

October 25, 2018

Bajaj Auto

A Cherry Pick in the Tough Time!

Q2FY19 Quarter – not a typical one!

The company's 2nd quarter results were a marginal miss majorly due to lower margins. Its volumes grew higher by 25% YoY to 13.4L units in Q2FY19, but the realization declined by 2.7% YoY to Rs. 60,256, impacted due to inferior product mix and increase in the discounting. The volume sales were higher in the lower CC segment, where it has reported a 50% YoY growth during the quarter led by CT100 & Platina. The top-line grew well by 21.6% YoY to Rs. 8,071 crores in Q2FY19. On the operational front, the EBITDA Margin decelerated by 280bps YoY to 18.0% in Q2FY19, impacted as the company has shifted its focus on the domestic entry level bikes to gain the market share (which worked well). Additionally, increase in the commodity prices & slow start to the festivals increased the discounting in the market, which has added further pain. The bottom-line increased by 3.7% YoY to Rs. 1,152 crores in Q2FY19 was due to poor operational performance and higher effective tax rate, which increased by 350bps YoY to 30.3% for the quarter.

All the Products & Geographies Performing Fine

The domestic motorcycle reported 8% YoY growth during the quarter, while Bajaj has outperformed the market and reported 19% YoY growth in the same quarter, thus gained market share. On the 3W side, Bajaj Auto is the market leader and has reported 32% YoY growth vis-à-vis 23% growth reported by the industry. The performance of the export market too was encouraging with the company reported a 33% YoY growth led by Africa, South Asia and the Middle East.

Soft Demand for the Industry – Bajaj Stayed Strong

For the industry, the season has not progressed as per the expectation and has reported a de-growth of ~5%, however, Bajaj Auto is growing at double digit and expected to clock 10-15% growth in the entire festival season. The industry demand remained soft and the whole focus is shifted to volumes from the margins, however, directionally the trend is improving marginally. Although in the short-run, the margins to remain lower, however, higher volume sales to trigger the operating leverage benefit, along with rupee depreciation and higher sales from the sports segment to improve the margins in the medium term.

Valuations

The stock has corrected by approximately ~29% from its 52W high, which makes the valuation very attractive. At a CMP of Rs. 2,475, the stock is trading at 13.1x of FY20E EPS of Rs. 189. The company is a cash generating machine and we believe it has a lot of potential in the coming years both in 2Ws as well as 3Ws. The company has been trading at a forward P/E of 16.0x in the past few years and looking at the current domestic environment, we have reduced the earnings multiple to 13.6x plus KTM and Cash per Share takes the **fair value to 2,978 per share**, seeking an upside of 20.3% from the current levels.

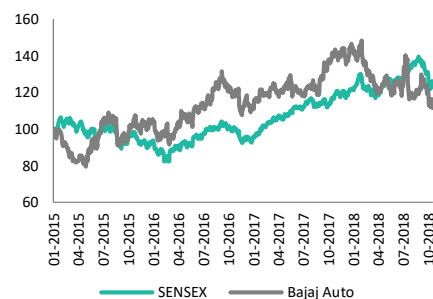
Strong Buy*

Downside Scenario	Current Price	Price Target	Upside Scenario
	2,475	2,978	
20.3% ▲			

Market Data	
Industry	Automobile
Sensex	34,034
Nifty	10,225
Bloomberg Code	BJAUT:IN
Eq. Cap. (INR Crores)	289
Face Value (INR)	10
52-w H/L	3,473/2,460
Market Cap (INR Crores)	71,627

Valuation Data	FY19E	FY20E	FY21E
OPM	18.2%	18.5%	19.2%
NPM	15.7%	15.9%	16.4%
P/E (x)	15.8	13.1	10.9
EV/EBITDA (x)	13.3	11.0	9.0

Bajaj Auto vs SENSEX



Shareholding Pattern (%)

	Sep-17	Mar-18	Sep-18
Promoters	49.3%	49.3%	49.3%
FII	17.3%	17.6%	16.4%
DII	16.2%	15.9%	8.0%
Retail	17.2%	17.3%	26.3%
Total	100%	100%	100%

(INR Crores)	FY17	FY18	FY19E	FY20E	FY21E
Revenue	21,767	25,165	29,329	34,890	40,715
Growth (%)	-3.6%	15.6%	16.5%	19.0%	16.7%
EBITDA	4,422	4,783	5,327	6,454	7,801
Growth (%)	-7.5%	8.2%	11.4%	21.2%	20.9%
EBITDA Margin (%)	20.3%	19.0%	18.2%	18.5%	19.2%
PAT	3,828	4,068	4,526	5,459	6,550
Growth (%)	-2.6%	6.3%	11.3%	20.6%	20.0%
EPS (INR)	132	141	156	189	226
P/E (x)	19.7	20.9	15.8	13.1	10.9
EV/EBITDA (x)	17.0	17.6	13.3	11.0	9.0

Source: Company, NSPL Research

* Read last page for disclaimer & rating rationale

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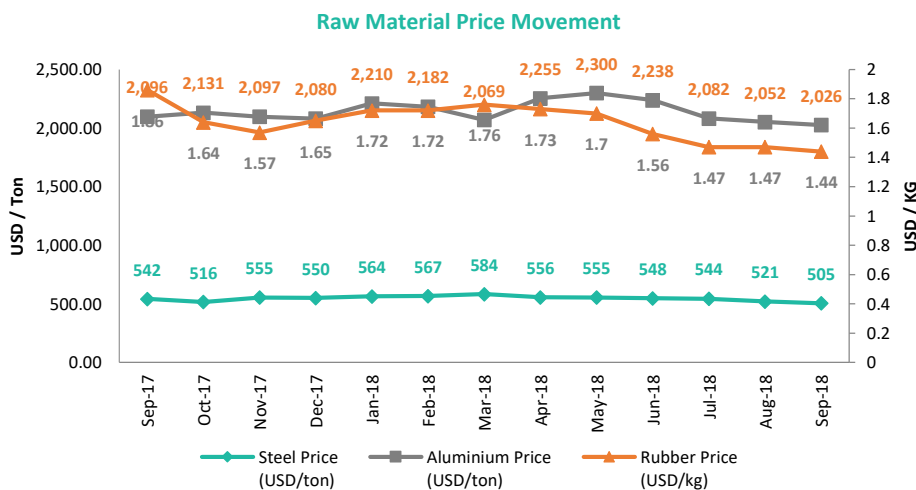


Q2FY19 Result Analysis

(INR Crores)	Q2FY19	Q2FY18	YoY (%)	Q1FY19	QoQ (%)	H1FY19	H1FY18	YoY (%)
Volumes (Nos)	13,39,444	10,71,510	25.0%	12,26,641	9.2%	25,66,085	19,59,944	30.9%
Realization (Rs)	60,256	61,922	-2.7%	61,045	-1.3%	60,629	61,941	-2.1%
Net sales	8,071	6,635	21.6%	7,488	7.8%	15,558	12,140	28.2%
COGS	5,783	4,549	27.1%	5,299	9.1%	11,082	8,358	32.6%
Employee Expenses	312	264	18.0%	314	-0.7%	626	537	16.6%
Other Expenses	555	472	17.6%	529	5.0%	1,084	899	20.6%
EBITDA	1,454	1,383	5.1%	1,378	5.5%	2,831	2,389	18.5%
D&A	72	77	-7.1%	70	2.2%	141	152	-7.1%
Other income	382	296	28.7%	404	-5.7%	786	754	4.3%
EBIT	1,382	1,306	5.9%	1,308	5.7%	2,690	2,237	20.2%
Interest Expense	0.3	0.5	-34.0%	0.3	0.0%	0.6	0.7	-12.7%
PBT	1,653	1,517	8.9%	1,616	2.3%	3,268	2,806	16.5%
Tax	500	406	23.3%	500	0.0%	1,000	770	30.0%
PAT	1,152	1,112	3.7%	1,115	3.3%	2,268	2,036	11.4%
EPS in INR	40	38	3.6%	39	3.4%	78	70	11.4%

Margin Analysis	Q2FY19	Q2FY18	YoY (%)	Q1FY19	QoQ (%)	H1FY19	H1FY18	YoY (%)
Material Expenses % Net Sales	71.6%	68.6%	3.1%	70.8%	0.9%	71.2%	68.9%	2.4%
Gross Margin	28.4%	31.4%	-3.1%	29.2%	-0.9%	28.8%	31.1%	-2.4%
Employee Expenses % Net Sales	3.9%	4.0%	-0.1%	4.2%	-0.3%	4.0%	4.4%	-0.4%
Other Expenses % Net Sales	6.9%	7.1%	-0.2%	7.1%	-0.2%	7.0%	7.4%	-0.4%
EBITDA Margin (%)	18.0%	20.8%	-2.8%	18.4%	-0.4%	18.2%	19.7%	-1.5%
Tax Rate (%)	30.3%	26.7%	3.5%	31.0%	-0.7%	30.6%	27.4%	3.2%
PAT Margin (%)	14.3%	16.8%	-2.5%	14.9%	-0.6%	14.6%	16.8%	-2.2%

- Bajaj Auto's Q2FY19 volumes rose by 25.0%** YoY to 13.4L units led by performance across its products and geographies. The domestic market reported a jump of 20% YoY, while Exports growth climbed higher by 33% YoY for the quarter. On the products segments, the 2Ws grew by 23% YoY to ~11.3L units and 3Ws reported a growth of 39% YoY to ~2.1L units.
- The company's 58% unit sales came from the lower CC motorcycles (in domestic markets), which has lower realization and thus **impacted the overall blended realization** for the company. However, the top-line performance was impressive during the quarter, which grew by 21.6% YoY to Rs. 8,071 crores.
- The cause of concern was Bajaj's lower than expected EBITDA Margin** during the quarter, which declined by 280bps YoY to 18.0% in Q2FY19. The margins declined on account of increase in the commodity prices, which shoot up by 310bps YoY to 71.6% in Q2FY19. Additionally, the poor product mix and higher discounting in the market added fuel to the flame.
- Although in the short-run, the margins would come down a little, however, we believe that **Bajaj has the ability to surprise us on the higher side** led by premium 2W & 3W sales, along with better operating leverage advantage. At present, we have estimated a conservative margins.



Source: LME



Bajaj Auto's Volume Projections

Volume Projections (in units)	FY17	FY18	FY19E	FY20E	FY21E
Domestic Sales	22,54,538	23,44,214	28,34,235	33,01,944	36,53,122
YoY Growth (%)	-	4.0%	20.9%	16.5%	10.6%
Two-Wheelers	20,01,391	19,74,577	23,51,078	27,43,147	30,24,094
YoY Growth (%)	-	-1.3%	19.1%	16.7%	10.2%
Three Wheelers	2,53,147	3,69,637	4,83,157	5,58,797	6,29,028
YoY Growth (%)	-	46.0%	30.7%	15.7%	12.6%
Export Sales	14,11,333	16,62,577	20,23,103	23,15,214	25,32,874
YoY Growth (%)	-	17.8%	21.7%	14.4%	9.4%
Two Wheelers	12,18,541	13,94,757	16,31,899	18,21,809	19,61,353
YoY Growth (%)	-	14.5%	17.0%	11.6%	7.7%
Three Wheelers	1,92,792	2,67,820	3,91,205	4,93,405	5,71,520
YoY Growth (%)	-	38.9%	46.1%	26.1%	15.8%
Segment wise Volume Breakup (in units)	FY17	FY18	FY19E	FY20E	FY21E
Two-Wheelers	32,19,932	33,69,334	39,82,976	45,64,956	49,85,448
YoY Growth (%)	-	4.6%	18.2%	14.6%	9.2%
Three-Wheelers	4,45,939	6,37,457	8,74,362	10,52,202	12,00,549
YoY Growth (%)	-	42.9%	37.2%	20.3%	14.1%
Total No. of Units	36,65,871	40,06,791	48,57,338	56,17,158	61,85,996
YoY Growth (%)	-	9.3%	21.2%	15.6%	10.1%
Blended Realization (Rs/unit)	58,304	61,646	60,381	62,112	65,818
YoY Growth (%)	-	5.7%	-2.1%	2.9%	6.0%
%tage of total units sold	FY17	FY18	FY19E	FY20E	FY21E
Two-wheeler	87.8%	84.1%	82.0%	81.3%	80.6%
Three-wheeler	12.2%	15.9%	18.0%	18.7%	19.4%

Source: Company, NSPL Research

Demand Outlook:

- The volume growth for the next two years would come from the Platina and Pulsar family.** On one side, the growth in the Platina will improve the market share and on the other side, Pulsars segment will maintain the margins/realization performance. The profitability of the lower cc motorcycles has also improved and the company has taken a price increase of Rs. 1,000 in the CT100.
- The start of the festival season remained soft** as the automotive industry reported a de-growth of ~5%, while Bajaj has posted growth and expects to report double digit volume growth in the complete festival season. The demand impacted majorly due to the insurance bouncer & higher fuel costs. We believe the timing of the higher insurance prices was unfortunate before the strong season, however, there has been a marginal improvement directionally.
- On the motorcycle exports**, the share of Africa is rising for the last 12-18 months led by pickup in the oil & commodity prices. It now contributes 45% of the motorcycle exports and expected to climb up towards 50%.
- On the 3W segment**, the management were optimistic on gaining market share in the passenger as well as goods carrier. The company is observing gradual shift towards alternate fuel in the domestic market, where Bajaj has market share upwards of 80%. The 3W exports too surprised positively and expects to continue to grow.

We believe Bajaj Auto can recover & grow faster than the industry majorly due to:

Regulatory changes in the domestic 3W markets, which provides good volume visibility in the short-medium term. The scenario for growth in domestic 3W continues to be strong, led by continued tailwinds of discontinuation of permits in Maharashtra and Karnataka, with possibilities of further permits being released in Delhi/Telangana.

Bajaj has launched many new variants in 2Ws and filled up the required product gaps to regain its lost market share. Buyers are moving towards higher CC bikes, where Bajaj is the market leader and have a wide variety of options. We believe this trend of premiumization should continue and expect robust growth in the domestic motorcycles, led by Pulsar, Dominar, Platina series and upcoming new launches in the near term.

The export market has clearly emerged out after the commodity and oil price run-up. Moreover, to reduce the dependency from Africa, Bajaj Auto has entered into ASEAN and LATAM countries. The sales from these new countries have increased.

We continue to see higher growth in FY20E as we expect pre-buying in the 2nd half of FY20E before the implementation of BS6 and expects higher realization in FY21E as the prices post BS6 will shoot up.

Source: Company, NSPL Research

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Key Quarterly Highlights

- Bajaj Auto expects Rs. 300 crores of capex.** This will be spent on increasing the 3W capacity from 8,50,000 p.a. to 10,00,000 p.a. Additionally, will be utilized for de-bottlenecking, R&D, Dies & Tools for the new models, etc.
- About the competition,** there is no significant change in the intensity. The Indian competitors viz. Hero and TVS are playing the pricing game and remained the tough competitors for Bajaj. There are no major changes from the Japanese and Chinese competitors.
- The company has taken a price increase** in the 1st week of October. It was Rs. 500-1,000 for motorcycles and Rs. 1,500-2,000 for 3Ws.
- The revenues from the spare parts has grown by 20%** on a QoQ basis. The domestic reported Rs. 567 crores, while exports were Rs. 243 crores on the spare parts sales.
- The export revenues** were Rs. 2,879 crores from vehicle sales and Rs. 243 crores from spare parts for Q2FY19. The export revenues contributed ~39% of the net sales in Q2FY19.
- A&P spends** for the complete year would remain at similar levels.

Key Risks:

- Higher than expected increase in the commodity prices can impact its margins.
- Weakness in the domestic motorcycles.
- Rising scooterization, which now contributes about 33% of the industry volumes and Bajaj has no presence in it.
- Sharp weakness in the export markets led by a correction in the oil and commodity prices, etc.

SOTP Valuation	FY20E
FY20E Core EPS (INR)	189
Target P/E (x)	13.6
Core Business (per share)	2,560
KTM Market Cap (Rs in Crores)	12,002
Bajaj Auto's Stake (%)	48%
Bajaj Auto's Stake (Rs in Crores)	5,761
HoldCo Discount	40%
Bajaj's Share (Net HoldCo Discount)	3,457
KTM Per Share	119
FY20E Cash per Share	298
Bajaj Auto's Fair Value	2,978
Upside/(Downside)	20.3%

Valuations:

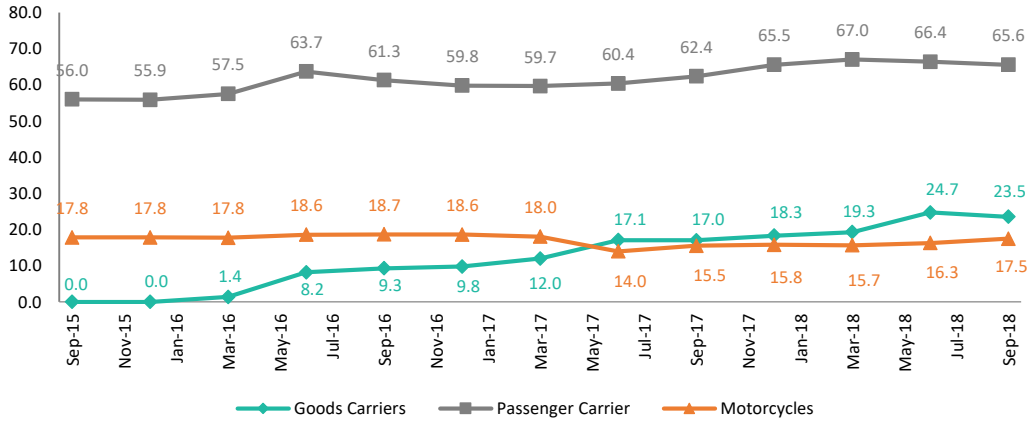
The stock has corrected by approximately ~29% from its 52W high, which makes the valuation very attractive. At a CMP of Rs. 2,475, the stock is trading at 13.1x of FY20E EPS of Rs. 189. The company is a cash generating machine and we believe it has a lot of potential in the coming years both in 2Ws as well as 3Ws. The company has been trading at a forward P/E of 16.0x in the past few years and looking at the current domestic environment, we have reduced the earnings multiple to 13.6x plus KTM and Cash per Share takes the fair value to 2,978 per share, seeking an upside of 20.3% from the current levels.

Source: Company, NSPL Research

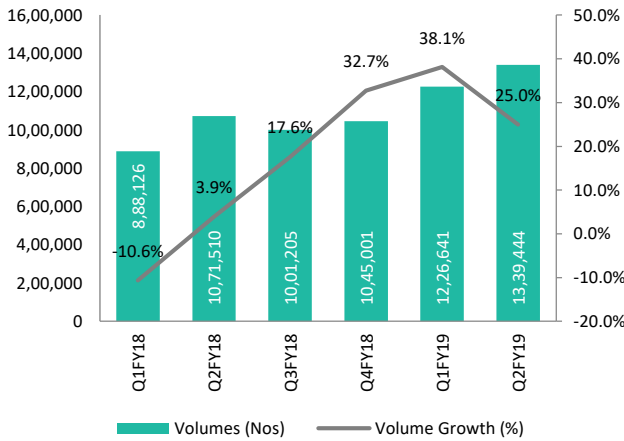


Story in Charts

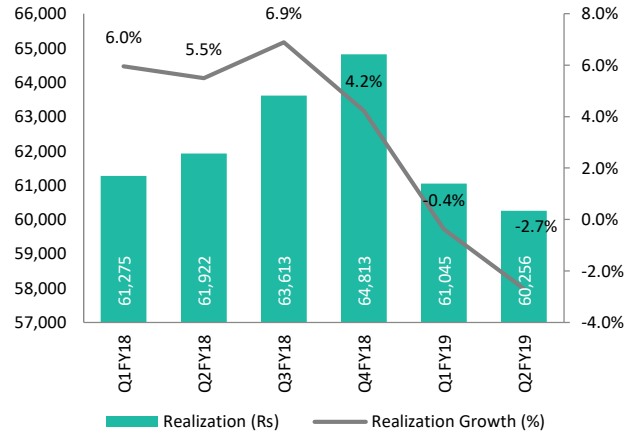
Gradually Rising Domestic Market Share (%)



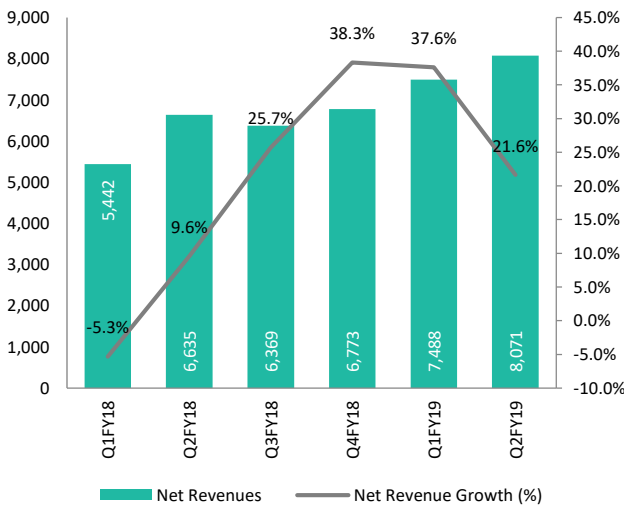
High Double Digit Volume Growth



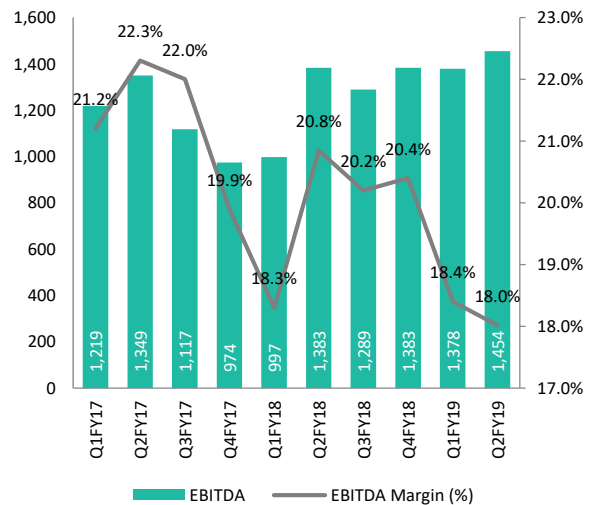
Realization Performance



Superior YoY Revenue Growth



Healthy EBITDA Margin



Source: Company, NSPL Research

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Profit & Loss (INR Crores)	FY17	FY18	FY19E	FY20E	FY21E
Net Revenues	21,767	25,165	29,329	34,890	40,715
COGS	14,624	17,410	20,842	25,066	29,338
Employee Expenses	997	1,069	1,212	1,400	1,588
Other Expenses	1,745	1,926	1,948	1,969	1,989
EBITDA	4,422	4,783	5,327	6,454	7,801
D&A	307	315	286	304	322
Other income	1,222	1,347	1,521	1,762	2,015
EBIT	5,337	5,816	6,561	7,912	9,494
Interest Expense	1	1	1	1	1
PBT	5,336	5,783	6,560	7,911	9,492
Tax	1,508	1,714	2,034	2,452	2,943
PAT	3,828	4,068	4,526	5,459	6,550
EPS in INR	132	141	156	189	226

Balance Sheet (INR Crores)	FY17	FY18	FY19E	FY20E	FY21E
ASSETS					
Non-Current Assets					
(a) Property, plant and equipment	1,899	1,821	1,985	2,141	2,288
(b) Capital work-in-progress	11	11	11	12	13
(c) Investment property	59	57	57	57	57
(d) Intangible assets	45	0	0	0	0
(e) Intangible assets under development	32	45	0	0	0
(f) Investment in subsidiaries	1,223	1,223	1,223	1,223	1,223
(g) Financial assets	7,488	10,631	12,390	14,739	17,200
(h) Income tax assets (net)	400	439	498	600	720
(i) Other non-current assets	268	357	416	495	577
Total Non-Current Assets	11,424	14,584	16,580	19,267	22,078
Current Assets					
(a) Inventories	728	743	889	1,069	1,251
(b) <u>Financial assets</u>					
(i) Investments	6,050	5,765	6,719	7,993	9,328
(ii) Trade receivables	953	1,492	1,768	2,007	2,231
(iii) Cash and cash equivalents	280	761	739	614	1,197
(iv) Other bank balances	14	17	17	17	17
(v) Loans	6	6	7	9	10
(c) Other financial assets	263	79	92	110	128
(d) Other current assets	1,096	372	434	516	602
Total Current Assets	9,391	9,236	10,665	12,335	14,765
Total Assets	20,815	23,819	27,245	31,602	36,843
EQUITY AND LIABILITIES					
Equity					
(a) Equity Share capital	289	289	289	289	289
(b) Other equity	16,745	18,814	21,244	24,328	28,225
Total Equity	17,034	19,104	21,533	24,617	28,514
LIABILITIES					
Non-current liabilities					
(a) Financial liabilities	120	121	141	167	195
(b) Provisions	78	112	131	156	182
(c) Deferred tax liabilities (net)	314	323	377	449	523
(d) Government grant	49	47	54	65	75
(e) Other non-current liabilities	7	1	2	2	2
Total Non - Current Liabilities	568	604	705	838	978
Current liabilities					
(a) Financial liabilities					
(i) Trade payables	2,236	3,244	3,997	4,945	5,948
(ii) Other financial liabilities	280	329	384	457	533
(b) Other current liabilities	558	394	459	546	637
(c) Provisions	121	126	146	174	203
(d) Government grant	3	3	3	4	4
(e) Current tax liabilities (net)	16	16	18	22	25
Total Current Liabilities	3,213	4,111	5,008	6,147	7,351
Total Equity and Liabilities	20,815	23,819	27,245	31,602	36,843

Source: Company, NSPL Research

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Cash Flow (INR Crores)	FY17	FY18	FY19E	FY20E	FY21E
Profit Before Tax	5,336	5,783	6,560	7,911	9,492
Operating Profit before Working Capital Changes	4,616	4,924	6,673	8,035	9,627
Cash Generated from Operations	4,842	5,946	7,049	8,599	10,250
Less: income tax paid	-1,503	-1,685	-2,034	-2,452	-2,943
Cash Flow from Operating	3,339	4,261	5,015	6,147	7,307
(Incr)/ Decr in Gross PP&E	-199	-183	-405	-460	-470
Cash Flow from Investing	-3,688	-1,918	-2,940	-3,897	-4,071
Dividends Paid (including tax on dividend)	-202	-1,885	-2,097	-2,375	-2,653
Finance costs	-1	0	0	0	0
Cash Flow from Financing	-190	-1,885	-2,098	-2,375	-2,653
Incr/(Decr) in Balance Sheet Cash	-539	458	-22	-125	583
Cash at the Start of the Year	818	280	761	739	614
Cash at the End of the Year	280	761	739	614	1,197

RATIOS	FY17	FY18	FY19E	FY20E	FY21E
Growth (%)					
Net Revenues	-3.5%	15.6%	16.6%	19.0%	16.7%
EBITDA	-7.5%	8.2%	11.4%	21.2%	20.9%
PAT	-2.6%	6.3%	11.3%	20.6%	20.0%
Profitability					
Return on Capital (%)	31.3%	30.4%	30.5%	32.1%	33.3%
Return on Equity (%)	22.5%	21.3%	21.0%	22.2%	23.0%
Margin Trend					
EBITDA Margin (%)	20.3%	19.0%	18.2%	18.5%	19.2%
Net profit Margin (%)	17.9%	16.5%	15.7%	15.9%	16.4%
Solvency					
Total Debt / Equity	0.0	0.0	0.0	0.0	0.0
Net Debt / Equity	0.0	0.0	0.0	0.0	0.0
Valuation Ratios					
P/E	19.7	20.9	15.8	13.1	10.9
EV/EBITDA	17.0	17.6	13.3	11.0	9.0

Source: Company, NSPL Research



Hero MotoCorp				Rating Legend	
Date	CMP (INR)	Target Price (INR)	Recommendation	Strong Buy	More than 15%
October 25, 2018	2,475	2,978	Strong Buy	Buy	5% - 15%
				Hold	0 - 5%
				Reduce	-5% - 0
				Sell	Less than -5%

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Other disclosures	NO

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