

New price strategy clouds margins; Maintain Buy

We maintain our Buy rating on Bajaj Auto with a downward revised TP of Rs3,188 as the company's management has clearly highlighted that they are focusing on market share and their new price strategy, to offer few products at lower prices, will be continued till they achieve >20% market share. We expect pressure on margins will be continued on account of discount pricing strategy, higher RM costs and regulatory costs in coming years. Despite this, Bajaj Auto is expected to deliver near double digit earning growth over next two years aided by continued recovery in the export business and good volume growth in domestic bike business, well supported by new pricing strategy. Q1FY19 performance was below our estimates as good volume growth has not translated to good PAT growth as the company failed to meet our margin expectations.

- **Strong sales performance led by volume growth:** The company's revenue rose 36.3% YoY to Rs74,193mn in Q1FY19, driven by strong overall volume growth of 38.1%. Domestic sales stood at 688,665 units, a growth of 43.8% yoy whereas exports sales reported a growth of 31.4% to 537,976 units. The average realization contracted by 1.2% yoy due to adverse product mix as strong sales came from entry level bikes.
- **Margin disappoints with no signal of recovery in near term:** Bajaj's standalone EBITDA margin stood at 17.3% in Q1FY19 vs 17.2% in Q1FY18 (19.4% in Q4FY18), below our estimates. The marginal yoy expansion in margin was mainly due to lower employee cost as a % of sales which was 4.2% in Q1FY19 vs 5.0% in Q1FY18 and decrease in other expenses as a % of sales which was 7.1% in Q1FY19 vs 7.8% in Q1FY18. These positives were totally offset by increase in RM cost as a % of sales which was 71.4% in Q1FY19 vs 70% in Q1FY18. Sequentially, the RM cost increased by 208bps, which led to margin contraction in Q1FY19. The company has started offering big discounts in CT100 and launched new Pulsar Classic 150 at very attractive price, which hurt the overall margin performance. As the management aspires to gain >20% market share as soon as possible, the company is going to maintain its new pricing strategy in coming quarters.
- **Growth outlook okay:** Bajaj Auto has done well in Q1FY19, as far as sales volumes are concerned at both domestic and export fronts. Growth at export front was well supported by recovery in African countries and success in new export markets. On domestic fronts, new discount pricing strategy will help propel the growth momentum. Also, the growth momentum is continuing in its 3W segment. We expect the company will report double digit CAGR growth in volumes over next two years.
- **Valuation and Risk:** Considering the clarity given by management on new discount pricing strategy to gain market share, we have cut our FY19E/FY20E earnings estimates by 7.9%/5.4%. We value Bajaj Auto on our differentiated AOCF/EV methodology and arrive at a TP of Rs3,188 (18.4x FY20E core EPS, plus Rs117 for KTM investments), which implies 19.1x FY20E EPS. At CMP of Rs2,684, we see an upside of 18.8% and hence maintain our Buy rating. Key downside risk: Intensifying price war in 2W sector.

Y/E Mar (Rs mn)	Q1FY19	Q1FY18	YoY(%)	Q4FY18	QoQ(%)	Q1FY19E	Var.(%)
Total Income	74,193	54,424	36.3	67,733	9.5	77,282	(4.0)
Op. cost	61,379	45,040	36.3	54,581	12.5	62,275	(1.4)
EBITDA	12,814	9,384	36.6	13,152	(2.6)	15,007	(14.6)
EBITDA margin (%)	17.3	17.2	3bps	19.4	(215)bps	19.4	(215)bps
Depreciation	700	753	(7.0)	879	(20.4)	879	(20.4)
Interest	3	2	29.2	3	3.3	3	3.3
Other Income	4,044	4,573	(11.6)	3,667	10.3	3,890	4.0
Exceptional item	-	(320.0)	-	-	-	-	-
Taxes paid	5,003	3,642	37.4	5,138	(2.6)	5,808	(13.9)
Reported PAT	11,152	9,239	20.7	10,799	3.3	12,206	(8.6)
Adjusted PAT	11,152	9,469	17.8	10,799	3.3	12,206	(8.6)
Adj PAT margin (%)	15.0	17.4	(237)bps	15.9	(91)bps	15.8	(76)bps

Source: Company, Centrum Research Estimates

Y/E Mar (Rsmn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adj. PAT	YoY (%)	Adj. EPS (Rs)	RoE (%)	RoCE (%)	PE (x)	EV/EBITDA (x)
FY16	2,25,865	4.5	47,819	21.2	39,297	28.9	135.8	30.1	29.0	17.3	12.2
FY17	2,17,667	(3.6)	44,224	20.3	38,276	(2.6)	132.3	25.3	24.5	20.6	14.7
FY18	2,51,649	15.6	47,834	19.0	40,906	6.9	141.4	22.6	21.9	21.3	14.6
FY19E	2,79,704	11.1	48,889	17.5	42,745	4.5	147.7	21.2	20.5	18.2	12.0
FY20E	3,10,007	10.8	55,949	18.0	48,403	13.2	167.3	21.4	20.8	16.0	10.0

Source: Company, Centrum Research Estimates

In the interest of timeliness, this document is not edited

Centrum Equity Research is available on Bloomberg, Thomson Reuters and FactSet

Target Price	Rs3,188	Key Data			
CMP*	Rs2,684	Bloomberg Code	BJAUT IN		
Upside	18.8%	Curr Shares O/S (mn)	289.4		
Previous Target	Rs3,413	Diluted Shares O/S(mn)	289.4		
Previous Rating	Buy	Mkt Cap (Rsbn/USDbn)	776.7/111.3		
Price Performance (%)*		52 Wk H / L (Rs)	3472.6/2655		
	1M	6M	1Yr		
			5 Year H / L (Rs)	3473/1680	
BJAUT IN	(5.2)	(18.6)	(4.7)	Daily Vol. (3M NSE Avg.)	614606
NIFTY	2.4	0.0	11.8		

*as on 23 July 2018; Source: Bloomberg, Centrum Research

Shareholding pattern (%)*

	Jun-18	Mar-18	Dec-17	Jun-17
Promoter	49.3	49.3	49.3	49.3
FIs	16.7	17.2	17.2	17.0
Dom. Inst.	7.9	8.5	8.8	9.1
Public & Others	26.1	25.0	24.7	24.7

Source: BSE, *as on 23 July 2018

Earning Revisions summary

Particulars (Rs mn)	FY19E			FY20E		
	New	Old	Chg (%)	New	Old	Chg (%)
Sales	2,79,704	2,80,729	(0.4)	3,10,007	3,09,656	0.1
EBITDA	48,889	53,602	(8.8)	55,949	59,587	(6.1)
EBITDA Margin (%)	17.5	19.1	(162)bps	18.0	19.2	(120)bps
PAT	42,745	46,414	(7.9)	48,403	51,145	(5.4)

Source: Centrum Research Estimates

Centrum vs. Bloomberg Consensus*

Particulars (Rs mn)	FY19E			FY20E		
	Centrum	BBG	Var (%)	Centrum	BBG	Var (%)
Sales	2,79,704	2,86,724	(2.4)	3,10,007	3,20,163	(3.2)
EBITDA	48,889	54,890	(10.9)	55,949	61,813	(9.5)
PAT	42,745	46,443	(8.0)	48,403	52,207	(7.3)

Bloomberg Consensus*				Centrum Target Price (Rs)	Variance (%)
BUY	SELL	HOLD	Target Price (Rs)		
32	7	15	3,186	3,188	0.1

*as on 23 July 2018; Source: Bloomberg, Centrum Research Estimates

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Q1FY19 Conference Call Highlights

FY19 Volume Growth Guidance

- **Exports:** Total exports target is 1.9mn units. In Q1FY19, exports were 537,976 units and the company expects to report similar numbers in Q2FY19 as well.
- **3W:** In Q1FY19 Bajaj sold, 94,431 3Ws in the domestic market and the company is confident of achieving annual domestic sales of 335,000-400,000 units in FY19.
- **2W:** In the domestic market, Bajaj is averaging sales of close to 200,000 units a month and is confident of achieving its sales target of 2.4mn motorcycles in FY19.
- **Total sales:** The total domestic and exports of the company stood at ~4mn in FY18, and the company is confident of achieving sales of ~4.8mn units in FY19.

Several Cost Pressures

- Like Q1FY19, in Q2FY19 as well Bajaj may witness some RM cost pressure as the suppliers don't have enough capacity to cater to the growing demand of the 2W industry and hence, vendors are asking for higher prices. For example, manufacturers of alloy wheel rim and fasteners are charging the OEMs higher, as they don't have enough capacity, due to which RM cost may remain high.
- Additionally, due to aluminium short supply in the country, the alloy wheel rims costs also have gone up.
- Another cost pressure in from the freight cost, which have gone up due to higher diesel prices.
- The company has been passing on the RM cost pressure (without any margin top-up) to its customers as it had taken several price hikes recently. At the export front price hike was not taken as the currency tailwinds has taken care of the RM cost pressure. Additionally, in the entry level segment (*CT & Platina*), where the company intends to gain market share, they have not taken price hike.

Price cuts in the entry segment (M1)

- Bajaj has taken price cuts in its entry segment motorcycles which generates ~50% of the total domestic volumes and accounts for just ~14% of the company's turnover.
- The intention of price cut is to gain market share in this segment where it currently stands at 33.7% and the target is to achieve 45%-50% share in the next 2-3 years. This effort will gain support when the festive season sets in and the demand picks up. Additionally, the demand is expected to come from the rural areas which will benefit from the MSP hike.
- Bajaj intends to maintain its new pricing strategy for the next 2 years, which will be margin dilutive for the company, as the M1 segment is loss making for the company at EBITDA level.
- Additionally, Bajaj recently launched *Pulsar Classic* 150cc at a very competitive price of Rs67,000 ex-showroom, to compete with *CB Shine* and *Glamour*. The intention was to bridge the price gap between the 125cc bikes (*CB Shine* and *Glamour*) and *Pulsar Classic*.

Margin Pressure

- Bajaj expects its domestic motorcycle segment to grow faster than exports and 3W sales. Within the motorcycle, the M1 segment is expected to grow faster, which will have a negative impact on the margin. So despite growth, Q2FY19 margins may remain at a level similar to Q1FY19.
- At the export front, major growth has come from Nigeria where *Boxers* are sold which led to the unfavourable change in product mix and hence, the margins got affected from export business.

Capex

- Capex for FY19 is expected to be ~Rs3.0bn. FY20 onwards the company intends to do a capex of ~Rs5.0bn to increase capacity.

Tax Rate

- Tax rate for FY19, will be around 31%, similar to Q1FY19 level.

Valuation and recommendations

AOCF/EV valuation – 5% discount ascribed to historical AOCF/EV yield

Valuing Bajaj on our differentiated AOCF/EV methodology, we have arrived at a target price of Rs3,188/share. The company's standalone five-year average AOCF/EV yield stands at 5.0%, we have given a small discount of 5% to it and arrived at an implied EV/AOCF multiple of 19x. We have used average AOCF over FY16-20E and 19x EV/AOCF multiple to arrive at our target EV and Rs3,070/share from standalone business. We have valued FY20E PAT of Bajaj Auto International Holding BV (KTM investments) at 15x PE and arrived at a contribution of Rs117/share to Bajaj's TP. Thus, our final target price is Rs3,188. We maintain our 'BUY' rating on the stock.

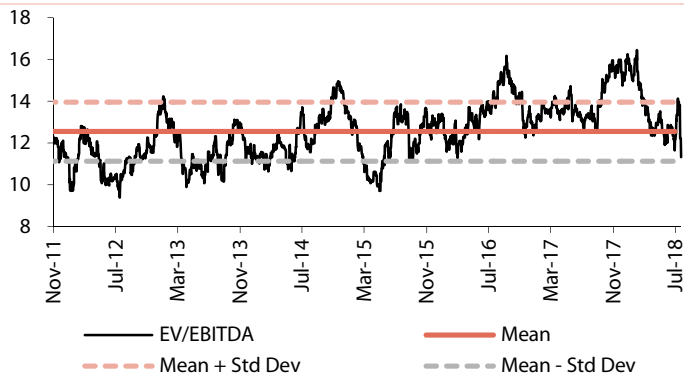
Exhibit 1: AOCF/EV based valuation

Average 5-yr adj. cash flow yield (FY14-18, %)	5.0
Discount	5%
Average 5-yr adj. cash flow yield (FY14-18, %) after premium	5.3
Implied EV/5 year AOCF Multiple (x)	19.0
Average Operating cash flow after interest (FY16-20E, Rs mn)	34,766
Target Enterprise Value (Rs mn)	6,60,999
Net Debt (FY20, Rs mn)	(2,27,500)
Target Market Cap (Rs mn)	8,88,499
No of shares	289
Contribution from KTM investments (Rs per share)	117
Target Price (Rs/share)	3,188

Source: Company, Centrum Research Estimates

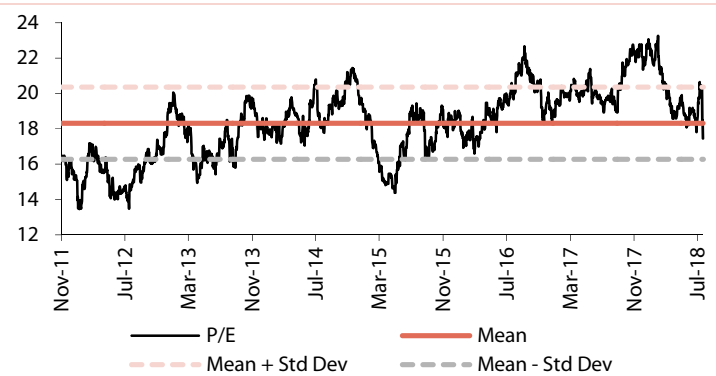
We believe that the discount assigned to the multiple is justified on account of lower margin profile in the near term.

Exhibit 2: 1 year forward EV/EBITDA chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 3: 1 year forward P/E chart



Source: Bloomberg, Company, Centrum Research Estimates

Quarterly financials, Operating Metrics and Key Performance Indicators

Exhibit 4: Quarterly Financials

Y/E March (Rs mn)	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19
Net Sales	60,545	50,669	48,973	54,424	65,799	63,693	67,733	74,193
Raw Materials	(40,571)	(33,841)	(33,203)	(38,093)	(45,492)	(43,547)	(46,969)	(52,993)
Employee Costs	(2,587)	(2,427)	(2,273)	(2,725)	(2,644)	(2,652)	(2,670)	(3,140)
Other Expenditure	(4,426)	(3,962)	(4,438)	(4,222)	(4,679)	(5,180)	(4,942)	(5,246)
EBITDA	12,961	10,439	9,060	9,384	12,984	12,315	13,152	12,814
Depreciation	(770)	(772)	(757)	(753)	(770)	(747)	(879)	(700)
Interest	(7)	(3)	(2)	(2)	(5)	(3)	(3)	(3)
Other Income	3,420	3,193	2,936	4,573	2,964	2,269	3,667	4,044
Exceptional Item	-	-	-	(320)	-	-	-	-
PBT	15,605	12,858	11,236	12,881	15,174	13,833	15,937	16,156
Tax	(4,378)	(3,612)	(3,218)	(3,642)	(4,055)	(4,309)	(5,138)	(5,003)
Tax rate (%)	28.1	28.1	28.6	28.3	26.7	31.1	32.2	31.0
Reported PAT	11,228	9,246	8,018	9,239	11,119	9,524	10,799	11,152
Add extraordinary items	-	-	-	-	-	-	-	-
Adj. PAT	11,228	9,246	8,018	9,239	11,119	9,524	10,799	11,152
YoY Growth (%)								
Revenue	(0.4)	(8.7)	(8.6)	(5.3)	8.7	25.7	38.3	36.3
EBITDA	(1.6)	(10.9)	(21.4)	(20.2)	0.2	18.0	45.2	36.6
PAT	6.7	(4.7)	(15.5)	(5.6)	(1.0)	3.0	34.7	20.7
QoQ Growth (%)								
Revenue	5.3	(16.3)	(3.3)	11.1	20.9	(3.2)	6.3	9.5
EBITDA	10.2	(19.5)	(13.2)	3.6	38.4	(5.2)	6.8	(2.6)
PAT	14.8	(17.6)	(13.3)	15.2	20.3	(14.3)	13.4	3.3
Margin (%)								
EBITDA	21.4	20.6	18.5	17.2	19.7	19.3	19.4	17.3
PAT	18.5	18.2	16.4	17.0	16.9	15.0	15.9	15.0

Source: Company, Centrum Research

Exhibit 5: Key Assumptions

Key Assumptions	FY16	FY17	FY18	FY19E	FY20E
Domestic Sales Volume					
Three-wheelers (Passenger carrier)	2,53,670	2,39,985	3,46,846	3,67,657	3,89,716
Three-wheelers (Goods carrier)	1,325	13,162	22,791	24,842	26,830
Motorcycles	18,98,957	20,01,391	19,74,577	22,46,039	24,80,926
Quadracycles	-	-	-	-	-
Total Domestic Sales	21,53,952	22,54,538	23,44,214	26,38,538	28,97,471
Growth %	7.4	4.7	4.0	12.6	9.8
Exports Volume					
Three-wheelers (Passenger carrier)	2,80,000	1,90,950	2,65,752	2,97,642	3,21,454
Three-wheelers (Goods carrier)	-	286	463	519	581
Motorcycles	14,59,295	12,18,541	13,94,757	15,47,453	16,97,364
Quadracycles	334	1,556	1,605	1,766	1,942
Total Exports	17,39,629	14,11,333	16,62,577	18,47,379	20,21,341
Growth %	(3.7)	(18.9)	17.8	11.1	9.4
Total Sales Volume					
Three-wheelers (Passenger carrier)	5,33,670	4,30,935	6,12,598	6,65,299	7,11,170
Three-wheelers (Goods carrier)	1,325	13,448	23,254	25,361	27,410
Motorcycles	33,58,252	32,19,932	33,69,334	37,93,492	41,78,290
Quadracycles	334	1,556	1,605	1,766	1,942
Total Sales	38,93,581	36,65,871	40,06,791	44,85,917	49,18,812
Growth	2.2	(5.8)	9.3	12.0	9.7
Total Revenues (Rs mn)					
Realization per unit (Rs)	58,010	59,377	62,806	62,352	63,025
Growth %	2.3	2.4	5.8	(0.7)	1.1

Source: Centrum Research Estimates

Financials

Exhibit 6: Income Statement

P&L - Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Revenues	2,25,865	2,17,667	2,51,649	2,79,704	3,10,007
Materials cost	1,50,569	1,46,242	1,74,101	1,97,751	2,17,625
% of revenues	66.7	67.2	69.2	70.7	70.2
Employee cost	9,171	9,971	10,691	11,653	12,702
% of revenues	4.1	4.6	4.2	4.2	4.1
Others	18,306	17,231	19,023	21,411	23,731
% of revenues	8.1	7.9	7.6	7.7	7.7
EBITDA	47,819	44,224	47,834	48,889	55,949
EBITDA margin (%)	21.2	20.3	19.0	17.5	18.0
Depreciation & Amortisation	3,072	3,073	3,148	2,840	3,011
EBIT	44,748	41,151	44,686	46,049	52,939
Interest expenses	11	14	13	-	-
PBT from operations	44,737	41,137	44,673	46,049	52,939
Other income	10,736	12,220	13,473	15,454	17,211
Exceptional items	-	-	(320)	-	-
PBT	55,473	53,356	57,826	61,503	70,149
Taxes	16,177	15,081	17,145	18,758	21,746
Effective tax rate (%)	29.2	28.3	29.6	30.5	31.0
PAT	39,297	38,276	40,681	42,745	48,403
Extraordinary Items	-	-	-	-	-
Reported PAT	39,297	38,276	40,681	42,745	48,403
Adjusted PAT	39,297	38,276	40,906	42,745	48,403

Source: Company, Centrum Research Estimates

Exhibit 7: Key Ratios

Y/E March	FY16	FY17	FY18	FY19E	FY20E
Growth Ratio (%)					
Revenue	4.5	(3.6)	15.6	11.1	10.8
EBITDA	16.2	(7.5)	8.2	2.2	14.4
Adjusted PAT	28.9	(2.6)	6.9	4.5	13.2
Margin Ratios (%)					
EBITDA	21.2	20.3	19.0	17.5	18.0
PBT from operations	19.8	18.9	17.8	16.5	17.1
Adjusted PAT	17.4	17.6	16.3	15.3	15.6
Return Ratios (%)					
ROE	30.1	25.3	22.6	21.2	21.4
ROCE	29.0	24.5	21.9	20.5	20.8
ROIC	77.5	77.6	98.8	116.4	120.3
Turnover Ratios (days)					
Gross block turnover ratio (x)	5.2	4.8	5.4	5.9	6.1
Debtors	12	16	22	20	18
Inventory	17	18	16	18	18
Creditors	49	56	68	60	56
Cash conversion cycle	(20.1)	(21.6)	(31)	(22)	(20)
Solvency Ratio (x)					
Net debt-equity	(0.7)	(0.8)	(0.9)	(0.9)	(0.9)
Debt-equity	-	-	-	-	-
Interest coverage ratio	4,261.7	2,939.3	3,411.2	NA	NA
Gross debt/EBITDA	-	-	-	-	-
Current Ratio	1.7	2.9	2.2	2.6	3.1
Per share Ratios (Rs)					
Adjusted EPS	135.8	132.3	141.4	147.7	167.3
BVPS	458.5	588.7	660.2	735.6	830.6
CEPS	146.4	142.9	152.2	157.5	177.7
DPS	55.0	55.0	60.0	60.0	65.0
Dividend pay-out %	48.8	50.1	51.4	48.9	46.8
Valuation					
P/E (adjusted)	17.3	20.6	21.3	18.2	16.0
P/BV	5.1	4.6	4.6	3.6	3.2
EV/EBITDA	12.2	14.7	14.6	12.0	10.0
Dividend yield %	4.2	0.2	1.8	2.2	2.2
5 Yr Avg AOCF/EV yield %	5.1	4.7	4.9	5.6	6.3

Source: Company, Centrum Research Estimates

Exhibit 8: Balance Sheet

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Equity Share Capital	2,894	2,894	2,894	2,894	2,894
Reserves & Surplus	1,29,772	1,67,448	1,88,145	2,09,968	2,37,450
Shareholders' Fund	1,32,666	1,70,341	1,91,039	2,12,862	2,40,344
Total Debt	-	-	-	-	-
Deferred Tax Liabilities	2,028	3,136	3,234	3,234	3,234
Other Liabilities	2,362	2,546	2,809	2,934	3,069
Total Liabilities	1,37,055	1,76,023	1,97,082	2,19,030	2,46,647
Gross Block	45,044	46,027	46,527	48,641	52,242
Less: Acc. Depreciation	(24,183)	(26,009)	(27,744)	(29,109)	(30,572)
Net Block	20,861	20,018	18,783	19,532	21,670
Capital WIP	522	422	565	338	112
Long term Investments	89,407	86,814	1,18,229	1,21,026	1,24,126
Other Non-Current Assets	6,823	6,982	8,262	8,694	9,160
Inventories	7,191	7,284	7,426	9,752	10,732
Sundry Debtors	7,179	9,533	14,919	15,326	15,288
Cash	8,595	2,937	7,780	20,429	39,823
Loans & Advances	71	65	63	70	77
Short term Investments	13,199	60,501	57,654	60,451	63,551
Other Current Assets	11,017	13,595	4,515	5,535	6,135
Total Current Asset	47,253	93,914	92,356	1,11,563	1,35,606
Trade Payables	20,270	22,357	32,443	32,507	33,389
Other Current Liabilities	6,410	8,559	7,414	8,220	9,090
Provisions	1,130	1,209	1,256	1,396	1,547
Net Current Assets	19,443	61,788	51,243	69,440	91,579
Total Assets	1,37,055	1,76,023	1,97,082	2,19,030	2,46,647

Source: Company, Centrum Research Estimates

Exhibit 9: Cash Flow

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Op. profit before WC changes	49,010	45,885	49,008	48,889	55,949
Changes in working capital	5,753	2,533	10,451	(3,058)	23
Cash flow from operations	36,568	33,392	42,608	27,073	34,226
Adj. OCF (OCF - Interest)	36,558	33,378	42,595	27,073	34,226
Capex	(2,651)	(1,994)	(1,826)	(3,378)	(4,938)
Adj. FCF	33,906	31,384	40,769	23,694	29,288
Cash flow from investments	(188)	(36,883)	(19,180)	6,498	6,089
Cash flow from financing	(33,841)	(1,901)	(18,853)	(20,921)	(20,921)
Net change in cash	2,425	(5,377)	4,811	12,649	19,394

Source: Company, Centrum Research Estimates

Appendix A

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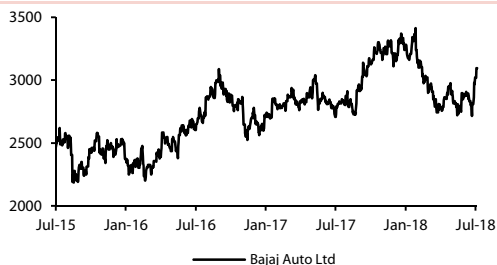
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Bajaj Auto price chart



Source: Bloomberg, Centrum Research

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		Bajaj Auto
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