Q1FY13 Result Update

July 23, 2012

BAL recently reported its Q1FY13 results, which were below street estimates. Given below are some of the key highlights, which we came across while reviewing the results.

Scrip Code	Industry	CMP	Recommended Action	Time Horizon
BAJLTDEQNR	Automobile	Rs.1,561.2	Exit on rises to Rs.1,632 and buyback on dips to Rs. 1,431-1,460 band	1 quarter

Key highlights of Q1FY13 results:

- Net sales including other operating income came in at Rs.4,865 cr, which was a 4.6% up q-o-q and 3.4% y-o-y. Net realisations were up 5.3% y-o-y but down 1.6% q-o-q to Rs.43,686 which more than offset the 1.3% y-o-y decline in volumes to 1.078 mn. BAL has held on to its margins on a y-o-y basis despite a fall in three-wheeler exports and a slight fall in domestic sales. Demand could improve from the third quarter onwards with the onset of festivals and new launches. A sharp fall in the rupee nullified gains it could have accrued from the softening of global raw material prices like aluminum.

- Other income witnessed sharp growth on account of reversal gain of Rs.33 cr booked. However, effective tax rate on PBT rose to 29.5% as 70% of tax benefit at Pantnagar plant expired during the quarter. Higher than expected tax rate impacted depressing the bottomline, which saw a 4.4% dip q-o-q and a flattish growth y-o-y.

Quarter Financials:

(Rs. in Cr)

Particulars	Q1FY13	Q1FY12	% Chg	Q4FY12	% Chg	Remarks
Revenues	4713.6	4535.4	3.9%	4515.6	4.4%	Grew on the back of a 5% growth in net realisations which offset a 1% decline in volumes
Other operating income	152.0	170.9	-11.1%	135.9	11.9%	
Total Operating Income	4865.7	4706.3	3.4%	4651.4	4.6%	
Expenditure						
Raw Materials	3508.0	3465.9	1.2%	3312.6	5.9%	Product mix turned negative with lower proportion of three-wheelers
Employees Cost	160.4	143.1	12.1%	119.6	34.2%	Salary increments offered to the employees led to increase in staff cost
Other Expenditure	336.2	258.9	29.9%	319.0	5.4%	
Expenses capitalised	-10.7	-1.4	661.4%	-20.3	-47.6%	
Total Opex	3994.0	3866.5	3.3%	3730.8	7.1%	
EBIDTA	**871.7**	**839.8**	3.8%	**920.6**	-5.3%	
EBIDTA Margins %	*17.9%*	*17.8%*		*19.8%*		In a challenging business environment, BAL's EBIDTA margin remained stable y-o-y. However, sequentially it declined on the back of cost pressure and weaker product mix.
Other Income	182.0	144.1	26.3%	139.5	30.5%	Higher than normal on reversal of hedging related losses incurred in FY12 (Rs.33 cr reversal gain booked)
Interest Expenses	0.0	0.2	-82.6%	1.8	-97.7%	
Depreciation	35.2	30.6	15.0%	43.4	-18.8%	
Profit after interest and depreciation before exceptional items	1018.4	953.1	6.9%	1014.9	0.3%	
PBTM %	*20.9%*	*20.3%*		*21.8%*		
Valuation gain/(losses) on derivable	0.0	0.0	-	20.3	-100.0%	

hedging instruments						
Profit from ordinary activities before tax	1018.4	953.1	6.9%	1035.2	-1.6%	
Tax	300.0	242.0	24.0%	263.1	14.0%	
Effective Tax Rate %	*29.5%*	*25.4%*		*25.9%*		Higher as Pantnagar tax benefits partially expired during the quarter
Reported Net Profit	**718.4**	**711.1**	1.0%	**772.1**	-7.0%	
Normalised Net Profit	**718.4**	**711.1**	1.0%	**751.8**	-4.4%	
Reported NPM %	*14.8%*	*15.1%*		*16.6%*		
Normalised NPM%	*14.8%*	*15.1%*		*16.2%*		
Equity Capital	289.4	289.4	0.0%	289.4	0.0%	
Reported EPS	**24.8**	**24.6**	1.0%	**26.7**	-7.0%	
Normalised EPS	**24.8**	**24.6**	1.0%	**26.0**	-4.4%	

(Source: Company, HDFC Sec)

Some observations on Q1FY13 results:
Volume Break up:

Particulars	Q1FY13	Q1FY12	% Chg	Q4FY12	% Chg	Remarks
Motorcycles						
- Domestic	618,489	623,175	-0.8%	616,516	0.3%	Commuter deluxe segment (64% of domestic 2-wheeler market) witnessed a 3% growth but BAL's volumes declined by 16% y-o-y in the segment. BAL maintains 46% market share in higher margin sports segment. Volume growth witnessed slowdown.
- Exports	364,134	339,876	7.1%	280,732	29.7%	
Total 2 Wheelers	**982,623**	**963,051**	2.0%	**897,248**	9.5%	
% of total	*91.1%*	*88.1%*		*88.2%*		
Three Wheelers						
- Domestic	44,837	42,276	6.1%	53,237	-15.8%	
- Exports	51,511	87,488	-41.1%	66,682	-22.8%	Demand trend for exports remained weaker due to problems In Srilanka and Egypt
Total 3 Wheelers	**96,348**	**129,764**	-25.8%	**119,919**	-19.7%	
% of total	*8.9%*	*11.9%*		*11.8%*		
Total Volumes	**1,078,971**	**1,092,815**	-1.3%	**1,017,167**	6.1%	
Realisation (Rs/unit)	43,686	41,502	5.3%	44,393	-1.6%	Sequential realisation dip on lower proportion of three-wheelers in sales, and weaker motorcycle mix
EBIDTA/Vehicle	8,079	7,685	5.1%	9,051	-10.7%	

(Source: Company)

Other Highlights:

- Q1FY13 performance was impacted by subdued domestic demand, disruption in exports and rising input costs. Volume declined by 1% y-o-y as rising cost of ownership and slowdown in market increased bias towards lower displacement bikes, which are cheaper and more fuel-efficient. Q1FY13 exports were down at 4.16 lakh units against 4.27 lakh units in Q1FY12. Sales of commercial vehicles (CVs) in the international market were down 41%, while motorcycle volumes grew 7% at 3.6 lakh units. Political unrest affected sales in Egypt, where BAL sold 25,000 fewer units, while the duty hike in Sri Lanka resulted in lost sales of 20,000 units. On the domestic front, motorcycle sales were down 1% at 6.18 lakh units, while CV sales were higher by 6%. Industry outperformed BAL by witnessing 6% y-o-y growth in the domestic 2-wheeler segment. Its diesel passenger carrier

segment grew by 29% against an industry growth of 10% and its market share rose to 31% from 27%. Export realisation for Q1FY13 was at Re/USD 49.8 and 90-95% of remaining exports in FY13 are covered at Re/USD exchange rate of 50.

- The higher tax expense of Rs.300 cr in Q1FY13 could be attributed to the bottoming out of the tax benefits BAL had enjoyed for one of its plants in Pantnagar, Uttarakhand, with the five-year tax holiday ending in March 2012.

- Recently the company received Rs.780 mn VAT refund out of the outstanding Rs.1,100 mn. Balance refund is expected to come by October 2012.

- With the revised price structure, BAL expects to sell about 7,000 bikes and three-wheelers each every month in Sri Lanka, compared with over 10,000 each before the import duty hike. The pricing pressure is also reflected in net average realisation, which fell about 1.6% from the previous quarter, though it rose about 5% y-o-y. To improve realisations, BAL raised prices of bikes by Rs.500 and of three-wheelers by Rs.500 - Rs.1,500 in July, after a marginal increase in May. This is expected to ease the burden of rising input costs.

- However, given the already decelerating demand for 2 wheelers in the country, the frequent price hikes could further dent BAL's volumes. To avoid customer migration, it is now focusing on new product launches. It has already launched Pulsar 200 NS in the sports segment and Discover 125 ST in the deluxe segment. Another launch is likely by September this year. However, with the festive season delayed by nearly a month this year, BAL expects sales to boom only in the H2FY13.

Guidance:

- Q2FY13 may not be as good as Q2FY12 as last year in the second quarter it was the month when BAL build stock for Dussehra and Diwali which came around in October. This time Dussehra is towards the end of October and Diwali is in November. So September may not give the manufacturers the opportunity to build stock at dealerships. The 2-wheeler industry is expected to witness less offtake in Q2FY13 and the festive period of sale has shifted to Q3.

- The management expects Q1FY13 to have been the worst in terms of profitability and EBITDA margins because it expects sales to grow as production is ramped up with new products. It expects the mix to improve particularly in the domestic market as it would sell the bigger 'Discover' and the 'Pulsar' models. Also the three wheeler sales could grow in the domestic market because April-May is usually the worst time for three-wheeler sales in the domestic market. The sports segment in which Pulsar holds 50% of the share and inched to garner close to 20% of the motorcycle industry slipped to about 16-17%. So, the adversity of the mix between Pulsar and Discover and Platina has also not worked in BAL's favour.

- Management expects the domestic motorcycle industry to grow by around 7-8% in FY13. While the industry grew by 6% in Q1FY13, the company expects the growth in Q2FY13 to be around 5%. Accordingly growth in H2FY13 should be higher than H1FY13.

- On the hedging part, the company has covered almost 95% of its expected FY13 exposure and expects to realize ~Rs.50/USD. For FY14, the company has started taking cover in the range of Rs.54-64/USD.

- FY13 capex plans for BAL stands at Rs.3.5 bn. R&D spend is expected to be ~Rs.2 bn.

Concerns

- Economic/Political disturbances/tariff changes in key export markets could impact volume growth in exports of BAL.

- Higher than expected commodity prices could lead to pressure on margins, which BAL may not be able to pass on through higher product prices.

- BAL faces stiff competition from new and existing players. Various product launches by HMCL, Honda, Yamaha and TVS are expected over the medium term and this could put pressure on the domestic market share of BAL. However a lot would depend on when the capacities of competitors are ramped up.

- BAL's dependence on two wheeler financing is high at 28%. In case the liquidity situation continues to be tight and/or interest rates continue to rise, it could affect the sales growth of BAL.

- Scooters segment is growing faster than the motorcycles segment over the past few quarters. BAL does not have any presence in this segment and is unable to encash the good times in scooters segment.

Conclusion & Recommendation

BAL's Q1FY13 results were below expectations at the operating level thereby leading to lower PAT. Y-o-Y EBIDTA margins were stable but sequentially margins could not sustain on account of higher input cost, adverse product mix and higher employee cost. The company maintained margins on a y-o-y basis despite tough market conditions and the management said that it would be able to maintain margins in FY13 despite headwinds. According to industry body Society of India Automobile Makers (SIAM), two-wheelers will grow by about 11% while three-wheeler sales will rise a mere 5% in FY13.

BAL has taken a price hike in domestic market to pass on the input cost pressures. Further new launches could help the company improve product mix thereby aiding margin expansion. Revival of volumes in Sri Lanka will be positive for the margins (as compared to 1QFY13) despite the price cut taken by the company.

BAL lost sales of 25,000 units in this quarter on account of higher import duty in Sri Lanka and political unrest in Egypt. The company, along with its distributors, has undertaken proactive measures like rationalising the end user cost of vehicles in Sri Lanka (price cut of 10-15% to be borne by company and the distributor) and expects normalised volumes of ~20K to Sri Lanka, starting Q3FY13.

Over long term, the new launches could provide a kicker to domestic growth in FY13. The sector suffers from weak demand environment, which is vindicated by managements of 2-w companies as well. 3-w domestic demand could also remain under pressure as no new permits are likely to be released in the near term. The management stressed that its marketshare remained stable w.r.t the retail volumes even though in wholesale volumes it had lost market share (other players increased inventory levels with dealers)

Despite weak performance of Q1FY13, we are not revising downwards the sales and operating profit estimate for FY13. At the CMP of Rs.1,561.2, the stock is trading at 13.7x its FY13E earnings of Rs.114.3.

In our Q4FY12 result update dated January 27, 2012, we had stated the stock could trade in the range of Rs.1,343-1,686 over the next quarter. Post the issue of the report, the stock made a low of Rs.1,423.1 on July 18, 2012 and made a high of Rs.1,591 on July 4, 2012.

We think that investors could exit BAL on rises to Rs.1632 (14.25x FY13E EPS) with a view to re enter the stock on dips to Rs.1431-1460 band (12.5-12.75x FY13E EPS) over the next quarter.

Financial Estimates:

Particulars (Rs in Crs)	FY09	FY10	FY11	FY12	FY13 (E)*
Revenue	8446.0	11543.2	16398.2	19594.7	21897.1
PBIDT	755.5	2156.2	3171.2	3720.0	4357.1
PBIDTM (%)	8.9%	18.7%	19.3%	19.0%	19.9%
Profit after Tax	535.8	1594.6	3339.7	3004.1	3306.5
PATM (%)	6.3%	13.8%	20.4%	15.3%	15.1%
EPS	18.5	55.1	115.4	103.8	114.3
P/E (x)	84.3	28.3	13.5	15.0	13.7

* - Quick Estimates (**Source:** Annual Report, HDFC Sec Estimates)

Equity Capital increased to Rs.289.4 cr from FY11 onwards

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