investor's eye

Index

Bajaj Corp

Ugly Duckling

Stock Update

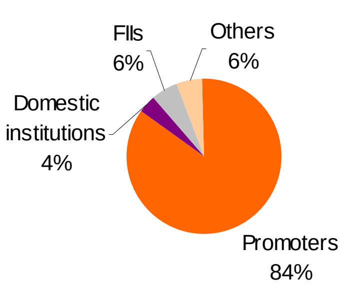
Operating performance in-line with expectation

Buy; CMP: Rs102

Company details

Price target:	Rs142
Market cap:	Rs1,504.5 cr
52 week high/low:	Rs144/73
NSE volume: (No of shares)	66,565 lakh
BSE code:	533229
NSE code:	BAJAJCORP
Sharekhan code:	BAJAJCORP
Free float: (No of shares)	2.2 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-20.1	-10.7	2.4	-28.8
Relative to Sensex	-22.2	-3.4	15.0	-16.4

Key points

- **Operating performance in line with expectation:** Bajaj Corp Ltd (BCL)'s operating performance was in line with our expectation with the gross profit margin (GPM) standing at 25.6% and the operating profit at Rs27.4 crore (in keeping with our expectation of Rs27.3 crore) in Q2FY2012. The sales volume growth stood at 22% year on year (YoY), which was the highest in eight quarters.

- **Volume-led top line growth:** The total revenues (including the operating income) grew by 31.8% YoY to Rs107.1 crore during the quarter. This was on the back of a strong 22% year-on-year (Y-o-Y) volume-led growth and an improvement in the sales realisation. The company did not implement any fresh hike during the quarter and hence the year-to-date price hike stands at 8.5%. The 20%+ Y-o-Y volume growth was achieved on the back of around 23% Y-o-Y volume growth in Almond Drops hair oil (ADHO; which contributes around 96% to the top line). Kailash Parbat hair oil (KPHO), which is currently available in 3.6 lakh outlets, contributed around 1% to the total volume growth.

- **GPM improved on Q-o-Q basis:** The prices of the key raw materials such as LLP, glass bottles and refined oil were up by 31.1%, 27% and 31.5% YoY respectively during the quarter. Hence the GPM was down by 331 basis points YoY to 53.8%. Having said that, the prices of the key raw materials (except for refined oils) remained stable on a quarter-on-quarter (Q-o-Q) basis, which resulted in a 133-basis-point improvement in the GPM on a Q-o-Q basis.

- **Operating profit grew by 19% YoY:** The operating profit margin (OPM) was down by 277 basis points YoY to 25.6%. Hence the operating profit grew by 19% YoY to Rs27.4 crore (which was lower than the top line growth of about 32% YoY). However the OPM improved sequentially by 90 basis points during the quarter.

Results table (Rs cr)

Particulars	Q2FY12	Q2FY11	% YoY
Total revenues	**107.1**	**81.2**	**31.8**
Raw material cost	49.4	34.8	42.0
Employee cost	5.7	4.0	41.3
Ad-spends & promotions	13.1	10.4	26.3
Other expenses	11.4	9.0	27.5
Total expenditure	79.7	58.2	36.9
Operating profit	**27.4**	**23.1**	**19.0**
Other income	9.9	2.6	-
Depreciation	0.5	0.4	25.8
PBT	36.7	25.2	46.1
Tax	8.0	5.3	50.4
PAT	**28.7**	**19.8**	**45.0**
EPS (Rs)	**1.9**	**1.3**	**45.0**
GPM (%)	53.8	57.2	(331) bps
OPM (%)	25.6	28.4	(277) bps

- **Higher other income boosted bottom line growth:** The higher other income helped the company to achieve a 45% Y-o-Y growth in the bottom line to Rs28.7 crore (ahead of our estimate of Rs25.1crore) during the quarter. The other income stood at Rs9.9 crore in Q2FY2012 as against Rs2.6 crore in Q2FY2011. The other income was higher on the back of the huge cash of around Rs400 crore during the quarter. However, with the company investing around Rs90 crore in non-yielding assets (at the end of Q2FY2012), we expect the other income to be lower in H2FY2012 in comparison with that in H1FY2012.

- **Upward revision in estimates:** We have slightly revised upwards (by 3.6%) our estimate for FY2012 to factor in the higher than estimated sales volume growth and other income. Also, we have fine tuned our estimates for FY2013.

- **Outlook and valuation:** With the category growth likely to sustain above 15% YoY, we expect BCL's volume growth to sustain in the range of 18-20% in the coming quarters. Overall, we expect the company to achieve around 31% top line growth in FY2012. With the volume growth in ADHO likely to sustain above 15% YoY, we expect the FY2013 top line growth to be at around 20% YoY. With the OPM sustaining in the range of 27-28%, we expect the bottom line to grow at a compounded annual growth rate (CAGR) of 17% over FY2011-13.

At the current market price the stock is trading at 12.6x its FY2012E earnings per share (EPS) of Rs8.1 and 10.7x its FY2013E EPS of Rs9.5. We maintain our Buy recommendation on the stock with the price target of Rs142. Going ahead, any organic or inorganic initiative taken to improve the growth prospects of the business would act as a key trigger for the stock.

Conference call highlights

- **Volume growth to sustain:** BCL has not witnessed any slowdown in demand for its products against the backdrop of the current high inflationary scenario. Though the overall hair oil segment's sales volume growth moderated from around 4% YoY in Q1FY2012 to 1.9% YoY in July-August 2011, the light hair oil (LHO) category's growth stood at around 17% YoY during the quarter. This was on the back of a sustained strong demand for value-added hair oils in the domestic market. The company expects the LHO category's growth to sustain above 15% in the coming quarters. This gives us an indication that the robust volume growth for BCL will sustain in the coming quarters. Hence in FY2012 we expect the company's overall volume growth to stand at around 20% YoY.

- **Snapshot of recent initiatives:** The recently launched 500ml pet bottle of ADHO has got a good response in the market and currently contributes around 4% to the total sales volume of ADHO. The reach of KPCO increased to 3.6 lakh outlets from 2.5 lakh outlets in Q1FY2012. The product's performance would be keenly monitored in Q4FY2012 (which is seasonally a strong quarter for cooling oils).

- **Raw material prices likely to decline on Q-o-Q basis:** With the recent fall in the crude oil prices, the company expects a drop in the prices of the key raw materials such as LLP in the coming quarters. However, due to the appreciating dollar the drop would be lower compared to the decline in the crude oil prices. This would result in a sequential improvement in the GPM.

- **Focus on improving the market share in LHO category:** The company has maintained its aim to achieve around 65% market share (vs 53.5% currently) in the LHO category over the next three to four years. This will be done by enhancing the reach of its LHO product portfolio and improving the brand awareness through adequate media and promotional activities. Hence we expect the advertisement spend as a percentage of sales to remain above 12% in the coming years.

- **Scouting for acquisition in domestic and international markets:** With above Rs330 crore of cash and cash equivalent on its books the company is scouting for an acquisition in the domestic as well as the international market. The acquisition could be of a brand or multiple products that would complement the company's existing product portfolio.

Upward revision in estimates

Upward revision in estimates: We have slightly revised upwards (by 3.6%) our estimate for FY2012 to factor in the higher than estimated sales volume growth and other income. Also, we have fine tuned our estimates for FY2013.

Revision in estimates	FY2012	FY2013
Net sales	469.6	560.7
Chg (%)	1.2	1.9
PAT	119.3	140.5
Chg (%)	3.6	0.5

Outlook and valuation

With the category growth likely to sustain above 15% YoY, we expect BCL's volume growth to sustain in the range of 18-20% in the coming quarters. Overall, we expect the company to achieve around 31% top line growth in FY2012. With the volume growth in ADHO likely to sustain above 15% YoY, we expect the FY2013 top line growth to be at around 20% YoY. With the OPM sustaining in the range of 27-28%, we expect the bottom line to grow at a CAGR of 17% over FY2011-13.

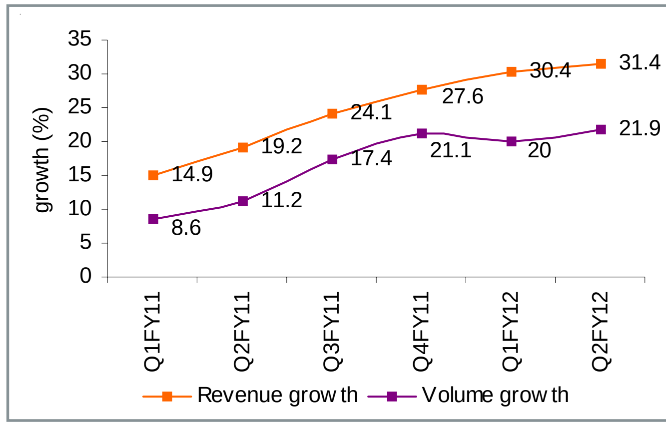
At the current market price the stock is trading at 12.6x its FY2012E earnings per share (EPS) of Rs8.1 and 10.7x its FY2013E EPS of Rs9.5. We maintain our Buy recommendation on the stock with the price target of Rs142. Going ahead, any organic or inorganic initiative taken to improve the growth prospects of the business would act as a key trigger for the stock.

Valuation table

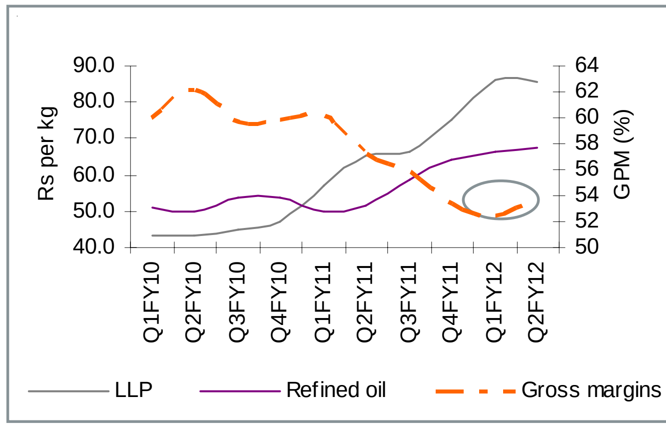
Particulars	FY2010	FY2011	FY2012E	FY2013E
Net sales (Rs cr)	294.9	359.4	469.6	560.7
Operating profit (Rs cr)	97.7	108.9	125.6	155.3
Adjusted PAT (Rs cr)	83.9	103.1	119.3	140.5
EPS (Rs)	5.7	7.0	8.1	9.5
OPM (%)	33.1	30.3	26.7	27.7
PE (x)	18.0	14.6	12.6	10.7
Market cap/sales	4.3	4.2	3.2	2.7
EV/EBIDTA (x)	12.9	13.0	8.6	6.2
RoE (%)	211.0	49.2	27.5	26.6
RoCE (%)	256.2	59.2	34.7	33.4

The author doesn't hold any investment in any of the companies mentioned in the article.

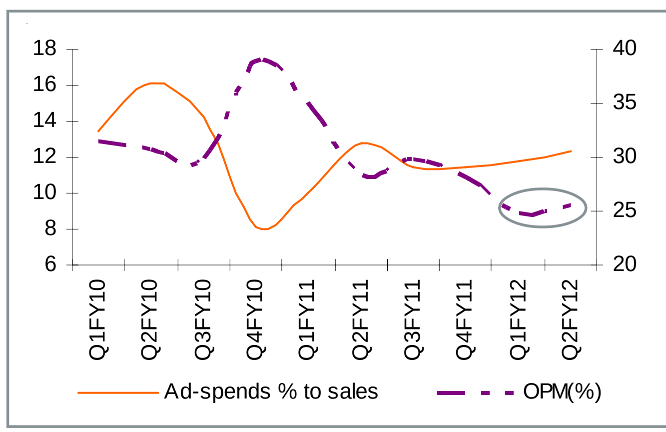
Volume-led top line growth



GPM affected by higher raw material cost



Trend in the OPM



CMC

Viewpoint

Extraordinaries pull down otherwise strong operating performance

CMP: Rs778

CMC announced the second quarter results for FY2012 recently. We attended the post-results conference call. We present below the highlights of the results and the takeaways from the call.

Result highlights:

- On reported basis, for Q2FY2012, revenues grew by 17.1% quarter on quarter (QoQ) and 32% year on year (YoY) to Rs357.7 crore with the rupee depreciation benefiting by Rs4 crore. The EBITDA margin dropped to 14.9%, down 170 basis points QoQ affected by a wage hike (of 9% taken w.e.f. July 1, 2011), mark-to-market (MTM) foreign exchange (forex) losses of Rs3.63 crore and a one-time charge of Rs2.2 crore on re-calculation of gratuity and leave encashment benefits. The effective tax rate increased to 38.1% from 29.6% in the sequential quarter on the back of an additional tax charge of Rs4.16 crore on the dividend received from CMC Americas Inc (its 100% subsidiary). The reported net profit was down 6.5% QoQ and 25.2% YoY to Rs32.6 crore.

- Adjusting for the forex loss of Rs3.63 crore and one-time gratuity and leave encashment charge of Rs2.2 crore, the EBITDA margin stood at 16.5%, down 10 basis points on a sequential basis and 290 basis points on a year-on-year (Y-o-Y) basis. Adjusting for the tax on the dividend of Rs4.16 crore, the effective tax rate stood at 27.2%, down from 29.6% in the sequential quarter. The adjusted net profit grew 22.2% QoQ and declined 2.3% YoY to Rs42.6 crore.

Results table Rs (cr)

Particulars	Q2FY12			Q1FY12	% QoQ		Q2FY11	YoY %
	Reported	Adjustment	Adjusted		Reported	Adjusted		
Revenues	**357.7**	**0.0**	**357.7**	**305.6**	**17.1**	**17.1**	**271.1**	**32.0**
Expenditure								
Materials	44.5	0.0	44.5	37.3	19.3	19.3	31.0	43.6
Staff costs	108.2	-2.2	106.0	95.8	12.9	10.6	87.3	21.3
Other expenses	44.1	-3.6	40.4	41.3	6.8	(2.0)	35.6	13.7
Sub contracting and outsourcing	107.8	0.0	107.8	80.5	33.9	33.9	64.5	67.0
Total expenditure	304.5	(5.8)	298.7	254.9	19.5	17.2	218.4	36.7
Operating profit	**53.2**	**5.8**	**59.0**	**50.7**	**4.9**	**16.4**	**52.6**	**12.2**
Other income	4.9	0.0	4.9	2.6	91.2	91.2	2.1	130.6
EBIDTA	58.1	5.8	64.0	53.3	9.1	20.0	54.8	16.8
Depreciation	5.4	0.0	5.4	3.7	45.1	45.1	2.4	122.8
Interest	0.0	0.0	0.0	0.0	(15.9)	(15.9)	0.1	-94.9
PBT	52.7	5.8	58.5	49.6	6.4	18.1	52.3	12.0
Tax	20.1	-4.16	15.9	14.7	36.9	8.5	8.6	84.5
PAT	**32.6**	**10.0**	**42.6**	**34.9**	**(6.5)**	**22.2**	**43.6**	**-2.3**
Equity capital (FV Rs 10)	30.3		30.3	30.3			30.3	
EPS	10.8		14.1	11.5			14.4	
Margin analysis								
OPM (%)	14.9		16.5	16.6			19.4	
Staff costs (%)	30.2		29.6	31.4			32.2	
Tax rate (%)	38.1		27.2	29.6			16.5	
NPM (%)	9.1		11.9	11.4			16.1	

- The depreciation charge for the quarter increased by 45.1% QoQ and 122.8% YoY to Rs5.4 crore on the back of capitalisation of part of Phase II of the Hyderabad special economic zone (SEZ) facility. The total amount capitalised in H1FY2012 is Rs118 crore.
- The services revenues grew 17% QoQ to Rs316.5 crore contributing 88.6% of the total revenues. Equipment sale grew 17.7% QoQ to Rs40.7 crore. The international business revenues grew 19.3% QoQ to Rs211.1 crore, contributing 59.1% of the total revenues, whereas the domestic revenues grew by 14% QoQ to Rs146.1 crore.
- In terms of business segments, the customer services (CS) revenues grew 12% QoQ to Rs84.5 crore with the EBIT margin up 80 basis points QoQ to 7.9%. The system integration (SI) revenues grew by 19.9% QoQ to Rs204.5 crore with the EBIT margin down 480 basis points QoQ to 21.4%. Within the SI revenues, the embedded systems revenues grew by 10% QoQ. The IT enabled services (ITES) revenues grew by 13% QoQ to Rs48.4 crore with the EBIT margin down 470 basis points QoQ to 28.6%. The education & training revenues grew 20.9% QoQ to Rs15.4 crore with the EBIT margin up 820 basis points QoQ to 18.4%.

Segmental results Rs (cr)

Particulars	Q2 FY12	Q1 FY12	Q2 FY11	% QoQ	% YoY
Customer services	84.5	75.4	68.5	12.0	23.3
PBIT	6.7	5.3	5.1	25.6	30.8
Margins (%)	7.9	7.1	7.5	86	45
% of revenues	*23.6*	*24.7*	*25.3*		
System integration	204.5	170.5	144.3	19.9	41.7
PBIT	43.7	44.6	45.3	-1.9	-3.6
Margins (%)	21.4	26.1	31.4	-476	-1004
% of revenues	*57.2*	*55.8*	*53.2*		
ITES	48.4	42.9	42.7	13.0	13.5
PBIT	13.8	14.3	13.3	-3.1	4.3
Margins (%)	28.6	33.3	31.1	-475	-253
% of revenues	*13.5*	*14.0*	*15.7*		
Education and training	15.4	12.8	12.6	20.9	22.2
PBIT	2.8	1.3	2.5	117.2	13.5
Margins (%)	18.4	10.2	19.8	814	-140
% of revenues	*4.3*	*4.2*	*4.7*		
SEZ	4.8	4.0	3.0	21.7	60.6
PBIT	2.7	3.1	2.8	-13.7	-4.1
Margins (%)	56.1	79.2	94.0	-2304	-3783
% of revenues	*1.4*	*1.3*	*1.1*		
Total revenues	357.7	305.6	271.1		
Total PBIT	69.8	68.7	69.1		
Blended margins (%)	19.5	22.5	25.5		

Other highlights:

- The company added 23 new clients in the quarter: 21 in India and 2 in the overseas markets. Tata Consultancy Services (TCS) channel's contribution to the total revenues grew to 51% from 47% in the previous quarter of which 39% was from the international operations.
- During the quarter, the company added 691 employees taking the total headcount including contractors to 8,500. Of the employee strength, 4,334 people are on the company's rolls whereas 4,166 employees are on sub-contracting. Since Q2FY2011 the company has added 222 employees on its rolls and 1,703 employees on sub-contracting.
- The company has won a couple of large deals in the ITES space, which currently has a higher portion of onsite operations leading to an adverse impact on the company's margins. This led to a rise of 380 basis points in the sub-contracting expenses to 30.1% as a percentage of sales. The management expects the shift towards offshore to happen by the end of Q3FY2012 and the full benefit of offshoring to be visible in Q4FY2012.
- The cash & cash equivalents stood at Rs222 crore at the end of the quarter. The company has done a capital expenditure (capex) of Rs56 crore in H1FY2012 and expects another Rs140 crore to be done in H2FY2012, taking the total capex for FY2012 to Rs200 crore (down from the earlier guidance of Rs246 crore). Of the Rs200 crore, about Rs175 crore would be towards the Phase II of the Hyderabad SEZ.
- A large part of the Phase II is going to be leased to TCS. The management expects lease rentals for FY2012 to be about Rs22 crore, up from Rs12 crore in FY2011.
- Going forward, the management is witnessing traction for its ITES solutions and services in India and the USA in the digitisation segment. The SI business is seeing traction in India as well as international markets mainly in ports and the insurance solutions space. The company has formed a team in Europe and plans to target the digitisation business in the region alongwith its ports and insurance solution business.
- The management expects to maintain the EBITDA margin in the 16-17% range going forward. The margin would be benefited by the higher offshoring of the recently won ITES deals.
- The adjusted tax rate for H1FY2012 is about 28.3%; the management expects the same to come down to 26-27% for FY2012. For FY2013, the tax rate would be 22% as the share of the SEZ revenues improves.

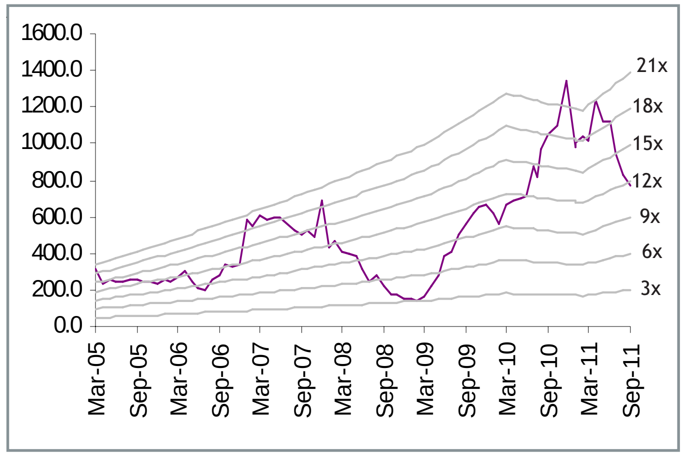
Valuation:

In the last three months CMC has corrected heavily (by close to 34%) and is currently hovering around Rs775. We believe CMC is one of the few mid-cap IT companies that is better placed to combat the tough macro environment. Being a TCS subsidiary immensely helps CMC to garner higher value-added deals and provides business visibility for the future. We remain positive on the long-term sustainability of the company's business model and believe that after a sharp correction in the stock price in the last three months, at the existing valuation the stock looks attractive from a 12-month investment perspective. At the current market price the stock trades at 13.8x FY2012 and 10.6x FY2013 consensus earnings estimates. We do not have any active rating on the stock.

Valuation table

Particulars	FY2011	FY2012E	FY013E
Revenues	1080.5	1369.9	1656.0
EBITDA	206.8	235.8	294.0
PAT	183.9	167.5	217.9
EPS	60.7	56.2	73.2
PE (x)	12.8	13.8	10.6
EBITDAM (%)	19.1	17.2	17.8
PATM (%)	17.0	12.2	13.2

One-year forward PE band



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Evergreen

Housing Development Finance Corporation
HDFC Bank
Infosys
Larsen & Toubro
Reliance Industries
Tata Consultancy Services

Apple Green

Apollo Tyres
Bajaj Auto
Bajaj FinServ
Bajaj Holdings & Investment
Bank of Baroda
Bank of India
Bharat Electronics
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Union Bank of India
United Phosphorus
V-Guard Industries

Vulture's Pick

Mahindra Lifespace Developers
Orient Paper and Industries
Tata Chemicals
Unity Infraprojects