

Stock Idea

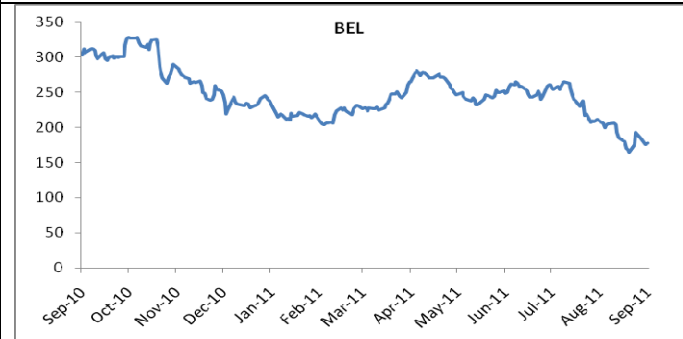
Bajaj Electricals Ltd. (BEL)

Recommendation	BUY
CMP (08/09/2011)	Rs. 180
Sector	Household Appliances

Stock Details

BSE Code	500031
NSE Code	BAJAJELEC
Bloomberg Code	BJE IN
Market Cap (Rs. cr)	1802
Free Float (%)	35.22
52- wk HI/Lo (Rs.)	347/160
Avg. volume BSE (Monthly)	89131
Face Value	Rs.2
Shares o/s (Crs)	9.88

Relative Performance	1Mth	3Mth	1Yr
BEL	-14.3%	-28.3%	-41.3%
Sensex	0.4%	-7.7%	-8.5%



Shareholding Pattern

Promoters Holding	64.78%
Institutional (Incl. FII)	20.96%
Corporate Bodies	2.37%
Public & others	11.89%

Ruchita Maheshwari, Research Analyst
(022 – 3027 8023)
E-mail Id: ruchita.maheshwari@nirmalbang.com

Investment Rationale

- ✍ **Well Diversified product portfolio; presence at all price point:** Over the past seven decades, BEL has established strong presence in 'value for money' segment of consumer durable products. To strengthen its product portfolio, BEL strategically entered the premium segment through tie-ups with global premium brands. BEL also launched its own brand "Bajaj Platini" to bridge the gap between the value and premium brands.
- ✍ **Nationwide distribution network with wide urban and retail penetration:** We believe that consumer durables market is highly fragmented with stiff competition from regional and national players. Thus, to beat the competition BEL has created a strong presence in pan India with network of 19 branch offices besides being supported by a chain of about 1000 distributors, 4000 authorized dealers, over 4,00,000 retail outlets and over 282 Customer Care centers.
- ✍ **E&P business strained: Expected to improve in Q3FY12:** BEL registered 2.5% revenue growth in the E&P business during Q1FY12 due to slower execution. Though the project was not of low margin but due to the extended time in closure of the project resulted into additional cost pressure. BEL has started the cleaning process by bringing down the projects from the current 82 level to ~ 50 projects by the end of the year. This cleaning activity is expected to continue through Q2FY12 and will improve margins thereafter.
- ✍ **Vendor driven outsourcing model:** BEL attributed huge benefit through vendor driven outsourcing model. This approach provides flexibility in operation and competitive pricing. BEL sources consumer appliances from its dedicated vendors in northern India (Noida, Delhi and Himachal) and some products are imported from China. With such kind of set-up, BEL has more time and resources in its core competency of R&D and marketing & distribution.
- ✍ **Raw-Material Hedging - Maintain EBIT margins:** BEL consumes aluminum, copper, zinc and steel. BEL has a committee to hedge commodity on quarterly basis. The hedge ratio varies according to the projected price pressure. BEL being a market leader in most of the segment it operates can easily pass on the increase in cost to its consumers. Recently, the company has increased prices of its various products which in our view will benefit the company going forward as the prices of commodities have declined in the current quarter.

Valuation & Recommendation

BEL can be purchased at current price of Rs. 180. Stock is trading at ~11x FY12E earnings which look very attractive. It can give 15-20% returns in near term.

Year	Net Sales	Growth %	EBIDTA	EBIDTA (%)	PAT	PAT (%)	EPS (Rs.)	P/E(x)	P/BV(x)
FY09	1764.1	28%	178.2	10.1%	89.1	5.1%	10.3	17.5	6.3
FY10	2227.2	26%	241.2	10.8%	117.1	5.3%	12.0	15.0	3.6
FY11	2739.4	23%	256.6	9.4%	143.8	5.2%	14.5	12.4	2.9

Investment Rationale

Q1FY12 was in aberration; though FY12E remains positive

BEL reported a poor performance in Q1FY12 due to the consumer business facing poor market conditions (reported a moderate growth of 15.5%) and E&P (Engineering & Projects) business showcased just a meager 2.5% growth against last year. The consumer business was affected badly due to the markets for fan and room coolers were extremely depressed in the quarter because of shorter summer season this time. The inventory for fans and room coolers shot up due to the sluggish quarter. BEL reported negative margin of 6.7% during Q1FY12 in E&P business. The company had incurred an additional cost for closing down its several old/stuck projects to free up more working capital and bring efficiency in employee costs.

We expect 2HYFY12E result to be an excellent result on the account of better performance by E&P business and the consumer facing business. To improve the E&P business, the company is in the cleaning process where it's planning to reduce the number of projects from 82 to ~ 50 levels. This cleaning process is expected to continue through Q2FY12 and margins are expected to improve thereafter. BEL expects to register a growth of 24% in consumer facing business in FY12E.

The company being a strong leader in most of the segment it operates enjoys a pricing power. The company has taken several price increases to counter the negative effects of the high raw-material prices. These raw-materials (copper, aluminium, zinc, plastic & steel) have softened in the current quarter. We expect BEL to get benefit from the hike in prices and softening of raw-material prices.

Management Guidance:

- ✍ BEL intends to bring down the number of projects from 82 to ~ 50 projects in E&P division. This will bring down the cost, check inventory management, improve working capital position and will improve balance sheet going forward.
- ✍ Management has guided for EBIT margin improving in E&P division from negative 6.7% in Q1FY12 to 12.7% by Q4FY12, indicating full year margin at ~8%.
- ✍ BEL expects to clock – in growth of 24% in Consumer durable business in FY12E and expect to maintain margin of FY11.

Well Diversified product portfolio; presence at all price point enjoys leadership position:

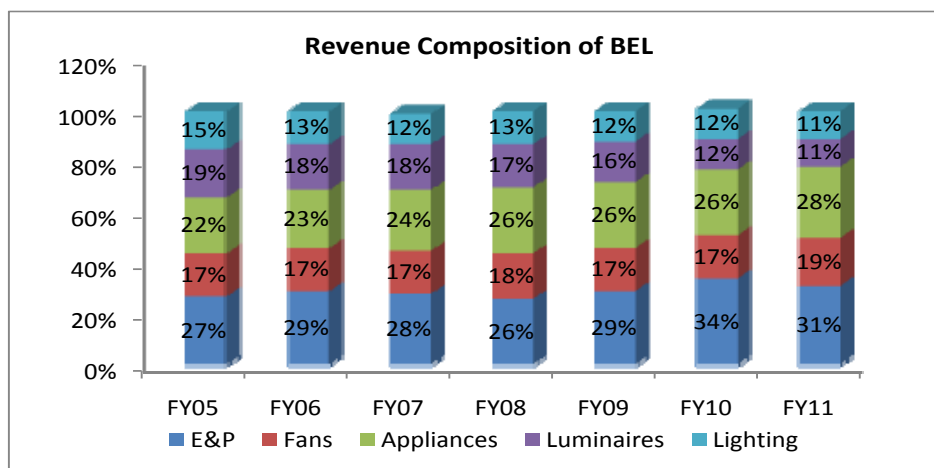
BEL with its comprehensive product portfolio is present across segments and various price points. Over the past seven decades, BEL has established strong presence in 'value for money' segment of consumer durable products. To strengthen its product portfolio, BEL strategically entered the premium segment through tie-ups with global premium brands.

The Global Tie – Ups:

Segment	Company	Strategy
Fans	Midea (World's largest fan company)	TPW fans (Table, Pedestal & Walls)
Fans	Walt Disney	For Children
Appliances	Morphy Richards, UK	For Premium Appliances
Appliances	Nardi, Italy	For gas Appliances & Cooking range
Luminaires / Lighting	Trilux, Germany	For premium technical lighting
Luminaires / Lighting	RUUD, US	For LED Lighting
Luminaires / Lighting	Disano, Italy	For Street Lighting
Luminaires / Lighting	Securiton, Switzerland	For the Alarm system
Luminaires / Lighting	Delta Controls, Canada	For access controls and building management
Luminaires / Lighting	Abacus, UK	For sports lighting

Source: Company & Nirmal Bang Research

BEL also launched its own premium sub-brand "Bajaj Platini" to further explore the fast growing premium segment apart from being present in premium segment under the brand Morphy Richards.



Source: Company & Nirmal Bang Research

BEL enjoys 15-30% market share in various product categories like Oven Toaster and Griller (30%), Irons (26%), Water Heaters (23%). Apart from appliances, BEL is one of the top 3 players in Fans (16% of organized market), Lighting (8%) and Luminaires (17%).

Segment	Market Share	Market Position	Competitors
Fans	16%	3 rd	Crompton Greaves (24%), Usha (17%), Orient, Khaitan, Polar, Havells
Lighting	8%	3 rd	Philips (26%), Surya (12%), Crompton, Wipro, Osram, Havells
Luminaires	17%	2 nd	Philips (23%), Crompton (13%)
Appliances	15-30% organized	NA	Philips, Usha, Kenstar, Preeti, Prestige, Maharaja, Inalsa, Pigeon, Black & Decker, tefals, Delonghi, Braun, Kenwood, National
High Masts / Tower Projects	NA	NA	Philips, Crompton, BP Projects, Utkal Galvanizers, KEC, Kalpatru, L&T, Jyoti
Lighting, Illumination, Rural Electrification	NA	NA	Philips, GE, Crompton, IVRCL, KBL, Kalpatru

Source: Company & Nirmal Bang Research

Nationwide distribution network with wide urban and retail penetration

We believe that consumer durables market is highly fragmented with stiff competition from regional and national players. BEL sells its products, spread over five business verticals, through a network of 1000 distributors and 4000 authorized dealers. Its products, ranging from bulbs and lamps to fans and a wide range of domestic appliances, are sold through over 4,00,000 retail outlets. BEL has created a strong presence in pan India with network of 19 branch offices and over 282 Customer Care centers. With the economy growing and demography changing, the market is expected to get more organized in the coming years. BEL with the diversified product portfolio and presence in all price points will benefit the most.

E&P business strained: Expected to improve in Q3FY12

The Engineering & Projects (E&P) segment has three main divisions:

- ✍ **High-mast & Street Lighting Division:** BEL entered the high-mast and street lighting business in 1983. Currently, it also undertakes civil, structural, and illumination design and development of accessories. The division's portfolio also includes signage, flag mast and night raider mobile light towers.
- ✍ **Special Projects:** The division's competency areas are power plant lighting, stadium and monument lighting, as well as rural electrification programme.
- ✍ **Transmission Line Towers:** This division has one of the best manufacturing plants. The plant manufactures a wide variety of towers of 110, 132, 220, 400 and 765 KV single and double circuit power transmission lines. The present capacity of BEL for manufacturing TLT is over 30,000 MT.

The E&P division has grown at a CAGR of more than 30% for the last five years. The E&P division has also started exporting high masts, towers and poles to Kenya, Uruguay, the Caribbean, Sri Lanka, Mauritius and the Maldives. BEL has also undertaken few street lighting projects in the Middle East and Ethiopia. All these export – related activities are carried through its group company – Bajaj International.

BEL registered 2.5% revenue growth in the E&P business during Q1FY12 due to slower execution. The project was not of low margin but due to the extended time in closure of the project resulted into the additional cost. This has resulted into the negative margin of 6.7% in Q1FY12. BEL has started the cleaning process by bringing down the projects from the current 82 level to ~ 50 projects by the end of the year. This cleansing activity is expected to continue through Q2FY12 and will improve margins thereafter. Management has guided for EBIT margin improving from negative 6.7% in Q1FY12 to 12.7% by Q4FY12, indicating full year margin at ~8% with revenue of around Rs. 1000 crores.

Order book declined 10% to Rs. 730 crores as order inflows are subdued at Rs. 48.6 crores during the quarter (Q1FY12). The company expects to close the year with an order backlog of Rs. 1100-1200 crores given strong order pipeline. The company has bid for projects worth Rs. 2300 crores and is awaiting awards.

Vendor driven outsourcing model

BEL attributed huge benefit through vendor driven outsourcing model. Most of the product manufacturing is outsourced to third party vendors, who manufacture most of the products according to the specification provided by the company. This approach provides flexibility in operation and competitive pricing. BEL has built up a strong base of 200 vendors to outsource its manufacturing jobs. More than 70% of the vendors are dedicated and have associated with the company for several years. BEL has prompted a large number of its dedicated vendors to move production base to backward areas in Himachal Pradesh and other similar locations for cost effective production.

BEL sources consumer appliances from its dedicated vendors in northern India (Noida, Delhi and Himachal) and some products are imported from China (less than 10% of total). BEL is outsourcing 20% of appliances and fans and 5% of luminaires from China. Apart from enjoying the competitive pricing, the company has also been able to effectively face the competition from the Chinese companies. With such kind of set-up, BEL is an asset light entity. BEL has more time and resources in its core competency of R&D and marketing & distribution.

Product Information:

Product	In – house Manufacturing / Outsourced
Appliances	<ul style="list-style-type: none"> ✓ Outsourced to dedicated vendors in Noida, Delhi & Himachal Pradesh ✓ Imports from China (~20%)
Fans	<ul style="list-style-type: none"> ✓ Own plant at Chakan near Pune ✓ Outsourced to dedicated vendors in Hyderabad & Himachal Pradesh ✓ Imports from China (~5%)
Lamps & Tubelights	<ul style="list-style-type: none"> ✓ Manufactured by its UP based sister concern Hind Lamps
CFL Lamps	<ul style="list-style-type: none"> ✓ Manufactured by its Nasik based sister concern Starlite Lighting
Luminaires	<ul style="list-style-type: none"> ✓ Outsourced to dedicated vendors in Daman & Himachal Pradesh ✓ Imports from China
High Masts, Poles & Towers	<ul style="list-style-type: none"> ✓ Own plant at Ranjangoan & Chakan near Pune

Source: Company & Nirmal Bang Research

Introduction of new products at various price points:

Backed by its R&D efforts and global collaborations, the company has been able to launch newer products across various price points/segments. The company is re-entering the pressure cooker sector after a gap of 25 years. The company has completed successful test marketing in Orissa and West Bengal and is planning to launch it in pan India in 2011. The company is also planning to foray into water purifier segment for rural as well urban markets. Besides, BEL is also planning to launch DG sets after test-marketing in Tamil Nadu and Kerala. The company is also trying to consolidate its position in the water lifting pumps after being in the market for two years. BEL is planning to Introduce Microwave ovens under Morphy Richards in the near future.

In our view, these initiatives will help the company to register strong growth going forward on the back of strong distribution network and strong brand equity.

Raw-Material Hedging - Maintain EBIT margins

BEL consumes aluminum, copper, zinc and steel. BEL has a committee to hedge commodity on quarterly basis. The hedge ratio varies according to the projected price pressures on commodities market. The Company increases hedge ratio if the projected price rise is high and decreases if the expected price rise is low. BEL being a market leader in most of the segment it operates can easily pass on the increase in cost to its consumers. In E&P Business Unit, 75% of transmission line projects and 40% of remaining projects are covered in price variation. We believe that raw-material hedging coupled with pricing power in consumer segment will help the company to protect its EBIT margins even in adverse global commodity markets.

Recently, the company has increased its prices of various products which in our view will benefit the company going forward as the prices of commodities have declined in the current quarter.

Key Risks & Concerns

- ✍ Sharp increase in raw material like copper, zinc, aluminium, plastic and steel will impact the margins.
- ✍ Inability to take further price hike to mitigate the rise in raw-material prices will impact the margins.
- ✍ Any sharp decline in market share due to rise in competition or increase in advertisement expenses could adversely affect earnings.
- ✍ Any slowdown in economy may cause de-growth in real estate sector. That may impact business growth of BEL.
- ✍ Rising interest rates, environmental clearances for various projects and land acquisition issues can cause in the delay in investments in the T&D space. We believe that severe delays in the execution of these projects and further delay in the closure of projects would negatively impact company's E&P division.

Valuation & Recommendation

With a strong positive outlook in all segments that BEL is present in, the company is poised to record strong growth going forward.

The stock has corrected sustainably post Q1FY12 results which were disappointing due to loss reported by Engineering and Project (E&P) division and some margin pressure witnessed in consumer division. The E&P division reported losses because of seasonally weak quarter (Q1) coupled with closure of some old projects by the company resulting into the cost pressure. The company is taking several initiatives to bring back the E&P business on track. For this, the company is busy in cleaning process where it's bringing down the project from 82 levels to ~ 50 projects by the end of the year. This will help the company in better management of working capital, better inventory management and control in costs overrun in the future. Management has guided the completion of the cleaning process by Q2FY12 and the improvement in margins thereafter. We expect E&P division to bounce back and report normal profit in 2HFY12.

The concern of margins in consumer division is also easing off with some price increases taken by the company and decline in the commodity prices. The company expects to register a growth of 24% in consumer facing business unit in FY12E.

Stock is trading at ~11x FY12E earnings which look very attractive. The stock can be purchased at CMP and may see positive upside of 15-20% in the near term.

Stock Idea

Bajaj Electricals Ltd. (BEL)

Financial Analysis

Rs. In Crores

Particulars	Q1FY12	Q1FY11	YoY%	Q4FY11	QoQ%	FY11	FY10	YoY%
Net Sales	544.07	483.69	12.5%	979.38	-44.4%	2739.43	2227.16	23.0%
Total Expenditure	514.09	443.24	16.0%	877.87	-41.4%	2482.79	1985.95	25.0%
PBIDT	29.98	40.45	-25.9%	101.51	-70.5%	256.64	241.21	6.4%
Interest	10.67	5.69	87.5%	6.52	63.7%	29.08	31.47	-7.6%
Other Income	0.85	1.59	-46.5%	2.49	-65.9%	7.05	5.08	38.8%
PBDT	20.16	36.35	-44.5%	97.48	-79.3%	234.61	214.82	9.2%
Depreciation	3.07	2.35	30.6%	3.41	-10.0%	10.76	9.20	17.0%
Portion of irrecoverable loans given to company	0.00	0		5		5.00	5.00	
Tax	6.00	11.49	-47.8%	30.56	-80.4%	73.99	75.35	-1.8%
Reported Profit After Tax	11.09	22.51	-50.7%	58.51	-81.0%	144.86	125.27	15.6%
Prior period Adjustments	0.03	0.01		1.05		1.07	8.18	-86.9%
Adjusted Profit After Extraordinary item	11.06	22.50	-50.8%	57.46	-80.8%	143.79	117.09	22.8%
EPS (Unit Curr.)	1.11	2.30		5.81		14.55	12.00	
Equity	19.90	19.57		19.77		19.77	19.51	
Face Value	2	2		2		2	2	
PBIDTM(%)	5.5%	8.4%		10.4%		9.4%	10.8%	
PBDTM(%)	3.7%	7.5%		10.0%		8.6%	9.6%	
PATM(%)	2.0%	4.7%		5.9%		5.2%	5.3%	

Segment Revenue

Lighting	127.41	109.98	15.8%	201.33	-36.7%	631.15	535.87	17.8%
Consumer Durables	303.09	262.97	15.3%	402.2	-24.6%	1276.86	954.45	33.8%
Engineering & Projects	113.57	110.74	2.6%	375.85	-69.8%	831.42	736.84	12.8%
Others	0.18	0.18	0.0%	0.21	-14.3%	1.32	1.47	-10.2%
Total	544.25	483.87	12.5%	979.59	-44.4%	2740.75	2228.63	23.0%

Less: Intersegment Revenue 0 0 0 0 0 0 0

Net Sales 544.25 483.87 12.5% 979.59 -44.4% 2740.75 2228.63 23.0%

Segment Results

Lighting	6.2	2.19	183.1%	16.05	-61.4%	32.34	33.47	-3.4%
Consumer Durables	29.12	25.08	16.1%	44.59	-34.7%	144.48	123.6	16.9%
Engineering & Projects	-7.63	11.35	-167.2%	39.59	-119.3%	73.57	79.18	-7.1%
Others	-0.1	-0.01	900.0%	-0.13	-23.1%	0.35	0.66	-47.0%
Total	27.59	38.61	-28.5%	100.1	-72.4%	250.74	236.91	5.8%

Less:
Interest 10.67 5.69 6.52 29.08 31.47
Other Unallocable expenditure -0.17 -1.08 4.51 2.81 4.82

PBT 17.09 34 -49.7% 89.07 -80.8% 218.85 200.62 9.1%

NOTE

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