

BAJAJ HINDUSTHAN

INR 289

*Judgemental respite*

SELL

In the backdrop of a benchmark judgement issued by the Allahabad High Court (key highlights in annexure 1), Bajaj Hindusthan (BJH) surprised us with its profit declaration of INR 456 mn profit for FY07 (against our and Street's expectations of huge losses). A cane cost write-back of INR 4.6 bn (based on the judgement, adjusting cane costs to SMP) in Q4FY07 resulted in INR 852 mn profit in the quarter. For FY07, topline grew 18% Y-o-Y, as anticipated, to INR 17.1 bn due to ~20% fall in sugar realisations over the last year.

* **From red to black, cane costs write-back save the day**

BJH reported a meager 18% Y-o-Y growth in revenues, despite 63% higher sugar capacity and double distillery capacity, pre-dominantly on lower sugar realizations of INR 14,473/MT in FY07 vis-à-vis INR 18,442/MT last year. Based on the Allahabad High Court judgment, BJH wrote back INR 4.6 bn of cane costs, boosting the EBITDA to INR 2.1 bn for FY07 (of which, 98% was reported in Q4FY07). The cane write-back ensured that the sugar segment barely managed to break-even at the EBIT levels and reported tax asset of INR 78 mn, leading to INR 456 mn profit for FY07.

* **Hearing on the much awaited judgement soon: Revival expected**

The Allahabad High Court's interim order has asked the UP millers to start crushing by paying a cane price of INR 110/quintal (down INR 15/quintal vis-à-vis SS07). The hearing to establish the SAP for SS08 is due on January 7, 2008, which we believe, is likely to be based on lines similar to Allahabad High Court judgement, establishing guidelines for SS07 SAP. If the revised SAP is based on the lines of SMP, as expected by most UP-based sugar millers, it could act as a huge catalyst in reviving the sugar sector with UP transforming into a market-driven industry from a highly regulated one.

* **Lower cane costs benefit adequately factored in stock price, Maintain 'SELL'**

With higher level of integration (distillery, cogeneration, and MDF boards) and sugar segment likely to break-even in FY08, we expect BJH to turnaround and report consolidated profit of INR 631 mn and INR 1,148 mn for FY08E and FY09E respectively. There are signs of improvement in operating performance with lower cane costs (INR 110/quintal). However, a highly leveraged balance sheet (debt/equity of 2.5:1), lower single digit return ratios, (ROCE), and non-supportive cash flows remain the biggest concerns. We maintain our 'SELL' recommendation on the stock, as we believe the current stock price of INR 290 more than adequately factors in the benefit accruing to BJH from lower cane costs of INR 110/quintal for SS08. However, we await the judgement of the Lucknow bench to establish SAP for SS08. Since the sugar sector is highly sensitive to the cane costs, SAP for SS08 (if revised in line with SMP), will act as a positive catalyst. In such a case, we would need to re-look at our recommendation.

Financials (standalone)

Year to September	Q4FY07	Q4FY06	% change	Q3FY07	% change	FY06	FY07
Revenues (INR mn)	4,323	3,682	17.4	4,802	(10.0)	14,472	17,130
EBITDA (INR mn)	2,142	536	299.5	(638)	NA	3,108	2,178
Adj. net profit (INR mn)	852	382	123.0	(605)	NA	1,908	456
EPS (INR)	6.1	2.7	123.0	(4.3)	NA	13.5	3.2
P/E (x)						21.4	89.5

January 2, 2008

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Bloomberg : BJH IN

Market Data

52-week range (INR) : 309 / 116
Share in issue (mn) : 141.0
M cap (INR bn/USD mn) : 40.7 / 1,034.2
Avg. Daily Vol. BSE/NSE ('000) : 2,022.4

Share Holding Pattern (%)

Promoters : 40.9
MFs, Fls & Banks : 5.6
Fls : 21.6
Others : 31.8

* **High integration levels to yield profits**

Incorporating the revenue subsidy of INR 1,500/tonne on sale of sugar from new units under the U.P sugar promotion scheme, we expect the blended sugar prices of INR 14,400/tonne for SS08 and SS09 despite a huge inventory pile up. We expect the sugar segment to break-even based on interim SAP (Allahabad judgement) of INR 110/quintal. Any downward revision from the currently fixed SAP of INR 110/quintal for SS08 will result in profit from the sugar segment, which will change our view for the sugar sector, especially for the U.P-based sugar mills. With incremental distillery capacities coming on stream in FY08, BJH will have the highest distillery capacity of 800 KLPD and will be one of the leading suppliers of ethanol in India. Further, 90 MW of saleable power would be operational in the current crushing season. Also, BJH's 100% subsidiary, Bajaj Eco-tec products (BEP, manufacturing of medium density fibre boards and particle boards) is likely to be operational in FY08. With higher level of integration and sugar segment expected to break-even in FY08, we expect BJH to turnaround and report consolidated profit of INR 631 mn and INR 1,148 mn for FY08 and FY09E respectively.

Table 1: Operating performance snapshot

	INR mn					
	BJH		BHSIL		BEP	
	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E
Revenues	22,928	23,901	6,561	6,635	1,800	2,340
EBITDA	2,818	3,015	776	872	796	1,035
PAT	437	582	(295)	(338)	451	655

Source: Edelweiss research

Table 2: Production snapshot

	Bajaj Hindusthan - West/Central/East U.P				
September ending	FY05	FY06	FY07E	FY08E	FY09E
Sugar					
Capacity (TCD)	31,000	56,200	95,000	136,000	136,000
Sugarcane crushed (MMT)	4.3	8.0	12.5	19.0	19.0
Blended crushing days	138.8	142.6	131.7	139.9	139.9
Blended sugar recovery (%)	9.2	9.9	10.4	10.0	10.0
Sugar production (MMT)	0.4	0.8	1.3	1.9	1.9
Sugar sales (MMT)	0.5	0.8	1.1	1.7	1.8
Realisations INR per MT	17,516	18,428	14,422	14,406	14,439
Sugar revenues (INR mn)	8,022	14,325	16,139	25,155	25,966
Distillery					
Distillery capacity (KLPD)	160	320	640	800	800
Production - million litres per annum	28	65	88	168	180
Realizations (INR/Litres)	23	22	22	22	22
Distillery revenues (INR mn)	592	1,462	1,970	3,677	3,923
Cogeneration					
Saleable surplus (MW)	-	-	-	90.0	90.0
Total power generation days	-	-	-	160	160
Total Power generation (mn units)	-	-	-	1,382	1,382
Captive consumption (mn units)	-	-	-	1,037	1,037
Export (mn units)	-	-	-	346	346
Rate / Kw of power generation	-	-	-	2.97	3.12
Cogen revenues (INR mn)	-	-	-	1,027	1,078

Source: Company, Edelweiss research

* **Allahabad judgement a huge positive; however, accounting treatment seems aggressive**

Post the recent Allahabad High Court judgment on reassessment of SAP for SS07, the management is confident of state government revising the SAP for SS07 close to SMP fixed by the central government. BJH has therefore revalued its entire cane procurement for SS07 at SMP (INR 81.5/ quintal linked to 9% recovery), thereby leading to exceptionally high write back of INR 4.5 bn in Q4FY07. This has resulted in significant improvement in margins from the sugar segment (30.8% in Q4FY07 against -8% in 9MFY07). However, we believe, the write-back is aggressive and disappointment could come pre-dominantly on the following two counts:

- Of the INR 4.5 bn write back, INR 1.5 bn has already been paid to farmers and BJH may not be able to recover the same by adjusting against the future cane procurement (leading to a negative cash flow impact in the near term).
- Given that BJH has revalued the cane cost at SMP, any contrary revision by the state government will expense out the difference between revised SAP and SMP, thereby adversely affecting the P&L.

* **Segmental results**

Despite 68% higher sugar capacity and double distillery capacity vis-à-vis FY06, BJH reported a meager 18% revenue growth. The muted revenue growth was largely on account of lower sugar realisations of INR 14,473/MT in FY07 vis-à-vis INR 18,442/MT last year. However, the sugar segment still continues to contribute in excess of 90% to the overall revenues.

Despite the sugar segment reporting EBIT losses of INR 984 mn for 9MFY07 due to cane costs write-back of INR 4.5 bn in the last quarter, the segment reported EBIT of INR 67 mn for the fiscal. However, given the poor performance of the sugar segment, the EBIT mix has reversed to more than 80% contribution from distillery in FY07.

Table 3: Segmental performance

Year to September	Q4FY07	Q4FY06	Q3FY07	FY06	FY07
Segment revenue mix (%)					
Sugar	80.3	88.9	93.8	90.8	90.1
Distillery	19.7	11.1	6.2	9.2	9.9
EBIT margin (%)					
Sugar	30.8	8.9	(21.2)	15.3	0.4
Distillery	62.1	4.8	39.8	23.5	19.0
EBIT mix (%)					
Sugar	66.9	93.7	(114.2)	86.5	16.8
Distillery	33.1	6.3	14.2	13.5	83.2

Source: Company, Edelweiss research

Financials snapshot (standalone)

Year to September	Q4FY07	Q4FY06	% change	Q3FY07	% change	FY06	FY07
Total revenues (net)	4,323	3,682	17.4	4,802	(10.0)	14,472	17,130
Direct cost	1,294	2,793	(53.7)	4,682	(72.4)	10,077	11,510
Staff cost	282	111	154.2	299	(5.7)	566	1,125
Other operating expenses	606	242	150.2	459	32.0	721	2,317
Total expenditure	2,181	3,145	(30.7)	5,440	(59.9)	11,363	14,952
EBITDA	2,142	536	299.5	(638)	NA	3,108	2,178
Depreciation	552	158	249.3	349	57.9	724	1,469
EBIT	1,591	378	320.4	(987)	NA	2,384	709
Interest	337	16	2,059.6	202	66.9	(21)	637
Other income	(50)	129	(138.3)	139	(135.5)	396	307
PBT	1,204	492	144.7	(1,050)	NA	2,802	378
Tax	353	110	220.2	(445)	(179.1)	893	(78)
Reported net profit	852	382	123.0	(605)	NA	1,908	456
Adjusted net profit	852	382	123.0	(605)	NA	1,908	456
Equity capital(FV:INR 1)	141	141	-	141	(0.6)	141	141
# of shares (mn)	141	141	-	141	(0.6)	141	141
EPS (INR)	6.1	2.7	123.0	(4.3)	NA	13.5	3
Current market cap (INR mn)							40,626
P/E (x)							89.5
as % of net revenues							
Direct cost	29.9	75.9	(60.5)	97.5	(69.3)	69.6	67.2
Staff cost	6.5	3.0	116.4	6.2	4.7	3.9	6.6
Other operating expenses	14.0	6.6	113.1	9.6	46.6	5.0	13.5
EBITDA	49.6	14.6	240.2	(13.3)	NA	21.5	12.7
Adjusted net profit	19.7	10.4	89.9	(12.6)	NA	13.2	2.7
Tax rate	29.3	22.4	30.8	42.4	(31.0)	31.9	(20.6)

Annexure – I

Reg: Writ Petition on SAP for 06-07

Judgement was rendered today by the bench of Justice Amitav Lala & Justice V.C. Misra. Their Lordships were pleased to pronounce the operative portion of the judgement which reads as follows:

- ♦ All circulars/letters/notifications announcing/declaring SAP for 2006-07 are quashed.
- ♦ Government to reassess SAP for 2006-07 in a period of 3 months from today.
- ♦ The above exercise to be undertaken after consultation with representatives of the cane union, sugar factories, Union of India, CAB,
- ♦ CACP.
- ♦ The invitation of views of the representatives of the Union of India and other bodies not to detract from the power of the State to fix a price for sugarcane.
- ♦ Order announcing / fixing SAP to indicate the factors, guidelines on the basis of which the price has been determined.
- ♦ Till such exercise is undertaken no coercive action to be taken against factories. The issues of readjustment/payment of shortfall etc. to be considered subsequent to the decision of the Government.
- ♦ Money already paid towards SAP not liable to be refunded
- ♦ If the Government deems it appropriate to form a committee headed by a retired or a sitting High Court Judge it would be free to do so.

The above is subject to verification from the certified copy of the judgement which should be available in 48 hours time.

Company Description

Bajaj Hindusthan Limited (BJH), a Shishir Bajaj promoted company headquartered at Mumbai, is India's largest and the world's leading sugar and ethanol producer. With its huge presence in western and central cane-rich UP belt and venture into eastern UP, BHL is likely to have a pan-UP presence. BJH also owns ~74% in Bajaj Hindusthan Sugar & Industries Limited (BHSIL), erstwhile Pratappur Sugar. BJH group's manufacturing facilities are spread across UP with a capacity of 1, 36,000 TCD and 90 MW of saleable power currently. Further, the group is likely to have distillery capacity of 800 KLPD by mid-SS08.

Post expansion, the BHL group is expected to have 14 operating mills across UP. The Indian giant is also looking at inorganic growth opportunities in the South American market, particularly Brazil, to tap opportunities coming from the fuel market.

Investment Theme

The Allahabad High Court judgement (December 19, 2007), ordering the UP government to re-assess the SAP for SS07, has come in as a huge positive. However, we believe the management has been slightly aggressive in write-back of cane costs. Any disappointment on the company's expectation (re-assessed SAP to come in line with SMP) could have a detrimental impact both in terms of profit and loss, and cash flows, percolating to balance sheet in the coming years. At the interim SAP (INR 110/quintal), though we expect the operating performance to improve, our main concerns continue to be high leverage, low return ratios, and non-supportive cash flows. We believe the current stock price adequately factors in the recent positive news flows and maintain our negative view.

Key Risks

- a) Dramatic improvement in sugar realisations in the short-to-medium term in the domestic or international markets.
- b) Any medium term adverse climatic changes can affect cane availability, hampering growth.
- c) Any additional subsidy/government incentive, not factored in our estimates, could however bail out the sugar companies.

Financial Statement (Consolidated)

Income statement					(INR mn)
Year to September	FY05	FY06	FY07E	FY08E	FY09E
Income from operations	8,368	14,828	17,805	31,289	32,876
Direct costs	5,622	9,746	13,427	22,139	22,965
Employee costs	297	585	1,200	2,408	2,532
Other expenses	443	1,390	1,082	2,353	2,457
Total operating expenses	6,361	11,721	15,709	26,900	27,953
EBITDA	2,006	3,108	2,096	4,390	4,922
Depreciation and amortisation	351	733	1,577	2,403	2,540
EBIT	1,655	2,375	519	1,987	2,382
Interest expenses	132	33	915	1,419	1,454
Other income	182	399	324	326	356
Profit before tax	1,705	2,740	(72)	894	1,284
Provision for tax	301	897	(127)	339	475
Extraordinary items	0	0	(148)	0	0
Reported profit before minority interest	1,404	1,843	(93)	555	809
Less: Minority interest	0	0	(115)	(76)	(338)
Reported profit	1,404	1,843	21	631	1,148
Adjusted profit	1,404	1,843	169	631	1,148
Shares outstanding	116	141	141	141	141
Dividend per share	0.5	0.6	0.6	0.6	0.6
Dividend payout (%)	4.3	4.6	50.1	13.4	7.4

Common size metrics- as % of net revenues

Year to September	FY05	FY06	FY07E	FY08E	FY09E
Operating expenses	76.0	79.0	88.2	86.0	85.0
Depreciation	4.2	4.9	8.9	7.7	7.7
Interest expenditure	1.6	0.2	5.1	4.5	4.4
EBITDA margins	24.0	21.0	11.8	14.0	15.0
Net profit margins	16.8	12.4	1.0	2.0	3.5

Annualised growth metrics (%)

Year to September	FY05	FY06	FY07E	FY08E	FY09E
Revenues	68.2	77.2	20.1	75.7	5.1
EBITDA	116.0	54.9	(32.6)	109.5	12.1
PBT	118.9	60.7	(102.6)	(1,340.6)	43.6
Net profit	130.1	31.3	(90.8)	272.4	81.8
EPS	72.7	8.0	(90.8)	272.4	81.8

Cash flow statement

Cash flow statement					(INR mn)
Year to September	FY05	FY06	FY07E	FY08E	FY09E
Net profit	1,404	1,843	169	631	1,148
Add: Depreciation	351	733	1,577	2,403	2,540
Add: Deferred tax	29	573	(127)	0	0
Gross cash flow	1,784	3,148	1,619	3,034	3,688
Less: Dividends	68	97	95	95	95
Less: Changes in W. C.	39	1,731	9,044	2,625	1,952
Operating cash flow	1,677	1,321	(7,520)	314	1,641
Less: Change in investments	50	(51)	50	0	0
Less: Capex	6,916	15,726	18,294	4,250	1,250
Free cash flow	(5,289)	(14,354)	(25,864)	(3,936)	391

Balance sheet					(INR mn)
As on 30th September	FY05	FY06	FY07E	FY08E	FY09E
Equity capital	116	141	141	141	141
Reserves & surplus	6,026	13,473	15,251	19,723	20,613
Shareholders funds	6,142	13,615	15,392	19,864	20,755
Minority interest	0	0	908	1,415	1,279
Secured loans	3,818	4,753	6,303	6,303	6,303
Unsecured loans	1,282	10,658	32,927	34,127	35,327
Borrowings	5,100	15,412	39,230	40,430	41,630
Sources of funds	11,243	29,026	55,530	61,709	63,664
Gross block	6,552	28,512	44,406	51,056	52,306
Depreciation	1,989	3,055	4,605	7,008	9,548
Net block	4,563	25,457	39,801	44,049	42,758
Capital work in progress	6,234	0	2,400	0	0
Total fixed assets	10,797	25,457	42,201	44,049	42,758
Goodwill on consolidation	0	0	2,001	3,426	3,378
Investments	51	0	50	50	50
Inventories	555	1,433	6,012	7,008	7,454
Sundry debtors	179	663	769	1,339	1,384
Cash and equivalents	58	2,311	849	1,130	2,472
Loans and advances	1,030	4,438	8,826	12,155	14,155
Total current assets	1,823	8,846	16,456	21,632	25,465
Sundry creditors and others	550	2,024	1,926	3,287	3,204
Provisions	425	1,991	2,117	3,027	3,649
Total CL & provisions	975	4,015	4,044	6,313	6,853
Net current assets	848	4,832	12,413	15,319	18,612
Net deferred tax	(453)	(1,262)	(1,135)	(1,135)	(1,135)
Uses of funds	11,243	29,026	55,530	61,709	63,664
Book value per share (INR)	53	96	109	140	147

Ratios

Year to September	FY05	FY06	FY07E	FY08E	FY09E
ROAE (%)	37.3	18.7	1.2	3.6	5.7
ROACE (%)	20.9	11.8	1.2	3.4	3.8
Current ratio	1.9	2.2	4.1	3.4	3.7
Debtors (days)	8	16	16	16	15
Fixed assets t/o (x)	0.8	0.6	0.4	0.7	0.8
Average working capital t/o (x)	10.2	5.2	2.1	2.3	1.9
Debt/Equity	0.8	1.1	2.5	2.0	2.0

Valuations parameters

Year to September	FY05	FY06	FY07E	FY08E	FY09E
Annualized EPS (INR)	12.1	13.0	1.2	4.5	8.1
<i>Y-o-Y growth</i>	<i>72.7</i>	<i>8.0</i>	<i>(90.8)</i>	<i>272.4</i>	<i>81.8</i>
Annualised CEPS (INR)	15.1	18.2	12.3	21.5	26.1
P/E (x)	23.9	22.2	241.1	64.7	35.6
Price/BV(x)	5.5	3.0	2.7	2.1	2.0
EV/Sales (x)	9.6	5.4	4.5	2.6	2.4
EV/EBITDA (x)	39.9	25.8	38.2	18.2	16.2

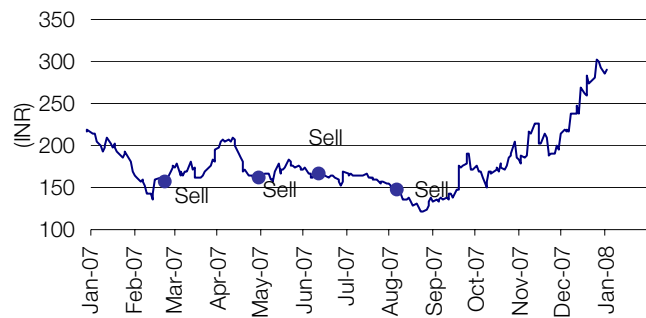
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Coverage group(s) of stocks by primary analyst(s): Sugar:

Bajaj Hindusthan, Balrampur Chini, Dwarikesh Sugar Industries, Sakthi Sugars and Shree Renuka Sugars

Bajaj Hindustan



Recent Research

Date	Report	Title	Price (INR)	Recos
27-Nov-07	Balrampur Chini Mills	Still not out of the woods; Result Update	96	Reduce
24-Oct-07	Sakthi Sugars	South bound; Result Update	76	Sell
10-Oct-07	Sugar	Sugar-coated bitter pills; Sector Update		
28-Sep-07	Sakthi Sugars	Shifting focus; Result Update	85	Sell

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	107	45	18	3	193

* 13 stocks under review / 7 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	104	69	20

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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