

Bajaj AutoSumeet Pillai (sumeetpillai@karvy.com)**Buy****Rs508**

Bajaj Auto (BAL) has reported a 23.9% rise in net profits to Rs1.34bn in its third quarter FY03 results. While the reported net profit was in line with our estimates of Rs1.33bn (and way below the consensus estimates of Rs1.46bn), additional expense on a second VRS for the Akurdi workers (company had initiated VRS for staff in Q2 FY02) during the quarter resulted in a growth in reported PAT being much lower than operating profits growth. Total operating income grew by 14.3% to Rs11.2bn during the quarter under review.

Pricing environment- back on track

BAL effected a Rs1000 increase in prices in its key *Boxer* models - *AT* and *AR* post the festival season. The price hike has resulted in a roll back of discounts offered by the company to customers during Q2FY03. We believe this is ample evidence of alleviations of pricing pressures for BAL in the market, despite continued promotions by competition (Hero Honda). This has been reflected in the current quarter with BAL's average realizations staying flat from Q2FY03 levels. Going forward too, we believe that the pricing environment will remain stable and we expect BAL to maintain its average two-wheeler realisations at current levels. However, with ever increasing contribution from three-wheelers to the total turnover, overall realisations will move up in the medium-term.

Another quarter of strong operating profit growth

BAL's operating profits, in the quarter under review, grew by 45.9% YoY and by 11% QoQ aided by continued cost cutting efforts, improved product mix and better margin contribution from new products. As a result, OPMs expanded by over 450 basis points (bps) YoY and by 50 bps QoQ to 21.0%. As was the case during Q2FY03, cost cutting and increased three-wheeler contribution to overall turnover continued to provide most of the upside to operating margins. In addition to this, greater margin contribution from the *Boxer AR* and *Pulsar* (these have a much higher margin contribution compared to the older models) as well as exports (exports enjoy higher margins than domestic sales) drove the company's margins during the quarter.

VRS expenditure spurts

BAL announced a new VRS for its workers at the Akurdi plant, of which 1106 employees opted for the scheme. This is the second such VRS to be announced by the company this year. BAL had initiated a similar VRS for its staff (562 employees opted for it) in Q2FY03. Both these schemes have resulted in a total VRS liability of Rs460mn. BAL amortised Rs193mn in Q3FY03 in addition to the Rs76mn amortised in Q2FY03. We had mentioned there could be a possibility of this occurrence at the time of our Q2FY03 Results Review. Barring further VRS announcements (which is highly unlikely in our view), BAL will incur a further Rs193mn towards VRS amortisation during Q4FY03.

Busy launch season ahead

Among all two and three-wheeler manufacturers, BAL has the busiest launch schedule ahead. Planned launches over the next six months include:-

- The refurbished *Caliber KTECH* - stability and efficiency of the KTECH engine has already been proven with the success of the *Boxer KTECH*;
- The world bike developed with Kawasaki – code-named *612*;
- *K60*- the 125cc variant of the *Pulsar*- Bajaj's most serious attempt to counter Hero Honda's *Ambition*
- And the 1T three-wheeler goods carrier aimed at stealing market share away from Piaggio.

Raising price objective and estimates

Since our **Buy** report dated 23 September 2002, the stock has risen by 36%. We are now raising our target price to Rs600 from Rs508 on the back of the following:

- Improved visibility over new product launches and export volumes (primarily to Brazil and Indonesia). Hence, we have raised our FY03E motorcycle volume estimates from 8.60mn to

8.65mn and our FY03E three-wheeler estimates from 1.78mn to 1.93mn units. Subsequently, our FY03 and FY04 EPS is higher by 2.6% and 5.7%, respectively.

- Factoring in increased margin contribution from three-wheeler business, which has become a cash cow for BAL.
- Improved outlook on the two and three-wheeler industry, given the lesser-than-expected impact of poor monsoons on two and three-wheeler sales. We believe this demonstrates, to an extent, the reduced dependence of two-wheeler sales on the quality of monsoons.

Investors should note that we haven't factored in any major upsides from the Kawasaki venture, apart from the 612 world bike slated for launch sometime later during the year. With Kawasaki and BAL in talks to make BAL a global sourcing base for the under 250cc bikes, potential volumes could be huge, giving further upsides to our target price. We will review our estimates once we have more visibility on the Kawasaki venture front.

Valuation

Our target price of Rs600 is based on 9.5x FY04E EPS. The discounting is in line with last five years' median PER and is reasonable given the expected EPS growth of 18% in FY04E and operating profit growth of 17% in FY04E. We reiterate our **BUY** rating on the stock.

Quarterly Analysis		Rs Million		
	Q3 FY02	Q3 FY03	% chg	
Gross sales - Auto	11254	12734.6	13.2%	
Windpower captively consumed	37	36.6		
Less Excise	1443	1514		
Net Sales	9848	11257	14.3%	
Total Expenditure	8230	8897	8.1%	
Inc./Dec. in stock	-227	-235	-3301.2%	
RM consumption	6483	7276	12.2%	
Staff cost	559	588	5.4%	
Other expenditure	1485	1317	-11.3%	
Exp capitalised	70	50		
Operating Profit	1618	2360	45.9%	
Interest	5.0	2.4	-52.0%	
Gross Profit	1613	2358	46.2%	
Depreciation	445	420	-5.6%	
Other income	433	295	-31.9%	
VRS expenditure	25	193	680.6%	
Non recurring income	0	0		
PBT	1577	2040	29.4%	
Prov. For tax	495	700		
Reported PAT	1082	1340	23.9%	
Prior period items		-1		
OPM (%)	16.5	21.0	4.5	
NPM (%)	11.0	11.9	0.9	
EPS (Rs)	10.7	13.2		
Volumes				
Step thrus	18144	14644	-19%	
Mcycle Japanese	188973	229643	22%	
Mopeds	19712	19143	-3%	
Scooters	97649	62635	-36%	
Three wheelers	39375	51724	31%	
Total	363853	377789	4%	

Stock Ratings Absolute Returns

Buy : > 25%
Out Performer : 16 - 25%
Market Performer : 0 - 15%
Under Performer : < 0%

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