

Bajaj Electricals - BUY

05 December 2011

Management meeting



IIFL
Institutional Equities

Growth likely to improve in 2H

Bajaj Electricals (BJE), a leading player in consumer appliances, continues to see strong demand in the consumer durables category. Margins are set to revive as metal prices are on a declining trend. We believe the recent fall in stock price more than reflects the concerns on the industrial segment. The stock is trading at FY13ii PER of 9x and is attractive, in our view. We recommend BUY on the stock.

Consumer appliances demand continues to be strong: BJE's consumer appliances segment delivered 31% revenue CAGR over the past five years; the management expects the strong growth to continue in FY12 as well. BJE's market share is 15% in the organised segment; a shift in consumer preferences from the unorganised to organised segment, rapid urbanisation and increasing purchasing power are likely to drive demand. A higher base in FY11 in the fan segment is hurting growth this fiscal, but it would improve in FY13E as the base effect wanes. Overall growth is likely to improve in 2H, owing to seasonality.

Margins to improve as metal prices are on a declining trend: International metal prices are down ~25% from the peak in March-April 2011; adjusting for rupee depreciation, they are flat YoY. BJE increased product prices by 4% each in October 2010 and January 2011. We expect margins to improve QoQ and YoY due to fall in metal prices and higher YoY realisations.

Concerns on the E&P order book priced in: BJE's stock price has declined 25% in the past six months due to concerns on the stagnant order book in the industrial segment and likely margin pressure due to a sluggish economy. The current order book is Rs7.4bn and the management is confident about winning more orders in 2H, which will likely generate ~Rs10bn in revenue in the current fiscal. Although margins may not decline from the current levels, they would continue to be depressed for new orders due to the economic slowdown and a likely increase in competition, in our view. We believe the current stock price more than reflects the concerns on the industrial segment.

Company update

CMP	Rs180
12-mth TP (Rs)	245 (36%)
Market cap (US\$m)	346
Enterprise value(US\$m)	366
Bloomberg	BJE IN
Sector	Midcaps

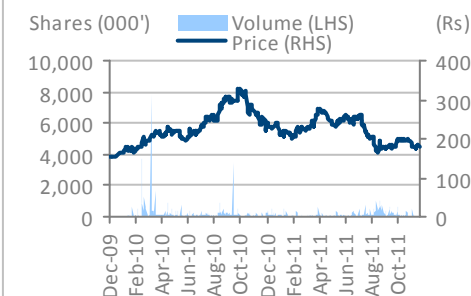
Shareholding pattern (%)

Promoter	65.6
FII	6.5
DII	10.1
Others	17.8
52Wk High/Low (Rs)	296/160
Shares o/s (m)	100
Daily volume (US\$ m)	0.6
Dividend yield FY12ii (%)	1.3
Free float (%)	34.4

Price performance (%)

	1M	3M	1Y
Absolute (Rs)	-10.0	-1.0	-30.7
Absolute (US\$)	-13.7	-11.6	-38.1
Cagr (%)	3 yrs	5 yrs	
EPS	19.8	20.1	
DPS	20.1	22.6	

Stock performance



Financial summary (Rs m)

Y/e 31 Mar, Consolidated	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Revenues (Rs m)	22,286	27,408	31,936	37,542	44,267
EBITDA margins (%)	10.9	9.4	9.1	9.2	9.3
Pre-exceptional PAT (Rs m)	1,304	1,499	1,568	1,931	2,282
Reported PAT (Rs m)	1,254	1,438	1,568	1,931	2,282
Pre-exceptional EPS (Rs)	13.4	15.2	15.9	19.5	23.1
Growth (%)	29.3	13.4	4.6	23.2	18.2
IIFL vs consensus (%)			(2.0)	(0.7)	(14.2)
PER (x)	13.5	11.9	11.3	9.2	7.8
ROE (%)	33.9	26.0	23.1	23.4	22.7
Net debt/equity (x)	0.2	0.1	0.3	0.3	0.3
EV/EBITDA (x)	7.6	7.2	6.3	5.3	4.5
Price/book (x)	3.6	2.9	2.4	2.0	1.6

Source: Company, IIFL Research. Priced as on 02 December 2011

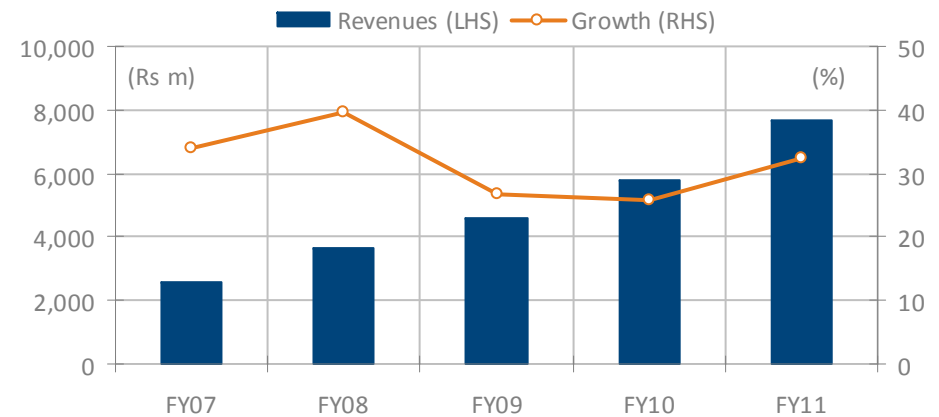
Consumer appliances demand continues to be strong

BJE achieved a 31% CAGR in consumer appliances revenue over the past five years, on the back of a large product portfolio, regular new product launches in the mass and premium segments, a pan-India network, and a strong brand franchise. The company continues to see strong demand in this segment, owing to rapid urbanisation, increasing income levels of the Indian middle class, and shift in consumer preferences towards branded products from non-branded ones with reducing price difference.

Large product portfolio: BJE has presence across irons, oven toaster grillers, water heaters, air coolers, room heaters, toasters and sandwich makers, mixer grinders, juicers, food processors, coffee makers, tea makers, gas stoves, pressure cookers, induction stoves, and home UPS. The company focuses on research and product development and regularly introduces products to suit latest requirements. Recently, BJE introduced an induction stove, which has been received well. BJE is the leader in the small appliances market with a market share of 15-30% in categories it operates in. The management pegs the domestic appliance market at ~Rs60bn and the segment is growing around 15% per year. BJE expects its appliances segment to grow at 30% this year.

Present in both mass and premium segments: BJE has a strong brand franchise, particularly in the mass segment. To extend its presence to higher-priced segments, in FY03, BJE signed a technical collaboration and brand licensing agreement with Morphy Richards (UK's No.1 brand in home appliances) for sales and marketing of electrical appliances under the 'Morphy Richards' brand in India. Revenue from the Morphy Richards brand is Rs1bn at present. In FY09, BJE tied up with Nardi, Italy, to enter the growing premium kitchen appliance market in India. It also introduced its own premium brand, 'Bajaj Platini'.

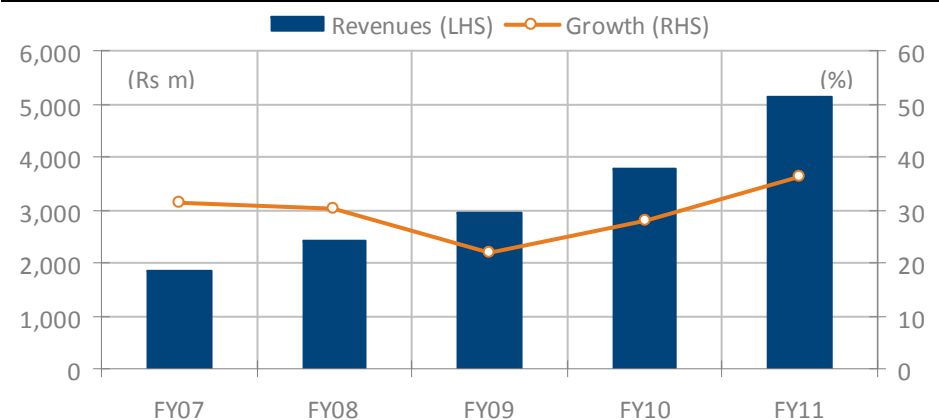
Figure 1: Revenue and growth trend of the consumer appliances segment



Source: Company, IIFL Research

Higher base hurting growth in the fan segment; to revive from FY13: The fan segment recorded a high 36% growth in FY11, against a five-year CAGR of 29%, driven by re-stocking demand from dealers; a higher base in FY11 is hurting growth this fiscal. The management expects growth to return in FY13 as the high-base effect wanes and the shift from unorganised to organised segment continues. The key factor to watch out is revival in the housing industry.

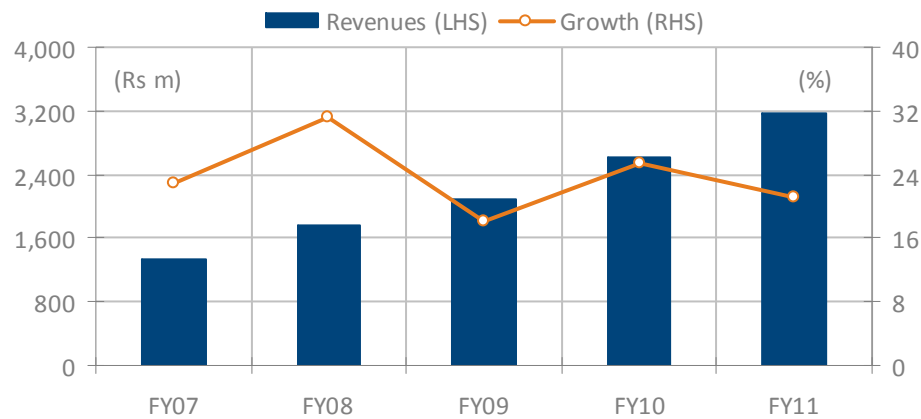
Figure 2: Revenue and growth trend of the fan segment



Source: Company, IIFL Research

Lighting – business as usual: BJE’s lighting segment achieved a 24% CAGR over the past five years, primarily driven by the CFL segment, which is currently growing at 30%. Growth in the lighting segment is likely to be driven by replacement demand and growth in the CFL segment with energy conservation gaining importance. Overall market size for the lighting segment is estimated at Rs36bn and CFL’s share is Rs19bn. BJE’s market share in lighting is ~8%.

Figure 3: Revenue and growth trend of the lighting segment



Source: Company, IIFL Research

Luminaires – continues to see robust order flow: BJE continues to see strong order flow in the luminaires segment and growth is likely to be 21% this fiscal. The luminaires segment mainly caters to industrial applications, flood lighting, street lights, malls, and IT parks. Current domestic market size is Rs25bn with organised market share at 60-65%; BJE’s share in the organised market is ~17%. BJE is the second-largest player in this segment after Phillips.

BJE has tie-ups with several global majors in this segment to cater to the Indian market. The company has a tie-up with Trilux Lenze, Germany, for premium technical lighting, RUUD lighting, USA, for LED lighting, Disano, Italy, for street lighting, Securiton, Switzerland, for fire alarm systems, and Delta Controls, Canada, for access control and building management systems (BMS).

Pan-India network: BJE’s consumer appliance and lighting products are available across India and are distributed through more than 40,000 and 400,000 retailers, respectively. BJE continues to focus on brand development through marketing efforts, widening its distribution network in both urban and rural areas, and enhancing its after-sales services. Since after-sales service is the key to success for a consumer appliance brand, BJE is focusing on widening its after-sales service network, which already comprises 270+ service centres.

Figure 4: BJE reaches out to more than 400,000 outlets in India—one of the largest distribution networks among consumer durable companies

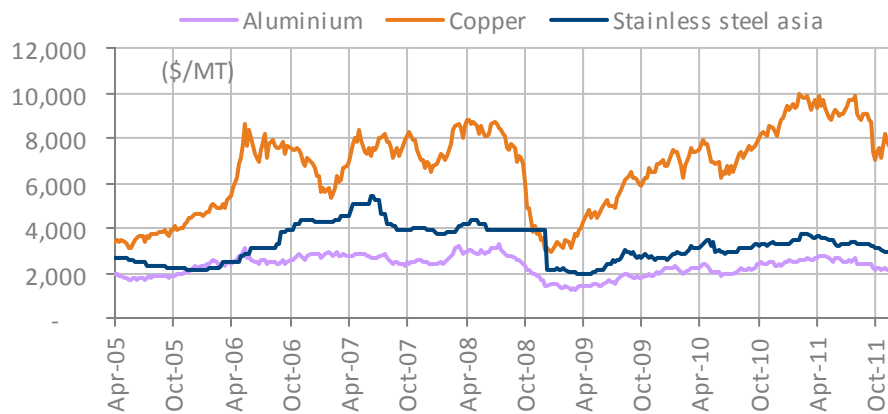


Source: Company, IIFL Research

Margins to improve with metal prices on a declining trend

Prices of key raw materials, copper, aluminium and steel, have been declining over the past six months and are down 25% from the peak in March-April 2011 and 7-12% lower YoY (flat YoY adjusting for rupee depreciation). BJE's margins were negatively impacted for the past two quarters due to higher raw material prices despite two rounds of price increases of 4% each in October 2010 and January 2011. We expect margins to improve in coming quarters as key raw material prices have declined and price increases would stay.

Figure 5: Raw material prices are off from their peak in recent months



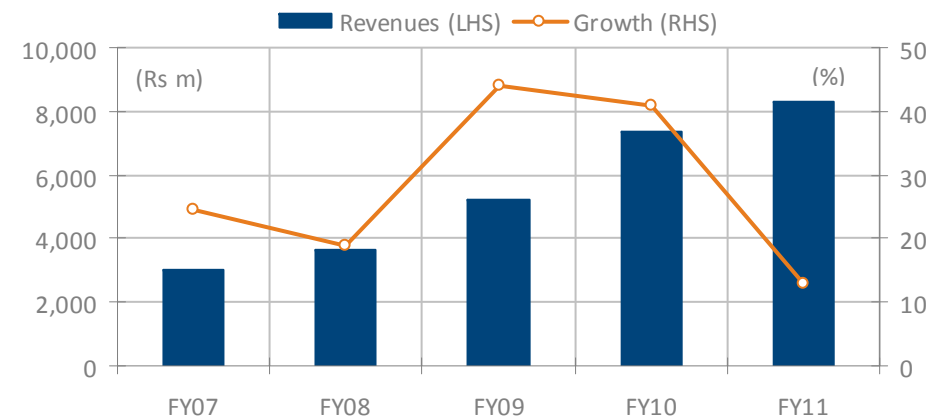
Source: Industry, IIFL Research

EBITDA margin declined 130bps in 1HFY12 on high raw material costs, but we factor in margin improvement of 40bps YoY in 2HFY12 as prices of key raw materials have declined. We build in a moderate improvement in margins, as we believe slowdown in the projects segment will limit the improvement in overall margins.

Concerns on E&P order book decline priced in: Due to a sluggish economy and slowdown in the infrastructure segment, particularly power, BJE's E&P order book is down 35% YoY at present.. Its current

order book of Rs7.4bn is 0.9x FY11 revenue. The order book has halved in the transmission line tower division. BJE is confident of securing more orders in 2H as it expects renewed thrust on infrastructure by the government. The management expects E&P revenue of about ~10bn in FY12. BJE continues to focus on maintaining margins and does not expect further erosion in E&P margins. While margins may not decline further, we believe a swift recovery is unlikely, given the low order flow.

Figure 6: Revenue and growth trend of the E&P segment



Source: Company, IIFL Research

Our target price of Rs245 offers 36% upside from the current level: We value the company as a sum of its consumer (72% of revenue in FY12ii) and industrial segments (28% of FY12ii revenue).

We estimate BJE's consumer products revenue to grow at ~21% annually over the next three years. Most peers in the Indian consumer segment trade at an average PEG of 0.8x and FY12E P/E of 18.9x. Peers in the industrial segment trade at an average PEG of 0.3x and FY12E P/E of 5.6x. We do not expect further erosion in margins for BJE after two years of sharp decline in the industrial segment.

Assigning a PEG of 0.8x to the consumer segment and 0.3x to the industrial segment, we arrive at a one-year forward P/E of 12.5x, which yields a target price of Rs245, offering 36% upside from the current level.

Figure 7: Applying peer average PEG to the consumer and industrial segments yields one-year target price of Rs245

	CMP	Market cap	PE		RoE	EBITDA margin	PEG
	(28-Nov-10)	(US\$m)	FY12	FY13			
Consumer							
Whirlpool	183	446	15.4	10.5	31.7	8.9	0.3
Voltas	92	587	11.9	10.1	16.9	6.6	0.7
TTK Prestige	2709	598	26.4	20.2	49.3	16.1	0.9
Havells	426	1036	14.8	12.3	43.6	10.1	0.7
Godrej consumer	397	2502	22.4	18.0	31.3	17.9	0.9
Emami	396	1168	22.1	18.4	35.3	19.6	1.1
Average			18.9	15.2	34.7	11.7	0.8
Industrial							
KEC	42	208	5.2	4.3	20.2	9.5	0.2
Kalpataru	100	299	6.7	5.8	12.7	10.5	0.4
Jyoti Structures	49	79	4.0	3.5	17.3	11.2	0.3
Average			5.6	4.8	16.7	10.2	0.3

Source: Bloomberg, IIFL Research

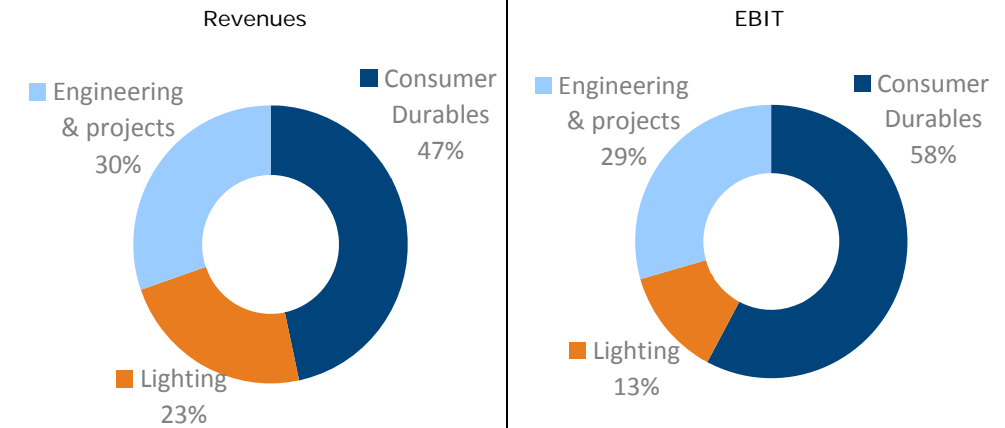
Note: All multiples and estimates are based on Bloomberg consensus estimates

Figure 8: BJE's stock has come off from its peak and offers an attractive entry point with a medium term timeframe



Source: Bloomberg, IIFL Research

Figure 9: Segmental performance of BJE in FY11



Source: Company, IIFL Research

Assumptions

Y/e 31 Mar	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Appliances revenue growth	25%	33%	30%	25%	25%
Fans revenue growth	27%	36%	5%	20%	20%
Lighting revenue growth	25%	21%	21%	20%	20%
Luminaires revenue growth	-2%	15%	21%	10%	10%
Engineering & projects revenue growth	41%	13%	8%	10%	10%

Source: Company data, IIFL Research

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar, Consolidated	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Revenues	22,286	27,408	31,936	37,542	44,267
EBITDA	2,434	2,580	2,918	3,455	4,123
Depreciation and amortisation	(91)	(108)	(134)	(146)	(158)
Ebit	2,343	2,472	2,784	3,309	3,965
Non-operating income	29	57	29	26	38
Financial expense	(314)	(291)	(473)	(453)	(597)
PBT	2,057	2,239	2,340	2,882	3,406
Tax expense	(754)	(740)	(772)	(951)	(1,124)
PAT	1,304	1,499	1,568	1,931	2,282

Ratio analysis

Y/e 31 Mar, Consolidated	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Per share data (Rs)					
Pre-exceptional EPS	13.4	15.2	15.9	19.5	23.1
DPS	2.4	2.8	2.4	2.9	3.5
BVPS	50.7	61.8	75.3	91.9	111.5
Growth ratios (%)					
Revenues	26.2	23.0	16.5	17.6	17.9
Ebitda	35.3	6.0	13.1	18.4	19.3
EPS	24.3	13.2	9.0	23.2	18.2
Profitability ratios (%)					
Ebitda margin	10.9	9.4	9.1	9.2	9.3
Ebit margin	10.5	9.0	8.7	8.8	9.0
Tax rate	36.6	33.1	33.0	33.0	33.0
Net profit margin	5.8	5.5	4.9	5.1	5.2
Return ratios (%)					
ROE	33.9	26.0	23.1	23.4	22.7
ROCE	42.8	36.9	33.0	31.0	30.5
Solvency ratios (x)					
Net debt-equity	0.2	0.1	0.3	0.3	0.3
Net debt to EBITDA	0.2	0.1	0.6	0.6	0.7
Interest coverage	7.4	8.5	5.9	7.3	6.6

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Y/e 31 Mar, Consolidated	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Cash & cash equivalents	978	847	652	624	747
Inventories	2,094	2,946	3,689	4,334	5,104
Receivables	7,507	10,654	12,687	12,857	15,160
Other current assets	1,777	1,668	2,625	3,086	3,638
Creditors	3,034	4,361	6,372	5,752	6,774
Other current liabilities	3,882	6,031	5,091	5,091	5,092
Net current assets	5,440	5,723	8,189	10,057	12,784
Fixed assets	1,017	1,533	1,599	1,673	1,735
Total net assets	6,457	7,256	9,788	11,730	14,519
Borrowings	1,519	1,165	2,365	2,665	3,515
Other long-term liabilities	(5)	(20)	(20)	(20)	(20)
Shareholders equity	4,944	6,111	7,444	9,085	11,025
Total liabilities	6,457	7,256	9,788	11,730	14,519

Cash flow summary (Rs m)

Y/e 31 Mar, Consolidated	FY10A	FY11A	FY12ii	FY13ii	FY14ii
EBIT	2,343	2,472	2,784	3,309	3,965
Tax paid	(912)	(806)	(772)	(951)	(1,124)
Depreciation and amortization	91	108	134	146	158
Net working capital change	(1,564)	(828)	(2,662)	(1,896)	(2,604)
Other operating items	518	467	607	599	755
Operating cash flow before interest	476	1,413	92	1,207	1,150
Financial expense	(369)	(365)	(473)	(453)	(597)
Non-operating income	29	57	29	26	38
Operating cash flow after interest	136	1,105	-353	780	591
Capital expenditure	(147)	(631)	(200)	(220)	(220)
Others	(643)	(32)	(607)	(599)	(755)
Free cash flow	(654)	442	(1,160)	(39)	(384)
Equity raising	1,599	55	0	0	0
Borrowings	(620)	(354)	1,200	300	850
Dividend	(201)	(274)	(235)	(290)	(342)
Net chg in cash and equivalents	124	-131	-195	-28	124

Source: Company data, IIFL Research

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.

SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.

Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.

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