

Bajaj Electricals Ltd (BJE IN)

Stronger distribution and RREP continue to drive growth

INDIA | MIDCAP - ELECTRICALS | Company Update

Our recent channel checks indicate that implementation of TOC (Theory of Constraints, started two years ago) and RREP (Range and Reach Expansion Program) have started yielding strong results for BJE. With a solid distribution channel, BJE is increasing its product penetration and improving visibility, which, channel partners indicate has resulted in a strong double-digit revenue growth in CD (consumer durables). We estimate 24%/20% growth in CD in FY19/20.

- In CD, BJE has deeply penetrated the market and is gaining wallet share with an expansion in its product range, new launches, and new products additions (Nirlep + Morphy Richard - MR).
- It has also aggressively focused on advertising and incentivising the channel to maintain/improve its RREP process.
- In EPC, improvement in execution (in its UP order under the government's Saubhagya Scheme) and being selective in project bidding has resulted in strong revenue. It has implemented TOC for its project execution business to improve supply chain and execution capabilities. Our checks suggest that it is focussing on project completion rather than order booking. We expect revenue growth of 60%/12% in FY19/20, but lower margin of 6.6% in FY19 (majorly because of the UP order) and 8% in FY20.

What did BJE do over the last two years in CD? Its TOC and RREP implementation involved increasing touch points, counters, and SKUs, improving inventory, stocking management, and product reach, and reducing working capital needs. It also set out to recreate its brand to ride a revival in the consumer segment.

RREP – reaping benefits after two years of pain: RREP implementation gave BJE two years of pain where it lost sales worth ~Rs 7bn (over FY15-18). With full RREP implementation, BJE has established a strong distribution network of 180,000 (industry leaders are at 120,000). Our checks indicated that it is able to achieve deeper product penetration with stronger distribution. It is also focussing on improving its wallet share by adding new products (such as Nirlep + MR) and expanding its existing product range. Additionally, to maintain its RREP process (frequency of retail counter visits, increasing product portfolio), BJE is motivating and encouraging its distributors with new incentive schemes and training sessions. This is in line with our theory of BJE moving up in the distribution channel. For a detailed report on [TOC and RREP, click here](#). BJE has taken a price hike of ~3% to pass on higher commodity prices, in 3QFY19 (~3% in LED, 7% in geysers, and 10% in Morphy Richards – details on page 2). It also improved margins, and with channel financing, it improved its WC cycle.

Outlook and valuation

- Currently, CD is trading at a PE of 20.5x FY20 and E&P is trading at an FY20 EV/EBITDA of 7x. In E&P, healthy order book and improved execution will result in strong revenue growth.
- Over the next two years, we expect the valuation gap between BJE and its peers to narrow as: (1) TOC yields results, (2) its focus on leveraging its distribution network through geographical and product expansion will result in market share gains, (3) there is strong revenue visibility, with levers for margin expansion, and (4) working capital improves.
- We expect PAT CAGR of 97% over FY18-20 for BJE.
- We assign a target multiple of 30x to CD (12% discount to the industry average) and 8x EV/EBITDA for E&P. Maintain BUY with an SOTP-based revised target of Rs 660 (Rs 491 CD + Rs 169 E&P).

10 December 2018

BUY (Maintain)

CMP RS 474

TARGET RS 660 (+39%)

COMPANY DATA

O/S SHARES (MN) :	102
MARKET CAP (RSBN) :	48
MARKET CAP (USDBN) :	0.7
52 - WK HI/LO (RS) :	706 / 403
LIQUIDITY 3M (USDMN) :	2.1
PAR VALUE (RS) :	???

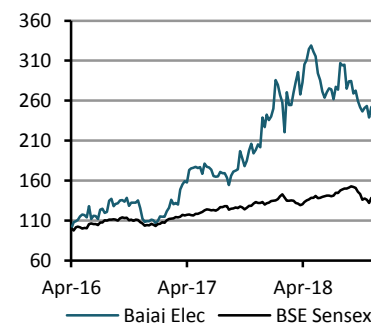
SHARE HOLDING PATTERN, %

	Sep 18	Jun 18	Mar 18
PROMOTERS :	62.8	62.9	62.9
FII / NRI :	9.9	10.2	10.1
FI / MF :	5.0	4.8	5.4
NON PRO :	6.5	6.8	6.9
PUBLIC & OTHERS :	15.9	15.4	14.6

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	-6.2	-12.0	5.5
REL TO BSE	-8.8	-6.3	-3.8

PRICE VS. SENSEX



Source: Phillip Capital India Research

KEY FINANCIALS: Orient Electric Ltd.

Rs mn	FY18	FY19E	FY20E
Net Sales	47,074	67,398	77,716
EBIDTA	2,820	4,392	6,092
Net Profit	836	2,299	3,235
EPS, Rs	17.1	22.7	31.9
PER, x	29.6	22.2	15.8
EV/EBIDTA, x	16.9	13.2	9.9
P/BV, x	5.4	4.5	3.7
ROE, %	18.3	20.4	23.1
Debt/Equity (%)	0.8	1.0	0.9

Source: PhillipCapital estimates.

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Other takeaways from our channel checks

The CD business has opted for an FMCG distribution model

- **RREP has helped expand distributor touch points (up by ~50%).**
- BJE is now focussing on increasing its wallet share by increasing the number of its products on retail counters. Previously, one counter used to sell three products but now sells 5-7 with a complete product range. This has helped BJE in product penetration. Seasonal products such as water heaters and room heaters show strong double-digit growth. Additionally, it has also launched three new products in this segment.
- In fans, it expects robust growth from January 2019, driven by strong network (expect to gain back its lost market share).
- BJE is not only building a strong distribution network, but also motivating and encouraging its dealers with its new incentive scheme. DSOs (sales representatives of distributor) are rewarded with incentives of Rs 2,000-2,500 per month on achieving targets such as frequency of visits and increasing the product basket on counters.
- Over the last six months, BJE has also aggressively focused on advertisement – regular newspaper advertisements, new hoardings and posters according to festivals and setting up an ‘In Shoppe’ that cost Rs 2,000-4,000 per Shoppe. Bajaj has started aggressive marketing in tier-2 and tier-3 cities.
- Uniform Pricing Policy – this has resulted in improving the confidence of dealers and retailers. Only 1.5% difference between urban and rural regions.
- New products launched in the last three months – high-voltage lamps (30W and 40W), batters (1ft, 2ft and 4ft), Sauna 750W mixer grinder, and irons.
- To increase its presence in the south market, BJE has launched four products in the mixer-grinders category with a focus on the south where it currently does not have strong presence.
- Nirlep Appliances has started picking up in the RREP network.
- Morphy Richards will take 2-3 months to stabilise in the RREP network. Early BJE sold MR products through its traditional network. On some counters, MR products were available at par prices or below Bajaj’s products because of dumping. With RREP, MR products are ~10% higher than Bajaj products.
- BJE is filling in the gaps in the market by adding wholesalers.

Nirlep now available in RREP network



Pic from Rajasthan dealer warehouse

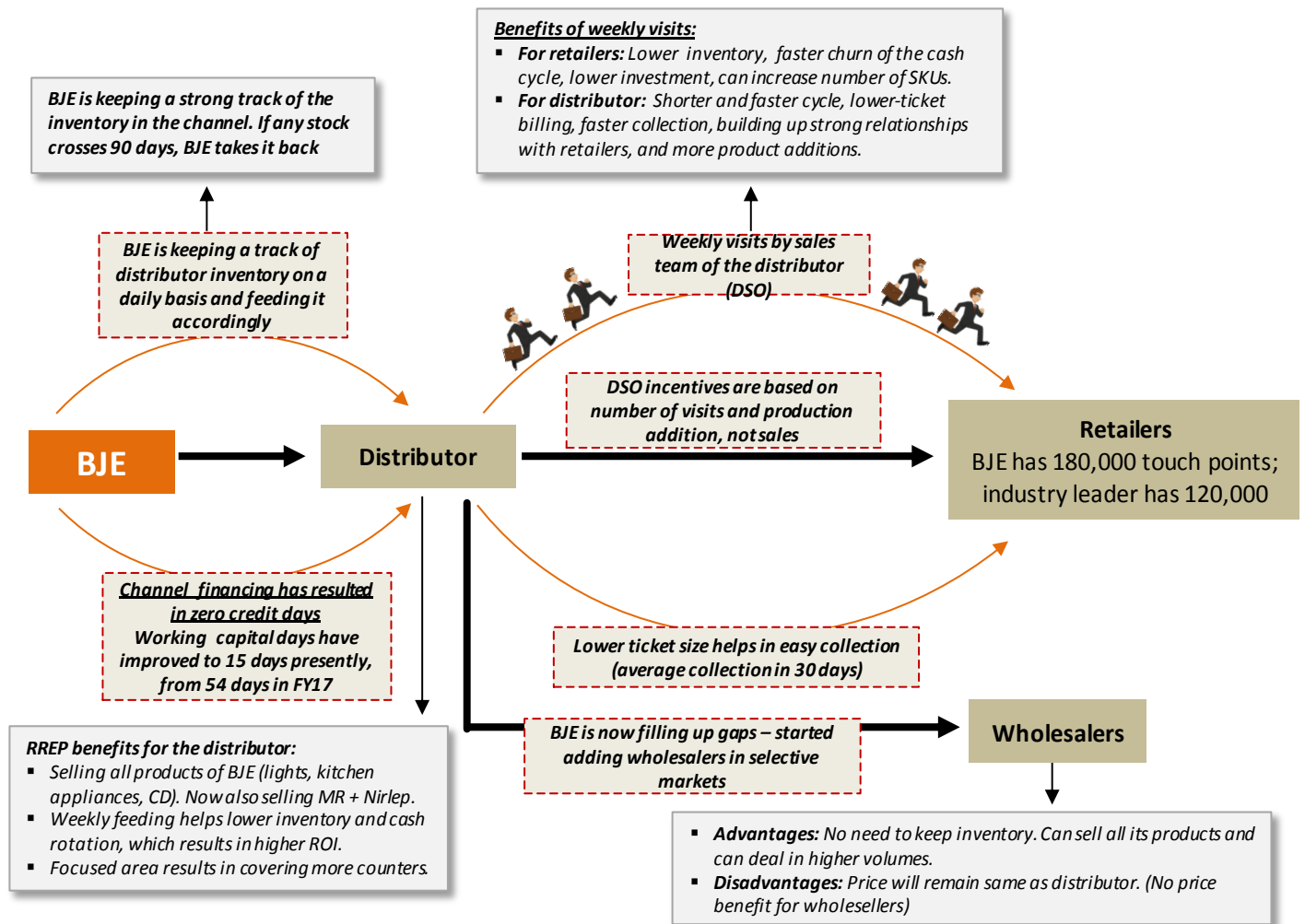
Increasing its presence in the south market



MR products compete with Philips, Panasonic

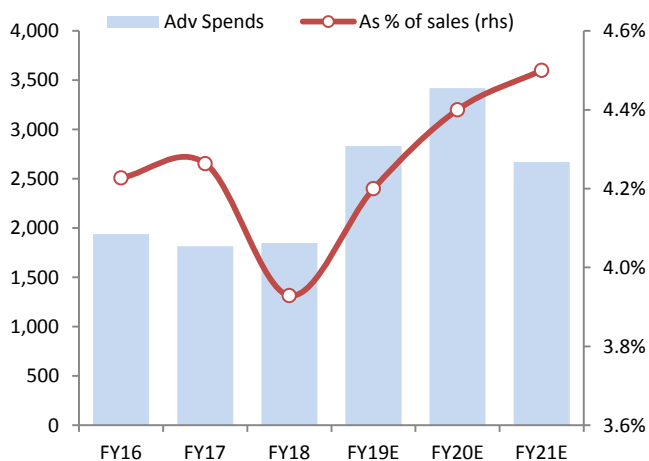


BJE: Distribution process and key benefits; RREP showing results



RREP has resulted in improvement in sales ratio; ~80% sales are booked in secondary sales vs. ~30% earlier. This has resulted in more visibility and availability of BJE products and is also helping the company to recover market share. We expect that with a larger channel, branding, product addition, launches, and strong after-sales services will lead to robust improvement in market share. We expect this segment's CAGR at 22% over FY18-20, with a 280bps improvement in margins (operating leverage + lower RREP implementation expenses).

Polishing the Bajaj brand



Source: Company, PhillipCapital India Research estimates

Festive season marketing by BJE for Nirlep and BJE products



EPC: Healthy order book = strong revenue growth; two-year CAGR of 34%

In EPC, improvement in execution (in its UP order) and being selective about project bidding has resulted in strong growth in EPC revenue. BJE has implemented TOC for its project execution business in order to improve supply chain and execution capabilities. To ensure that fixed costs are covered and to protect margins, it is selective about picking up orders. We expect that increase in commodity prices and slightly higher execution cost in UP orders could dent margins by 150-200bps in FY19. TOC has speeded up project execution, which will help BJE to improve its margins in this segment (early completion bonus). Management expects revenue of Rs 40bn in FY19.

Total UP order = Rs 59.6bn

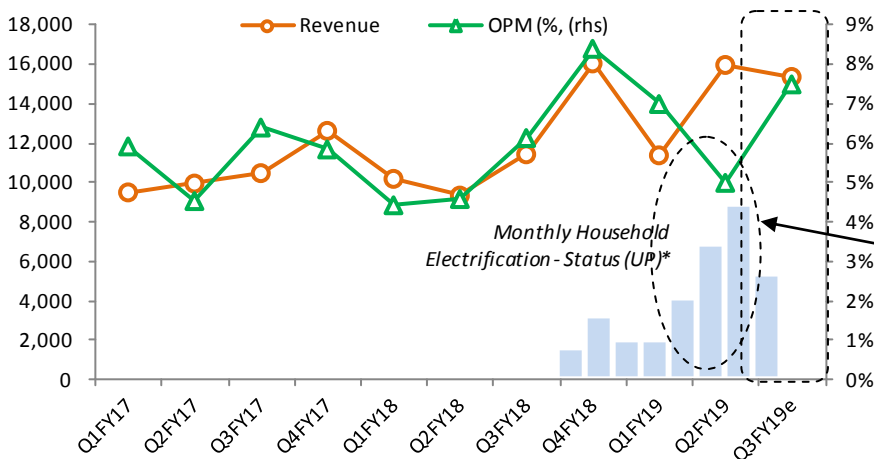
Management expects order size to come down to Rs 40bn

Currently BJE's total order book is Rs 73bn

BJE: UP order (under Saubhagya scheme) – Monthly tracker

		Monthly Household Electrification - Status													
Discom	City	Total Household	To be electrified										Dec18 TD*	To be Electrified	As % of total
			Mar18	Apr18	May18	Jun18	Jul18	Aug18	Sept18	Oct18	Nov18				
PuVVNL	Varanasi	7,92,815	1,309	3,563	1,57,530	3,362	5,106	3,442	8,774	25,805	28,845	12,615	675	68,906	9%
PuVVNL	Fatehpur	6,99,189	148	887	2,81,335	5,447	2,470	3,125	25,597	23,065	28,381	11,953	1,393	1,79,904	26%
PuVVNL	Azimgarh	7,35,779	1,191	1,334	2,88,615	17,467	5,069	11,174	29,620	19,716	27,023	24,587	4,158	1,49,801	20%
PuVVNL	Jaunpur	8,32,136	4,539	10,912	3,51,207	2,353	5,548	2,202	15,714	32,996	24,242	16,605	1,209	2,50,338	30%
PuVVNL	Pratapgarh	6,17,672	4,306	3,320	2,38,349	4,188	2,416	3,748	9,066	17,824	16,294	13,956	338	1,70,519	28%
PuVVNL	Mau	3,36,639	1,551	732	85,411	3,716	14,492	2,253	10,889	7,338	10,935	5,282	3,785	26,721	8%
PuVVNL	Ballia	5,18,434	6,362	2,448	2,26,919	10,941	4,924	5,193	10,417	29,229	17,044	14,316	972	1,33,883	26%
MVVNL	Budaun	4,45,328	2,869	7,634	1,88,105	10,939	1,648	2,889	2,915	4,736	14,663	5,170	113	1,45,032	33%
MVVNL	Bareilly	6,39,515	1,357	12,802	1,50,096	5,284	2,729	3,242	4,089	7,008	13,420	15,821	421	98,082	15%
MVVNL	Lucknow	9,83,732	1,841	1,749	1,11,693	11,442	4,627	1,093	2,547	6,652	19,642	15,398	206	50,086	5%
MVVNL	Unnao	6,32,165	9,184	4,400	3,34,828	11,603	9,903	13,406	12,516	22,778	31,607	17,392	3,323	2,12,300	34%
MVVNL	Shajapur	5,48,479	1,506	3,093	2,69,885	4,469	2,708	1,102	2,673	17,934	25,378	11,696	408	2,03,517	37%
MVVNL	Pilibhit	3,74,934	5,372	1,784	1,33,918	5,419	3,621	4,074	3,726	3,649	18,322	8,172	466	86,469	23%
MVVNL	Sultanpur	4,55,603	1,681	1,180	1,58,399	1,707	1,693	3,825	5,619	19,466	24,657	14,324	759	86,349	19%
MVVNL	Amethi	2,81,330	2,144	1,236	1,18,303	1,915	343	905	2,510	9,548	13,493	10,001	1,949	77,639	28%
MVVNL	Sitapur	6,94,352	1,064	4,045	3,59,791	19,378	3,998	4,287	11,033	31,335	32,460	16,090	2,005	2,39,205	34%
MVVNL	Hardoi	7,14,221	2,774	3,193	4,28,844	23,667	3,331	3,829	22,811	19,754	33,579	34,198	1,684	2,85,991	40%
MVVNL	Faizabad	5,61,331	524	1,353	2,86,651	2,361	978	11,277	5,864	7,996	17,299	5,165	97	2,35,614	42%
MVVNL	Barabanki	5,68,013	9,336	4,630	2,98,102	8,619	9,390	5,254	9,608	9,876	22,843	9,540	196	2,22,776	39%
MVVNL	Gonda	5,91,448	1,852	1,525	3,96,636	2,562	5,377	5,191	9,589	27,482	26,191	8,929	737	3,10,578	53%
MVVNL	Ambedkar Nagar	4,06,237	417	687	1,52,071	1,333	1,139	2,166	3,248	9,298	18,470	3,876	360	1,12,181	28%
		1,24,29,352	61,327	72,507	50,16,688	1,58,172	91,510	93,677	2,08,825	3,53,485	4,64,788	2,75,086	25,254	33,45,891	27%

Source: Saubhagya, Company, PhillipCapital India Research Note: TD – Till date, BJE got LOI in may'18

E&P: Revenue and EBIT margin (%) with UP order monthly execution rate


According to the monthly tracker, BJE has completed ~33% of the work as on November 2018 and will be completing ~67% of the work by June 2019

Higher execution but lower billing impacted margin in 2QFY18. We expect billing to improve in 3QFY19, which will result in better margins

Source: Company, PhillipCapital India Research estimates

Balance sheet to remain starved for one year; will be comfortable in FY21

The UP order has resulted in an increase in debt to Rs 13bn in September 2018 from Rs 7.2bn in FY18. Over the next one year, until the completion of the large UP order, debt will remain at Rs 11-12bn. Additionally, this order will also use the cash flow of the consumer business. With the completion of the UP order in FY20, BJE will reduce its debt to Rs 6.6bn as funds are released from the UP order (Saubhagya scheme).

Outlook and valuation: Gap with peers to narrow

- Currently, CD is trading at a PE of 22x FY20 and E&P is trading at an FY20 EV/EBITDA of 7x. In E&P, healthy order book and improved execution will result in strong revenue growth.
- Over the next two years, we expect the valuation gap between BJE and its peers to narrow as: (1) TOC yields results, (2) its focus on leveraging distribution network through geographical and product expansion will result in market share gains, (3) there is strong revenue visibility, with levers for margin expansion, and (4) working capital improves.
- We expect PAT CAGR of 97% over FY18-20 for BJE
- We assign a target multiple of 30x to CD (12% discount to the industry average) and 8x EV/EBITDA for E&P (in line with the industry). Maintain BUY with an SOTP-based revised target of Rs 660 (Rs 491 CD + Rs 169 E&P) vs. Rs 690 earlier.

Valuation - Bajaj Electricals	FY20E
1) Consumer Business	
PAT (Rs mn)	1,657
PE (x)	30.0
CD / Share Value (Rs)	491
2) E&P Business	FY20
EBITDA (Rs mn)	3,534
EV/EBITDA (x)	8.0
EV (Rs mn)	28,271
Net Debt (Rs mn)	11,142
No. of Share (No. mn)	101
E&P per Share Value (Rs.)	169
TP - Comp.	660

Source: Company, PhillipCapital India Research estimates

Financials

Income Statement

Y/E Mar, Rs mn	FY17	FY18	FY19e	FY20e
Net sales	42,617	47,074	67,398	77,716
Growth, %	-7.2%	10.5%	43.2%	15.3%
Raw Material expenses	27,612	31,045	45,156	51,702
Operating expenses	9,375	10,030	14,295	16,048
Employee expenses	3,289	3,179	3,554	3,874
EBITDA (Core)	2,341	2,820	4,391	6,091
Growth, %	-11.4%	20.5%	55.7%	38.7%
Margin, %	5.5%	6.0%	6.5%	7.8%
Depreciation	299	339	358	378
EBIT	2,042	2,481	4,034	5,713
Growth, %	-13.8%	21.5%	62.6%	41.6%
Margin, %	4.8%	5.3%	6.0%	7.4%
Interest paid	804	589	877	1,107
Other Non-Operating Income	356	646	380	370
Pre-tax profit	1,594	2,538	3,537	4,976
Tax provided	604	809	1,238	1,742
Profit after tax	990	1,729	2,298	3,234
(-) Exceptional Expenses	0	(894)	0	0
Net Profit	990	836	2,298	3,234
Growth, %	-10.3%	-15.6%	175.0%	40.7%
Margin, %	2.3%	1.8%	3.4%	4.2%
Net Profit (adjusted)	990	1,729	2,298	3,234
No. of Eq. Sh O/S (m nos)	101	102	102	102

Balance Sheet

Y/E Mar, Rs mn	FY17	FY18	FY19e	FY20e
Cash & bank	653	257	-128	-629
Debtors	18,018	21,265	29,136	34,109
Inventory	5,712	5,792	8,749	9,948
Loans & advances	1,495	3,229	3,579	3,929
Other current assets	0	0	1	1
Total current assets	25,877	30,543	41,336	47,357
Investments	802	145	145	145
Gross fixed assets	3,662	4,069	4,769	5,769
Less: Depreciation	561	882	1,240	1,617
Add: Capital WIP	79	35	50	50
Net fixed assets	3,180	3,222	3,579	4,201
Total assets	29,860	33,910	45,060	51,704
Current liabilities	14,765	17,060	22,404	25,469
Provisions	789	760	760	760
Total current liabilities	15,554	17,820	23,164	26,229
Debt	6,466	7,231	11,231	12,066
Deferred Tax Liability	-875	-589	-589	-589
Total liabilities	21,145	24,462	33,806	37,706
Paid-up capital	203	204	204	204
Reserves & surplus	8,512	9,243	11,049	13,794
Shareholders' equity	8,715	9,448	11,254	13,998
Total equity & liabilities	29,860	33,910	45,060	51,704

Source: Company, PhillipCapital India Research Estimates

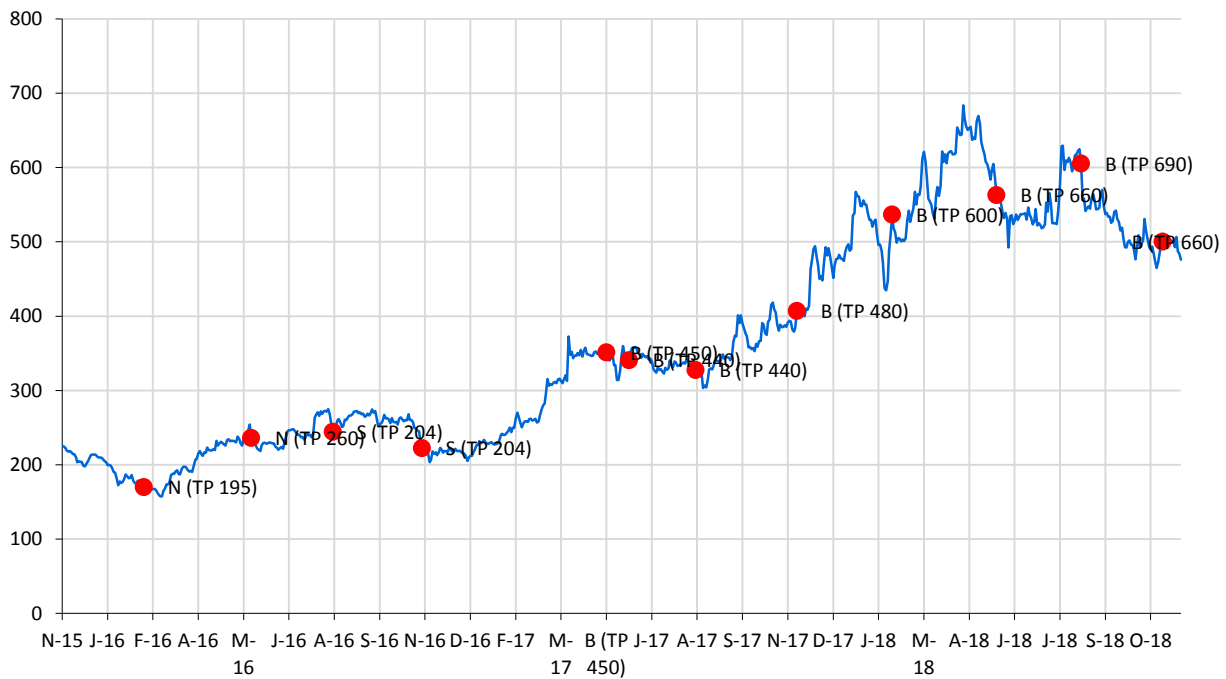
Cash Flow

Y/E Mar, Rs mn	FY17	FY18	FY19e	FY20e
Pre-tax profit	1,680	1,644	3,538	4,977
Depreciation	299	339	358	378
Chg in working capital	1,838	(4,155)	(5,837)	(3,458)
Total tax paid	(437)	(544)	(1,238)	(1,742)
Other operating activities	990	1,686	497	737
Cash flow from operating activities	4,370	(1,029)	(2,683)	892
Capital expenditure	(472)	(355)	(715)	(1,000)
Chg in investments	12	3	0	0
Other investing activities	(445)	712	380	370
Cash flow from investing activities	(905)	361	(335)	(630)
Free cash flow	3,464	(668)	(3,018)	262
Equity raised/(repaid)	59	167	0	0
Debt raised/(repaid)	(2,972)	1,515	4,000	835
Dividend (incl. tax)	(1)	(283)	(491)	(491)
Other financing activities	(766)	(763)	(877)	(1,107)
Cash flow from financing activities	(3,680)	635	2,632	(763)
Net chg in cash	(216)	(33)	(386)	(501)

Valuation Ratios

	FY17	FY18	FY19e	FY20e
Per Share data				
EPS (INR)	9.8	17.1	22.7	31.9
Growth, %	-10%	75%	33%	41%
Book NAV/share (INR)	86.0	93.3	111.1	138.2
FDEPS (INR)	12.7	11.5	26.0	35.4
CEPS (INR)	43.1	(10.2)	(26.5)	8.8
CFPS (INR)	2.8	3.5	4.0	4.0
DPS (INR)				
Return ratios	3.3	5.1	5.1	6.3
Return on assets (%)	11.4	18.3	20.4	23.1
Return on equity (%)	16.1	20.6	23.2	25.7
Return on capital employed (%)				
Turnover ratios	3.0	2.9	3.1	3.1
Sales/Total assets (x)	13.7	14.8	19.1	18.7
Sales/Net FA (x)	0.2	0.3	0.3	0.3
Working capital/Sales (x)	0.1	0.1	0.1	0.1
Fixed capital/Sales (x)	152.2	162.6	155.6	158.0
Receivable days	51.1	47.1	50.0	50.0
Inventory days	12.6	24.7	19.1	18.2
Payable days	132.0	138.8	128.0	128.0
Working capital days	83.9	95.7	96.7	98.2
Liquidity ratios				
Current ratio (x)	1.7	1.7	1.8	1.8
Quick ratio (x)	1.3	1.4	1.4	1.4
Interest cover (x)	2.6	3.0	4.0	4.3
Dividend cover (x)	3.5	2.3	5.6	7.9
Total debt/Equity (x)	0.7	0.8	1.0	0.9
Net debt/Equity (x)	0.7	0.7	1.0	0.9
Valuation				
PER (x)	48.5	27.8	20.9	14.8
Price/Book (x)	5.5	5.1	4.3	3.4
Yield (%)	0.6	0.7	0.8	0.8
EV/Net sales (x)	1.3	1.2	0.9	0.8
EV/EBITDA (x)	20.0	16.0	12.5	9.5
EV/EBIT (x)	22.4	17.7	13.5	10.0

Stock Price, Price Target and Rating History



Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	$\geq +15\%$	Target price is equal to or more than 15% of current market price
NEUTRAL	$-15\% > \text{to} < +15\%$	Target price is less than +15% but more than -15%
SELL	$\leq -15\%$	Target price is less than or equal to -15%.

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