Stock Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Bajaj Auto Ltd

Strong business outlook comfortable valuation

Automobiles	Sharekhan code: BAJAJ-AUTO

Reco/View	Reco: **Buy**	↔	CMP: **Rs. 3,701**	Price Target: **Rs. 4,800**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Bajaj Auto Limited (BAL) reported strong operational performance during Q2FY22, led by higher average realisation and EBITDA margin expansion.
- The management remained positive on growth prospects, especially exports, where BAL expects to further strengthen its market share in key regions, driven by brand recall, product launches and value-for-money proposition.
- We expect BAL's earnings to report a 23.2% CAGR during FY2021-FY2023E, driven by a 19.8% revenue CAGR and a 50 bps improvement in EBITDA margin from 17.8% in FY2021 to 18.3% in FY2023E.
- We maintain a Buy on stock with an unchanged PT of Rs. 4,800, factoring strong business outlook and comfortable valuations. Stock trades below historical average P/E multiple of 16.4x and EV/EBITDA multiple of 11.1x its FY2023E estimates.

Bajaj Auto Limited (BAL) reported strong operational performance during Q2FY22, led by higher average realization and EBITDA margin expansion. Net operating revenue was up 22.4% y-o-y to Rs8,762 crore, led by 8.8% growth in volumes and 12.6% growth in average realization. EBITDA margin improved 80 bps q-o-q to 16% in Q2FY22, led by operating leverage benefits and cost reductions, partially mitigated by a rise in raw material costs. As a result, EBITDA and PAT improved 10.7% y-o-y and 12% y-o-y at Rs1,401 crore and Rs1,275 crore respectively. We continue to remain positive on BAL's performance going forward, led by its expected market share gains in domestic 125cc+ markets and continued dominancy in key export markets. The company is well placed in terms of capabilities to scale up its electric vehicle (EV) production when it witnesses faster adoption of EVs than expected. Also, there has been a recovery in three wheeler (3W) sales across its sub-segments, small/large passenger vehicles and cargo vehicles. We maintain buy on the stock given its strong business outlook and comfortable valuation.

Key positives

- BAL's continues to gain market share across segments, viz. two-wheelers and three-wheelers. The company's market share was at 20% in 2Ws and 68% in 3Ws in H1FY2022.
- EBITDA margin improved 80 bps q-o-q to 16% in Q2FY22, led by operating leverage benefits and cost reductions, partially mitigated by rise in raw material costs.

Key negatives

- Increasing commodity prices led to decline in gross margins by 70 bps q-o-q to 26.3%, despite ~3% price hikes taken by the company during Q2FY2022.
- Sales of premium bikes got affected by ~20% due to semi-conductor shortage.

Management Commentary

- The management was positive on the growth outlook and expects the volumes to improve in the festive season, led by recovery in rural demand.
- Export outlook positive with markets such as Philippines yet to recover and BAL expects to exceed 200,000 volumes every month at least for next 2-3 months
- EV plans well in control and the company is ready if the demand exceeds expectations. BAL to add another half a million e-scooter capacity per annum, besides the current installed capacity of 5,000/month.
- The company expects a further rise in raw material prices by ~2% q-o-q in Q3FY22.

Revision in estimates – We have maintained our estimates given positive outlook. We expect BAL's earnings to report a 23.2% CAGR during FY2021-FY2023E, driven by a 19.8% revenue CAGR and a 50 bps improvement in EBITDA margin from 17.8% in FY2021 to 18.3% in FY2023E.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 4,800: BAL's business outlook remains positive with a recovery expected in FY2022, as economic activities normalise in the domestic market. The management expects exports to remain a key growth driver in FY2022. We expect BAL to continue to increase its market share in the domestic and export markets, given its strong portfolio of premium brands and cost-effective, entry-level electronic injection systems. OPM would expand because of a richer product mix, operating leverage and cost-control measures. The company has strong long-term revenue visibility, given its leadership position in the premium bikes segment and key export destinations. The stock trades below its historical average P/E multiple of 14.5x and EV/EBITDA multiple of 9.4x its FY2023E estimates. Hence, we retain our Buy rating on the stock with an unchanged price target of Rs. 4,800.

Key Risks

BAL can lose its market share if electric vehicle penetration rises rapidly in the domestic three-wheeler market. Moreover, BAL has significant exposure to export markets. Any slowdown in export markets and unfavourable forex fluctuations can affect the company's profits.

Valuation (Standalone)

Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Net Sales	27,741	33,882	39,702	44,037
Growth (%)	-7.3	22.1	17.2	10.9
EBIDTA	4,928	5,917	7,268	8,156
OPM (%)	17.8	17.5	18.3	18.5
Recurring PAT	4,555	5,495	6,541	7,267
Growth (%)	-10.7	20.6	19.0	11.1
EPS (Rs)	157.5	190.0	226.2	251.3
PE (x)	23.5	19.5	16.4	14.7
P/BV (x)	5.2	4.5	3.9	3.5
EV/EBIDTA (x)	17.8	14.2	11.1	9.5
RoNW (%)	21.9	22.9	23.5	23.7
RoCE (%)	23.0	24.0	25.6	26.1

Source: Company; Sharekhan estimates

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score

NEW

ESG RISK RATING 16.31

Updated Oct 08, 2021

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

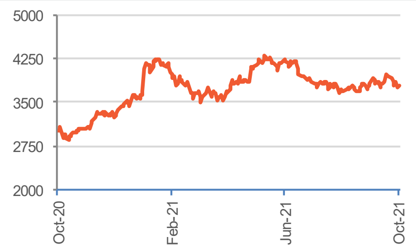
Company details

Market cap:	Rs. 1,07,086 cr
52-week high/low:	Rs. 4,361 / 2,823
NSE volume: (No of shares)	4.7 lakh
BSE code:	532977
NSE code:	BAJAJ-AUTO
Free float: (No of shares)	13.4 cr

Shareholding (%)

Promoters	53.7
FII	11.8
DII	12.7
Others	21.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.8	-1.5	4.9	25.2
Relative to Sensex	-2.6	-17.2	-23.2	-25.0

Sharekhan Research, Bloomberg

Key Highlights of Conference Call

- **Q2FY22 results were ahead of expectations:** Bajaj Auto Limited (BAL) reported strong operational performance during Q2FY22, led by higher average realisation and EBITDA margin expansion. Net operating revenue was up 22.4% y-o-y to Rs8,762 crore, led by 8.8% growth in volumes and 12.6% growth in average realisation. The volume growth was on back of robust 27.8% growth in export volumes, while the improvement in average realisation was aided by price hikes taken by the company during the year. EBITDA margin improved 80 bps q-o-q to 16% in Q2FY22, led by operating leverage benefits and cost reductions, partially mitigated by rise in raw material costs. The raw material cost per vehicle increased 5.2% q-o-q against 4.3% q-o-q increase in average realisation. As a result, EBITDA and PAT improved 10.7% y-o-y and 12% y-o-y at Rs1,401 crore and Rs1,275 crore respectively.

- **Management outlook:** The management was positive on the growth outlook and expects the volumes to improve in the festive season, led by a recovery in rural demand. Export outlook positive with markets such as Philippines are yet to recover and BAL expects to exceed 200,000 volumes every month at least for next 2-3 months. EV plans well in control and the company is ready if the demand exceeds expectations. Company expects further rise in raw material prices by ~2% q-o-q in Q3FY22. The company might look to increase vehicle prices to pass on rise in material costs to customers, depending upon the market scenario. The recovery in the 3Ws, led by the opening of schools, corporate houses and metro trains, are a key positive development for the company.

- **Well-set to boost market share in export destinations:** BAL has positioned itself strongly in export markets with a focus on Nigeria, Bangladesh, Philippines, and Colombia, which account for ~50% of its two-wheeler export revenue. In 3W exports, BAL has a strong presence in Nigeria, Egypt, Cambodia, and Iraq. Products are well-diversified and BAL has a favourable sales mix in underpenetrated markets such as Africa. BAL has improved its brand equity in these markets, which will help to improve its market share. In H1FY2022, BAL generated 85% of its revenue from markets, where it is among the top two players. Export growth is organic and will continue to be a long-term driver for BAL. The company has gained market share in all international destinations and aims to further improve its market share, driven by increased distribution reach. BAL is focusing on an increase in the proportion of high-end Pulsar bikes and other bikes in the export market to improve its product mix. Africa is largely a market for taxis and BAL has a 30-35% market share. The company expects major growth to come from Africa, as it expects to further gain market share, led by brand recall and value for money proposition. In addition, penetration levels are quite low in Africa. In Latin America, the markets are mixed, selling bikes across the segments – commuter as well as sports. In the ASEAN region, BAL has a dominant market share in Philippines. The trends in SAAME regions such as Bangladesh and Nepal have trends similar to that of India's.

- **Domestic outlook remains firm:** In FY2022, we expect demand to arise from urban markets as well, where we believe BAL will be a major beneficiary in the two-wheeler space, given its dominant position in the premium bike segment. Demand for 3W is also expected to improve and help BAL to improve its margin because of richer product mix and operating efficiencies. BAL will also benefit from new launches in the premium segment, which it has lined up in the premium segment over the next 12-18 months. Management continues to focus on new launches and expects to launch at least one model (either new or upgraded model) every quarter. BAL expects the trend of premiumisation to continue in the domestic two-wheeler industry, which would enable it to gain market share, especially in the 125cc+ segment. Three-wheeler volumes are also improving on m-o-m basis, as the economy is moving towards normalcy. Domestic 3W sales are expected to improve with the opening of schools, colleges, other educational institutions and corporates.

- **Electrification in two-wheeler/ three-wheeler segments will be gradual:** BAL has proposed to form a wholly owned subsidiary company in India to carry out business in the manufacturing of electric and hybrid vehicles in the two-wheeler, three-wheeler and light four-wheeler segments. The management expects the electrification of vehicles to be gradual in India and that the EV adoption would take 3-5 years, till it starts contributing significantly to overall industry sales. BAL is well positioned to expedite capex, if EV adoption is faster than expectations. The formation of separate company for EVs is a first step towards BAL's commitment towards e-mobility business. The booking of Chetak has now increased to 8 cities, with a target to reach 30 cities by March 2022. The company has current installed capacity of producing 5,000 e-scooters per month. The company is not able to fully utilise capacity due to component shortage currently. BAL is planning to add another half a million capacity per annum for e-scooters at its Akurdi plant. The investment plan for 3W EV is under discussion and can be announced in H2FY22.

- **Strong balance sheet to drive stability in cash flow generation:** The company is debt-free and generates strong cash flows, which are enough to expand capacity through internal accruals. The company has a strong long-term revenue visibility, given its leadership position in the premium bikes segment and key export destinations. We expect BAL's earnings to report a 23.2% CAGR during FY2021-FY2023E, driven by a 19.8% revenue CAGR and a 50 bps improvement in EBITDA margin from 17.8% in FY2021 to 18.3% in FY2023E.

Results (Standalone) Rs cr

Particulars	Q2FY22	Q2FY21	Y-o-Y %	Q1FY22	Q-o-Q %
Net Revenue	8,762	7,156	22.4	7,386	18.6
EBIDTA	1,401	1,266	10.7	1,120	25.1
Depreciation	65.6	64.3	1.99	64.1	2.4
Interest	2	3	-35.8	2	-25.8
Other Income	318	286	11.4	329	-3.3
PBT	1,652	1,485	11.3	1,383	19.5
Tax	378	347	8.9	322	17.4
Reported PAT	1,275	1,138	12.0	1,061	20.1
Adjusted PAT	1,275	1,138	12.0	1,061	20.1
EPS	44.1	39.4	12.0	36.7	20.1

Source: Company; Sharekhan Research

Key Ratios (Standalone)

Particulars	Q2FY22	Q2FY21	Y-o-Y (bps)	Q1FY22	Q-o-Q (bps)
Gross margin (%)	26.3	29.3	-300	27.0	-70
EBIDTA margin (%)	16.0	17.7	-170	15.2	80
EBIT margin (%)	15.2	16.8	-160	14.3	90
Net profit margin (%)	14.5	15.9	-140	14.4	20
Effective tax rate (%)	22.9	23.4	-50	23.3	-40

Source: Company; Sharekhan Research

Volume Analysis (Rs/vehicle)

Particulars	Q2FY22	Q2FY21	Y-o-Y %	Q1FY22	Q-o-Q %
Volumes (Units)	1,144,407	1,052,149	8.8	1,006,014	13.8
Average Realisation	76,565	68,012	12.6	73,419	4.3
RMC/Vehicle	56,418	48,074	17.4	53,621	5.2
EBITDA/vehicle	12,243	12,035	1.7	11,131	10.0
PAT/Vehicle	11,137	10,818	3.0	10,548	5.6

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook – Demand picking up in domestic as well as export markets

Two-wheeler demand improved m-o-m and continued through the festive season in October-November last year. We expect growth momentum to continue in FY2022E, driven by strong rural sentiments in domestic market. The government's reform measures coupled with increased preference for personal transport are expected to improve volumes. We expect a recovery from FY2022E, driven by normalisation of economic activity and pent-up. Export markets have witnessed a notable recovery in volume sales offtake across regional markets - ASEAN, South Asia, Middle East, and Africa. OEMs are positive on recovery and expect these markets to improve further. Most of the market have reached to pre-COVID levels.

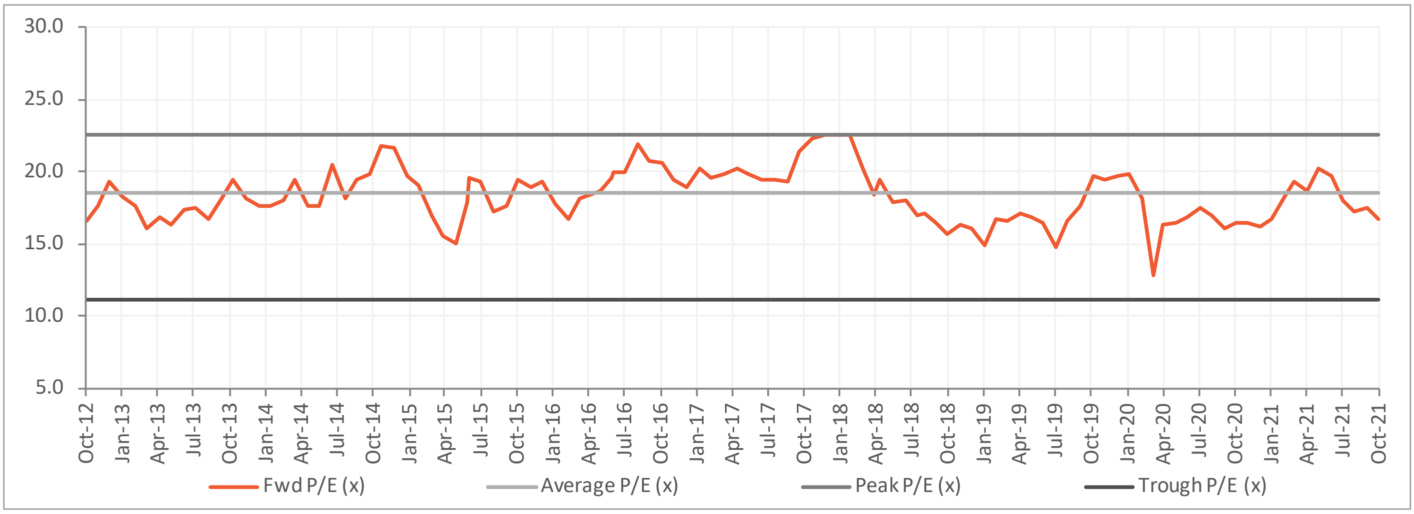
■ Company outlook – Strong earnings growth; Upgrade earnings estimates

BAL is India's second-largest motorcycle player with a market share of about 20%. The company is the market leader in the premium motorcycle segment (125-200 cc) with a market share of 41%. With new launches, BAL aims to increase its market share further and is targeting market share of ~25% over the next few years. With network expansion, BAL aims to retain its leadership position in motorcycle exports. BAL has a strong, debt-free balance sheet. It has cash & cash equivalents of Rs. 16,240 crore with strong return ratios. BAL has healthy dividend pay-out ratio of 90%. BAL is uniquely positioned to benefit from domestic two-wheeler demand and the export market, driven by its brand equity and value proposition.

■ Valuation – Maintain Buy with an unchanged PT of Rs. 4,800

BAL's business outlook remains positive with a recovery expected in FY2022, as economic activities normalise in the domestic market. The management expects exports to remain a key growth driver in FY2022. We expect BAL to continue to increase its market share in the domestic and export markets, given its strong portfolio of premium brands and cost-effective, entry-level electronic injection systems. OPM would expand because of a richer product mix, operating leverage and cost-control measures. The company has strong long-term revenue visibility, given its leadership position in the premium bikes segment and key export destinations. The stock trades below its historical average P/E multiple of 14.5x and EV/EBITDA multiple of 9.4x its FY2023E estimates. Hence, we retain our Buy rating on the stock with an unchanged price target of Rs. 4,800.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	Rs/ Share	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Bajaj Auto	3,701	23.5	19.5	16.4	17.8	14.2	11.1	23.0	24.0	25.6
Hero MotoCorp	2,669	18.3	14.0	12.6	11.3	8.5	6.9	25.3	30.7	27.2
TVS Motor	652	50.6	31.6	25.9	22.8	16.3	13.8	16.2	22.1	22.8

Source: Company, Sharekhan estimates

About company

BAL is one of the leading automobile manufacturers in India and is a leader in the premium motorcycle segment with a lion's share. The company also makes three-wheelers (3W) and is a leader in the 3W segment. Motorcycles constitute around 85% of overall volumes, while 3W contributes around 15% share.

Investment theme

BAL is the second largest motorcycle manufacturer in India with a market share of about 20%. Over the years, BAL has created a strong brand not only domestically but also in export markets. BAL is the leader in the premium motorcycle segment having a market share of 41%. Apart from premium motorcycles, BAL is also the leader in the 3W segment, commanding a market share of about 57%. Motorcycles constitute about 85% of overall volumes, while 3W contribute 15% share. BAL is well positioned in the domestic as well as in global markets to deliver sustained growth in the long term. The company is a leader in the premium segment bikes such as Pulsar, Avenger, KTM, Dominar, and Husqvarna. Exports currently constitute about 45% of overall volumes, with Africa, Southeast Asia, and Latin America among the key markets. The company generates more than 85% of its export revenue from geographies where BAL is either No. 1 or No. 2 player. Export growth is organic and will continue to be a long-term driver for BAL. We remain positive on the company's growth prospects going forward.

Key Risks

- BAL can lose its market share if EVs in the domestic 3W market rise faster than we expect.
- BAL has significant exposure to export markets. Any slowdown in export markets and unfavourable forex fluctuations can affect the company's profits adversely.

Additional Data

Key management personnel

Niraj Bajaj	Chairman
Rajiv Bajaj	Managing Director
Rakesh Sharma	Executive Director
Soumen Ray	CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Bajaj Holdings & Investment Ltd	33.4
2	Jamnalal Sons Pvt Ltd	9.1
3	Life Insurance Corp of India	7.1
4	Jaya Hind Industries Ltd	3.4
5	Maharashtra Scooters Ltd	2.3
6	Sbi Consumption Opportunities Fund	1.6
7	Bajaj Sevashram Pvt Ltd	1.5
8	Niraj Bajaj As A Trustee Of Yamuna Trust	1.3
9	Bachhraj & Co Pvt Ltd	1.3
10	Norges Bank	1.1

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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by BNP PARIBAS

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