

Consumer Brands & Retail
 Food & Staples Retailing
 Equity – India

Bajaj Hindusthan (BJH)

Overweight (V)

Target price (INR)	270.00
Share price (INR)	236.80
Potential total return (%)	14.0

Performance	1M	3M	12M
Absolute (%)	11.3	30.5	222.4
Relative ^A (%)	7.6	25.1	88.3

Index^A BOMBAY SE SENSITIVE INDEX

RIC BJHN.BO
 Bloomberg BJH IN

Market cap (USDm) 913
 Market cap (INRm) 41,880

Enterprise value (INRm) 68,341
 Free float (%) 62

Note: (V) = volatile (please see disclosure appendix)

OW(V); earnings should be positive catalyst

- ▶ **We expect strong stand-alone 1QFY10 earnings of INR755m, driven by a 125% y-o-y rise in sugar prices**
- ▶ **Updates also expected on power business, fund raising plans, and sugar business outlook**
- ▶ **We rate the stock Overweight (V) with a target price of INR270; key downside risk: higher sugar cane costs**

Strong earnings for 1QFY10 should be driven by higher sugar prices. Bajaj Hindusthan, the largest Indian sugar company by capacity, is likely to report earnings on 8 January. We expect 1QFY10 stand-alone profit of INR755m, compared to a loss of INR559m in 1QFY09 (one-time forex loss of INR273m). Earnings strength is primarily due to higher sugar prices (+125% y-o-y to INR32/kg), even though sugar sales volumes may decline 13% to 175m kgs due to low sugar opening inventory.

Key focus will be on an update on the power business and fund raising plans. Bajaj Hindusthan recently announced power capacity expansion plans of 400MW. In its 1QFY10 results announcement, we expect the company to provide an update on equipment ordering, government approvals, and fuel linkage. In addition, the company may announce equity issuance plans, if any, to fund capex on new power capacities.

Sugar production, cane cost, and levy price update. We expect an update from the company on the sugar business, which includes progress in the current crushing season that started in November 2009; likely cane costs, as the sugar price has increased; a likely rise in the levy price – 20% of production supplied to government at fixed price, currently INR13.8/kg – announced by the government; and the status of ethanol price revision.

We rate the stock Overweight (V) with an INR270 target price. We remain bullish on sugar cycle, and diversification into the power business should be positive for the company but has execution risk. Our target price is the midpoint of PB-based (target PB multiple of 2.5x on FY11 BVPS) fair value of INR310 and EV/EBITDA-based fair value of INR230. Higher cane cost is key downside risk to earnings.

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Bajaj Hindusthan: Key data points

(INRm)	Sales	EBITDA margin	PAT	EPS	RoE	PB	EV/EBITDA
2009	24,556	26%	682	3.6	5%	2.7	10.8
2010e	45,315	20%	3,686	19.3	20%	2.2	6.9
2011e	29,475	28%	3,186	16.6	14%	1.9	6.8

Note: Price valuation ratios base don closing price on 6 January 2010.
 Source: Company reports, HSBC estimates

Financials & valuation

Financial statements

Year to	09/2008a	09/2009e	09/2010e	09/2011e
Profit & loss summary (INRm)				
Revenue	21,203	24,556	45,315	29,475
EBITDA	1,938	6,315	8,970	8,312
Depreciation & amortisation	-2,799	-2,847	-2,847	-2,847
Operating profit/EBIT	-860	3,468	6,123	5,465
Net interest	-2,071	-2,647	-1,682	-1,627
PBT	-2,932	2,001	4,442	3,838
HSBC PBT	-2,932	821	4,442	3,838
Taxation	955	-340	-755	-652
Net profit	-1,976	1,661	3,686	3,186
HSBC net profit	-1,976	682	3,686	3,186

Cash flow summary (INRm)

Cash flow from operations	-2,876	6,837	6,987	5,161
Capex	-3,051	-100	-100	-100
Cash flow from investment	-2,126	-100	-100	-100
Dividends	-98	-85	-113	-128
Change in net debt	8,350	-15,149	-6,774	-4,933
FCF equity	-6,703	6,737	6,887	5,061

Balance sheet summary (INRm)

Intangible fixed assets	0	0	0	0
Tangible fixed assets	41,848	39,101	36,354	33,607
Current assets	22,064	23,345	28,197	22,388
Cash & others	1,740	6,572	11,346	6,279
Total assets	63,913	62,447	64,552	55,996
Operating liabilities	11,480	11,438	11,970	10,356
Gross debt	43,351	33,033	31,033	21,033
Net debt	41,610	26,461	19,687	14,754
Shareholders funds	8,157	17,050	20,624	23,681
Invested capital	50,692	44,437	41,236	39,360

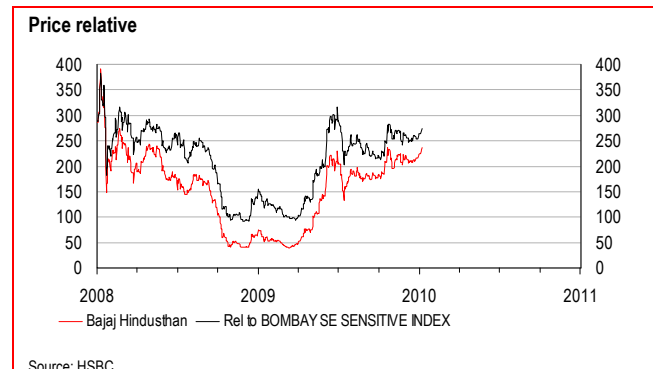
Ratio, growth and per share analysis

Year to	09/2008a	09/2009e	09/2010e	09/2011e
Y-o-y % change				
Revenue	17.0	15.8	84.5	-35.0
EBITDA		225.8	42.0	-7.3
Operating profit			76.6	-10.7
PBT			122.0	-13.6
HSBC EPS			440.7	-13.6
Ratios (%)				
Revenue/IC (x)	0.4	0.5	1.1	0.7
ROIC	-1.2	6.1	11.9	11.3
ROE	-21.5	5.4	19.6	14.4
ROA	-1.0	6.1	8.0	7.5
EBITDA margin	9.1	25.7	19.8	28.2
Operating profit margin	-4.1	14.1	13.5	18.5
EBITDA/net interest (x)	0.9	2.4	5.3	5.1
Net debt/equity	471.2	149.3	92.4	60.6
Net debt/EBITDA (x)	21.5	4.2	2.2	1.8
CF from operations/net debt		25.8	35.5	35.0
Per share data (INR)				
EPS reported (fully diluted)	-13.98	8.68	19.26	16.64
HSBC EPS (fully diluted)	-13.98	3.56	19.26	16.64
DPS	0.00	0.44	0.59	0.67
Book value	57.68	89.08	107.75	123.72

Valuation data

Year to	09/2008a	09/2009e	09/2010e	09/2011e
EV/sales	3.9	2.8	1.4	1.9
EV/EBITDA	43.1	10.8	6.9	6.8
EV/IC	1.6	1.5	1.5	1.4
PE*		66.5	12.3	14.2
P/Book value	4.1	2.7	2.2	1.9
FCF yield (%)	-16.0	16.1	16.4	12.1
Dividend yield (%)	0.0	0.2	0.2	0.3

Note: * = Based on HSBC EPS (fully diluted)



Note: price at close of 06 Jan 2010

Bajaj Hindusthan: Q1FY10 estimates

(INRm)	Q1FY10	Q1FY09	% change
Sales	5,287	3,600	47%
EBITDA	1,758	341	416%
EBITDA margin	33%	9%	
Depreciation	500	485	3%
Interest	350	486	-28%
PBT	908	(881)	
Tax	154	(321)	
Tax rate	17%	36%	
PAT	754	-559	
EPS	3.9	(4.0)	
Volume assumptions			
Sugar (m kgs)	175	200	-13%
Distillery(m litres)	62	43	44%
Cogen (m kWh)	34	31	11%
Price assumptions			
Sugar (INR/tonne)	28,370	14,240	99%
Distillery (INR/litre)	32	32	1%
Cogen (INR/kWh)	4.0	3.0	33%

Note: The company reported a loss due to foreign exchange fluctuation of INR273m in Q1FY09.
Source: Company reports, HSBC estimates

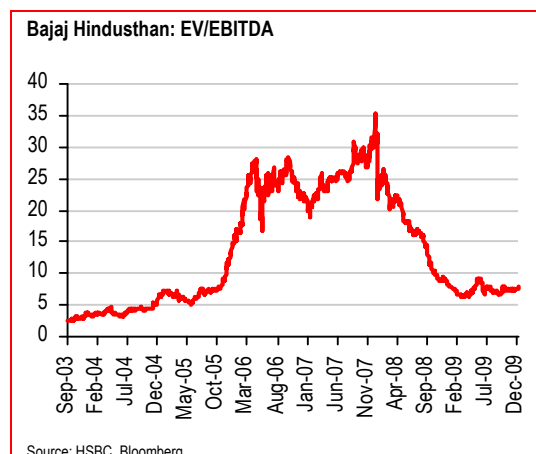
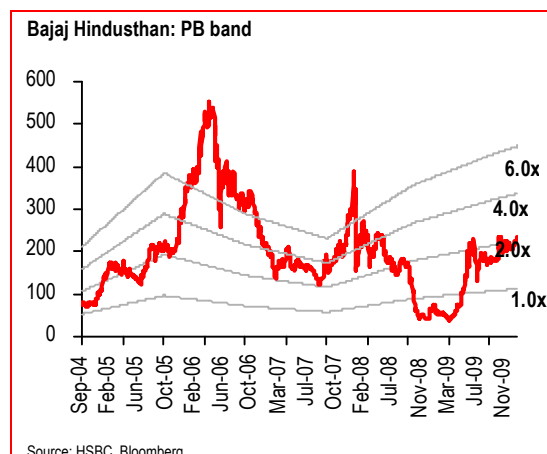
Investment thesis

Bajaj Hindusthan, the largest sugar company in India measured by capacity, is most sensitive to sugar prices (8% earnings increase on a 1% rise in the sugar price). The company is likely to see a sharp rise in profits for FY10 (+440% y-o-y) due to large imports leading to a 79% y-o-y sales volume increase. Higher earnings should substantially improve gearing – from 4.7x in FY08 to 1x in FY10e – which has been the key concern about the stock. Further, diversification into the power business should be positive but only with timely execution and fuel security. A higher sugar cane price is key downside risk to earnings.

Valuation

We value Bajaj using PB and EV/EBITDA multiple-based valuations.

PB methodology: We maintain a target PB multiple at 2.5x on the back of improved RoE from higher earnings. In view of recent measures undertaken by Bajaj Hindusthan, such as issuance of warrants to promoters, a buyback of foreign-currency convertible bonds (FCCB), and a qualified institutional



Bajaj Hindusthan: EV/EBITDA valuation

(INRm)	Calculation
Multiple (x)	7
EBITDA	8,312
EV	58,187
Net debt	14,754
Mcap	43,433
No. of shares (m)	191
Target price (INR)	230

Source: HSBC Estimates

placement (QIP) issuance, we expect the net debt-to-equity ratio to fall substantially. However, the PB multiple for Bajaj is lower than those for Balrampur Chini and Triveni, as Bajaj's gearing is higher and its return ratios are lower. Based on target PB of 2.5x and Sept-11 BVPS, we arrive at PB-based fair value of INR310.

EV/EBITDA methodology: After adjusting for higher cane costs in FY07, Bajaj Hindusthan may report losses. We have prepared an EV/EBITDA chart based on the company's reported results. We observe that the company has been trading at a premium to Balrampur Chini, primarily as a result of higher EV due to higher debt on its balance sheet.

We assign a target EV/EBITDA multiple of 7x, which is lower than those of other Uttar Pradesh-based peers, such as Balrampur and Triveni, as Bajaj Hindusthan it has higher gearing and lower RoE. We arrive at an EV/EBITDA-based fair value of INR230.

Target price: Our 12-month target price of INR270 is the midpoint of the fair values of INR310 and INR230 derived using PB and EV/EBITDA multiples, respectively.

Overweight (V) rating: Under our research model, for stocks with a volatility indicator, the Neutral band is 10 percentage points above and below the hurdle rate for India stocks of 10.5%. This translates into a Neutral band of 0.5% to 20.5% around the share price at the time we set our target price. Our target price of INR270 for Bajaj Hindusthan shares suggested a potential total return that was above the Neutral band of our model at the time we set our target; therefore, we rate the stock Overweight (V).

Risks

Key downside risks, in our view, are:

- ▶ Volatility in sugar cane prices and sugar prices. Further, each INR1 per kg fall in cane used per kg of sugar should lead to c26% increase in PAT.
- ▶ Lower-than-expected volumes and selling price, which would affect earnings. Each INR1 per litre change on either side would lead a 1.3% change in PAT.
- ▶ Higher-than-estimated margins from the MDF business in FY10.
- ▶ The government's failure to revise the levy price, which would imply an earnings decline of 3.1% in FY10 for INR1/kg lower than estimated INR20.8/kg.

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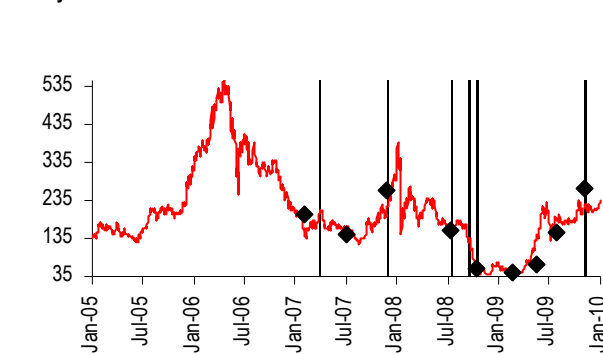
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Share price and rating changes for long-term investment opportunities

Bajaj Hindusthan (BJHN.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Neutral (V)	Underweight (V)	02 April 2007
Underweight (V)	Overweight (V)	27 November 2007
Overweight (V)	Underweight (V)	15 July 2008
Underweight (V)	Neutral (V)	19 September 2008
Neutral (V)	Underweight (V)	20 October 2008
Underweight (V)	Overweight (V)	08 November 2009
Target Price	Value	Date
Price 1	200.00	05 February 2007
Price 2	147.00	06 July 2007
Price 3	264.00	27 November 2007
Price 4	155.00	15 July 2008
Price 5	55.00	20 October 2008
Price 6	45.00	23 February 2009
Price 7	65.00	21 May 2009
Price 8	150.00	30 July 2009
Price 9	270.00	08 November 2009

Source: HSBC

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