

Country: India

Sector: Sugar

Achal Lohade

achal.lohade@jmfinancial.in

Tel: (91 22) 6646 0152

Jesal Shah

jesal.shah@jmfinancial.in

Tel: (91 22) 6646 0095

26 September 2008

Flash Update

Bajaj Hindusthan

Bloomberg: BJH IB

Sell

Price: Rs126

Target Price (Sept 09): Rs145

Expensive acquisition

Bajaj Hindusthan (BHL) announced acquisition and merger of 'Phenil Sugars Pvt Ltd' (PSPL) through its 75% owned subsidiary Bajaj Hindusthan and Sugar (BHSIL) at total enterprise value of Rs4.4 bn (including debt of Rs.4.3bn). PSPL has sugar units in Basti (6,000TCD) and Walterganj districts (6,000TCD) of eastern parts of Uttar Pradesh. Interestingly, BHL itself has given Rs4bn loan to PSPL in FY07. Upon acquisition, BHL has agreed for conversion of these loans into zero coupon convertible bonds. The company has not yet finalized convert price for these bonds.

- **Consideration much higher than replacement cost:** As mentioned above, PSPL has total capacity of 12,000TCD and we believe that BHL has acquired PSPL at much higher replacement cost.

Exhibit 1. : Consideration higher than replacement cost

| | Rs mn | Remarks |
|--------------------------|-------|---|
| Equity Issue (approx) | 75 | 3mn shares of BHSIL @Rs25 per share |
| Debt taken over (approx) | 4,300 | of which, loan from BHL - Rs4,000 mn |
| Total consideration | 4,375 | |
| Replacement cost | 3,600 | @Rs.0.3 mn per TCD (as per industry standard) |

Source: Company, JM Financial

- **Acquisition may not add much value:** We think BHL's acquisition will not add much value to BHSIL on account of higher outlay over replacement cost. Further, the carry forward losses on PSPL's balance sheet (undisclosed amount) and lower capacity utilization levels (reportedly, PSPL's units were operational for only 70-80 days in 2007-08 sugar season as against 100-110 days for peers) would put extra pressure on BHL to improve utilization even to justify EV/replacement of 1x vs. 1.20x they have paid.
- **Dilution in BHSIL will determine overall value for BHL:** Given that BHL is planning to convert bonds into equity, the eventual value creation for BHL shareholders may be different depending on the convert price. We await details of the scheme.
- **Maintain SELL on BHL:** As mentioned in our initiation report on September 9 08, we valued BHL at discount to peers at 10x FY10EPS on account of high risk. Despite the recent 27% correction in stock, we remain skeptical as we think risk-reward is still not favorable. We do not see this acquisition also adding value to shareholders. Further, due to recent flooding in certain parts of Central Uttar Pradesh (where BHL has 4 units of 41,000TCD, c.28% of total capacity), we think the upside of higher utilization also has diminished significantly, as cane availability and recovery rates are likely to be lower. This along with the likelihood of higher cane price will more than offset any benefit of higher sugar price. Hence, we maintain SELL.

Contact details – Sales & Dealing Team

Sales Team
Tel: (91 22) 6646 0017

Sales Trading & Dealing Team
Tel: (91 22) 2497 5601-05

Derivatives Team
Tel: (91 22) 2497 5601-05

JM Financial Institutional Securities Private Limited
MEMBER, BOMBAY STOCK EXCHANGE LIMITED AND NATIONAL STOCK EXCHANGE OF INDIA LIMITED

Bandbox House, 1st Floor • 254-D Dr Annie Besant Road, Worli • Mumbai 400 025
Tel: +9122 66460000 • Dealers: +91 22 2497 5601-05 • Fax: +91 22 2498 5666 • Email: research@jmfinancial.in

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