

Bajaj Auto (BJAUT IN)

Target Price **Rs2,952**
 Current Price **Rs2,721**
 % Upside **9%**

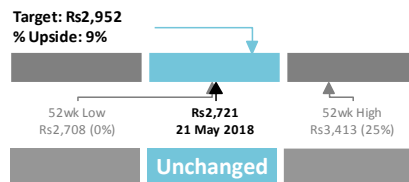
The Scoop: EBITDA Margin Likely to Dip Below 20% in FY3/19

Automobiles & Components

India

22 May 2018

NEUTRAL



Basic Share Information

Market cap	Rs787.2b / US\$11.56b
Daily traded value (3mth)	US\$14.45m
Shares outstanding	289.4m
Free float	50.7%
Net debt-to-equity	-4.1%
1 yr high	Rs3,413
1 yr low	Rs2,708
Foreign Shareholding	17.2%

Price/Volume



Source: Bloomberg

	1mth	3mth	12mth
Absolute	-4.6%	-9.7%	-8.5%
Absolute USD	-7.5%	-14.1%	-13.2%
Relative to SENSEX	-5.2%	-12%	-22.1%



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What event has happened?

Bajaj Auto's (BAL) Q4 FY3/18 earnings were ahead of our estimates due to slight EBITDA margin outperformance and higher other income than we expected.

Why is it significant?

In Q4 FY3/18 BAL reported an EBITDA margin of 20.8%, ahead of our estimate of 20.1% due to operating leverage benefits. Other income, at Rs2.4bn, was ahead of our estimate due to a reduction in yields in Q4, which management says is unlikely to recur in FY3/19. While management remained bullish on the trading outlook, it refrained from giving any volume guidance for FY3/19 despite the fact that rising crude prices augur well for Africa, one of BAL's major export markets. Management has indicated target export volumes of 0.5mn units per quarter in FY3/19. In domestic motorcycles, BAL aims to outperform industry growth in FY3/19 on the back of the recent launches of *Discover* variants and the new *Pulsar*, as well as price action on the *CT-100* and *Pulsar*. For domestic three-wheelers, management said it is aiming for growth in FY3/19, despite the high base in FY3/18. However, rising input costs continue to be a cause for concern. Also, customer acquisition costs are likely to remain elevated given heightened competitive pressure. This, coupled with a deteriorating product mix (a higher share of relatively low-margin domestic business), is likely to suppress margins in the coming fiscal year, in our view.

Implications for our earnings forecast?

On account of rising input cost pressure, we have lowered our FY3/19 earnings estimate by 3% and our FY3/20 estimate by 2%.

How do valuations look now?

BAL is currently trading at an FY3/20 PER of 15.0x on our estimate, and appears to be fully valued given our estimate of a modest 13.6% EPS CAGR over FY3/19–20. We lower our target price from Rs3,008 to Rs2,952 on the back of our lower earnings estimates. We value the standalone (core) business (excluding cash and investments) at 15x our FY3/20 EPS estimate of Rs139, in line with BAL's long-term average PER over the last eight years. To this, we add Rs871 per share of cash and investments (as at 31 March 2018) to arrive at our target price. Upside risk to our rating, earnings, and the attainment of our target price is a sustainable recovery in domestic motorcycle demand in FY3/19, and downside risk is a higher-than-expected rise in input costs.

What is distinctive about our stock view?

Rising cost headwinds are likely to keep earnings suppressed, which, in our view, should lead to range-bound movement of the stock.

	Mar-16A	Mar-17A	Mar-18A	Mar-19E	Mar-20E	Trend
Total turnover (Rsm)	227,591	220,255	255,265	293,232	330,220	■
Operating profit (Rsm)	46,473	43,738	48,302	54,004	62,644	■
Pre-tax profit (Rsm)	55,473	53,356	57,826	65,031	74,995	■
Net income to ord equity (Rsm)	39,297	38,276	40,681	45,879	52,496	■
Net profit growth	39.7%	(2.6%)	6.3%	12.8%	14.4%	■
P/E (x)	20.03	20.57	19.35	17.16	15.00	■
Adj P/E (x)	20.03	20.57	19.20	17.16	15.00	■
Adj EV/EBITDA (x)	3.44	2.21	1.06	0.62	0.48	■
P/B (x)	5.93	4.62	4.12	3.63	3.18	■
ROE	32.8%	25.3%	22.5%	22.5%	22.6%	■
Dividend yield	2.4%	2.3%	2.5%	3.0%	3.2%	■
EPS HTI old (Rs)	135.8	132.3	141.3	163.7	185.4	■
EPS HTI New (Rs)	135.8	132.3	140.6	158.5	181.4	■
Adj EPS (Rs)	135.8	132.3	141.7	158.5	181.4	■
Consensus EPS (Rs)	130.6	139.7	145.7	168.2	186.8	■
HTI EPS vs Consensus	4.0%	(5.3%)	(3.5%)	(5.7%)	(2.9%)	■

Source: Company data, Bloomberg, HTI estimates

Click [here](#) to download the working model

Volume in Q4 grew 33% YoY over a low base last year

EBIDTA margin, at 20.8%, exceeded our estimate of 20.1% due to operating leverage benefits

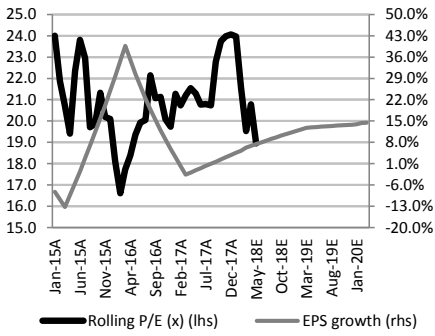
Other income was buoyed by a Rs700mn marked-to-market gain in Q4, unlikely to recur in Q1 FY3/19, according to management

Quarterly Performance

Y/E MARCH	FY17				FY18	
Rs Mn	3Q	4Q	1Q	2Q	3Q	4Q
Total Volumes (nos)	851,645	787,627	888,434	1,071,510	1,001,469	1,045,378
yoy change (%)	-10.5	-9.7	-10.7	3.8	17.6	32.7
ASP (Rs)	58,423	61,006	59,976	60,427	62,371	63,621
yoy change (%)	2.1	1.3	5.7	4.8	6.8	4.3
Net Sales	49,756	48,050	53,285	64,748	62,462	66,508
yoy change (%)	-8.6	-8.6	-5.6	8.8	25.5	38.4
Other Operating Income	1,784	1,693	1,819	1,897	2,167	2,383
yoy change (%)	8.1	-20.9	17.3	9.6	21.4	40.7
Total Income	51,540	49,743	55,104	66,645	64,629	68,891
yoy change (%)	-8.1	-9.0	-5.0	8.9	25.4	38.5
Raw Materials	33,841	33,203	38,093	45,492	43,547	46,969
RM/Sales (%)	65.7	66.7	69.1	68.3	67.4	68.2
Staff Cost	2,427	2,273	2,725	2,644	2,652	2,670
Staff cost/Sales (%)	4.7	4.6	4.9	4.0	4.1	3.9
Other Expenditure	4,107	3,783	4,222	4,679	5,180	4,942
Oth. Exp./Sales (%)	8.0	7.6	7.7	7.0	8.0	7.2
EBITDA	11,165	10,485	10,064	13,830	13,250	14,310
EBITDA Margin (%)	21.7	21.1	18.3	20.8	20.5	20.8
yoy change (%)	-9.6	-16.8	-16.8	2.7	18.7	36.5
Other Income	2,322.0	2,166.0	3,892.8	2,118.4	1,333.2	2,508.6
Extraordinary Expenses	0.0	655.0	320.0	0.0	0.0	0.0
Interest	2.6	2.4	2.4	4.7	3.0	3.0
Depreciation	772	757	753	770	747	879
PBT	12,858	11,236	12,881	15,174	13,833	15,937
Tax	3,612	3,218	3,642	4,055	4,309	5,138
Effective Tax Rate (%)	28.1	28.6	28.3	26.7	31.1	32.2
Adj. PAT	9,145	8,477	9,463	11,119	9,524	10,798
PAT Margin (%)	17.7	17.0	17.2	16.7	14.7	15.7
yoy change (%)	-5.8	-10.7	-2.0	0.1	4.2	27.4

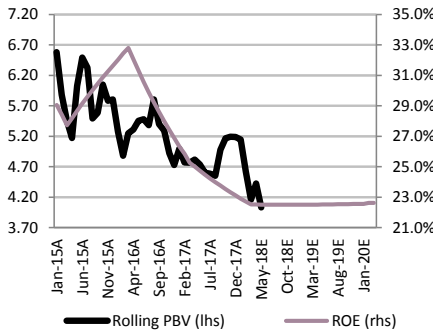
Source: Company data

P/E (x) vs EPS Growth (%)



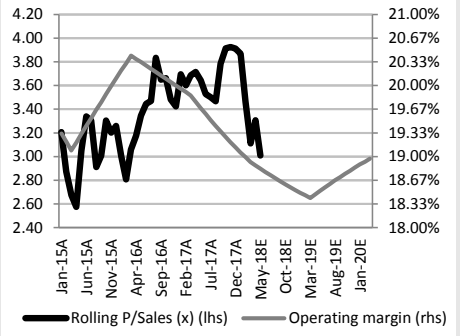
Source: Company data, Bloomberg, HTI estimates

P/B (x) vs ROE



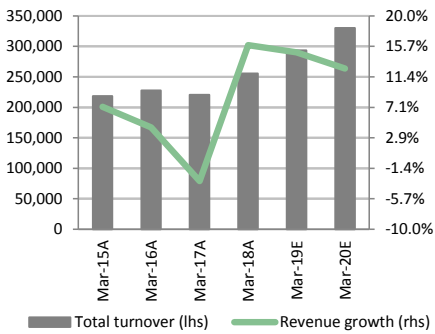
Source: Company data, Bloomberg, HTI estimates

PSR (x) vs OPM (%)



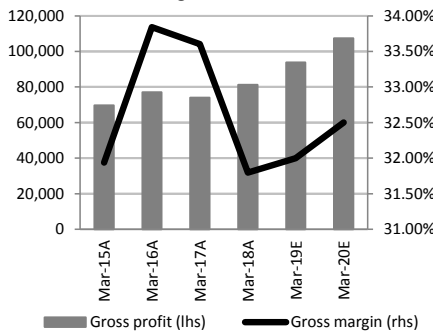
Source: Company data, Bloomberg, HTI estimates

Turnover and Growth



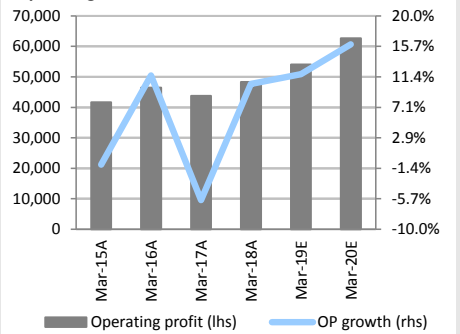
Source: Company data, Bloomberg, HTI estimates

Gross Profit and Margin



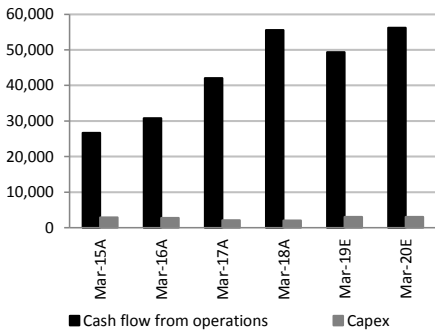
Source: Company data, Bloomberg, HTI estimates

Operating Profit and OP Growth



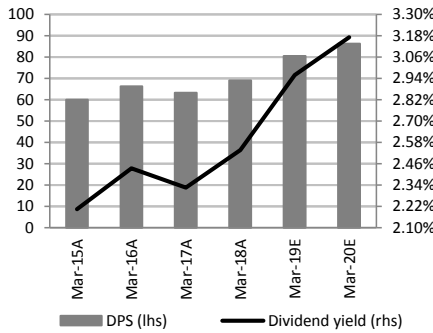
Source: Company data, Bloomberg, HTI estimates

CF from operations vs Capex (Rsm)



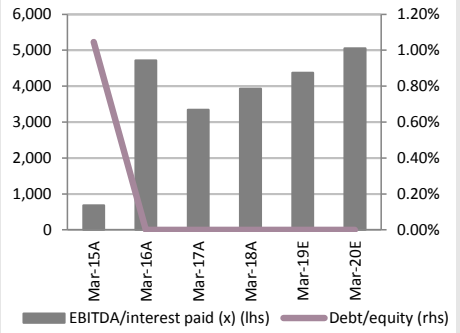
Source: Company data, Bloomberg, HTI estimates

Dividend Payout and Yield (Rs)



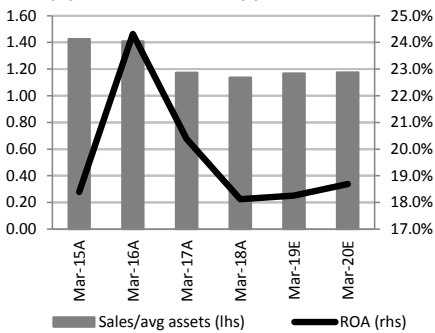
Source: Company data, Bloomberg, HTI estimates

Debt to Equity (%) and Interest Cover (x)



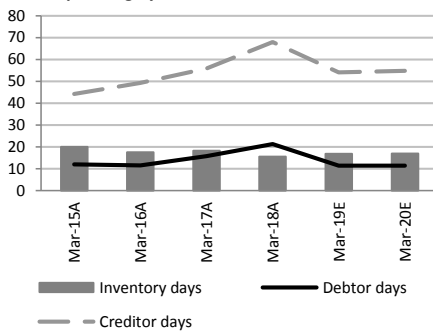
Source: Company data, Bloomberg, HTI estimates

ROA (%) and Asset Turnover (x)



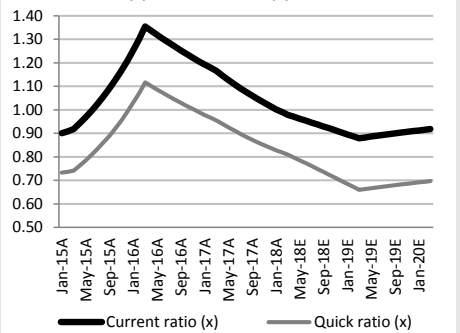
Source: Company data, Bloomberg, HTI estimates

Cash Operating Cycle



Source: Company data, Bloomberg, HTI estimates

Current Ratio (x) vs Quick Ratio (x)



Source: Company data, Bloomberg, HTI estimates

APPENDIX

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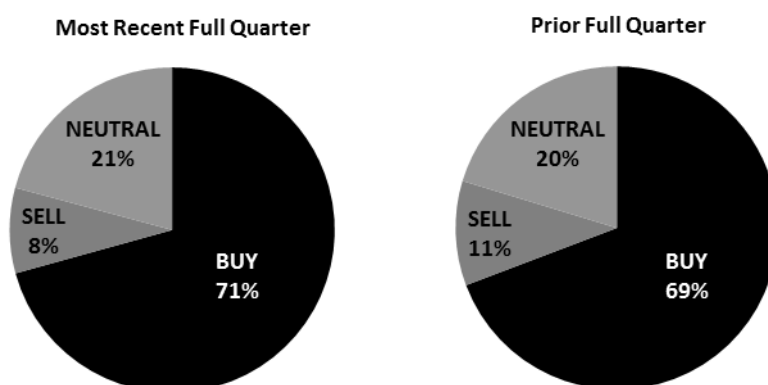
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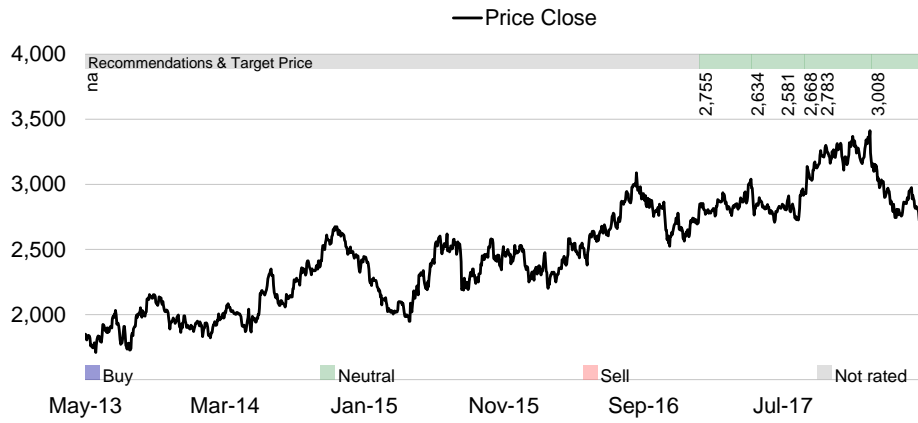
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Recommendation Chart



Date	Recommendation	Target (Rs)	Price (Rs)
2018-02-06	Neutral	3,008	3,135
2017-10-18	Neutral	2,783	3,227
2017-09-12	Neutral	2,668	2,936
2017-07-24	Neutral	2,581	2,827
2017-05-19	Neutral	2,634	2,973
2017-01-25	Neutral	2,755	2,850

Source: Company data Bloomberg, HTI estimates

Definitions for Key Investment Metrics

Business Growth

This is the metric which matches the top line in our report.

Business profit

This is the metric which best represents operating profit in our report

Shareholder Returns

Return on Equity

Balance Sheet Risk

Net Debt to Equity