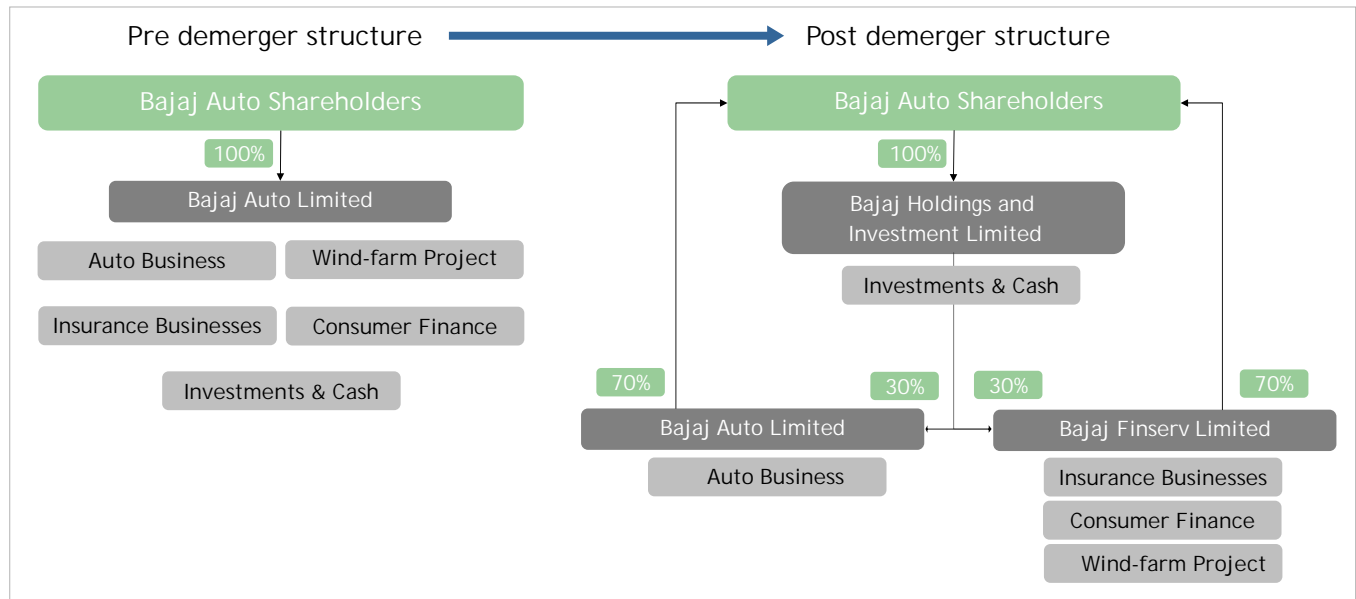


<h1 style="margin: 0;">Bajaj Auto Limited</h1>	Post de-merger listing Viewpoint
--	-------------------------------------

The de-merger process of the erstwhile Bajaj Auto finally culminated yesterday with the re-listing of new Bajaj Auto Limited (BAL) & Bajaj Finserv Limited (BFL). However, the much analyzed re-listing was a tad downcast with BAL & BFL closing at ~Rs. 592 and ~Rs. 568 respectively. Bajaj Holdings & Investments Limited (BHIL) too seem to have been moderated at ~Rs. 568 levels.



Performance Highlights

Particulars (Rs Mn)	Bajaj Auto	Hero Honda
No of Units Sold	2,451,407	3,336,756
Net Sales	90,413.10	103,318.00
Operating Profit	12,538.20	13,493.70
Operating Margins	13.87%	13.06%
Depreciation	1,746.10	1,603.20
Interest	51.60	(358.10)
PBT before Other Income	10,740.50	12,248.60
PBT Margins	11.88%	11.86%
Other Income	1,226.90	1,854.20
Exceptional Items	(794.10)	-
PBT	11,173.30	14,102.80
Tax	3,684.20	4,424.00
PAT before Minority Interest	7,489.10	9,678.80
Minority Interest	(6.50)	-
PAT after Minority Interest	7,495.60	9,678.80
PAT Margins	8.29%	9.37%
EPS	54.70	48.50

Erstwhile Bajaj, which got de-listed at ~Rs. 2100 levels, to de-merge its three businesses, namely auto, insurance & consumer finance and investments into BAL, BFL & BHIL respectively, with an identical equity distribution in each of the three companies. The exercise intended to address the dual objectives of settling the succession issue and enable better valuation (i.e. SOTP to be greater than the whole). The combined valuation of the three companies now stand at Rs. 1728, 19% lower than that at the time of its de-listing. This is despite the Sensex and the BSE Auto Index, both increasing by 1.6% during the intervening period. Close competitor Hero Honda increased by 6.5%.

What has changed in the transient time?

- The detailed separate financials of the three entities are now available.
- The fourth quarter results have been declared and is the new input made available.

Ostensibly, it seems that the muted performance in the fourth quarter has taken a toll on the company's impending valuation. Also, this time it also sets the underpinning for the subdued outlook for the FY09 fiscal as well.

However, during the same period, the key competitor Hero Honda has done well with the Q4 performance as well as the scrip price on the bourses. Hero Honda had an impressive Q4 performance aided by 460 bps increase in margins led by cost savings. Its strong positioning in the relatively higher margin executive segment coupled with decent savings on ad-spends aided the Still-No-1 player.

The contrasting near-term performance by the two two-wheeler majors has slightly widened the valuation gap between them. At the CMP of Rs. 592, Bajaj is trading at 11x FY08 consolidated EPS of Rs. 53.7, an austere discount to Hero Honda, which is trading at 16x its FY08 earnings of Rs. 48.5 per share.

We check out on what could possibly justify this large gap in valuation, which otherwise provides a fantastic arbitrage opportunity to investors.

To give a little background, Bajaj Auto has also done XCDingly well in the past 5 years on the back of its pulsurous performance to become a very close No 2 to Hero Honda, which has been more like a surviving no 1, thanks to its splendid splendour. So now with Hero Honda reporting good results after 7 ok-ok quarters, has the market again shifted loyalties, anticipating the contrasting performance to continue going ahead?

Segment Mix

Important to note here is the segment mix for the two companies.

Company	As a % of total Volumes		
	Entry	Exec.	Premium
Bajaj Auto	46	32	22
Hero Honda	24	72	4

A fundamental aspect to the segment mix is that the low-end and price-sensitive entry segment has lower margins as compared to the higher aspirational segments. So, while Bajaj has done well with its Pulsar to be the undisputed leader in the premium segment, it still has a huge 50% of its sales coming in from the entry segment. For Hero Honda, only 25% of its sales is exposed to the critically margin sensitive segment.

Now on the strategy of the two companies for the current fiscal. For Hero Honda, it is more about maintaining its business mix and some savings in ad & selling expenses. However, for Bajaj, it is a little different, as the company is striving to improvise its business mix, especially in favour of the executive segment. It is looking forward to launch as many as 4 new bikes this year in the non-entry segment to bring in the desired segment mix & margin maintenance/improvement. However, this would have to be executed with some check on the ad & selling costs. It is important for Bajaj, which is under greater pressure to bring about a segment mix change, to ensure a proper check on the overall/absolute profitability as well. In the latest Q4 quarter, we saw that the benefit on account of the improving business mix was more than offset on account of poor offtake & performance in the entry segment. This is certainly not the way the mix-change was/is desired.

Exports

However, one should not forget that Bajaj has a few more feathers in its hat, on account of its strong positioning in the exports segment. While the Indian markets are stagnating for the frontline bike makers, the export markets are

still ill-tapped and present enormous potential. Bajaj Auto has been doing superbly in the export business. The recent volumes numbers, which showed a 10% drop, were well compensated by the 40% increase in export volumes (20% in value terms). However, Hero Honda is still restrained on account its limiting pact with Honda. Also, as Hero Honda is grappling with issues like direct competition from partner, Honda, Bajaj Auto is making strides with new tie-ups, ventures and acquisitions. With a proposed entry in the passenger car segment with Nissan, and new launches of power-sports bikes, Bajaj is ardent to be firing all guns.

Expansion

Overall, for both companies, we feel that the increasing production from the Uttranchal plants will help withstand margin pressures. Both the companies compare similar in terms of operating parameters and margins. The difference lies in the game-plan of the two companies. While seemingly, Bajaj may have a lot of things to be done on many fronts (& so the execution risks), it also has some clear advantages over the competitors in terms of exports & new ventures.

Our Recommendation

We clearly believe that the stark & widening valuation gap between the two companies is unjustifiable. With the double whammy of reducing demand and increasing costs, we feel that the valuation multiples should moderate. We would like to value both the companies at 13.5x, which would give a target price of Rs. 725 for Bajaj Auto (21% upside) and Rs. 655 for Hero Honda (16% downside). Our call is that, those who intend to play on the two-wheeler segment should shift from Hero Honda to Bajaj.

Contact

Jigar Valia
Analyst - Investment Research
email : jigar@ppfas.com
tel : 91 22 2284 6555 Extn 315

Hiten Sampat
President - Institutional Sales
email : hiten@ppfas.com
tel : 91 22 2284 6555 Extn 302

DISCLAIMER

This report does not constitute or form part of, and should not be construed as, any offer of sale or a solicitation to buy any security. The information contained herein is from sources believed to be reliable, but no representation or warranty, express or implied, is made to its accuracy. PPFAS and/or its clients may have positions in the securities mentioned in the report and may offer to buy, sell such securities or any related investments.

Parag Parikh Financial Advisory Services Limited

130/132, Great Western Building, 1st Floor, S. B. Marg, Near Lion Gate, Fort, Mumbai - 400 023.

Tel : 91-22-2284 6555 Fax : 91-22-2284 6553, e-mail : research@ppfas.com

Investment Boutique: Shiv Shakti, Gr. Floor, N. S. Rd. No.10, Opp. Haveli, Juhu Scheme, Mumbai - 400 049

Tel : 91-22- 2623 6555 Fax : 91-22-2623 6553, e-mail : ib@ppfas.com