-13x, the stock is overvalued at this juncture.

Figure 2. Bajaj Auto: P/EPS (x) band chart



Source: Company, dataCentral, Citi Research

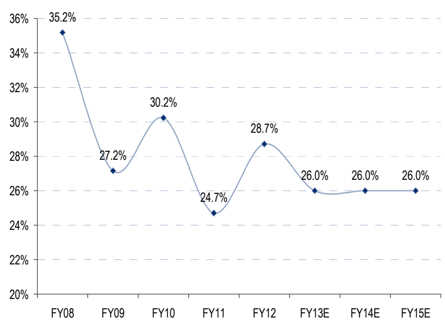
Figure 3. Bajaj Auto: 1 yr fwd P/E trends



Source: Company, dataCentral, Citi Research

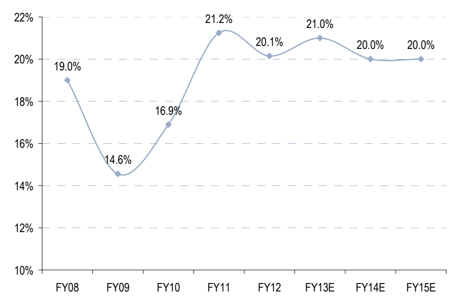
2 – The 'blind spot' vis-à-vis Honda – In our conversations with investors, most investors reckon that while Hero will be meaningfully impacted by Honda, Bajaj will be relatively unscathed. This view is a volte-face on the view held last year, that Honda's urban centric model would impact Bajaj and Hero would be better positioned given its rural thrust and scale and distribution network. We think this is incorrect too. As the data below indicates, Bajaj Auto has lost market share over FY13 in the economy and premium segments – though it has gained slightly in the premium segment. As Honda becomes more aggressive, we would expect the company to maintain share – rather than recoup market share.

Figure 4. Bajaj's Mkt Sh (%), Domestic Economy



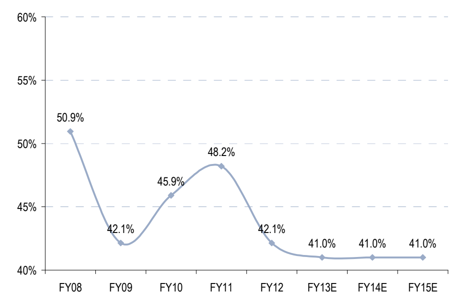
Source: CRISIL, SIAM, Citi Research

Figure 5. Bajaj's Mkt Sh (%), Domestic Executive



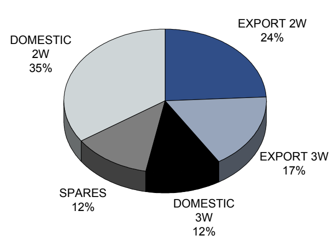
Source: CRISIL, SIAM, Citi Research

Figure 6. Bajaj's Mkt Sh (%), Domestic Premium



Source: CRISIL, SIAM, Citi Research

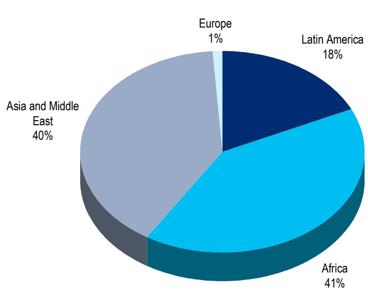
Figure 7. EBITDA Mix FY13 (%)



Source: Citi Research

3 – Domestic business is irrelevant – the way ahead is exports. We disagree with this thought process. Per our estimates, the domestic 2w business in FY13E accounts for around 35% of EBITDA. And while one could argue that its proportion will only decline going forward over the next 5 years, we think this will be relevant maybe 4-5 years down the line, once exports to Indonesia and Brazil are meaningfully in the base. From a nearer 12-24 month perspective, the domestic business will remain very important.

Figure 8. Bajaj's Export Markets (FY12)



Source: Company

4 – Rupee provides a significant cushion in FY14 – it does – and we reflect this benefit in our revised earnings – we forecast Rs136.84/share EPS in FY14 – and this meaningful uptick (vis-à-vis our previous Rs107 estimate in FY13) is driven to a great extent by better export realizations. There are however 2 risks, that we also think are worth articulating. A) In the event of a continued slowdown in both domestic/export markets, Bajaj might cut prices and pass on the currency benefit to drive volumes – this is pragmatic, but could result in an EPS miss (not reflected in expectations, which range from Rs130-Rs140 / share). B) The government further cuts the duty drawback/focus market scheme benefits – over 2 years, the government has reduced this benefit from ~10% to ~4%. The impact has not been reflected substantially due to the sharp depreciation of the Rupee from 45-55/US$. But if the government reckons that a) exporters are making sufficiently high margins and b) it needs to shore up its own finances, and cuts this benefit, then there would be an overall impact of ~150-200 bps on margins, which is not factored into these earnings/valuations.

Earnings Revision – Profits go up, volumes go down

We have pared volumes across 2w and 3w – the only exception being domestic 3w where we have increased volumes given the strong volume growth YTD and expectations of further permits being issued. The outlook on exports is in line with management's views – most key end markets continue to struggle slightly, given the macro environment.

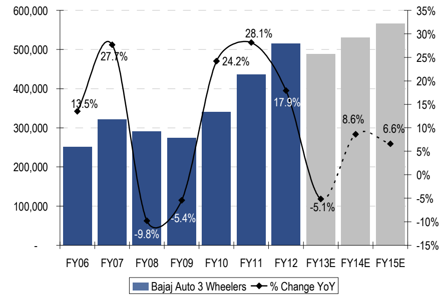
Profits go up – driven by higher financial income, also boosted by better realizations in exports (INR depreciation).

Figure 9. Bajaj Auto: Earnings Revision

	Old			New			Change		
	FY13	FY14	FY15	FY13	FY14	FY15	FY13	FY14	FY15
Domestic Motorcycles	2,589,049	2,797,776	3,115,281	2,563,126	2,790,727	3,133,287	-1.0%	-0.3%	0.6%
% Chg YoY	0.9%	8.1%	11.3%	-0.1%	8.9%	12.3%			
Export Motorcycles	1,394,413	1,603,575	1,924,290	1,309,694	1,466,857	1,713,543	-6.1%	-8.5%	-11.0%
% Chg YoY	10.0%	15.0%	20.0%	3.3%	12.0%	16.8%			
Total Motorcycles	**3,983,462**	**4,401,350**	**5,039,571**	**3,872,820**	**4,257,584**	**4,846,830**	**-2.8%**	**-3.3%**	**-3.8%**
% Chg YoY	3.9%	10.5%	14.5%	1.0%	9.9%	13.8%			
Domestic 3Ws	207,039	217,391	228,260	223,277	238,906	238,906	7.8%	9.9%	4.7%
% Chg YoY	2.0%	5.0%	5.0%	10.0%	7.0%	0.0%			
Export 3Ws	280,958	337,150	387,723	265,350	291,885	326,911	-5.6%	-13.4%	-15.7%
% Chg YoY	-10.0%	20.0%	15.0%	-15.0%	10.0%	12.0%			
Total 3Ws	**487,997**	**554,541**	**615,983**	**488,627**	**530,791**	**565,817**	**0.1%**	**-4.3%**	**-8.1%**
% Chg YoY	-5.3%	13.6%	11.1%	-5.1%	8.6%	6.6%			
Total Domestic Volumes	2,796,088	3,015,166	3,343,541	2,786,403	3,029,633	3,372,193	-0.3%	0.5%	0.9%
% Chg YoY	1.0%	7.8%	10.9%	0.6%	8.7%	11.3%			
Total Export Volumes	1,675,371	1,940,725	2,312,012	1575044	1758742	2040454	-6.0%	-9.4%	-11.7%
% Chg YoY	6.0%	15.8%	19.1%	-0.3%	11.7%	16.0%			
Overall Volumes	**4,471,459**	**4,955,891**	**5,655,554**	**4,361,447**	**4,788,375**	**5,412,647**	**-2.5%**	**-3.4%**	**-4.3%**
% Chg YoY	2.8%	10.8%	14.1%	0.3%	9.8%	13.0%			
Total Income	**205,997**	**236,750**	**270,129**	**203,474**	**235,245**	**271,349**	**-1.2%**	**-0.6%**	**0.5%**
EBITDA	**40,706**	**51,041**	**55,693**	**40,161**	**50,987**	**58,407**	**-1.3%**	**-0.1%**	**4.9%**
EBITDA Margin	19.8%	21.6%	20.6%	19.7%	21.7%	21.5%			
PAT	**31,037**	**37,926**	**41,780**	**31,544**	**39,597**	**45,716**	**1.6%**	**4.4%**	**9.4%**
EPS	**107.26**	**131.06**	**144.38**	**109.01**	**136.84**	**157.99**	**1.6%**	**4.4%**	**9.4%**

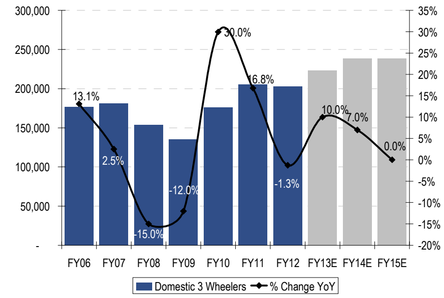
Source: Citi Research Estimates

Figure 10. Bajaj: Overall 3W Volume Trends



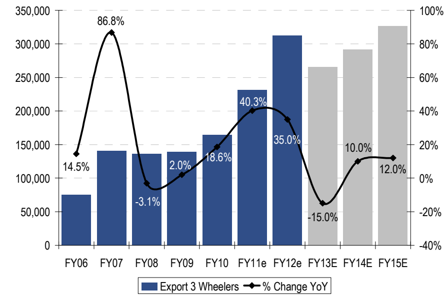
Source: Company, Citi Research

Figure 11. Bajaj: Domestic 3W Volume Trends



Source: Company, Citi Research

Figure 12. Bajaj: Export 3W Volume Trends

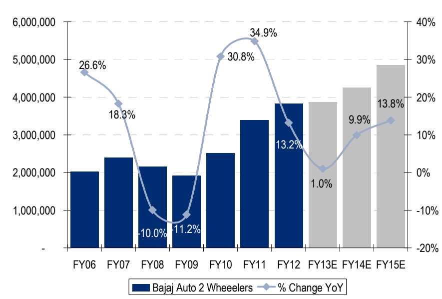


Source: Company, Citi Research

Within domestic 3w, the 10% growth estimate in FY13 reflects the 9MYTD run rate, and an expectation that domestic volumes will grow ~55,000-60,000 units in the last Q (current run rate). The FY14 estimate of around 239,000 units is based on mgmt's view that the current run rate of ~19,000 units / month is sustainable through next year. To this, we have added around 10,000 units on expectations of new permits being granted (mgmt noted there should be around 20,000 new permits in Hyderabad – we assume Bajaj will get 50% of these). In FY15, our volume estimates reflect flat growth. Typically after 2 strong years, the domestic 3w market flat lines for 1-2 years. Moreover with general elections in late FY14/early FY15, we expect all state/municipal departments will be in 'election mode' and would not be very positive on new permits being issued in that fiscal.

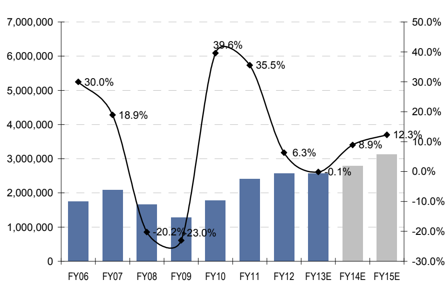
For export 3w, the FY13 estimate reflects the 9MYTD numbers and an expectation that the run rate of the last Q (around 75,000 units) will be maintained even going into 4Q. On this base, for FY14 we forecast growth of around 10% - which translates into monthly sales of around 24,000 units/ month – in the middle of mgmt's estimate of 22,000-25,000 units/ month. For FY15, we then forecast a slight acceleration in growth rates to around 12% as we expect key markets like Sri Lanka, Egypt to rebound after a slightly challenging FY13/FY14.

Figure 13. Bajaj: Overall 2W Volume Trends



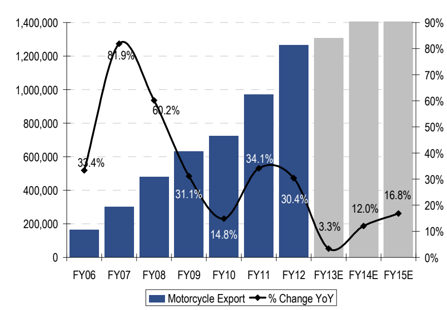
Source: Company, Citi Research

Figure 14. Bajaj: Domestic Motorcycles Volume Trends



Source: Company, Citi Research

Figure 15. Bajaj: Export Motorcycles Volume Trends

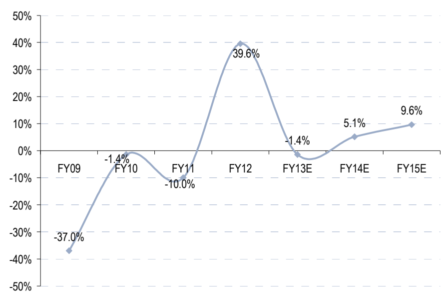


Source: CRISIL Citi Research

For export 2ws, we expect volumes to grow 3.3% in FY13, which is essentially a run rate of 320k bikes in 4Q added to the 9mYTD estimate. The 12% growth factored in FY14 is at the higher end of the 10-12% range that we think is possible given conditions in end markets like Sri Lanka. Finally, in FY15 our growth rate of 17% reflects a 12% organic growth rate and around 100k units from new markets entered

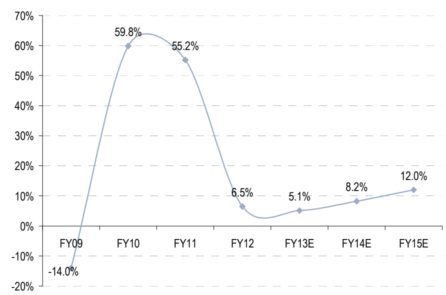
– principally Indonesia (with Kawasaki) and maybe a few months of Brazil. There is upside risk to the FY15 estimates, but it depends on management's ability to execute over the next 12-18 months.

Figure 16. Bajaj: Domestic Econ Segment Bike Growth (%)



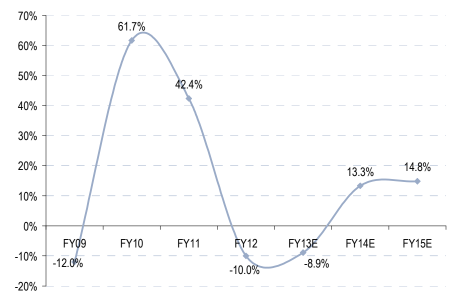
Source: CRISIL, SIAM, Citi Research

Figure 17. Bajaj: Domestic Exec Segment Bike Growth (%)



Source: CRISIL, SIAM, Citi Research

Figure 18. Bajaj: Domestic Premium Segment Bike Growth (%)



Source: CRISIL, SIAM, Citi Research

Our estimates for domestic 2 wheelers flow through a top–down industry model, wherein we assess the relative growth of the segments and assess the market share of Bajaj Auto within each segment.

Referring to Figs.16-18, we expect Bajaj to cede market share very slightly in the executive segment – around 100bps, based on our expectation that Honda will launch at least 2 bikes in this segment. This, despite the launch of the Discover 100T – Bajaj's 'varianting' strategy is impressive and could benefit volumes in an industry upturn; in a modest recovery phase we expect the model to cannibalize its peers to the extent of 60-70% - net growth is thus more modest.

2W Industry Outlook – Chugging Along

Our volume outlook for FY14/FY15 reflects fairly average growth – of around 12% Y/Y for both FY14/FY15. Reality will probably be different (it always is). While we forecast 12%, we think that around 10-15% is reasonable, given the following:

1) Base effect of FY13 is somewhat subdued (following a 14% volume growth in FY12),

2) Real wage growth in rural India should begin to decelerate – but the base of the past 2 years will make its effects felt.

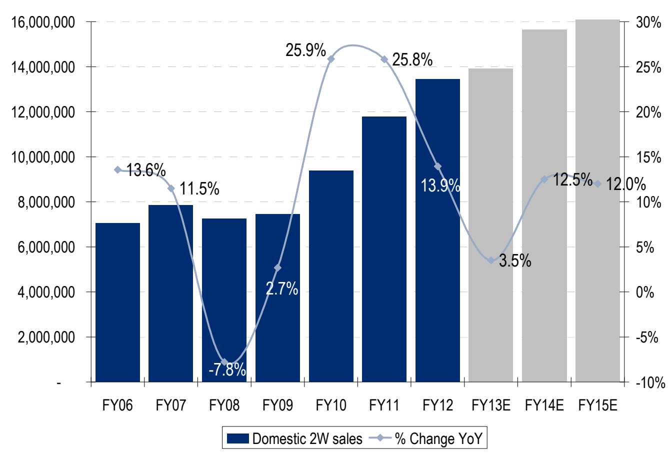
3) Any rural linked programs in the backdrop of a 2014 election should also be beneficial for rural consumer sentiment – which should reflect in volumes.

4) Based on our assumptions for both terminal life / scrappage rates, by FY15 2W penetration should be around 108/1000 – our terminal life assumption is 15 years and our parc size in FY15 (all 2w) should be around 136m units. This equates to a 10% penetration rate. In the past, 10% was considered high as the 'addressable population' was considered to be only males in the age group of 16-55/60. But we think this is slowly changing driven by 3 factors: A) product availability – the scooter has made a resurgence and is probably going to become more mainstream as OEMs

increase distribution / after-sales support and increase dealer networks in smaller towns. B) More women / young girls / older men are driving scooters – demand is thus broad basing away from only bikes to scooters too, C) Scooter sales are also increasing as the quality of tarred roads improves in India's smaller towns / villages. If one travels through smaller towns / villages in states where road quality has improved meaningfully (we cite Gujarat as one example where we saw this) then the scooter will continue to gradually increase as % of sales. The traditional bike with its sturdy shock absorbers will gradually become a product that is less about utility and merely transport to a product that is also associated with leisure applications. This is – we think – a secular trend and will continue to play out over the years, supporting a higher penetration level.

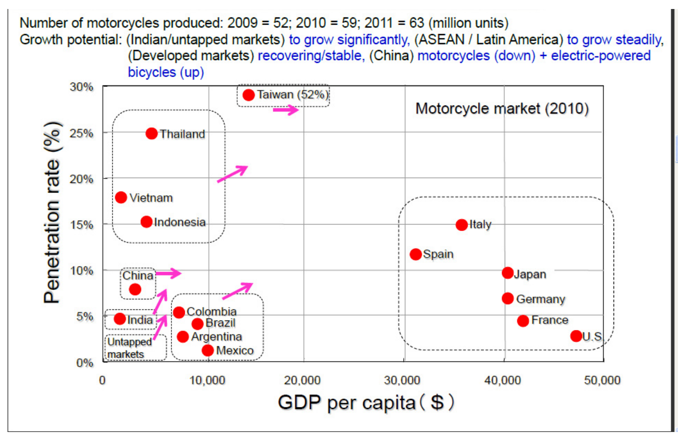
If one sees the figure below, in markets like Indonesia / Vietnam, Thailand – the penetration rates are much higher, but again, we think this is on account of higher proportion of a) mopeds / scooters in the mix, rather than just bikes, and b) a more broad-based consumer segment.

Figure 19. 2 Wheeler Industry Volume Outlook



Source: CRISIL, SIAM, Citi Research

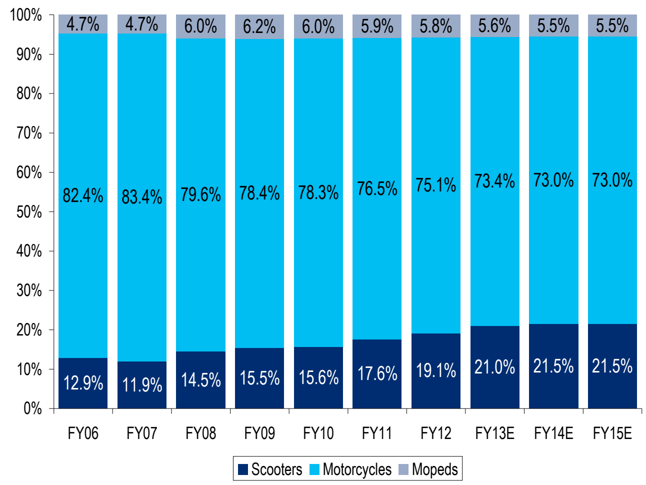
Figure 20. Motorcycle Penetration Rate vs Per Capita GDP



Source: Yamaha

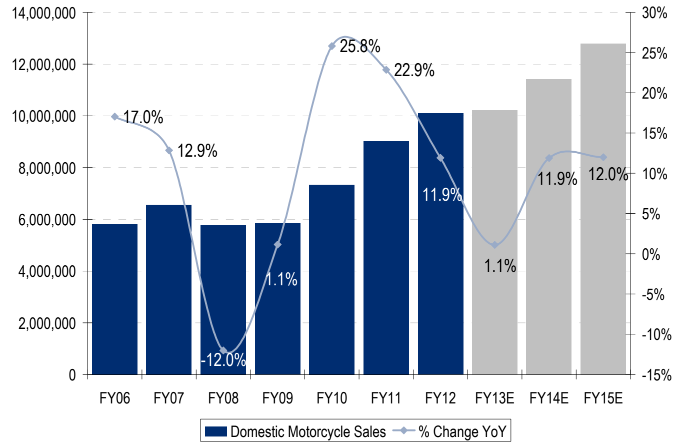
Our assumptions above lead us to think that scooters should continue to gradually increase as % of 2w volumes – after the sharp rise from ~17.6%-21% over FY11-FY13 (driven mostly by capacity expansion by Honda/Hero), we expect it to somewhat stabilize at around 21-22% of the overall volumes, though the upward bias will probably continue over time, supported by demographics (more women riders, older men, dual rider products), OEMs themselves (products, distribution) and finally supporting infrastructure (better road quality, especially in smaller towns).

Figure 21. 2 Wheeler Industry Mix Outlook



Source: CRISIL, SIAM, Citi Research

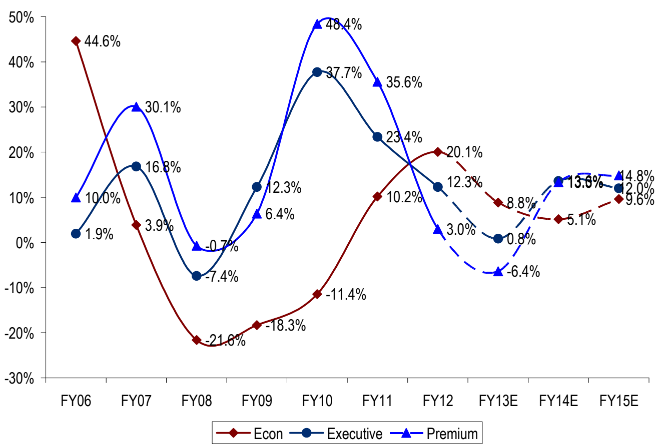
Figure 22. Domestic Motorcycles: Volume Outlook



Source: CRISIL, SIAM, Citi Research

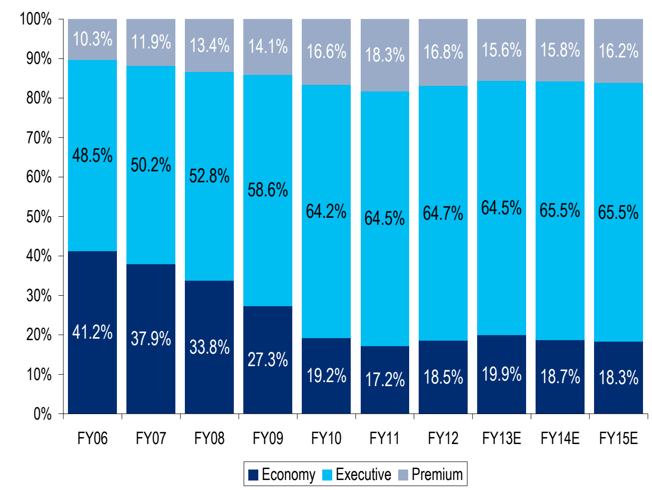
Within overall 2 wheelers, motorcycles should remain fairly steady at around 73%, as Honda looks to grow its market share in bikes, rather than scooters. This along with regular product introductions by Honda, Hero and Bajaj should ensure that the segment remains at around 73-74% of volumes, though longer term it should continue to decline as it cedes share to motorcycles. After FY13's weak base, we expect the segment to grow ~12% CAGR over the next 2 years.

Figure 23. Domestic Motorcycles: Segmental Volume Growth



Source: Citi Research

Figure 24. Domestic Motorcycles: Segmental Split



Source: CRISIL, SIAM, Citi Research

The general bias for the next 2 years is a slight upgradation trend – reversing the trends seen over FY12-FY13. We expect growth to be a tad more urban, rather than rural, and also expect players (notably Bajaj and Honda) to position new products in the premium 100cc segment (around Rs45,000-Rs50,000 segment) and the 125cc / 150cc segments, which should also stimulate growth and encourage a slight upward shift.

Financial Statements

Figure 25. Bajaj Auto: Profit and Loss Statement (Rs mn except volumes (units))

	FY2010	FY2011	FY2012	FY2013E	FY2014E	FY2015E
Volumes	**2,852,536**	**3,823,954**	**4,349,560**	**4,361,447**	**4,788,375**	**5,412,647**
% Change YoY	30.0%	34.1%	13.7%	0.3%	9.8%	13.0%
Gross Sales	**121,180.8**	**169,315**	**198,270**	**209,366**	**242,747**	**279,858**
Excise	6,096	9,334	9,468	11,554	12,910	14,829
Net Sales	**115,085**	**159,981**	**188,803**	**197,812**	**229,837**	**265,029**
Other operating Income	3,881	5,786	7,275	5,662	5,409	6,320
Net Revenue	**118,966**	**165,768**	**196,077**	**203,474**	**235,245**	**271,349**
Raw Material Expense	80,704.4	117,988	141,149	144,707	162,501	187,733
% of Net Revenue	67.8%	71.2%	72.0%	71.1%	69.1%	69.2%
Other variable expense	3,759.000	4,742.5	5,734	6,040	7,366	8,650
% of Net Revnue	3.2%	2.9%	2.9%	3.0%	3.1%	3.2%
Employee Expense	3,995	4,935.8	5,401	6,211	7,143	8,214
% of Net Revenue	3.4%	3.0%	2.8%	3.1%	3.0%	3.0%
Other Fixed Expense	4,983	4,740.3	6,301	6,854	7,749	8,844
% of Net Revenue	4.2%	2.9%	3.2%	3.4%	3.3%	3.3%
Expenses Capitalised	**157**	**167**	**494**	**500**	**500**	**500**
Total Expense	**93,284**	**132,240**	**158,090**	**163,313**	**184,258**	**212,943**
EBITDA	**25,681**	**33,528**	**37,988**	**40,161**	**50,987**	**58,407**
EBITDA Margin (%)	**21.6%**	**20.2%**	**19.4%**	**19.7%**	**21.7%**	**21.5%**
Other Income	1,469	3,980	5,293	6,336	7,525	9,131
Interest	60	17	222	150	150	150
EBDT	27,091	37,490	43,058	46,348	58,362	67,388
Depreciation	1,365	1,228	1,456	1,605	1,794	2,079
Exceptional	(1,650)	7,246	(1,340)	-	-	-
PBT	24,076	43,508	40,262	44,743	56,568	65,309
Tax	7,075	10,110	10,221	13,199	16,970	19,593
PAT	**17,001**	**33,397**	**30,041**	**31,544**	**39,597**	**45,716**
% of Net Revenue	14.3%	20.1%	15.3%	15.5%	16.8%	16.8%
Pre-exceptional PAT	**18,166**	**27,835**	**31,040**	**31,544**	**39,597**	**45,716**
Profitability Ratios (% of Net sales)						
Raw mat / sales	70.1%	73.8%	74.8%	73.2%	70.7%	70.8%
Other var exp / net sales	3.3%	3.0%	3.0%	3.1%	3.2%	3.3%
Employee cost / net sales	3.5%	3.1%	2.9%	3.1%	3.1%	3.1%
Tax / PBT	29.4%	23.2%	25.4%	29.5%	30.0%	30.0%
Excise / Gross sales	5.4%	5.9%	5.1%	6.0%	5.8%	5.8%
PAT / Net sales	15.8%	17.4%	16.4%	15.9%	17.2%	17.2%
EPS	**62.78**	**96.19**	**107.27**	**109.01**	**136.84**	**157.99**

Source: Company, Citi Research Estimates

Figure 26. Bajaj Auto: Balance Sheet (Rs mn)

	FY2010	FY2011	FY2012	FY2013E	FY2014E	FY2015E
SOURCES OF FUNDS						
Share Capital	1,447	2,894	2,894	2,894	2,894	2,894
Reserves and Surplus	27,837	46,209	57,517	77,635	95,372	115,865
Net Worth	**29,283**	**49,102**	**60,411**	**80,529**	**98,266**	**118,759**
Deferred tax Liabilty	17	297	484	500	500	500
Total Debt	**13,386**	**3,252**	**975**	**1,000**	**1,200**	**1,500**
Other long term liabilities			1,571	1,600	1,800	2,000
Long term provisions			1,119	1,200	1,400	1,800
Total Sources of funds	**42,686**	**52,651**	**64,559**	**84,829**	**103,166**	**124,559**
APPLICATION OF FUNDS						
Gross Block	33,793	33,909	33,939	37,439	39,939	42,939
Less: Depreciation	18,997	19,125	19,143	20,748	22,542	24,621
Net Block	**14,796**	**14,784**	**14,796**	**16,691**	**17,397**	**18,318**
Capital WIP	415	699	118	118	118	118
Intangible assets			21	40	40	40
Intangible assets under development			299	300	320	350
Net Fixed Assets	**15,211**	**15,483**	**15,234**	**17,149**	**17,875**	**18,826**
Total Investments	**40,215**	**47,952**	**48,828**	**66,549**	**85,537**	**102,229**
Long term loans and advance			5,799	8,000	10,000	12,000
Inventories	4,462	5,473	6,785	7,410	8,640	10,136
Sundry debtors	2,728	3,628	4,228	4,589	5,453	6,287
Cash & Bank Balances	1,014	5,565	16,538	16,737	18,366	23,972
Loans & advances	20,745	11,896	10,428	12,000	14,000	16,000
Others	1,060	2,164	2,956	3,000	3,000	3,000
Total current assets	**30,010**	**28,726**	**40,936**	**43,736**	**49,460**	**59,395**
Sundry Creditors	18,192	21,578	22,071	24,609	27,765	32,087
Others	2,071	2,689	3,550	3,600	4,200	4,500
Provisions :						
Taxation	14,171	30	90	100	100	100
Dividends & dividend tax	6,749	13,452	15,134	16,816	21,860	25,223
Others	1,568	1,804	5,406	5,500	5,800	6,000
Total current liabilities	**42,750**	**39,553**	**46,252**	**50,624**	**59,725**	**67,911**
Net current assets	**(12,740)**	**(10,827)**	**(5,316)**	**(6,889)**	**(10,265)**	**(8,516)**
Technical know how	-	43	-	-	-	-
Misc Exp not written off (VRS)	-	-	-	-	-	-
Other non current assets			14	20	20	20
Total Application of Funds	**42,686**	**52,651**	**64,559**	**84,829**	**103,166**	**124,559**

Source: Company, Citi Research Estimates

Companies Mentioned

Honda Motor (7267.T; ¥3,515; 1); Yamaha Motor (7272.T; ¥1,132; 1); Bajaj Auto (BAJA.BO; Rs2,053.45; 1); Hero MotoCorp (HROM.BO; Rs1,813.35; 3); Mahindra & Mahindra (MAHM.BO; Rs885.95; 2); Maruti Suzuki India (MRTI.BO; Rs1,608.70; 2); Tata Motors (TAMO.BO; Rs285.00; 1)

Quants View – Glamour

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Data as of: 25-Jan-13

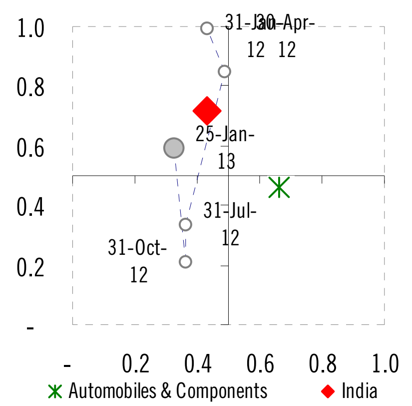
Bajaj Auto lies in the Glamour quadrant of our Value-Momentum map with strong momentum but relatively weak value scores. The stock has moved from the Unattractive quadrant to the Glamour quadrant in the past three months indicating an improvement in the momentum scores although valuation still remains expensive. Compared with its peers in the Automobiles & Components sector, Bajaj Auto fares worse on the valuation metric but better on the momentum metric. On the other hand, compared with its peers in its home market of India, Bajaj Auto fares worse on the valuation metric and on the momentum metric.

From a macro perspective, Bajaj Auto has a low beta to the region, so can be expected to hold its own given a decline in the regional market. It is also likely to benefit from large-cap outperformance, widening Asian interest rates, and a weaker US dollar.

Radar Screen Quadrant Definitions

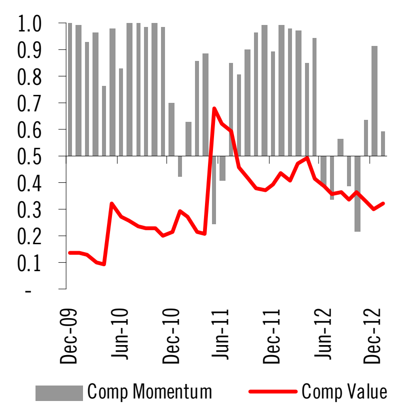
Glamour *Poor relative value but superior relative momentum*	**Attractive** *Superior relative value and superior relative momentum*
Unattractive *Poor relative value and poor relative momentum*	**Contrarian** *Superior relative value but poor relative momentum*

Figure 27. Radar Quadrant Chart History



Source: Citi Research

Figure 28. Radar Valuation and Momentum Scores



Source: Citi Research

Figure 29. Radar Model Inputs

IBES EPS (Actual and Estimates)

FY(-2)	55.20	Implied Trend Growth (%)	17.81
FY(-1)	90.83	Trailing PE (x)	19.77
FY0	109.82	Implied Cost of Debt (%)	9.29
FY1	109.77	Standardised MCap	0.16
FY2	134.84		

Note: Standardised MCap calculated as a Z score – (mkt cap - mean)/std dev – capped at 3

Source: Citi Research, Worldscope, I/B/E/S

Figure 30. Stock Performance Sensitivity to Key Macro Factors

Region	0.58	Commodity ex Oil	(0.07)
Widening APACxJ CDS	(0.01)	Rising Oil Prices	(0.16)
Growth	(0.58)	Rising Asian IR's	0.56
Value	(0.81)	Rising EM Yields	0.00
Small Caps Outperform Large Caps	(1.12)	Weaker US$ (vs Asia)	2.12
Widening US Credit Spreads	0.07	Weaker ¥ (vs US$)	0.12

Source: Citi Research

Bajaj Auto

Company description

Bajaj Auto (BAL) is a leading domestic auto OEM that is well positioned in the motorcycle segment as the 2nd largest player with around 25% market share, and is the largest player in the 3-wheeler industry with 55% market share.

Investment strategy

We rate Bajaj Auto as Neutral (2). Bajaj Auto stock has gone up ~27% over the last 6 months, outperforming the broader market by ~13%. While depreciating INR should buoy export earnings and Bajaj should be able to maintain a stable market share in the domestic 2 wheeler market, we believe that the current valuations price in the positives. We also believe that Bajaj's strategy of segmenting the market and launching new variants will have limited appeal in the short run (given significant cannibalization with other models), though it could improve over the longer term. We do not expect material upsides to the stock price from current levels, given a lack of meaningful fundamental catalysts.

Valuation

We value Bajaj Auto at Rs 2,189 based on 16x FY14E EPS. Our 16x multiple is slightly on the higher side, and it is at a 10% premium to the average of the past two years. We think that it should be well supported by earnings growth of around 20% CAGR over FY13-FY15E. We expect the re-rating should sustain, provided Bajaj a) doesn't cede too much market share in the domestic market to Hero, b) maintains its margins at around 18-20%, c) continues to grow market share in the export markets and thrust into new markets (Indonesia for 2 wheelers with Kawasaki and then Brazil – with KTM and Kawasaki). At our target price, the stock would trade at a multiple of around 6.5x, which is fairly substantial but supported by the 44-45% RoE that we forecast going forward.

Risks

The key downside risks to our investment thesis and target price on Bajaj Auto include: 1) Lower than forecast export growth in aggregate, driven by political/economic uncertainty in key end markets like Nigeria, Sri Lanka, Iran, Colombia, Egypt, etc. 2) Erosion of Bajaj's market share in the domestic Premium segment by competition - principally players like Hero, Yamaha and Honda. Key upside risks include 1) Better than expected growth in the overall domestic 2 wheeler industry with Bajaj maintaining its market share; and 2) further depreciation in INR, resulting in better export realizations

Appendix A-1

Analyst Certification

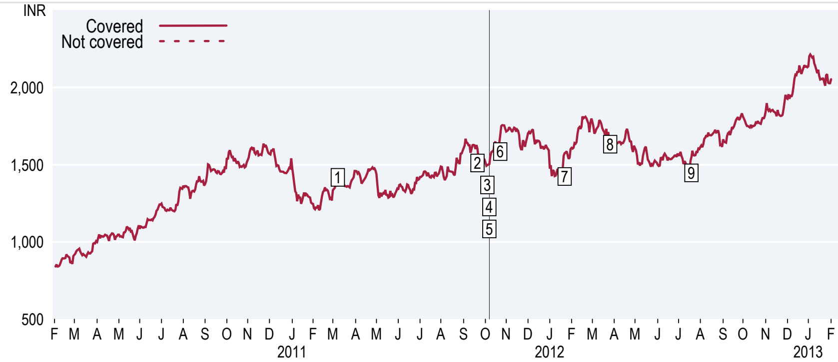
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Bajaj Auto (BAJA.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Jamshed Dadabhoy



	Date	Rating	Target Price	Closing Price
1	8-Mar-11	3L	*1,390.00	1,386.75
2	21-Sep-11	3L	*1,522.00	1,603.20
3	5-Oct-11	3L	*1,430.00	1,497.80
4	7-Oct-11	Stock rating system changed		
5	7-Oct-11	*3	1,430.00	1,503.75
6	24-Oct-11	3	*1,540.00	1,691.70
7	22-Jan-12	3	*1,482.00	1,557.80
8	27-Mar-12	3	*1,570.00	1,660.20
9	19-Jul-12	*1	*1,835.00	1,549.20

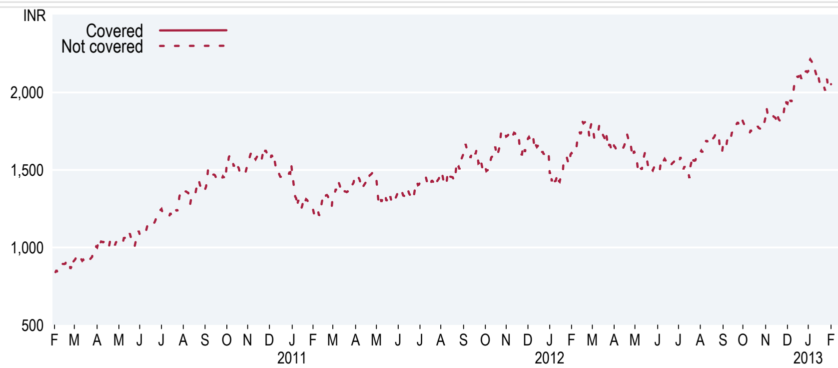
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Bajaj Auto (BAJA.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Jamshed Dadabhoy



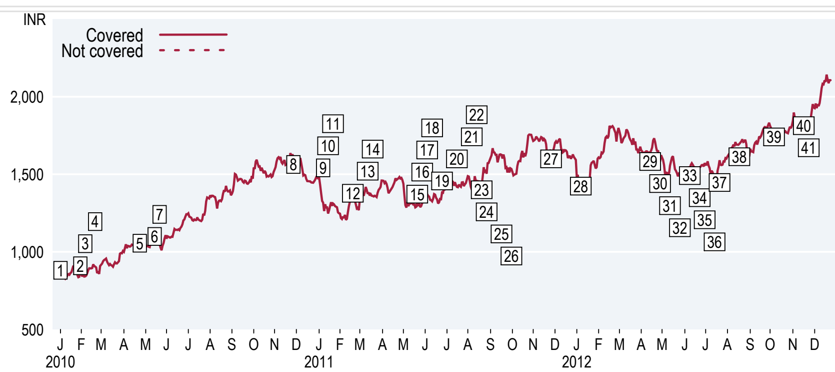
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Bajaj Auto Ltd (BAJA.BO)

Rating History
Global Quantitative Research
Asia Radar Screen

Analyst: Paul R Chanin



	Date	Rating	Target Price	Closing Price
1	1-Jan-10	*2	-	880.85
2	29-Jan-10	*3	-	886.55
3	5-Feb-10	*2	-	841.80
4	19-Feb-10	*3	-	904.83
5	23-Apr-10	*4	-	1,053.63
6	14-May-10	*1	-	1,092.75
7	21-May-10	*2	-	1,049.65
8	26-Nov-10	*3	-	1,615.55
9	7-Jan-11	*2	-	1,317.00
10	14-Jan-11	*4	-	1,246.90
11	21-Jan-11	*3	-	1,311.55
12	18-Feb-11	*4	-	1,335.20
13	11-Mar-11	*2	-	1,374.20
14	18-Mar-11	*3	-	1,360.50
15	20-May-11	*2	-	1,330.45
16	27-May-11	*3	-	1,314.30
17	3-Jun-11	*4	-	1,371.90
18	10-Jun-11	*1	-	1,325.50
19	24-Jun-11	*4	-	1,382.70
20	15-Jul-11	*1	-	1,418.80
21	5-Aug-11	*3	-	1,400.30
22	12-Aug-11	*4	-	1,457.30
23	19-Aug-11	*2	-	1,431.20
24	26-Aug-11	*3	-	1,503.90
25	16-Sep-11	*2	-	1,625.55
26	30-Sep-11	*1	-	1,534.35
27	25-Nov-11	*2	-	1,642.70
28	6-Jan-12	*1	-	1,459.20
29	13-Apr-12	*2	-	1,640.70
30	27-Apr-12	*1	-	1,582.55
31	11-May-12	*2	-	1,555.20
32	25-May-12	*3	-	1,496.35
33	8-Jun-12	*4	-	1,528.65
34	22-Jun-12	*3	-	1,545.30
35	29-Jun-12	*4	-	1,572.00
36	13-Jul-12	*5	-	1,497.15
37	20-Jul-12	*3	-	1,590.60
38	17-Aug-12	*4	-	1,696.50
39	5-Oct-12	*5	-	1,751.05
40	16-Nov-12	*4	-	1,813.60
41	23-Nov-12	*3	-	1,816.70

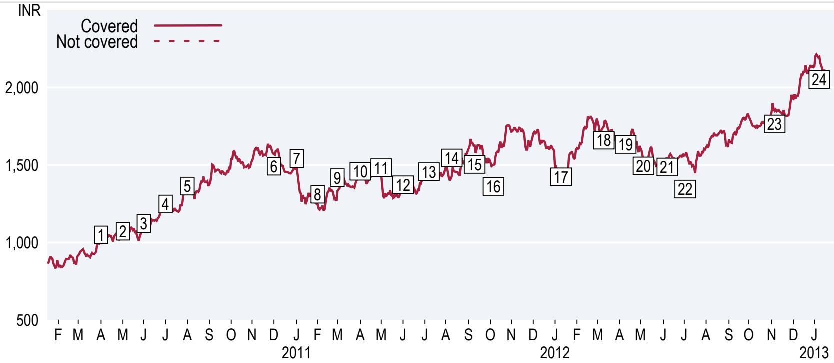
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Bajaj Auto Ltd (BAJA.BO)

Rating History
Global Quantitative Research
World Radar Screen

Analyst: Chris Montagu



#	Date	Rating	Target Price	Closing Price
1	1-Apr-10	*4	-	999.73
2	1-May-10	*8	-	1,047.15
3	1-Jun-10	*3	-	1,085.03
4	1-Jul-10	*4	-	1,248.23
5	1-Aug-10	*3	-	1,344.03
6	1-Dec-10	*7	-	1,569.85
7	1-Jan-11	*3	-	1,541.50
8	1-Feb-11	*5	-	1,246.25
9	1-Mar-11	*8	-	1,334.85
10	1-Apr-11	*7	-	1,459.50
11	1-May-11	*5	-	1,462.80
12	1-Jun-11	*8	-	1,338.55
13	7-Jul-11	*10	-	1,454.95
14	9-Aug-11	*7	-	1,427.35
15	9-Sep-11	*9	-	1,625.70
16	6-Oct-11	*4	-	1,497.80
17	10-Jan-12	*3	-	1,429.55
18	9-Mar-12	*5	-	1,749.50
19	10-Apr-12	*4	-	1,647.20
20	4-May-12	*3	-	1,501.75
21	7-Jun-12	*7	-	1,545.10
22	3-Jul-12	*8	-	1,562.05
23	6-Nov-12	*9	-	1,849.05
24	8-Jan-13	*4	-	2,198.60

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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	12 Month Rating			*Relative Rating*		
Data current as of 31 Dec 2012	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Research Global Fundamental Coverage	49%	38%	12%	7%	86%	7%
% of companies in each rating category that are investment banking clients	53%	49%	45%	60%	49%	55%
Citi Research Quantitative World Radar Screen Model Coverage	30%	40%	30%			
% of companies in each rating category that are investment banking clients	31%	28%	24%			
Citi Research Quantitative Decision Tree Model Coverage	46%	0%	54%			
% of companies in each rating category that are investment banking clients	64%	0%	50%			
Citi Research Asia Quantitative Radar Screen Model Coverage	20%	60%	20%			
% of companies in each rating category that are investment banking clients	33%	26%	26%			
Citi Research Australia Radar Model Coverage	42%	0%	58%			
% of companies in each rating category that are investment banking clients	33%	0%	19%			

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