

BAJAJ AUTO

Product mix supports margins

India Equity Research | Automobiles



Q2FY13 earnings were operationally better than expectation due to the improved product mix. EBITDA margin at 18.4% was higher by 50bps QoQ on superior product mix and higher average realization. However, PAT at INR7.4bn (up 2% YoY, up 3% QoQ) was in-line with estimates. Exports ramp up has been slow. Despite the good response to new launches (Discover 125 ST, Pulsar 200NS), domestic slow-down is weighing heavily on near term sales. Risk of pricing indiscipline is also rising. We cut our FY13E volume and EPS estimates by 2.4% and 3.5% to adjust for lower three wheeler sales but largely maintain FY14E estimates. We maintain our target price to INR1,830 but downgrade the stock to 'HOLD' from 'BUY' due to limited upside potential.

PAT in line; margins better than expectation

Net profit at INR7.4bn (up 2% YoY, up 3% QoQ) was exactly in line with our expectation. However, EBITDA margin at 18.4% (17.9% in Q1FY13) was better than expectation due to superior product mix and higher average realisation. Total revenue stood at INR49.7bn (down 5.6% YoY, up 2.2% QoQ) with average realization at INR46k (up 6% YoY, up 5% QoQ).

Better product mix aids margin expansion

BAL gained market share by 220bps QoQ in the domestic motorcycle segment on the back on new launches in the executive segment (Discover 125 ST, Pulsar 200 NS). Three wheelers sales were also higher QoQ in both domestic and export markets, thus aided in margin expansion by 50bps QoQ. The company plans to launch Discover 100cc bike by December to take on rivals in the economy segment.

Outlook and valuations: Favourable; downgrade to 'HOLD'

Revival in exports, new launches in domestic market and weak INR make the company's business outlook favourable. Currently, the stock is trading at 11.6x FY14E core EPS of INR131. We maintain our target price to INR1,830 but downgrade the stock to 'HOLD' from 'BUY' due to limited upside potential. We prefer Bajaj Auto over Hero Motocorp due to superior earnings visibility.

EDELWEISS 4D RATINGS

Absolute Rating	HOLD
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

MARKET DATA (R: BAJA.BO, B: BJAUT IN)

CMP	: INR 1,786
Target Price	: INR 1,830
52-week range (INR)	: 1,850 / 1,407
Share in issue (mn)	: 289.4
M cap (INR bn/USD mn)	: 517/ 9,649
Avg. Daily Vol.BSE/NSE('000)	: 524.5

SHARE HOLDING PATTERN (%)

	Current	Q1FY13	Q4FY12
Promoters *	50.0	50.0	50.0
MF's, FI's & BK's	10.0	9.8	8.4
FII's	15.1	14.8	16.4
others	24.9	25.4	25.1
* Promoters pledged shares (% of share in issue)			0.9

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Auto Index
1 month	1.3	1.5	7.8
3 months	14.5	8.4	12.0
12 months	8.3	10.6	27.9

Financials

(INR mn)

Year to March	Q2FY13	Q2FY12	% change	Q1FY13	% change	FY12	FY13E	FY14E
Net revenues	49,724	52,673	(4.5)	48,657	2.2	195,297	207,030	258,513
EBITDA	9,152	10,574	(13.4)	8,717	5.0	37,206	38,290	51,826
Adj. net profit	7,407	7,900	(6.2)	7,184	3.1	31,387	30,184	40,505
Diluted EPS (INR)	25.6	27.3	(6.2)	24.8	3.1	108.5	104.3	140.0
Diluted PE (x)						16.3	17.0	12.7
EV/EBITDA (x)						12.0	11.3	7.9
ROACE						67.0	61.6	65.2

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Key takeaways from earnings conference call

Industry outlook: Moderate

- Motorcycle sales in domestic market declined by ~1% in H1FY13
- The company expects industry to see a growth of 3-4% in FY13 (lower from 7-8% volume growth expected in July'12)

Company outlook: Improving

- Sales have been flat to marginally positive in the first five days of Navratri though the company expects sales to revive going forward along with sentiments.
- The company took a price hike of ~1% in the first week of October to pass on the rising input costs. This is after the price hike of INR500-1,500 across models (~2%) at the beginning of July'12.

Inventory:

- Bajaj is maintaining a normal level of inventory and expects correction during festive season.
- Inventory for Hero Moto is still very high.

New launches:

- The newly launched Discover 125 ST and Pulsar 200 NS have got very good response and have gained market share in their segments.
- The company is very much hopeful of gaining market share in the economy segment as well with the launch of new Discover 100cc bike in Dec'12.

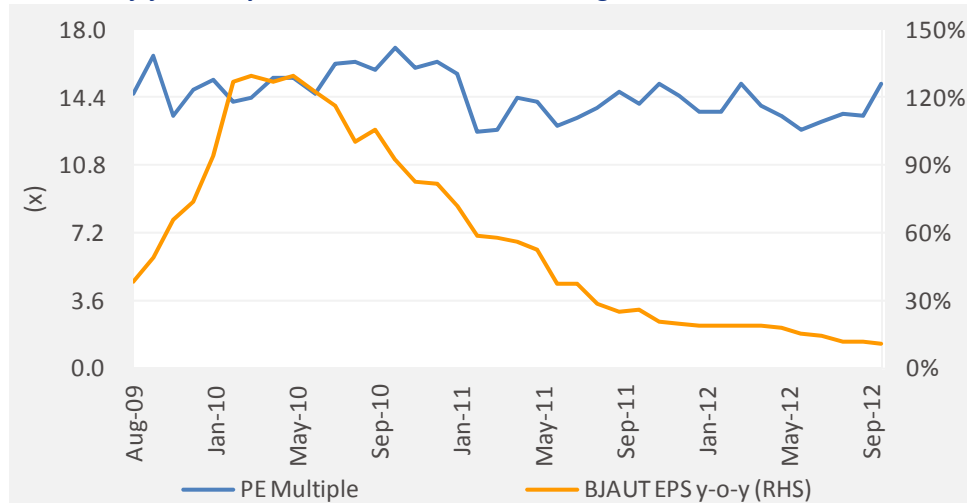
Exports

- Sales in Sri Lanka market is taking time to normalize. Earlier, the company expected it to normalize by Sep'12. The current run rate is ~14.5k units versus normal sales of ~22k units.
- Africa market is doing well and expected to grow by 10-15% for next couple of quarters.
- Rest of other export markets is showing a flat growth.
- Association with Kawasaki would help growth further.

Hedging

- Exports sales realised @48.8 USD/INR rate during Q2FY13 (49.8 in Q1FY13).
- BAL has taken cover for FY14 first half of exports (~600mn USD) as well at an average rate of ~54 USD/INR.

Chart 1: Bajaj Auto 1-yr forward PE vs consensus EPS growth



Source: Factset, Edelweiss research

Table 1: Volume/forex assumptions

	FY10	FY11	FY12	FY13E	FY14E
Domestic	1,962,626	2,620,206	2,766,737	2,851,532	3,264,830
Two-wheeler	1,786,599	2,414,603	2,564,255	2,645,000	3,037,645
Three-wheeler	176,027	205,603	202,482	206,532	227,185
Exports	889,984	1,203,718	1,579,824	1,675,272	2,063,925
Two-wheeler	725,097	972,437	1,267,151	1,393,866	1,658,701
Three-wheeler	164,887	231,281	312,673	281,406	405,224
Total	2,852,610	3,823,924	4,346,561	4,526,803	5,328,755
Product-mix (% total sales)					
Domestic	68.8	68.5	63.7	63.0	61.3
Two-wheeler	62.6	63.1	59.0	58.4	57.0
Three-wheeler	6.2	5.4	4.7	4.6	4.3
Exports	31.2	31.5	36.3	37.0	38.7
Two-wheeler	25.4	25.4	29.2	30.8	31.1
Three-wheeler	5.8	6.0	7.2	6.2	7.6
Total	100.0	100.0	100.0	100.0	100.0
Forex					
USD/INR forex cover rate		46.0	47.4	50.0	54.0
USD/INR spot avg.		45.6	48.1	53.5	52.0

Source: Company, Edelweiss research

Table 2: Edelweiss versus Bloomberg consensus estimates

Particulars	FY13E			FY14E		
	Edel	Consenses	% var	Edel	Consenses	% var
Sales (INR mn)	207,030	212,000	(2.3)	258,513	244,706	5.6
EBITDA (INR mn)	38,290	39,563	(3.2)	51,826	47,080	10.1
EBITDA (%)	18.5	18.7		20.0	19.2	
EPS (INR)	104.3	109.0	(4.3)	140.0	129.0	8.5

Source: Company, Edelweiss research

Financial snapshot								(INR m)
Year to March	Q2FY13	Q2FY12	% change	Q1FY13	% change	FY12	FY13E	FY14E
Total units sold (nos)	1,049,208	1,164,137	(9.9)	1,078,971	(2.8)	4,346,561	4,526,803	5,328,755
Avg Realisation (INR)	45,911	43,350	5.9	43,686	5.1	44,931	45,734	48,513
Total revenues	49,724	52,673	(5.6)	48,657	2.2	195,297	207,030	258,513
Raw material	35,686	37,616	(5.1)	35,080	1.7	141,025	146,085	178,156
Staff costs	1,532	1,311	16.9	1,604	(4.5)	5,401	5,833	6,533
Other expenses	3,479	3,285	5.9	3,362	3.5	12,158	17,340	22,542
Less: Expenses capitalised	(125)	(112)	(11.5)	(107)	(17.5)	(494)	(519)	(545)
Total expenditure	40,572	42,099	(3.6)	39,940	1.6	158,090	168,740	206,686
EBIDTA	9,152	10,574	(13.4)	8,717	5.0	37,206	38,290	51,826
Interest	2	202		0		222	6	6
Depreciation	410	394	4.1	352	16.5	1,456	1,481	1,515
Other income	1,667	745	123.8	1,820	(8.4)	6,080	5,710	6,745
PBT	10,407	10,722	(2.9)	10,184	2.2	41,608	42,513	57,050
Tax	3,000	2,822	6.3	3,000	-	10,221	12,329	16,544
Adjusted net profit	7,407	7,900	(6.2)	7,184	3.1	31,387	30,184	40,505
Extraordinary exp	0	642	0.0	0	-	(1,340)	0	0
Net profit	7,407	7,258	2.0	7,184	3.1	30,047	30,184	40,505
As a % net revenues								
Gross margins	28.2	28.6		27.9		27.8	29.4	31.1
Raw material	71.8	71.4		72.1		72.2	70.6	68.9
Staff costs	3.1	2.5		3.3		2.8	2.8	2.5
Other expenses	7.0	6.2		6.9		6.2	8.4	8.7
EBIDTA	18.4	20.1		17.9		19.1	18.5	20.0
Adjusted net profit	14.9	15.0		14.8		16.1	14.6	15.7
Tax rate (% PBT)	28.8	26.3		29.5		24.6	29.0	29.0

Change in estimates							(INR mn)
	FY13E			FY14E			Comments
	Earlier	Revised	% change	Earlier	Revised	% change	
Total volumes (nos)	4,639,005	4,526,803	(2.4)	5,330,929	5,328,755	(0.0)	To adjust for lower 3-wh exports sales
Net sales (INR mn)	215,684	207,030	(4.0)	260,153	258,513	(0.6)	On lower volume
EBITDA (INR mn)	39,725	38,290	(3.6)	51,624	51,826	0.4	
EBITDA margin (%)	18.4	18.5		19.8	20.0		
PAT (INR mn)	31,266	30,184	(3.5)	40,389	40,505	0.3	
PAT margin (%)	14.5	14.6		15.5	15.7		
EPS (INR)	108	104	(3.5)	140	140	0.3	
Capex	2,500	2,500	-	2,500	2,500	-	

Company Description

BAL is the second largest two-wheeler manufacturer in India with a domestic market share of 28%. It offers products in all motorcycle segments—Platina (entry), Discover (executive) and Pulsar (premium). It is also the largest three-wheeler manufacturer in India. Post the demerger in May 2008, BAL has been solely focused on the automobile business. In the past few years, the company has shown strong growth in exports that now forms nearly 35% of its total volumes.

Investment Theme

Bajaj Auto is a diversified play with domestic motorcycle, three wheeler and export portfolio. Revival of exports in key destinations (like Africa and Sri Lanka) and performance of new launches in the domestic market augur well for volume growth. Weak INR has improved the profitability prospects of the company.

Key Risks

Increasing competition

Intense competition could hit profitability; the risk could play out in FY14-15 when-ever Honda choose to launch cheap Chinese bikes. The probability at the moment is low.

Problems in exports market

Any disruption in key African market could affect exports numbers.

Financial Statements

Key Assumptions

Year to March		FY10	FY11	FY12	FY13E	FY14E
Macro -	GDP(Y-o-Y %)	8.4	8.4	6.5	5.8	6.5
	Inflation (Avg)	3.6	9.9	8.8	7.8	6.0
	Repo rate (exit rate)	5.0	6.8	8.5	7.5	6.8
	USD/INR (Avg)	47.4	45.6	47.9	53.5	52.0
Sector -	Motorcycle – Dom. Vol. YoY %	25.7	23.0	11.9	6.0	12.0
	3-wh (Passenger) – Dom. Vol. YoY %	26.1	19.6	(2.5)	3.0	8.0
Company -	Motorcycle – Dom. Vol. YoY %	39.6	35.5	6.2	3.1	14.8
	3-wh (Passenger) – Dom. Vol. YoY %	29.9	16.8	(1.5)	2.0	10.0

Income statement

(INR mn)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Income from operations	118,098	164,417	195,297	207,030	258,513
Materials costs	80,704	117,988	141,025	146,085	178,156
Manufacturing expenses	2,137	2,513	3,148	3,526	4,583
Employee costs	3,995	4,768	5,401	5,833	6,533
Total SG&A expenses	6,605	7,138	9,010	13,815	17,959
Expenses capitalised	157	167	494	519	545
EBITDA	24,814	32,177	37,206	38,290	51,826
Depreciation and amortisation	1,365	1,228	1,456	1,481	1,515
Non-Operational Income	2,329	5,331	6,080	5,710	6,745
Interest expenses	60	17	222	6	6
Profit before tax	25,718	36,262	41,608	42,513	57,050
Provision for tax	7,075	10,110	10,221	12,329	16,544
Net profit	18,643	26,152	31,387	30,184	40,505
Extraordinary income/ (loss)	(1,641)	7,246	(1,340)	-	-
Profit After Tax	16,993	33,397	30,047	30,184	40,505
Diluted EPS (INR)	64.4	90.4	108.5	104.3	140.0
CEPS (INR)	69.0	95.6	113.5	109.4	145.2
Dividend per share (INR)	20.0	40.0	45.0	50.0	50.0
Dividend payout (%)	34.1	34.7	43.3	47.9	35.7

Common size metrics - as % of net revenues

Year to March	FY10	FY11	FY12	FY13E	FY14E
Materials costs	68.3	71.8	72.2	70.6	68.9
S G & A expenses	5.6	4.3	4.6	6.7	6.9
EBITDA margins	21.0	19.6	19.1	18.5	20.0
Net profit margins	15.8	15.9	16.1	14.6	15.7

Growth ratios (%)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Rev. growth (%)	35.8	39.2	18.8	6.0	24.9
EBITDA	130.3	29.7	15.6	2.9	35.4
PBT	121.2	41.0	14.7	2.2	34.2
Net profit	116.5	40.3	20.0	(3.8)	34.2
EPS growth (%)	116.5	40.3	20.0	(3.8)	34.2

Balance sheet						(INR mn)
As on 31st March	FY10	FY11	FY12	FY13E	FY14E	
Equity capital	1,447	2,894	2,894	2,894	2,894	
Reserves & surplus	27,837	46,209	57,517	70,773	94,350	
Shareholders funds	29,283	49,102	60,411	73,667	97,244	
Secured loans	130	235	276	276	276	
Unsecured loans	13,256	3,016	1,250	1,250	1,250	
Borrowings	13,386	3,252	1,526	1,526	1,526	
Deferred tax (net)	17	297	484	484	484	
Sources of funds	42,686	52,651	62,421	75,677	99,255	
Gross block	33,793	33,952	33,961	36,578	39,196	
Depreciation	18,997	19,125	19,143	20,625	22,140	
Net block	14,796	14,827	14,817	15,954	17,056	
Capital work in progress	415	699	118	118	118	
Investments	40,215	47,952	49,935	66,051	84,733	
Inventories	4,462	5,473	6,785	8,326	10,433	
Sundry debtors	2,728	3,628	4,228	8,326	10,433	
Cash and equivalents	1,014	5,565	16,538	17,156	21,499	
Loans and advances	21,805	38,032	19,197	20,157	21,165	
Total current assets	30,009	52,697	46,749	53,964	63,531	
Sundry creditors and others	15,712	19,431	22,153	19,426	20,867	
Others current liabilities	4,551	4,836	4,764	4,764	4,764	
Provisions	22,487	39,257	22,281	36,102	40,318	
Total current liabilities & provisions	42,750	63,524	49,198	60,292	65,948	
Net current assets	(12,740)	(10,827)	(2,449)	(6,328)	(2,417)	
Uses of funds	42,686	52,651	62,421	75,677	99,255	
Book value per share (INR)	101.2	169.7	208.8	254.6	336.1	

Free cash flow						(INR mn)
Year to March	FY10	FY11	FY12	FY13E	FY14E	
Net profit	16,993	33,397	30,047	30,184	40,505	
Depreciation	1,365	1,228	1,456	1,481	1,515	
Deferred tax	(51)	280	-	-	-	
Others	51	(280)	-	-	-	
Gross cash flow	18,357	34,626	31,503	31,666	42,021	
Less: Changes in WC	(8,238)	4,066	(914)	(2,703)	(433)	
Operating cash flow	26,595	30,559	32,417	34,368	42,453	
Less: Capex	933	1,543	866	2,500	2,500	
Free cash flow	25,663	29,017	31,552	31,868	39,953	

Cash flow metrics					
Year to March	FY10	FY11	FY12	FY13E	FY14E
Operating cash flow	26,595	30,559	32,417	34,368	42,453
Investing cash flow	(23,063)	(9,279)	(2,848)	(18,617)	(21,182)
Financing cash flow	(6,038)	(16,883)	(15,178)	(15,134)	(16,928)
Net cash flow	(2,505)	4,397	14,391	618	4,343
Capex	(933)	(1,543)	(866)	(2,500)	(2,500)
Dividends paid	(3,724)	(6,749)	(13,452)	(15,134)	(16,928)

Profitability & efficiency ratios

Year to March	FY10	FY11	FY12	FY13E	FY14E
ROAE (%)	80.8	66.7	57.3	45.0	47.4
ROACE (%)	60.4	68.9	67.0	61.6	65.2
Inventory day	20	17	18	19	19
Debtors days	8	8	8	11	13
Payable days	61	54	51	52	41
Cash conversion cycle (days)	(33)	(29)	(26)	(22)	(9)
Current ratio	0.7	0.8	1.0	0.9	1.0
Debt/EBITDA	0.5	0.1	-	-	-
Fixed asset turnover (x)	3.5	4.8	5.8	5.9	6.8
Debt/Equity	0.5	0.1	-	-	-

Operating ratios

Year to March	FY10	FY11	FY12	FY13E	FY14E
Total asset turnover	3.1	3.4	3.4	3.0	3.0
Fixed asset turnover	7.8	11.1	13.2	13.5	15.7
Equity turnover	4.9	4.2	3.6	3.1	3.0

Valuation parameters

Year to March	FY10	FY11	FY12	FY13E	FY14E
Diluted EPS (INR)	64.4	90.4	108.5	104.3	140.0
Y-o-Y growth (%)	116.5	40.3	20.0	(3.8)	34.2
CEPS (INR)	69.0	95.6	113.5	109.4	145.2
Diluted PE (x)	27.5	19.6	16.3	17.0	12.6
Price/BV (x)	17.5	10.4	8.5	6.9	5.3
EV/Sales (x)	4.1	2.8	2.3	2.1	1.6
EV/EBITDA (x)	19.5	14.3	12.0	11.2	7.9
Dividend yield (%)	1.1	2.3	2.5	2.8	2.8

Peer comparison valuation

Company	Price INR	Market-cap (INRbn)	PE (x)		EV/EBITDA		RoE (%)	
			FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Bajaj Auto	1,771	512	17.0	12.7	11.3	7.9	45.0	47.4
Hero Motocorp	1,835	366	14.2	13.7	8.1	7.2	51.8	41.6
TVS Motor	42	20	9.0	7.6	6.0	5.4	19.0	19.6
Maruti Suzuki	1,370	399	19.6	13.0	10.4	6.4	12.4	16.4
Yamaha	523	183	16.0	10.3	7.4	5.5	5.8	8.6
Honda	1,751	3,171	9.6	8.2	8.3	7.3	10.8	11.5

Source: Bloomberg, Edelweiss research

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Ashok Leyland	BUY	SP	H	Bajaj Auto	BUY	SO	H
Eicher Motors	BUY	SO	M	Exide Industries	HOLD	SP	L
Hero MotoCorp	REDUCE	SU	M	Mahindra & Mahindra Ltd	BUY	SO	M
Maruti Suzuki India Ltd	BUY	SO	H	Tata Motors Ltd	BUY	SP	H

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



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Coverage group(s) of stocks by primary analyst(s): Automobiles

Ashok Leyland, Bajaj Auto, Eicher Motors, Exide Industries, Hero MotoCorp, Mahindra & Mahindra Ltd, Maruti Suzuki India Ltd, Tata Motors Ltd

Recent Research

Date	Company	Title	Price (INR)	Recos
19-Oct-12	Exide Industries	Margins disappoint; <i>Result Update</i>	148	Hold
10-Oct-12	Auto Compass	September: A dull month; <i>Monthly Update</i>		
01-Oct-12	Auto Sales Update	Mixed Bag; <i>Monthly Update</i>		

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	113	53	19	186
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	114	58	14	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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