FIRST LIGHT

23 July 2021

RESEARCH

Bajaj Auto | Target: Rs 3,200 | –17% | SELL

Input cost headwinds weaken margins

Ceat | Target: Rs 840 | –40% | SELL

Gross margin pressure and poor demand hit profitability

SUMMARY

Bajaj Auto

- BJAUT's Q1 revenue declined 14% QoQ on lower volumes (-14%) and flat ASP. High RM cost further pulled down profitability
- Management expects RM headwinds to continue in Q2 and domestic volumes to stay flat YoY on elevated dealer inventory
- We maintain our Mar'22 TP of Rs 3,200 based on 17x FY23E EPS and reiterate SELL

Click here for the full report.

Ceat

- CEAT's Q1 revenue fell below projections at Rs 19bn and gross margin declined, weakening EBITDA margin to 8.7%. Adj. PAT was at Rs 199mn
- We believe high RM cost and limited scope for material hikes in tyre prices would continue to depress profitability
- We maintain our TP of Rs 840 based on an unchanged 14x FY23E P/E multiple and reiterate SELL

Click here for the full report.

Daily macro indicators

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.29	7bps	(15bps)	69bps
India 10Y yield (%)	6.19	0bps	18bps	38bps
USD/INR	74.62	0.3	(1.0)	0.2
Brent Crude (US$/bbl)	72.23	4.2	(1.7)	63.1
Dow	34,798	0.8	4.5	28.9
Shanghai	3,563	0.7	1.1	6.9
Sensex	52,199	(0.7)	(0.3)	37.8
India FII (US$ mn)	**19-Jul**	**MTD**	**CYTD**	**FYTD**
FII-D	(13.2)	43.5	(3,123.3)	(1,096.1)
FII-E	(304.7)	(815.2)	7,269.0	(57.3)

Source: Bank of Baroda Economics Research

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SELL
TP: Rs 3,200 | ⩒ 17%

BAJAJ AUTO | Automobiles | 22 July 2021

Input cost headwinds weaken margins

- **BJAUT's Q1 revenue declined 14% QoQ on lower volumes (-14%) and flat ASP. High RM cost further pulled down profitability**
- **Management expects RM headwinds to continue in Q2 and domestic volumes to stay flat YoY on elevated dealer inventory**
- **We maintain our Mar'22 TP of Rs 3,200 based on 17x FY23E EPS and reiterate SELL**

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Higher RM cost dents profitability: BJAUT's Q1FY22 sale volumes declined 14% QoQ to 10mn units impacted by the second Covid wave coupled with flattish ASP, resulting in a 14% QoQ decline in revenue to Rs 73.9bn (Rs 76bn est.). Export revenue stood at Rs 45bn (US$ 580mn). Gross margin contracted 120bps QoQ while higher staff cost and lack of operating leverage further weakened EBITDA margin, which slipped 260bps QoQ to 15.2% (16.9% est.). Better forex realisation at Rs 74.25/USD cushioned the fall in EBITDA at 27% QoQ to Rs 11.2bn. Adj. PAT declined 20% QoQ to Rs 10.6bn.

Flat volumes and cost headwinds in Q2: Management has guided for flattish domestic sale volumes YoY in Q2FY22 but expects exports to improve on a softer base. The company anticipates better retail sales in Q2 given pent-up demand but believes the wholesale segment would lag retail owing to higher dealer inventory. Raw material costs are likely to remain high and management expects under-recovery of these costs in H1FY22.

EV update: BJAUT has received board approval to incorporate a wholly-owned subsidiary catering to electric mobility in the 2W/3W and light 4W categories. After introducing its electric scooter 'Chetak' in Bengaluru, Nagpur and Pune, the company is expanding availability and plans to sell this product in 22 cities by next year. It also aims to launch an electric 3W by CY21-end.

Maintain SELL: We maintain our FY22/FY23 revenue and earnings estimates and introduce forecasts for FY24, projecting a revenue/EBITDA/adj. PAT CAGR of +13%/+12%/+10% over FY21-FY24 with EBITDA margin at ~17%. Our FY22/FY23 EPS estimates are at Rs 175/Rs 190, ~10-15% lower than consensus as we bake in softer gross margin assumptions. We continue to value BJAUT at 17x FY23E EPS – in line with its 10-year average – for a Mar'22 TP of Rs 3,200. Reiterate SELL.

Key changes

Target	Rating
◀▶	◀▶

Ticker/Price	BJAUT IN/Rs 3,853
Market cap	US$ 15.0bn
Free float	46%
3M ADV	US$ 28.0mn
52wk high/low	Rs 4,361/Rs 2,822
Promoter/FPI/DII	54%/14%/9%

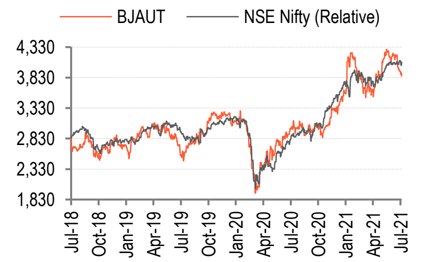
Source: NSE | Price as of 22 Jul 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	277,411	334,691	366,372
EBITDA (Rs mn)	49,285	56,474	62,619
Adj. net profit (Rs mn)	45,546	50,551	55,022
Adj. EPS (Rs)	157.4	174.7	190.1
Consensus EPS (Rs)	157.5	193.4	224.5
Adj. ROAE (%)	20.2	20.0	21.4
Adj. P/E (x)	24.5	22.1	20.3
EV/EBITDA (x)	22.4	20.1	18.1
Adj. EPS growth (%)	(10.7)	11.0	8.8

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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SELL
TP: Rs 840 | ⋎ 40%

CEAT | Auto Components | 22 July 2021

Gross margin pressure and poor demand hit profitability

- **CEAT's Q1 revenue fell below projections at Rs 19bn and gross margin declined, weakening EBITDA margin to 8.7%. Adj. PAT was at Rs 199mn**
- **We believe high RM cost and limited scope for material hikes in tyre prices would continue to depress profitability**
- **We maintain our TP of Rs 840 based on an unchanged 14x FY23E P/E multiple and reiterate SELL**

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Lacklustre quarter: CEAT's Q1FY22 revenue was below our projections, declining 17% QoQ to Rs 19bn (Rs 21.5bn est.). Volumes for Q1FY22 fell 20% QoQ while better product mix and price hikes supported a 3% increase in ASP's. Gross margin slipped further by 315bps QoQ to 38.7% (39.5% est.), reflecting the sharp increase in rubber and crude oil prices and the inability of tyre companies to take sufficient price hikes to mitigate the cost inflation. Below-expected other expenses partly offset the impact of deteriorating gross margins, limiting EBITDA margin contraction at 250bps QoQ to 8.7% (9% est.). Adj. PAT stood at Rs 199mn with EPS at Rs 4.9.

Surge in commodity prices to erode margins: Given the 12% QoQ cost increase in the raw material basket during Q4FY21 and Q1FY21 (per management) respectively, along with the inability of tyre companies to fully pass on the burden, we anticipate gross margin deterioration across the sector in FY22. We bake in a further decline of ~300bps in CEAT's gross margin for FY22 over FY21 levels, resulting in a weaker operating margin.

Estimates intact: We maintain our revenue and earnings estimates for FY22/FY23 and introduce forecasts for FY24, projecting a revenue/EBITDA /adj. PAT CAGR of +14%/+7%/-12% over FY21-FY24. Our FY22/FY23 EPS estimates are at Rs 58/ Rs 60, >40% lower than consensus. We diverge widely from the street as our gross margin assumptions of 40.5% for both years are ~200bps below consensus.

Maintain SELL: CEAT's Q1 gross margin has weakened to 38.7% and we do not see scope for quick recovery in the near term considering the steep increase in input cost and lag in price hikes taken by companies. External borrowings to fund capex will also undermine the balance sheet and depress profits due to higher interest cost. We maintain our Mar'22 TP of Rs 840, set at an unchanged 14x FY23E EPS – in line with the seven-year average. SELL.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	CEAT IN/Rs 1,400
Market cap	US$ 759.3mn
Free float	53%
3M ADV	US$ 5.0mn
52wk high/low	Rs 1,763/Rs 835
Promoter/FPI/DII	47%/28%/9%

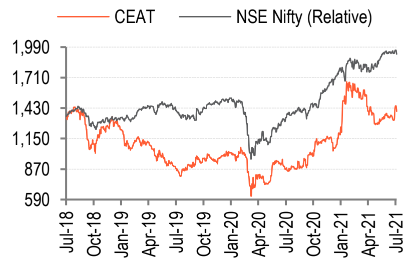
Source: NSE | Price as of 20 Jul 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	75,728	90,149	101,298
EBITDA (Rs mn)	9,738	8,901	10,438
Adj. net profit (Rs mn)	4,477	2,327	2,422
Adj. EPS (Rs)	110.7	57.5	59.9
Consensus EPS (Rs)	110.7	75.6	111.3
Adj. ROAE (%)	14.5	7.0	6.8
Adj. P/E (x)	12.6	24.3	23.4
EV/EBITDA (x)	7.2	8.0	7.0
Adj. EPS growth (%)	49.0	(48.0)	4.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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