Sugar

India

ATTRACTIVE

September 17, 2009

INITIATING COVERAGE

BSE-30:16,677

Still some juice in the cane. Even as sugar stocks enter expensive territory, we believe they offer moderate upside given high sugar prices and strong operating performance. We expect the current supply deficit to extend over the next two years led by poor rainfall and low inventory. Strong operating cash flows over the next two years will reduce the leverage, which will further support valuations. Lower sugar prices and adverse government actions are the key risks, in our view.

Strongest up-cycle in 50 years; expected to continue for next 12-15 months

We believe the current sugar shortfall, the most severe in 50 years, is likely to extend the up-cycle beyond the normal two-year period. We expect domestic sugar prices—currently at Rs31/kg, up 132% from the trough of Rs13.5/kg in Sep-2007—to sustain over the medium term due to a large deficit in India coupled with low output in Brazil.

Initiate coverage on the sector with an Attractive view driven by strong sugar prices

We initiate coverage on the sector with an Attractive view based on strong sugar prices that will drive strong earnings growth over the next few quarters. We initiate coverage on Shree Renuka Sugars (BUY, TP: Rs235), Balrampur Chini (ADD, TP: Rs140) and Bajaj Hindusthan (SELL, TP: Rs150). We use an EBITDA-based relative valuation to arrive at our fair values. Further upsides will be driven by sugar-price-linked earnings growth.

Valuations nearing saturation; sugar price trend to drive near-term performance

We believe valuations for sugar stocks are entering into expensive territory in anticipation of strong earnings growth over the next few quarters. Current valuations factor in most of the good news of high sugar prices and do not factor in the risk of adverse government actions to control prices. Strong operating cash flows will also reduce the risk of leverage, which will further support valuations. We expect near-term stock performance to be driven by sugar price movements due to the high sensitivity of earnings and valuations to sugar prices.

Key risks: Sugar price volatility, cane availability and government actions

Key risks to our estimates and valuations arise from (1) sugar price volatility, (2) lower cane availability and (3) government actions and regulations. Lower-than-estimated sugar realization can have a magnifying impact on earnings. Cane availability may be impacted by a poor monsoon, low acreage and shift of harvest to other sweeteners. Attempts by the government to control the sugar price rise may be a key risk for the sugar companies as the sector is highly regulated at all levels of the value chain.

Key calls

	Bajaj Hindusthan	Balrampur Chini	Shree Renuka Sugar
Current price (Rs)	187	125	203
Target price (Rs)	**150**	**140**	**235**
Upside/(downside) %	(20)	12	16
Rating	SELL	ADD	BUY
Market Cap. (Rs bn)	35.8	31.9	68.0

Source: Kotak Institutional Equities estimates

INSIDE

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Important disclosures appear at the back

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The prices in this report are based on the market close of September 16, 2009.

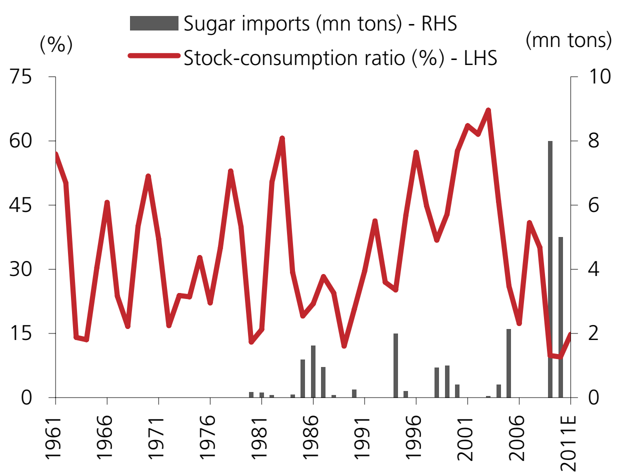
OVERVIEW—STILL SOME JUICE IN THE CANE

We believe the current sugar up-cycle will extend beyond the normal two-year cycle as low production and depleted inventories will make India a net importer for the next two years. International raw sugar prices are near their three-decade high at US$ c22/lb (up 95% CYTD) and we do not rule out a further increase led by low production in Brazil and India, the two largest sugar producers. We believe valuations are entering into expensive territory, however, further upsides will largely be driven by higher sugar prices. We initiate coverage on Shree Renuka Sugars (BUY, TP: Rs235), Balrampur Chini (ADD, TP: Rs140) and Bajaj Hindusthan (SELL, TP: Rs150).

Strongest domestic up-cycle in 50 years

The current rise in domestic sugar prices is backed by the most severe supply shortage in 50 years. Domestic sugar prices—currently at Rs31/kg—have increased 73% over the past year and 132% from the lows of Rs13.5/kg in Sep 2007. We expect sugar production in SS2010E at 15.5 mn tons, which will be 34% lower than the estimated demand of 23.5 mn tons. We expect sugar inventory to be 2.3 mn tons at end-SS2009E with a stock-to-consumption ratio of 9.8%, the lowest in 50 years. Low domestic availability will result in imports of 8 mn tons and 5 mn tons of sugar in SS2010E and SS2011E, respectively; which is the highest in 50 years. We expect the acute shortage in India to keep both domestic and international sugar prices high over the next 12-15 months.

Exhibit 1: Strongest up-cycle in 50 years
Sugar imports and stock-consumption ratio in India, September year-ends, 1961-2011E



Source: ISMA, Bloomberg, Kotak Institutional Equities estimates

Exhibit 2: High sugar prices likely to sustain over 12-15 months
Domestic sugar price (Mumbai S-30), Apr 2000 to Sep 2009, (Rs/kg)

Source: ISMA, Bloomberg, Kotak Institutional Equities estimates

Valuations nearing saturation; sugar prices to drive near-term stock performance

We believe valuations of sugar stocks are nearing saturation with most of the good news priced in already. We value the sugar stocks based on EBITDA multiple due to high cyclicality in earnings and sensitivity of EPS to sugar prices. Near-term stock performance is likely to be driven by movement in sugar prices. We believe the key factors impacting valuations will be (1) sensitivity of earnings to sugar price, (2) operating cash flows, (2) balance sheet leverage and (4) integration of operations.

Exhibit 3: Valuations nearing saturation
Valuation summary for BJH, BRCM and SHRS

	Bajaj Hindusthan	Balrampur Chini	Shree Renuka Sugar
Current price (Rs)	187	125	203
Target price (Rs)	**150**	**140**	**235**
Upside/(downside) %	(20)	12	16
Rating	SELL	ADD	BUY
Target valuation-FY2011E			
EV/EBITDA (X)	5.0	6.0	6.5
P/E (X)	8.3	10.5	11.5
P/B(X)	1.0	1.8	2.2
Return ratios			
RoAE-FY2011E (%)	12.0	16.4	20.8
RoACE-FY2011E (%)	7.9	14.7	19.0

Source: Kotak Institutional Equities estimates

Strong earnings growth driven by high sugar prices

Exhibit 4: We see potential upside in valuations from current levels
Summary financials, September fiscal year-ends, 2010-11E (Rs mn)

	Revenues (Rs bn)		EBITDA (Rs bn)		PAT (Rs bn)		EPS (Rs)	
	2010E	**2011E**	**2010E**	**2011E**	**2010E**	**2011E**	**2010E**	**2011E**
BJH	45.4	49.2	9.8	9.0	4.6	3.4	23.9	17.7
BRCM	21.0	24.2	5.9	5.6	3.4	3.3	13.4	13.0
SHRS	59.6	71.6	13.3	11.1	8.1	6.8	24.2	20.4

Source: Kotak Institutional Equities estimates

Key risks—sugar price, government actions and cane availability

The key risk for sugar companies is the sugar price realization, as their earnings and valuations are highly sensitive to small changes in sugar prices. A Re1 change in sugar price assumptions can impact the FY2010E EPS of BJH, BRCM and SHRS by 10.5%, 11.9% and 11.7%, respectively. The Indian sugar industry is highly regulated at all levels from cane procurement and pricing, monthly sales quantity and import, export restrictions and tariffs. Adverse government actions on any of these aspects can be a key risk for sugar manufacturers. The availability of sugarcane for crushing is dependent on the area planted, weather conditions and drawal rates, which are correlated to the economic viability of sugarcane versus other crops.

VALUATIONS NEARING SATURATION, SUGAR PRICES TO DRIVE UPSIDES

We believe valuations of sugar stocks are entering expensive territory driven by the expectation of strong near-term earnings growth. We expect near-term stock performance to be driven by (1) sensitivity of earnings to sugar price, (2) operating cash flows, (3) balance sheet leverage and (4) integration of operations. We prefer EBITDA-based valuation for the sugar stocks considering the cyclicality in their earnings and high sensitivity of EPS to sugar prices and cane availability. We believe the current up-cycle will last longer than the normal two-year period and that the larger companies will be better placed to survive the subsequent downturn due to their (1) strengthened balance sheets, (2) larger capacities and (3) higher contribution from non-cyclical by-products.

EBITDA multiple a better measure to value cyclicality in earnings

We believe EBITDA multiple is a better valuation methodology for the sugar companies considering (1) strong cyclicality in their earnings and (2) large disparity in capital structures of various companies. We do not prefer an EPS multiple due to (1) its high sensitivity to various factors like sugar and cane prices, (2) impact of high leverage for some of the companies and (3) tax benefits from brought forward losses, which will get exhausted over the next year. Currently high volatility in sugar prices makes EPS estimates highly vulnerable to change due to a small change in the realization estimate.

Exhibit 5: We use different target multiples based on relative RoACE and business risk
Valuation summary for our coverage universe

	BJH	BRCM	SHRS
EBITDA-FY2011E	8,992	5,556	11,119
EV/EBITDA (X)	5.0	6.0	6.5
EV	**44,962**	**33,334**	**72,274**
Net debt-FY2011E	16,765	(1,668)	(6,491)
Equity Value	**28,197**	**35,002**	**78,765**
Fully diluted shares (mn)	191	256	335
Value per share (Rs)	**147**	**137**	**235**
Target price (Rs)	**150**	**140**	**235**
Current price (Rs)	187	125	203
Upside (%)	(20)	12	16

Source: Kotak Institutional Equities estimates

Valuation based on business risk, sustainability and quality of earnings

We value SHRS at 6.5X FY2011E EBITDA, higher than the global players due to its distinguished low risk business model and higher sustainability of earnings in a normalized scenario.

We value BRCM at 6X FY2011E EBITDA, lower than SHRS, due to its higher vulnerability to sugar price volatility and higher risks from cane availability and government regulations.

We value BJH at 5X FY2011E EBITDA, due to the high sensitivity of its earnings to sugar prices and higher risks from cane availability and government regulations. We use a lower target multiple than BRCM due to its poor earnings quality reflected through its low RoACE at peak cycle earnings.

Differentiated business models pose different risks

We believe SHRS is best placed in the sector with its refinery-focused business model that protects it from the vagaries of cane availability and government regulations. We believe BJH and BRCM are more vulnerable to sugar price changes as cane sugar contributes majority of their earnings. The profitability of cane sugar manufacturers has significant downside risk from lower sugar prices since their input costs are fixed. However, for refiners like SHRS, the input cost (raw sugar price) is also likely to follow the trend in prices of refined sugar, hence it is likely to earn a normalized conversion margin on sustainable basis.

Exhibit 6: SHRS earnings are more stable due to higher share of refining
Revenue and EBITDA split for BJH, BRCM and SHRS, September fiscal year-ends, 2010-2011E

	BJH		BRCM		SHRS	
	2010E	2011E	2010E	2011E	2010E	2011E
Revenue						
Cane sugar	19,132	28,315	15,086	17,496	10,836	13,043
Refined sugar	21,659	14,579	2,909	2,708	35,311	43,648
Others	4,596	6,338	2,964	3,987	13,496	14,915
Total revenues	**45,387**	**49,232**	**20,958**	**24,191**	**59,643**	**71,607**
EBITDA						
Cane sugar	4,023	5,618	3,550	3,807	2,068	2,479
Refined sugar	4,198	830	1,156	250	7,592	3,961
Others	1,547	2,544	1,167	1,498	3,677	4,679
Total EBITDA	**9,768**	**8,992**	**5,873**	**5,556**	**13,337**	**11,119**

Source: Kotak Institutional Equities estimates

Normalized scenario analysis tests the sustainability of earnings

We believe the current high margins will not sustain beyond next 12-15 months, hence a normalized scenario would better test the sustainability of earnings. We understand that building a normalized scenario for the sugar sector is difficult considering the regulations on input pricing and sale quantity. However, we try to build a likely scenario post FY2011E when the sugar prices are likely to retrieve to more sustainable levels led by higher domestic production. Our normalized scenario is based on the assumption of sustainable sugar prices and production volumes.

We find SHRS's EPS to be most sustainable as it is largely a convertor, whereas BJH faces the largest downside risk to earnings due to its high depreciation and interest cost which lead to a magnified impact on EPS with a moderate change in sugar price. We see a lower downside risk to BRCM compared to BJH due to its lower depreciation and interest costs.

Exhibit 7: Normalized scenario analysis tests the sustainability of earnings
Normalized scenario analysis compared to FY2011E peak earnings, (Rs mn)

	Bajaj		Balrampur		Renuka	
	2011E	Normalised	2011E	Normalised	2011E	Normalised
Operational						
Avg. sugar price (Rs/kg)	29.7	24.6	29.4	24.0	29.1	23.8
Avg. cane cost (Rs/kg)	195.0	180.0	195.0	180.1	205.0	180.0
Avg. raw sugar price (US$ c/lb)	21.5	17.0	22.0	—	21.0	17.0
Sugar produced (mn tons)	1.2	1.5	0.7	0.9	0.6	0.7
Sugar refined (mn tons)	0.4	0.2	0.1	—	1.7	2.1
Financials						
Revenues	49,232	45,830	24,191	24,895	71,607	74,003
EBITDA	8,992	6,347	5,556	4,992	11,119	9,788
EBITDA (%)	18.3	13.8	23.0	20.1	15.5	13.2
EPS (Rs)	17.7	10.3	13.0	10.7	20.4	17.9
EPS change (%)		(42.0)		(17.8)		(12.2)

Source: Kotak Institutional Equities estimates

Quality of earnings indicated by varying return ratios

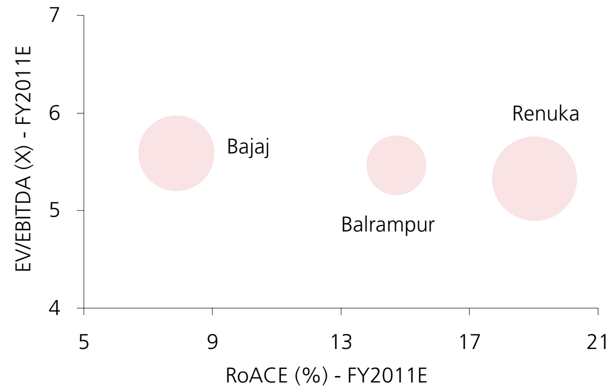
We believe the quality of earnings reflected by the different RoAE and RoACE of the three companies are indicative of their relative business risks and sustainability of earnings.

SHRS's low business risk and higher sustainability of earnings is reflected in its higher return ratios. Its low capital intensive model through a mix of leased assets and standalone refineries is reflected in its higher sales-to-assets ratio.

BJH's higher depreciation and interest costs eat into its operating profits resulting in lower PAT margin. BJH's RoACE is significantly lower than the peers, however, it benefits from higher leverage resulting in a higher RoAE.

BRCM's higher share of cane sugar and its investment in owned mills results in a lower RoACE than SHRS. However, its low tax and depreciation costs help it earn a higher PAT margin than BJH.

Exhibit 8: Relative valuations inconsistent with return ratios
Comparative EV/EBITDA and RoACE for our coverage universe, FY2011E



Note:
(1) Size of the bubbles indicate relative absolute EBITDA in FY2011E

Source: Kotak Institutional Equities estimates

Exhibit 9: Du-Pont analysis benchmarks the operational performance
Du-Pont analysis for FY2011E

	BJH	BRCM	SHRS
Profit margin (Adj PAT/Sales) (%)	6.9	13.8	9.5
Total Asset turnover (Sales/TA) (X)	0.8	0.8	1.6
Equity multiplier (TA/Avg. equity) (X)	2.1	1.6	1.4
RoAE (%)	**12.0**	**17.8**	**20.8**

Source: Kotak Institutional Equities estimates

Comparative valuations

Indian sugar companies are currently trading at a moderate discount to their global peers who are valued at around 6-6.5X two-year forward EBITDA. However, we expect strong earnings growth and higher sugar prices to improve valuations for the Indian companies. We believe the Indian companies will enjoy higher benefits of rising sugar prices compared to the Brazilian majors. Indian capacities are fully utilized for sugar production, whereas a significant portion of Brazilian capacity is used for ethanol production which does not offer the same profitability at current prices.

Exhibit 10: Indian sugar companies trading at a premium to global peers
Relative valuation of global sugar companies

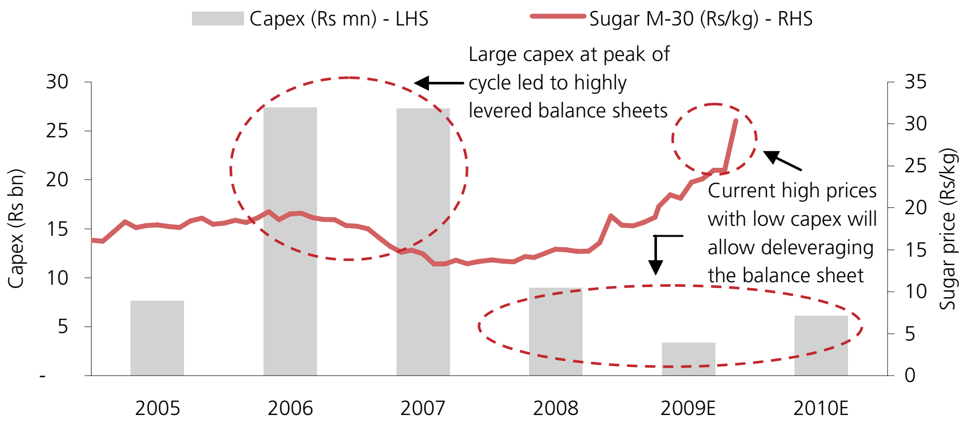
	16-Sep-09			Mkt Cap.	EV/EBITDA (X)			PER (X)			EV/Sales (X)		
Company	**Price (local)**	**Currency**	**Year-end**	**(US$ mn)**	**LFY**	**FY1**	**FY2**	**LFY**	**FY1**	**FY2**	**LFY**	**FY1**	**FY2**
India													
Bajaj Hindusthan	186.7	INR	Sep	683	12.8	5.8	5.6	NM	7.8	10.5	2.8	1.3	1.0
Balrampur Chini	124.7	INR	Sep	663	7.4	5.7	5.5	12.5	9.3	9.6	2.1	1.6	1.3
Shree Renuka Sugars	203.1	INR	Sep	1,332	12.9	4.7	5.3	25.0	8.4	10.1	2.3	1.1	0.8
Triveni Engineering	108.8	INR	Sep	580	13.8	8.0	7.2	23.0	16.9	15.6	2.4	1.8	1.5
Average India					**11.7**	**6.1**	**5.9**	**20.2**	**10.6**	**11.5**	**2.4**	**1.4**	**1.2**
Brazil													
Acucar Guarani	5.8	BRL	Mar	919	9.1	6.7	5.1	NM	14.1	10.4	1.8	1.9	1.5
Cosan	19.9	BRL	Mar	4,112	22.5	8.8	5.9	NM	11.4	11.9	1.9	0.8	0.8
Sao Martinho	16.5	BRL	Mar	1,032	11.5	8.3	7.4	NM	25.2	37.1	3.6	2.6	2.4
Average Brazil					**14.4**	**8.0**	**6.1**	**NM**	**16.9**	**19.8**	**2.5**	**1.8**	**1.6**
Europe													
Agrana	68.7	EUR	Feb	665	14.2	7.8	7.0	NM	19.7	17.1	0.8	0.7	0.6
Suedzucker	13.8	EUR	Feb	1,777	10.7	6.1	5.7	16.0	14.3	12.1	0.9	0.7	0.7
Tate & Lyle	4.2	GBP	Mar	1,160	10.6	7.0	6.5	21.4	11.4	10.3	0.9	0.8	0.8
Average Europe					**11.8**	**7.0**	**6.4**	**18.7**	**15.1**	**13.1**	**0.8**	**0.7**	**0.7**
Africa													
Illovo	33.5	ZAR	Mar	1,595	8.7	5.9	5.8	16.2	15.4	13.3	1.6	1.3	1.3
Tongaat Hulett	90.5	ZAR	Dec	1,267	7.4	6.6	6.3	14.4	13.4	11.6	1.6	1.3	1.2
Average Africa					**8.1**	**6.2**	**6.1**	**15.3**	**14.4**	**12.5**	**1.6**	**1.3**	**1.3**
Others													
CSR	2.0	AUD	Mar	2,902	9.2	7.3	5.5	NM	18.0	12.2	1.1	1.0	0.8
Khon Kaen Sugar	13.9	THB	Oct	639	16.8	12.7	11.0	25.3	20.5	16.2	2.4	2.4	2.1
Average Others					**13.0**	**10.0**	**8.2**	**25.3**	**19.2**	**14.2**	**1.7**	**1.7**	**1.5**
Global average					**12.0**	**7.3**	**6.4**	**19.2**	**14.7**	**14.1**	**1.9**	**1.4**	**1.2**

Source: Bloomberg, Kotak Institutional Equities estimates for Bajaj Hindusthan, Balrampur Chini and Shree Renuka sugars

Low capex means large free-cash-flow generation

We expect the three companies under our coverage to generate strong free cash flows over the next two years as they have no major capex plans except for SHRS, which has also raised equity to fund its capex requirements. Strong cash generation over the next two years will help the sugar companies reduce leverage and strengthen their balance sheets, thus becoming better prepared to face a subsequent down-cycle.

Exhibit 11: Strong free cash generation will strengthen the balance sheet
Sugar price and capex trend for our coverage universe

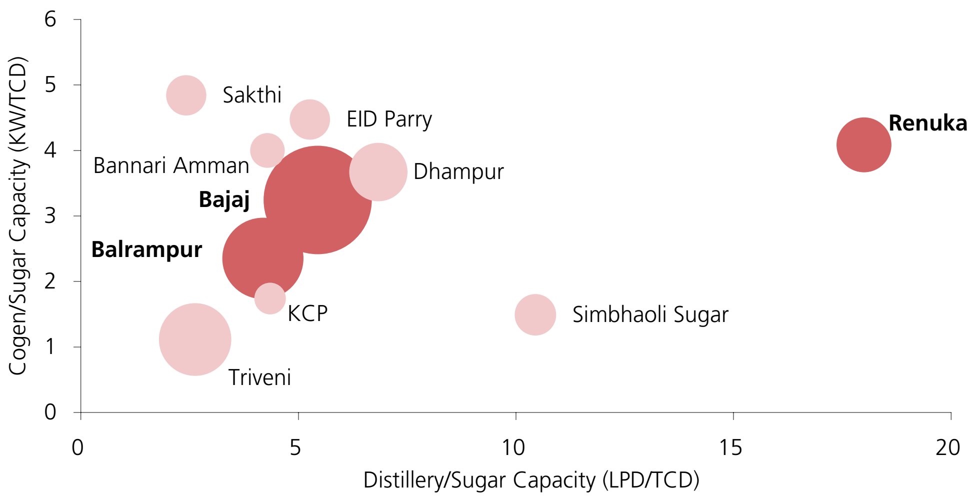


Source: Company, Bloomberg, Kotak Institutional Equities estimates

Stay with the larger players; look for higher integration

We prefer the larger players as they would be well placed to benefit from the current uptrend in sugar prices. We believe the larger players would be better placed to compete for scarce sugarcane as well as import raw sugar for domestic conversion. Higher integration in terms of distillery and co-generation capacities are key support features, which, in our view, will support earnings and profitability in periods of low crushing.

Exhibit 12: We prefer companies with larger capacities and higher integration
Comparative positioning of major sugar companies, FY2009



Note:
(1) Size of the bubble indicates sugar crushing capacity in TCD
(2) Renuka capacity excludes its standalone refineries and distilleries

Source: Company, Kotak Institutional Equities

DOMESTIC SCENARIO—STRONGEST UP-CYCLE IN LAST 50 YEARS

We expect the current sugar up-cycle, the strongest in 50 years, to last longer than the normal two-year period as low domestic production in two consecutive years has completely depleted sugar inventory. The stock-to-consumption ratio in Sep 2010 is expected to be 9.5% which is the lowest in 50 years. We estimate substantial imports over next two years to meet domestic demand. International sugar prices, which are at a three-decade high, are expected to rise further as poor production from both Brazil and India, the top-2 sugar producing countries globally, will further reduce the global supply-demand gap.

Supply-demand balance to be tight due to low production

We expect domestic sugar supply to remain constrained over the next two years as domestic sugar production falls short of demand for the second consecutive year. We expect the stock-to-consumption ratio to fall to a 50-year low of around 9.5% by end-SS2010E. We estimate India to import around 8mn tons of sugar in SS2010E, which is the highest in 50 years, indicating the severity of the current sugar shortfall. Sugar prices will likely remain firm as the large shortfall in India—the largest sugar consuming market and low production in Brazil—will shrink global inventory levels significantly.

Exhibit 13: We expect the domestic sugar supply-demand balance to be very tight over next two years
Domestic sugar supply-demand balance, September year-ends, 2000-2011E (mn tons)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009E	2010E	2011E
Opening stock	6.9	9.3	10.7	11.3	11.6	8.5	4.0	3.6	9.2	8.1	2.3	2.3
Production	18.2	18.5	18.5	20.1	14.0	12.7	19.3	28.3	26.3	14.7	15.5	21.1
Imports	0.4	—	—	0.0	0.4	2.1	—	—	—	2.5	8.0	5.0
Total sugar available [A]	**25.5**	**27.8**	**29.2**	**31.5**	**26.0**	**23.3**	**23.3**	**32.0**	**35.6**	**25.3**	**25.8**	**28.4**
Consumption	16.1	16.2	16.8	18.4	17.3	18.5	18.5	21.0	22.5	23.0	23.5	24.5
Exports	0.1	1.0	1.1	1.5	0.2	0.0	1.1	1.7	5.0	—	—	—
Total usage [B]	**16.2**	**17.2**	**17.9**	**19.9**	**17.5**	**18.5**	**19.6**	**22.7**	**27.5**	**23.0**	**23.5**	**24.5**
Closing stock [A-B]	**9.3**	**10.7**	**11.3**	**11.6**	**8.5**	**4.8**	**3.6**	**9.2**	**8.1**	**2.3**	**2.3**	**3.9**
Stock-to-use ratio (%)	54.3	59.6	56.9	66.3	45.9	24.5	16.0	33.6	35.3	9.8	9.5	14.8

Notes:
(1) 2006 opening stock adjusted as per excise certificate
(2) Stock-to-use based on next year's consumption

Source: ISMA., Kotak Institutional Equities estimates

Sugarcane crop impacted by decline in acreage and yield

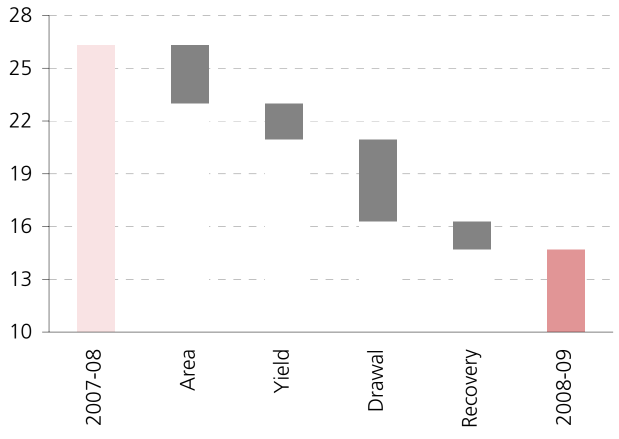
The decline in sugarcane crop in SS2009E and SS2010E is primarily due to low acreage and low crop yield. Further, high prices of alternative sweeteners, like 'gur' and 'khandsari' resulted in a sharp decline in drawal rates for sugarcane available to the mills to 57% in SS2009E from 73% in SS2008. We expect the drawal rates to improve marginally in SS2010E to 62%; however, poor monsoons will result in low acreage and yield, keeping sugarcane production low.

Exhibit 14: Low acreage and crop yield will keep sugarcane availability very low
Domestic sugar production drivers, September year-ends, 2000-2011E (mn tons)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009E	2010E	2011E
Cane acreage ('000 hectares)	4,220	4,316	4,411	4,520	3,938	3,662	4,201	5,151	5,043	4,408	4,300	5,000
Yield (ton/hectare)	70.9	68.6	67.4	63.6	59.4	64.7	66.9	69.0	67.5	61.5	60.0	63.0
Cane production (mn ton)	**299**	**296**	**297**	**287**	**234**	**237**	**281**	**356**	**341**	**271**	**258**	**315**
Drawal (%)	59.6	59.7	60.7	67.6	56.7	52.6	67.1	78.4	73.3	57.0	62.0	67.0
Cane crushed (mn ton)	178	177	180	194	133	125	189	279	250	155	160	211
Recovery (%)	10.2	10.5	10.3	10.4	10.6	10.2	10.2	10.2	10.5	9.5	9.7	10
Sugar production (mn ton)	**18.2**	**18.5**	**18.5**	**20.1**	**14.0**	**12.7**	**19.3**	**28.3**	**26.3**	**14.7**	**15.5**	**21.1**

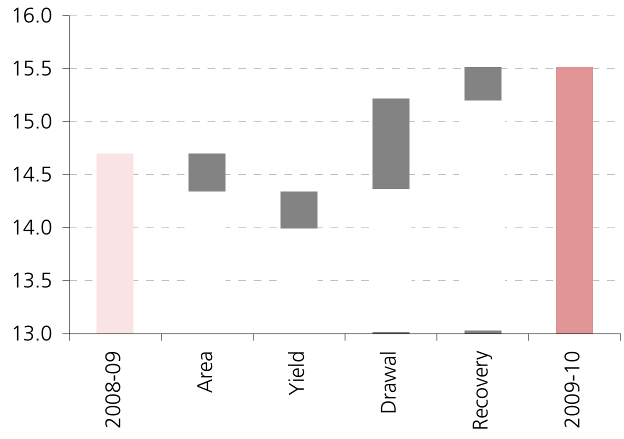
Source: ISMA., Kotak Institutional Equities estimates

Exhibit 15: Several factors depressed sugar production in 200E…
Impact of various drivers on sugar production, September year-ends, 2009E (mn tons)



Source: ISMA, Cris Infac, Kotak Institutional Equities estimates

Exhibit 16: ….and will continue to do so in 2010E
Impact of various drivers on sugar production, September year-ends, 2010E (mn tons)



Source: ISMA, Cris Infac,, Kotak Institutional Equities estimates

Farmer economics unfavorable for sugarcane cultivation

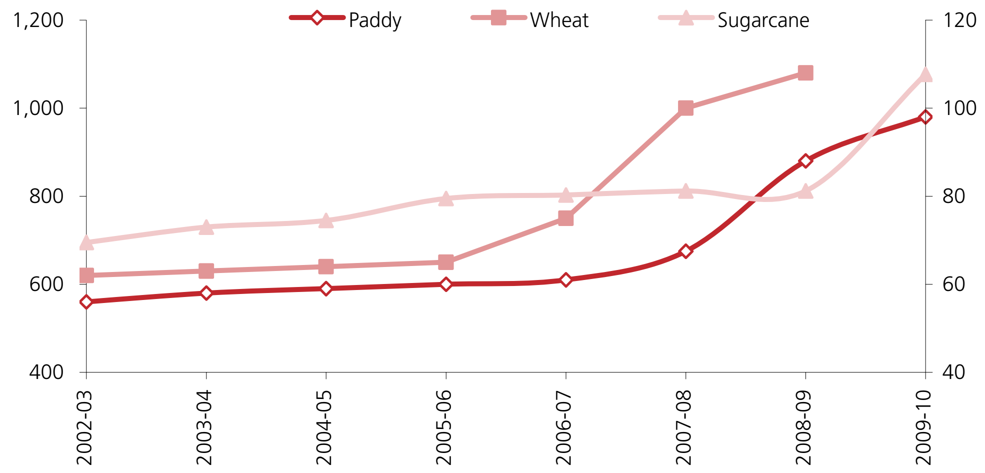
A key reason for the sharp decline in sugarcane production in the past two years is the reduction in cultivation area. A sharp increase in the Minimum Support Price (MSP) of paddy and wheat has made it unprofitable for farmers to grow sugarcane, hence the shift towards other crops. We believe the recent increase in the MSP of sugarcane is a delayed attempt to incentivize farmers to grow sugarcane. The current Statutory Minimum Price (SMP) of Rs108/qtl is much lower than the actual price of Rs150-170/qtl paid by the mills in the previous harvest season. Even at last year's State Advised Price (SAP) of Rs140/qtl, sugarcane cultivation remains unprofitable.

Exhibit 17: Farmer economics unfavorable for sugarcane cultivation
Comparative per acre profitability comparison for sugarcane and wheat-paddy cultivation (Rs)

Crop cycle period	Sugarcane 22 months	Paddy-wheat 22 months
Yields (qtl/acre)		
Sugarcane	186.4	0
Paddy	—	14
Wheat	—	12.5
Paddy-wheat straw	—	5
Realisation (Rs/qtl)		
Sugarcane	140	—
Paddy	—	950
Wheat	—	1,080
Paddy-wheat straw	—	125
Total gross income	**52,192**	**56,100**
Gross costs (Rs/acre)		
Seed	3,780	1,720
Fertilisers	1,773	4,412
Pesticides	600	880
Irrigation	2,800	5,840
Field preparation	3,200	4,160
Labour	2,240	2,520
Harvesting	4,750	6,400
Transport	4,500	1,020
Total costs	**23,643**	**26,952**
Net income	**28,549**	**29,148**
Annualised net income	**15,572**	**15,899**

Source: ISMA, News Reports, Kotak Institutional Equities

Exhibit 18: Sharp increase in MSP of wheat and paddy led to a decline in sugarcane acreage
MSPs of key crops, 2003-2010 (Rs/ton)

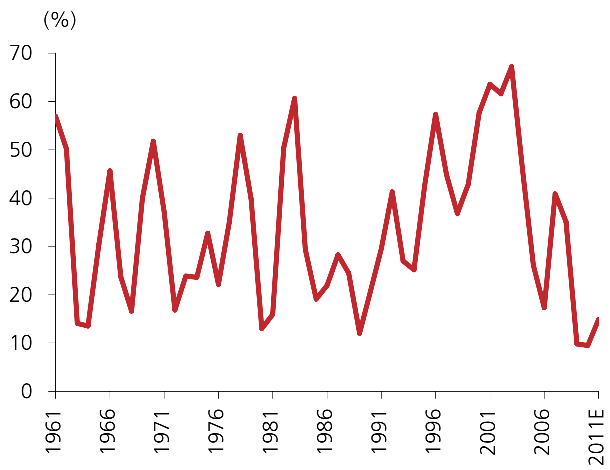


Source: Ministry of Agriculture

Stock-consumption ratio near 50-year low; imports to reach all-time high

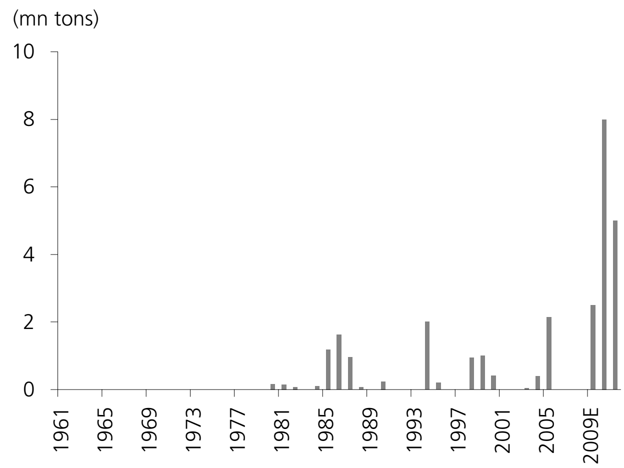
We estimate the stock-consumption ratio to fall to a 50 year low of around 9.5% (only half a month) by end-SS2010E compared to the normal stock-consumption level of around 40%. The low inventory levels will keep sugar supplies highly constrained and will result in sugar prices rising further even from current levels. We currently estimate 8 mn tons of imports in SS2010E that will leave a meager inventory of around 2.3 mn ton at end-SS2010E.

Exhibit 19: Stock-consumption ratio to fall to 50-year low
Sugar stock-consumption ratio for India, September year-ends, 1961-2011E (%)



Source: ISMA, Kotak Institutional Equities estimates

Exhibit 20: Sugar imports to be highest in last 50 years
Sugar imports in India, September year-ends, 1961-2011E (mn tons)



Source: ISMA, Kotak Institutional Equities estimates

GLOBAL SCENARIO—LOW PRODUCTION TO KEEP SUGAR PRICES FIRM

We expect international sugar prices to remain firm over the next 12-15 months, driven by low production in the two main sugar producing regions—Brazil and India. Brazil, the largest sugar producer, may produce lower-than-expected sugar as heavy rains in the early crushing season may impact yield and harvest. Higher imports by India—the largest sugar consumer—will be the key driver for raw and white sugar prices.

Poor weather conditions to impact production and inventory

We expect global sugar production to decline by 12.7% to 148 mn tons in SS2009E from 170 mn tons in SS2008, resulting in a shortfall of 9 mn tons. Production in SS2010E is also expected to be around 155 mn tons with a shortfall of around 6 mn tons. However, the SS2010E production estimates remain at further risk considering drought in many sugar producing areas in India and a poor harvest in Brazil due to excess rainfall.

Exhibit 21: Shortfall in sugar production to reduce inventory levels
Global sugar demand-supply scenario, September year-ends, 2000-2010E (mn tons)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009E	2010E
Opening stock	55.6	58.6	58.9	58.7	68.1	67.1	61.1	63.8	74.5	84.2	74.8
Production	134.3	133.0	138.3	150.4	143.7	141.2	151.4	167.0	170.4	148.7	154.9
Imports	41.0	43.9	44.9	48.4	49.1	51.0	54.1	51.7	51.5	48.0	49.6
Total sugar available [A]	**230.9**	**235.5**	**242.1**	**257.6**	**261.0**	**259.3**	**266.6**	**282.5**	**296.4**	**280.9**	**279.3**
Consumption	130.0	131.3	134.7	139.6	141.5	144.1	146.5	151.4	156.9	157.8	160.7
Exports	42.3	45.3	48.7	49.8	52.4	54.1	56.3	56.5	55.3	48.2	51.3
Total usage [B]	**172.3**	**176.6**	**183.4**	**189.5**	**193.9**	**198.1**	**202.8**	**207.9**	**212.2**	**206.1**	**211.9**
Closing stock [A-B]	**58.6**	**58.9**	**58.7**	**68.1**	**67.1**	**61.1**	**63.8**	**74.5**	**84.2**	**74.8**	**67.4**
Stock-to-use ratio (%)	33.2	32.1	31.0	35.1	33.9	30.1	30.7	35.1	40.8	35.3	31.5

Source: ISMA, USDA, Kotak Institutional Equities estimates

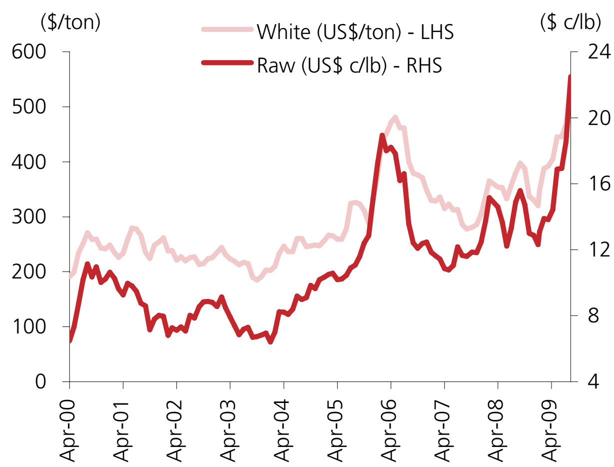
Sugar prices near three-decade high; may go up further

International raw sugar prices have reached near three-decade high of US$ c22/lb primarily driven by strong import demand from India. We expect sugar prices to remain high for the next 12 months at least, led by higher import demand from India; the imports may extend into SS2011E also due to a low inventory position.

Exhibit 22: Raw sugar prices reach near three-decade high
Raw sugar price, 1980-2009 (US$ c/lb)

Source: Bloomberg

Exhibit 23: Sharp jump in sugar prices likely to sustain
Raw and white sugar price, 2000-2009

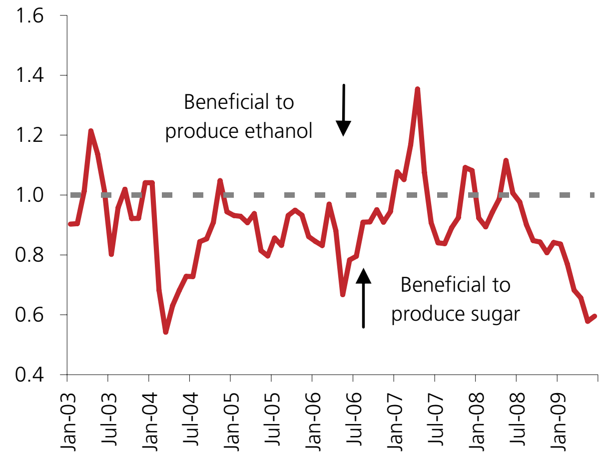


Source: Bloomberg

Brazil: Sugar production more profitable than ethanol

The current high sugar prices are highly favorable for the Brazilian millers to direct sugarcane towards sugar production instead of ethanol production. The Brazilian mills are currently producing sugar at full capacity, hence, there is limited scope to increase sugar production further by diverting cane from ethanol to sugar. As per UNICA, almost 43% of cane has been diverted to sugar production in the current harvest season, which is close to the maximum switching possible. Larger companies like Cosan, Sao Martinho and Guarani are already producing sugar at maximum capacity at 60%, 37.5% and 64%, respectively.

Exhibit 24: Current sugar prices highly favorable for sugar production
Sugar versus ethanol production preference



Source: Bloomberg, Kotak Institutional Equities estimates

Exhibit 25: Brazilian mills already producing sugar at maximum capacity
Break-up of Brazilian millers according to production flexibility

	No. of mills	% of total
Sugar/ethanol	247	59.8
Only sugar	15	3.6
Only ethanol	151	36.6
Total	**413**	**100.0**

Source: Industry and news reports

Landed cost of raw sugar suggests that high domestic prices will sustain

The current raw sugar price of US$ c22/lb implies a landed realization of Rs32/kg to make the import of sugar attractive for the domestic sugar companies. As India is expected to be import dependent over the next two years to meet its domestic requirement, we expect domestic prices to remain high unless international prices cool off substantially. Conversely, strong imports from India will keep international prices high. Therefore, until domestic production increases, we do not see a substantial decline in sugar prices.

Exhibit 26: Landed cost of imported sugar imply high prices to sustain
Implied landed price of imported sugar in India

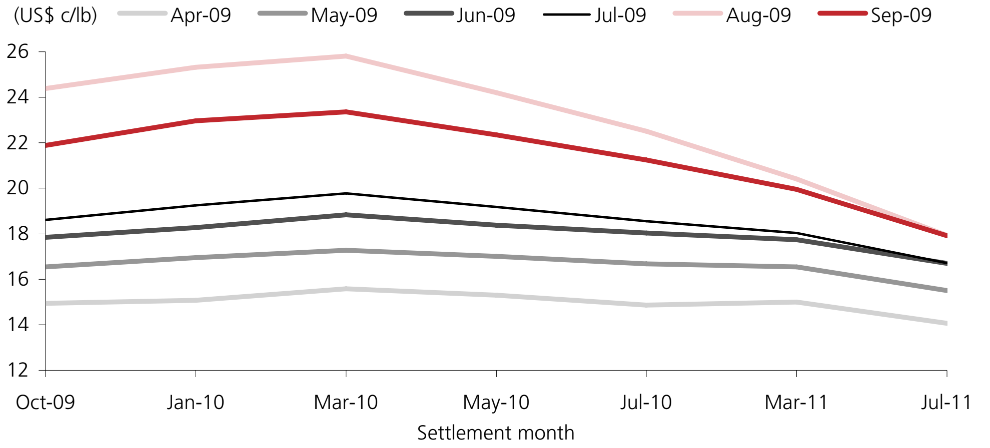
Raw sugar (US$ c/lb)	**16.0**	**17.0**	**18.0**	**19.0**	**20.0**	**21.0**	**22.0**	**23.0**
Raw sugar (US$/ton)	353	375	397	419	441	463	485	507
Freight	45	45	45	45	45	45	45	45
Port and other costs ($/ton)	10	10	10	10	10	10	10	10
Raw sugar at port ($/ton)	408	430	452	474	496	518	540	562
Exchange rate	49.0	49.0	49.0	49.0	49.0	49.0	49.0	49.0
Raw sugar (Rs/kg)	**20.0**	**21.0**	**22.1**	**23.2**	**24.3**	**25.4**	**26.4**	**27.5**
In-land freight (Rs/kg)	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Processing cost (Rs/kg)	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Total cost of production	**23.5**	**24.5**	**25.6**	**26.7**	**27.8**	**28.9**	**29.9**	**31.0**
Expected margin (Rs/kg)	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Implied domestic sugar price (Rs/kg)	**25.5**	**26.5**	**27.6**	**28.7**	**29.8**	**30.9**	**31.9**	**33.0**

Source: Kotak Institutional Equities estimates

Forward curves currently indicate possible price softening in SS2011

Current raw sugar futures indicate a possible softening of sugar prices in SS2010-11, which implies that the market is assuming higher sugar supply in SS2011. However, we expect the forward curve to shift laterally upwards as spot prices increase in the near term. We model a moderate decline in our FY2011E sugar price realization based on the expected downward trend indicated by the futures curve. We would continue to monitor this closely to watch for any distinct shift in long-term pricing trends.

Exhibit 27: Forward curves indicate possible price reduction in SS2011
Raw sugar futures price curves (US$ c/lb)



Source: Bloomberg

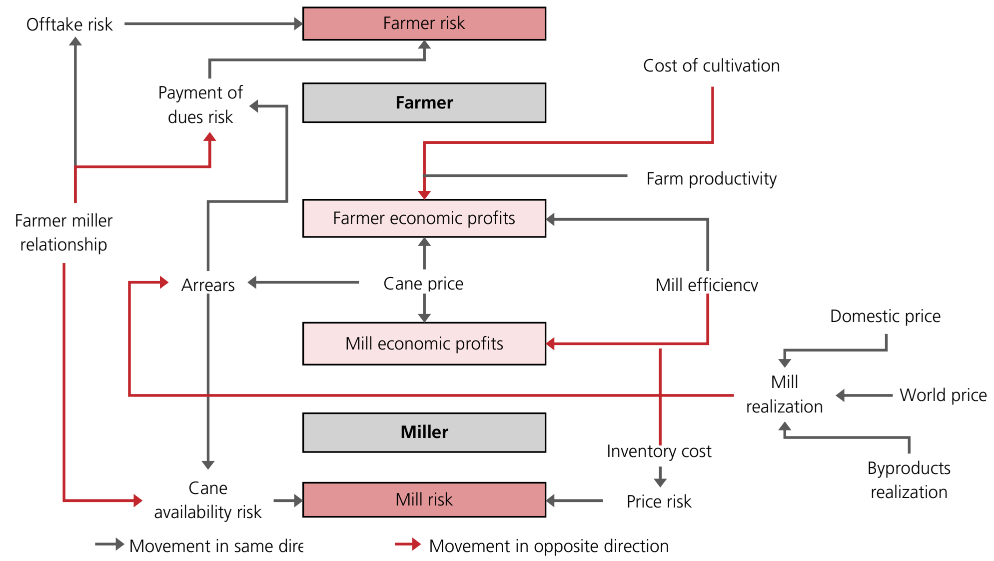
RISKS—SUGARCANE AVAILABILITY, MONSOON AND GOVERNMENT CONTROLS

We perceive low sugarcane availability, weak monsoon and stringent government controls as the key risks for sugar manufacturers. A patchy monsoon, as in the current year, is a big threat to the sugarcane crop which can significantly impact availability of cane for crushing. Other factors impacting the availability of sugarcane include low yield, decline in crop acreage, and diversion of cane to other forms of sweeteners like 'gur' and 'khandsari'. Stringent government controls on various aspects of sugar production, input pricing and monthly sale quotas are an impediment to a free market mechanism.

The risk model—integrated and interdependent

The sugar industry, which is highly agri-dependent, has an integrated risk model which is interdependent between the economic fortunes of the millers and the farmers. Higher profits for millers imply faster payments to farmers, which, in turn, will motivate them to increase cane acreage and raise cane supply to the mills. However, higher cane availability and resultant higher sugar production will depress realizations and profits for the millers, leading to delay in payment to farmers and reduction in cane cultivation.

Exhibit 28: Risks for farmers and millers are highly interdependent
Sugar industry risk model



Source: KPMG

Sugarcane availability—dependent on various factors

The availability of sugarcane for millers is dependent on various factors like acreage of crop sown, crop yield and drawal rate. The acreage is dependent upon farmer's incentive to cultivate sugarcane instead of other crops depending upon (1) the relative support prices and realization from various crops and (2) timely payment of cane arrears to farmers. The crop yield is largely dependent on factors like weather and irrigation. The drawal is the proportion of sugarcane made available to mills instead of selling them for alternate uses. Each of these factors can significantly impact sugar production as illustrated earlier in Exhibits 15 and 16.

Weak monsoon to impact sugarcane production

Weak monsoon and possible drought situation in large sugarcane producing states of Uttar Pradesh and Maharashtra will likely impact the sugarcane crop in SS2010E. We expect Uttar Pradesh farmers to be lesser impacted due to higher irrigation penetration; however, low reservoir levels may limit the benefits available from irrigation facilities. We would keenly follow developments over the next few weeks to ascertain the probable impact of the monsoon on the current crop.

Exhibit 29: Deficient monsoons may impact sugar production
Regional sugar production in SS2009 upto July 31, 2009

	MT ('000)	(%)
Maharashtra	4,579	31.9
Uttar Pradesh	4,064	28.3
Karnataka	1,601	11.2
Tamil Nadu	1,456	10.1
Gujarat	1,013	7.1
Andhra Pradesh	593	4.1
Others	1,038	7.2
Total	**14,343**	**100.0**

Source: NFCSF

Exhibit 30: Deficient monsoons may impact sugar production
Monsoon trend in key sugarcane producing regions, 1st Jun-9th Sep, 2009

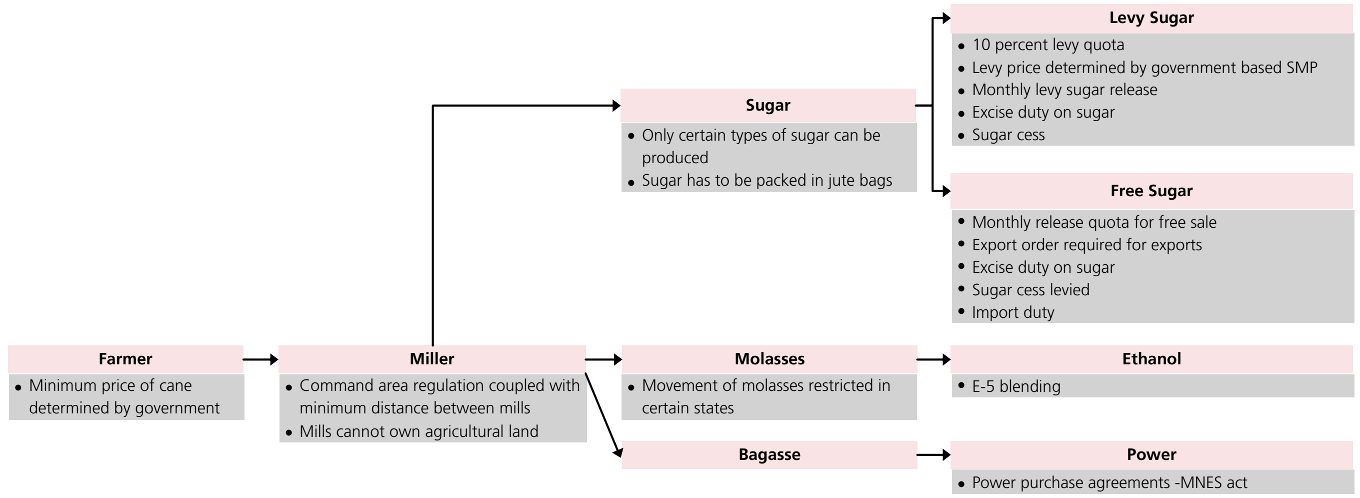
	Actual (mm)	Normal (mm)	Deficiency (%)
Maharashtra			
Marathwada	479	588	(19)
Vidarbha	637	870	(27)
Madhya Maharashtra	594	589	1
Konkan and Goa	2,205	2,593	(15)
Uttar Pradesh			
East U.P.	501	784	(36)
West U.P.	390	679	(43)
Karnataka			
Coastal	2,955	2,971	(1)
North Interior	432	370	17
South Interior	668	551	21
Tamil Nadu			
Tamil Nadu & Pondicherry	209	227	(8)
Gujarat			
Gujarat region	613	847	(28)
Saurashtra, Kutch & Diu	612	443	38

Source: IMD

Government controls impeding free market development

- Governmental controls are present in the entire chain, from input through to production and sales. The government controls sugarcane pricing, command area for cane procurement and monthly release quotas on the sale of levy sugar and free sugar.

Exhibit 31: Current regulations control various aspects in the sugar production chain
Overview of the current regulations on sugar industry



Source: KPMG

Exhibit 32: Indian sugar industry is the most regulated
Comparison of regulatory environment across various sugar producing countries

Regulation		Australia	Brazil	China	India	Thailand
		Large farmers	Large farmers	Large domestic market	Large domestic market	High export dependence
		High export dependence	Contract farming	Small land holdings	Small land holdings	Small land holdings
			High export dependence			
Command area	Mill viability Farmer protection				✓	
Cane Pricing	Equitable profit sharing between farmers and mills	✓*	✓	✓	✓	
Sugar price intervention	Export viability Consumer protection			✓	✓	✓
International trade	Domestic industry protection Consumer protection			✓	✓	✓

* Regulatory environment in key geographies (2006) 40

Source: KPMG

- Conflicting regulations of central government and various state governments compound further confusion and distort the level playing field across states.

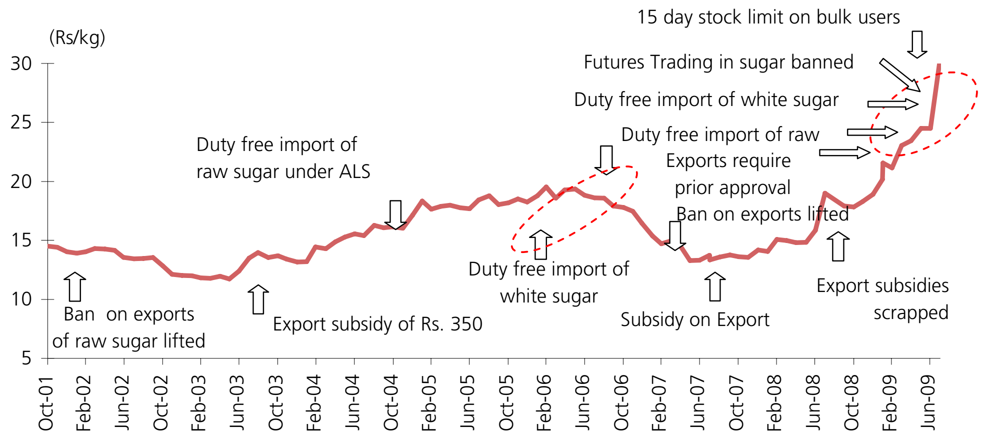
Exhibit 33: Contradictory state and central regulations add to the confusion
Comparative state and central regulations

Central regulations	State regulations	Areas of conflict
Statutory Minimum Price (SMP)	State Advised Price (SAP)	SAP is higher than SMP and may not be linked to recovery
		SAP varies across states leading to state level distortions
Incentive scheme for new and existing capacities	State governments announce incentive schemes to incentivize sugar capacities in their state	Incentive schemes distort level playing field thorugh fiscal benefits, capital expense subsidy or transport subsidy
Molasses decontrolled; national blending program	States continue to restrict the utilization, sale and movement of molasses	Distortion of level playing field through wide regional variations in molasses prices and returns from molasses-based value added products
Cogeneration MNES Act	Individual states have their own power purchasing agreements	State level tariffs are typically lower than tariffs as per MNES Act

Source: KPMG

- Regular government interference to maintain domestic sugar price and availability does not allow the development of free market and creates uncertainty in the minds of various associated groups—millers, farmers and consumers.

Exhibit 34: Recent government intervention has failed to control the rise in sugar prices
Sugar price (Mumbai S-30) and government intervention, SS2001-09 (Rs/kg)



Source: Cris Infac

- **Potential government actions to curb sugar prices.** The government is currently discussing with various industry members to find out a way to curb the sharp increase in sugar prices. We believe two scenario are possible:
  - **Increase levy sale quota and increase levy price.** The government can increase the levy-sales quota from the current level of 10% to 20-25% at the same time also increase the levy sale price to around Rs20/kg from current level of around Rs13.5/kg. This will result in higher availability of goods through the public distribution system at a significant discount to current retail price of around Rs32/kg.
  - **Cap on free-sale price (possibly linked to subsidy).** We cannot rule out the government putting a cap on the free-sale price of sugar and subsidizing the sugar companies on the difference between the market price and the capped price. A similar practice is followed in other commodities like oil and fertilizers, hence there is a high likelihood of it being replicated here too, in case of substantially high sugar prices.

companies

1. Bajaj Hindusthan
2. Balrampur Chini
3. Shree Renuka Sugars

kotak Institutional Equities

Bajaj Hindusthan (BJH)

Sugar

SELL

September 17, 2009

INITIATING COVERAGE

Sector view: Attractive

Price (Rs): 187

Target price (Rs): 150

BSE-30: 16,677

Too sweet for comfort. We believe BJH's current stock price already factors in most of the expected good news based on peak cycle earnings driven by high sugar prices. Strong earnings and cash flows will reduce the risk of higher leverage; however, low return ratios are a major concern for valuations. Higher-than-estimated sugar prices can provide further upside to our estimates and valuations. Volatile crop output and adverse government policies remain key risks for BJH.

Initiate with SELL and target price of Rs150

We initiate coverage on BJH with a SELL rating and a target price of Rs150 based on 5X FY2011E EBITDA. We believe current valuations at 5.6X FY2011E EBITDA already factor in peak cycle earnings with a risk of potential decline from normalized sugar price and higher tax rates post FY2011E. Peak cycle RoACE of only 7.9% in FY2011E compels a lower relative valuation.

Strong earnings driven by high sugar prices and low-cost imports; however, RoACE to remain low

We estimate BJH's EPS to increase to Rs23.9 and Rs17.7 in FY2010E and FY2011E, respectively, from a loss per share of Rs12.6 in FY2008. However, despite peak cycle earnings in the next two years, RoACE is expected to be a meager 10.3% and 7.9% in FY2010E and FY2011E, respectively. We estimate BJH will benefit from the low-cost raw sugar imports that it has contracted for FY2010E; however, this advantage is unlikely to be available in subsequent years, which will substantially impact margins.

Strong operating cash flows to reduce leverage

The biggest concern regarding BJH has been its high leverage and impending FCCB redemption. We believe high sugar prices, which are expected to remain strong over the next two years, will help BJH generate strong operating cash flows and reduce its debt burden. We expect BJH to use its large free cash flows of Rs18.7 bn over FY2009-11E to reduce its net debt-to-equity ratio to 0.6X at end-FY2011E from 3.4X at end-FY2008.

Key risks—patchy monsoon and potential government strictures

The key risks for BJH are the patchy monsoon and any adverse government action. Scanty rainfall in key regions is likely to impact the availability of sugarcane, which will result in low sugar production for a second consecutive year. Further government intervention to control the rise in sugar prices and any adverse judgments in ongoing litigation (for determining the SAP of earlier years) could have a negative impact on cash flows and earnings.

Company data and valuation summary

Company data	Stock data	High	Low	Price performance	1M	3M	12M
Rating: SELL	52-week range (Rs)	236	38	Absolute (%)	0.1	(12.4)	32.6
	Yield (%)		0.3	Rel. to BSE-30 (%)	(8.2)	(23.8)	9.2
Current price (Rs)	Priced at close of:		September 16, 2009				
187	**Capitalization**			**Forecasts/valuation**	**2008**	**2009E**	**2010E**
	Market cap (Rs bn)		35.8	EPS (Rs)	(12.6)	(1.0)	23.9
	Net debt/(cash) (Rs bn)		41.6	P/E (X)	NM	NM	7.8
	Free float (%)		62.7	RoAE (%)	(13.1)	(1.2)	19.4
	Shares outstanding (mn)		191.4	EV/EBITDA (X)	NM	13.3	6.1

Source: Company data, Kotak Institutional Equities estimates

VALUATIONS—GOOD NEWS PRICED IN

We believe current valuations at 10.5X and 5.6X FY2011E EBITDA and EPS already factor in most of the expected good news for BJH. We value BJH at Rs150 based on 5X FY2011E EBITDA implying a 20% downside from current levels. BJH is the largest sugar producer in India with 136,000 TCD capacity; however, low return ratios are a key concern—compelling a lower target multiple than peers. BJH's earnings are highly sensitive to sugar price change, as a small change in revenues has a magnified effect on EPS due to the high leverage. Higher-than-estimated sugar prices can drive further upside to our estimates and valuation.

We value BJH at Rs150/share

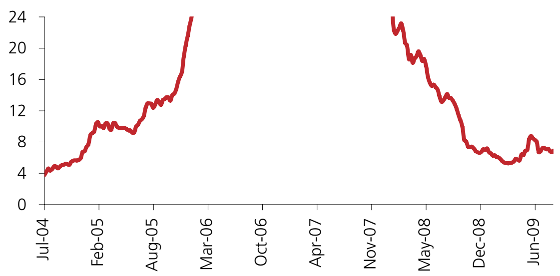
We value BJH at Rs150/share based on 5X FY2011E EBITDA at a discount to the global average of around 6X two-year forward EBITDA. We use a lower target multiple due to its significantly lower RoACE and higher leverage compared to peers. We believe a DCF-based valuation may not be appropriate since making a reasonable long-term estimate for earnings and cash flows is difficult considering (1) the high volatility in sugar and cane prices and (2) uncertainty about the crop pattern and availability. We prefer an enterprise level valuation over an EPS-based approach as it negates the impact of (1) different capital structures of various companies, (2) varying tax rates on account of brought forward losses and (3) high sensitivity of EPS to sugar price fluctuations. We treat the outstanding FCCBs as debt as they are currently out of money.

Exhibit 35: We value BJH at Rs150/share at 5X FY2011E EBITDA
Valuation table for BJH

	2010E	2011E
EBITDA	9,768	8,992
EV/EBITDA (X)	5.0	5.0
EV	**48,840**	**44,962**
Net debt	23,917	16,765
Equity Value	**24,923**	**28,197**
Fully diluted shares (mn)	191	191
Value per share (Rs)	**130**	**147**

Source: Kotak Institutional Equities estimates

Exhibit 36: Trading range for BJH has been very volatile
One-year forward rolling EV/EBITDA trend for BJH



Note: Intermediate valuations were very high due to low profitability hence excluded from the scale

Source: Bloomberg, Kotak Institutional Equities

Highly sensitive to sugar prices

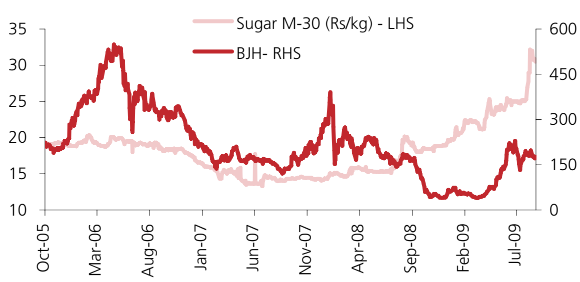
BJH's stock price performance and valuations are highly sensitive to sugar prices. A Re1 change in average realization impacts our target price by Rs39. We highlight that the sensitivity of the sugar price is much higher for BJH compared to peers due to its high financial leverage.

Exhibit 37: Valuation highly sensitive to sugar price
Sensitivity of fair value to sugar price (Rs/share)

Cane cost (Rs/ton)	Average realisation (Rs/kg)-FY2011E				
	27.7	**28.7**	**29.7**	**30.7**	**31.7**
1,850	104	144	183	222	262
1,900	86	126	165	205	244
1,950	69	108	**147**	187	226
2,000	51	90	129	169	208
2,050	33	72	112	151	190

Source: Kotak Institutional Equities estimates

Exhibit 38: Stock price movement related to sugar price movement
Comparative performance of sugar price versus BJH stock price



Source: Bloomberg

FINANCIALS—STRONG EARNINGS TO STRENGTHEN BALANCE SHEET

We expect BJH's strong earnings over the next two years to strengthen its balance sheet significantly and reduce concerns regarding high leverage. We estimate EPS to grow to Rs23.9 and Rs17.7 in FY2010E and FY2011E, respectively, from a loss per share of Rs12.6 in FY2008. Strong operating cash flows and a low capex requirement will reduce net debt-to-equity ratio to 0.6X by end-FY2011E from 3.4X at end-FY2008. We believe BJH will be able to meet its debt repayment and FCCB redemption obligations, largely through internal accruals. However, even with peak-cycle sugar prices, the RoACE is expected to remain low at 10.3% and 7.9% in FY2010E and FY2011E. The price realization for sugar and the recovery rate could pose upside risks to our estimates if they surpass expectations, whereas a lower supply of cane or higher costs present downside risks.

High sugar prices to drive earnings and cash flows

We expect high sugar prices to drive earnings and cash flows for BJH over the next two years. We currently estimate EPS of Rs23.9 and Rs17.7 for FY2010E and FY2011E, respectively based on an average sugar realization of Rs32.2 and Rs29.7 per kg for FY2010E and FY2011E, respectively.

Our FY2011E EPS estimates are lower on account of (1) lower sugar price assumption, (2) higher cost of imported sugar and (3) higher tax rate assumption as we expect BJH to move from MAT to normal tax rate. BJH has contracted for 0.7 mn tons of raw sugar to be processed in FY2010E. The imported sugar has been contracted at an average price of around US$ c18/lb, significantly lower than current price of around US$ c22/lb, hence we expect BJH to earn substantial margins in FY2010E from refining the same. However, this cost advantage is unlikely to be available in FY2011E unless domestic sugar prices increase substantially from current levels.

Key operating assumptions

Exhibit 39: Key operating assumptions for BJH, September year-ends, 2007-2011E

	2008	2009E	2010E	2011E
Sugar segment				
Sugarcane crushed (mn tons)	10.0	5.4	5.5	9.8
Average recovery ratio (%)	10.0	9.1	9.4	9.9
Sugar produced ('000 tons)	1,000	494	514	969
Raw sugar imports (mn tons)	—	—	0.7	0.4
Sugar sold (mn tons)	0.9	0.8	1.2	1.4
Average realisation (Rs/kg)	16.3	23.0	32.2	27.7
Sugarcane cost (Rs/ton)	1,370	1,550	1,950	1,850
Landed cost of raw sugar (US$ c/lb)	—	—	18	22
Distillery segment				
Alchohol produced (mn ltrs)	115	67	58	105
Alchohol sold (mn ltrs)	125	68	58	104
Average realisation (Rs/ltr)	24.0	23.0	29.0	27.0
Co-generation segment				
External sales (mn units)	103	76	70	125
Average realisation (Rs/unit)	3.2	3.1	4.0	4.1

Source: Company, Kotak Institutional Equities estimates

Exhibit 40: Key operating assumptions for BHSIL, September year-ends, 2007-2011E

	2008	2009E	2010E	2011E
Sugar segment				
Sugarcane crushed (mn tons)	1.5	1.3	1.4	2.0
Average recovery ratio (%)	9.5	8.8	9.2	9.4
Sugar produced ('000 tons)	140	115	125	192
Raw sugar imports (mn tons)	—	—	—	—
Sugar sold (mn tons)	1.5	1.6	1.2	1.9
Average realisation (Rs/kg)	16.3	24.0	32.2	27.7
Sugarcane cost (Rs/ton)	1,211	1,500	1,950	1,850
Landed cost of raw sugar (US$ c/lb)	—	—	—	—
Distillery segment				
Alchohol produced (mn ltrs)	24	16	16	23
Alchohol sold (mn ltrs)	25	17	16	21
Average realisation (Rs/ltr)	21.8	24.0	29.0	27.0
Co-generation segment				
External sales (mn units)	7.4	22.1	19.6	29.4
Average realisation (Rs/unit)	2.3	3.1	3.2	3.2

Source: Company, Kotak Institutional Equities estimates

Exhibit 41: Imported sugar to drive earnings in FY2010E
Comparison of landed cost of raw sugar for BJH versus current cost

	BJH contracted price		Current price
Raw sugar (US$ c/lb)	**14.5**	**20.5**	**22.0**
Raw sugar (US$/ton)	319	452	485
Freight	45	45	45
Port and other costs ($/ton)	10	10	10
Raw sugar at port ($/ton)	374	507	540
Exchange rate	49.0	49.0	49.0
Raw sugar (Rs/kg)	**18.3**	**24.8**	**26.4**
In-land freight (Rs/kg)	2.0	2.0	2.0
Processing cost (Rs/kg)	2.4	2.4	2.4
Total cost of production	**22.7**	**29.2**	**30.8**
Margin versus current price (Rs/kg)	8.1	1.6	
Qty contracted (mn tons)	0.3	0.4	

Source: Company, Kotak Institutional Equities estimates

Earnings highly sensitive to sugar price and cane cost

We highlight that BJH's EPS estimate is highly sensitive to sugar price realization and cane pricing, which are key earnings drivers. A shortage of cane due to low crop availability is likely to push cane prices up, in line with sugar prices. A change of Rs5 in the cane price/qtl can impact FY2010E EPS by Rs1.4, whereas a Re0.5 change in realization can impact FY2010E EPS by Rs2.5.

Exhibit 42: EPS highly sensitive to sugar price and cane cost
BJH, sensitivity of FY2010E EPS to sugar price and cane cost (Rs/share)

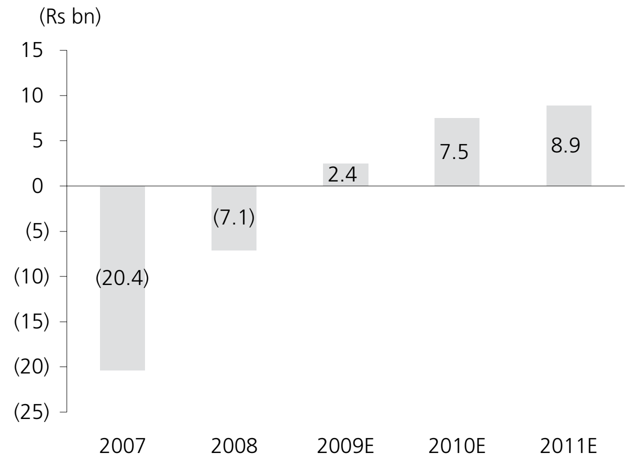
Cane cost (Rs/ton)	Average realisation (Rs/kg)-FY2010E: 31.2	31.7	32.2	32.7	33.2
1,850	21.6	24.1	26.7	29.2	31.7
1,900	20.3	22.8	25.3	27.8	30.3
1,950	18.9	21.4	**23.9**	26.4	28.9
2,000	17.5	20.0	22.6	25.1	27.6
2,050	16.2	18.7	21.2	23.7	26.2

Source: Kotak Institutional Equities estimates

Strong free cash generation to reduce leverage

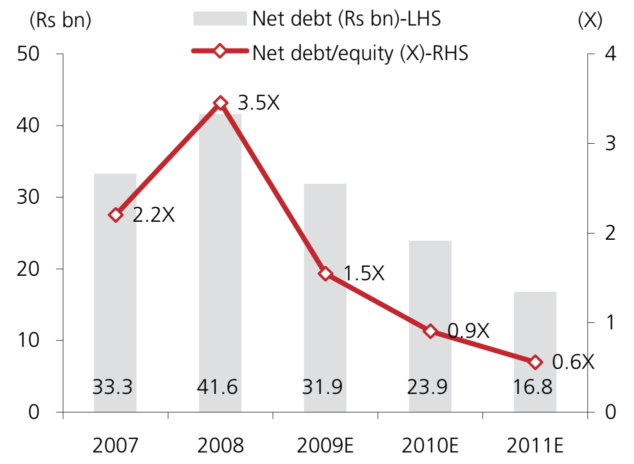
We estimate BJH to generate free cash of Rs18.7 bn over FY2009-11E as it has no major capex plans and will use the cash to reduce its debt. We expect inventory levels to remain significantly low over the next two years, resulting in substantial reduction in working capital investment. We estimate strong cash generation to reduce the net debt-to-equity ratio to 0.6X at end-FY2011E from 3.4X at end-FY2008. The net debt-to-EBITDA ratio is expected to come down to 1.9X by end-FY2011E. Lower debt will also reduce interest cost for BJH, thus supporting EPS growth.

Exhibit 43: Strong cash generation to substantially reduce leverage
Free cash flow for BJH, September fiscal year-ends, 2007-11E (Rs bn)



Source: Company, Kotak Institutional Equities estimates

Exhibit 44: Strong cash generation to substantially reduce leverage
Net debt, Net debt/EBITDA for BJH, September fiscal year-ends, 2007-11E (Rs bn)

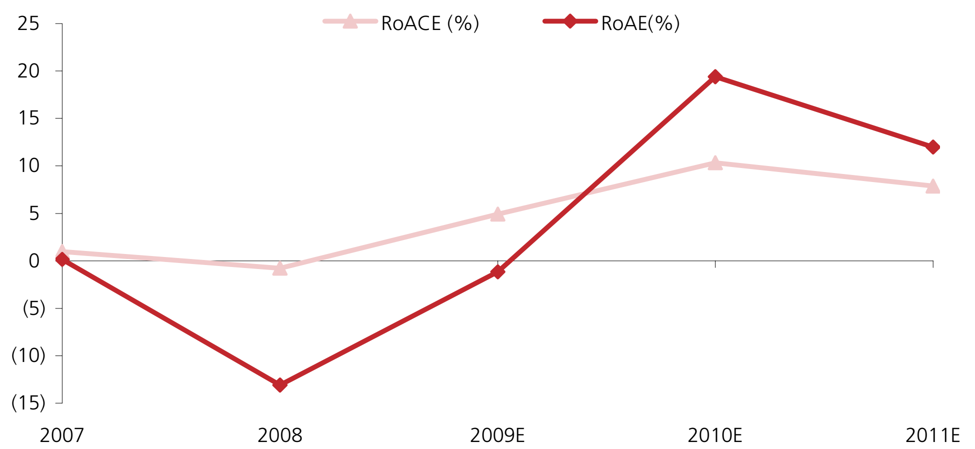


Source: Company, Kotak Institutional Equities estimates

Low return ratios an overhang on valuations

We believe BJH's low return ratios have been a key concern for valuations. We expect the return ratios to improve over next two years led by strong earnings and lower leverage. However, BJH's RoACE will still be in single digits, much below its competitors and will remain a concern for valuations.

Exhibit 45: Low return ratios are an overhang on valuations
RoE and RoCE for BJH, September fiscal year-ends, 2007-11E (%)



Source: Company, Kotak Institutional Equities estimates

BHSIL to pull down consolidated profits

We estimate Bajaj Hindusthan Sugar and Industries Ltd (BHSIL) to continue losing money on account of its high interest and depreciation costs, thus pulling down the consolidated earnings. BJH owns 75% in BHSIL, which operates four mills in eastern UP with a total capacity of 40,000 TCD.

Exhibit 46: Low volumes to keep BHSIL in the red
Key operating estimates for BHSIL, September fiscal year-ends, 2008-11E (Rs mn)

	2007	2008	2009E	2010E	2011E
Revenues	**675**	**2,987**	**4,121**	**4,189**	**5,978**
EBITDA	(267)	(223)	847	1,012	1,160
EBITDA (%)	NM	NM	20.6	24.2	19.4
Depreciation	(108)	(474)	(797)	(797)	(797)
Interest	(18)	(472)	(680)	(705)	(664)
Other income	17	35	30	40	40
Adjusted PBT	(375)	(1,135)	(599)	(450)	(261)
Adjusted PAT	**(251)**	**(757)**	**(396)**	**(297)**	**(172)**

Source: Company, Kotak Institutional Equities estimates

Bajaj Eco-tec—expect margins to improve with higher capacity utilization

We expect capacity utilization for Eco-tec (100% subsidiary engaged in manufacture of bagasse-based boards) to improve to 60% in FY2010E and total production to increase to 90,000 tons from 50,000 tons in FY2009. Higher capacity utilization and better realization will likely improve operating margins. The Eco-tec business is scalable, with high operating margins; however, it also suffers from cyclicality of cane availability.

Exhibit 47: We expect profitability for Eco-tec to improve in FY2010E
Key operating assumptions for Eco-tec, March fiscal year-ends, 2009-11E (Rs mn)

	2009	2010E	2011E
Volumes ('000 tons)			
Particle board	12	23	28
MDF	38	72	90
Realisation (Rs/ton)			
Particle board	10,000	15,000	18,000
MDF	12,500	15,000	18,000
Financials			
Total revenues	**604**	**1,418**	**2,126**
Material costs	250	697	1,050
Employee costs	72	80	88
Power costs	63	137	171
Manufacturing costs	91	100	110
Other costs	127	142	158
Total costs	**603**	**1,156**	**1,576**
EBITDA	**0**	**261**	**550**
EBITDA (%)	0.1	18.4	25.9

Source: Company, Kotak Institutional Equities estimates

Exhibit 48: Profit and loss model for BJH (consolidated), September fiscal year-ends, 2005-11E (Rs mn)

	2005	2006	2007	2008	2009E	2010E	2011E
Net revenues	**8,462**	**14,828**	**17,805**	**20,701**	**23,286**	**45,387**	**49,232**
Operating expenses							
Material and manufacturing cost	(5,316)	(9,746)	(12,049)	(13,693)	(14,621)	(30,316)	(34,103)
Employee cost	(297)	(585)	(1,423)	(1,483)	(1,488)	(1,854)	(2,100)
Manufacturing expense	(490)	(967)	(1,718)	(1,634)	(1,091)	(2,106)	(2,498)
Selling expense	(143)	(177)	(302)	(255)	(333)	(510)	(554)
Other costs	(116)	(246)	(405)	(1,328)	(684)	(833)	(985)
Operating expenses	**(6,361)**	**(11,721)**	**(15,897)**	**(18,393)**	**(18,217)**	**(35,619)**	**(40,239)**
(% of revenues)	75.2	79.0	89.3	88.9	78.2	78.5	81.7
EBITDA	**2,101**	**3,108**	**1,907**	**2,308**	**5,069**	**9,768**	**8,992**
Depreciation and amortisation	(351)	(733)	(1,611)	(2,799)	(2,994)	(3,136)	(3,174)
EBIT	**1,750**	**2,375**	**296**	**(490)**	**2,076**	**6,632**	**5,818**
Net finance (cost)/income	(132)	(33)	(915)	(2,071)	(2,805)	(1,663)	(1,148)
Other income	87	398	323	(370)	380	357	382
Profit before tax	**1,705**	**2,740**	**(295)**	**(2,932)**	**(350)**	**5,326**	**5,052**
Exceptional items	—	—	—	—	1,580	—	—
Reported PBT	**1,705**	**2,740**	**(295)**	**(2,932)**	**1,231**	**5,326**	**5,052**
Current tax	(267)	(313)	(42)	(1)	(285)	(988)	(1,267)
FBT	(4)	(11)	(15)	(23)	(8)	—	—
Deferred tax	(29)	(850)	217	1,004	(208)	(835)	(439)
MAT credit entitlement	—	276	41	—	285	988	—
Reported net profit	**1,404**	**1,842**	**(94)**	**(1,951)**	**1,014**	**4,491**	**3,346**
Minority interest	—	—	115	173	37	74	43
Consolidated PAT	**1,404**	**1,842**	**20**	**(1,779)**	**1,051**	**4,565**	**3,389**
Adjusted PAT	1,404	1,908	20	(1,779)	(191)	4,565	3,389
EPS							
Primary	14.6	14.3	0.1	(12.6)	(1.2)	24.8	17.7
Diluted	**14.6**	**14.3**	**0.1**	**(12.6)**	**(1.0)**	**23.9**	**17.7**
Shares outstanding (mn)							
Year end	116.3	141.4	141.4	141.4	176.9	191.4	191.4
Primary (weighted avg.)	96.1	133.7	141.4	141.4	159.1	184.1	191.4
Fully diluted	96.1	133.7	141.4	141.4	191.4	191.4	191.4
Margins (%)							
EBITDA margin	24.8	21.0	10.7	11.1	21.8	21.5	18.3
EBIT margin	20.7	16.0	1.7	(2.4)	8.9	14.6	11.8
Adjusted PBT margin	20.1	18.5	(1.7)	(14.2)	(1.5)	11.7	10.3
Net profit margin (w/o extra-ordinary)	16.6	12.4	(0.5)	(9.4)	4.4	9.9	6.8
Cash tax rate (%)	**15.7**	**11.4**	**(14.2)**	**(0.0)**	**23.1**	**18.6**	**25.1**
Effective tax rate (%)	**17.4**	**42.4**	**59.2**	**34.2**	**40.1**	**34.2**	**33.8**
Growth yoy (%)							
Revenues	—	75.2	20.1	16.3	12.5	94.9	8.5
EBITDA	—	47.9	(38.6)	21.0	119.6	92.7	(7.9)
Adjusted PBT	—	60.7	(110.8)	NM	NM	NM	(5.1)
Net profit (w/o extra-ordinaries)	—	31.2	(105.1)	NM	NM	342.7	(25.5)
Diluted EPS	—	**(2.3)**	**(99.0)**	**NM**	**NM**	**NM**	**(25.8)**

Source: Company, Kotak Institutional Equities estimates

Exhibit 49: Balance sheet model for BJH (consolidated), September fiscal year-ends, 2005-11E (Rs mn)

	2005	2006	2007	2008	2009E	2010E	2011E
Equity							
Equity share capital	116	141	141	141	177	191	191
Stock options	—	—	223	162	162	162	162
Equity warrants	—	—	—	—	189	—	—
Reserves & surplus	6,026	13,473	13,696	11,710	19,834	25,006	28,261
Deferred tax liability	453	1,262	1,045	39	248	1,082	1,522
Net worth	**6,596**	**14,876**	**15,105**	**12,053**	**20,609**	**26,442**	**30,136**
Minority Interest	—	—	**226**	**673**	**636**	**562**	**519**
Secured debt	3,818	4,753	26,788	36,637	27,966	21,774	16,949
Unsecured debt	1,282	10,659	9,146	6,714	5,918	5,769	3,155
Total debt	**5,100**	**15,412**	**35,934**	**43,351**	**33,885**	**27,544**	**20,104**
Current liability and provisions	975	4,015	10,129	11,693	7,312	10,152	9,718
Total sources of funds	**12,671**	**34,304**	**61,395**	**67,770**	**62,442**	**64,700**	**60,476**
Assets							
Cash and cash equivalents	58	2,311	2,674	1,740	2,027	3,627	3,339
Inventory	555	1,434	4,338	7,924	3,220	2,142	2,254
Sundry debtors	179	663	1,137	543	819	1,694	1,767
Loans and advances	1,030	4,438	12,083	15,398	16,307	18,669	18,326
Other current assets	—	—	317	317	601	1,590	323
Current assets	**1,823**	**8,847**	**20,549**	**25,921**	**22,975**	**27,721**	**26,010**
Gross block	6,552	13,791	29,218	47,452	49,437	50,085	50,746
Less: accum. depreciation & impairment	1,989	3,055	4,671	7,191	10,185	13,321	16,496
Net fixed assets	**4,563**	**10,736**	**24,547**	**40,261**	**39,252**	**36,764**	**34,251**
Capital -WIP	6,234	14,720	16,299	1,587	214	214	214
Net fixed assets (incl. C-WIP)	**10,797**	**25,456**	**40,846**	**41,848**	**39,466**	**36,978**	**34,465**
Investments	51	1	1	1	1	1	1
Total uses of funds	**12,671**	**34,304**	**61,395**	**67,770**	**62,442**	**64,700**	**60,476**
Leverage and return ratios (%)							
Debt/Equity	77.3	103.6	237.9	359.7	164.4	104.2	66.7
Debt/Capitalization	43.6	50.9	70.4	78.2	62.2	51.0	40.0
Net debt/Equity	76.4	88.1	220.2	345.2	154.6	90.5	55.6
Net debt/Capitalization	43.3	46.8	68.8	77.5	60.7	47.5	35.7
Net debt/EBITDA (X)	2.4	4.2	17.4	18.0	6.3	2.4	1.9
RoAE	21.3	17.2	0.1	(13.1)	6.4	19.4	12.0
RoACE	12.9	8.9	1.0	(0.8)	4.9	10.3	7.9
CRoCI	13.2	6.8	3.3	4.0	6.7	11.7	11.0

Source: Company, Kotak Institutional Equities estimates

Exhibit 50: Cash flow model for BJH (consolidated), September fiscal year-ends, 2007-11E (Rs mn)

	2007	2008	2009E	2010E	2011E
Operating					
Pre-tax and pre extra-ordinary income	(295)	(2,932)	(350)	5,326	5,052
Depreciation & amortization	1,611	2,799	2,994	3,136	3,174
Taxes paid	(196)	(247)	(293)	(988)	(1,267)
Dividend and other income	(4)	(84)	(380)	(357)	(382)
Interest expense	915	2,071	2,805	1,663	1,148
Interest paid	(782)	(1,793)	(2,805)	(1,663)	(1,148)
Extra-ordinary	—	—	1,580	—	—
Other non-cash items	223	1,209	(267)	(50)	—
Working capital changes	(1,379)	(4,474)	(621)	722	2,555
Cash flow from operations	**93**	**(3,449)**	**2,663**	**7,789**	**9,132**
Operating, excl. working capital	**1,472**	**1,025**	**3,284**	**7,067**	**6,577**
Investing					
Capital investment	(16,969)	(2,916)	(611)	(648)	(661)
Purchase/sale of asset/business	—	(165)	—	—	—
Investment changes	3	83	—	—	—
Loans and advances	(3,500)	(643)	—	—	—
Interest/dividend received	3	8	380	357	382
Cash flow from investing	**(20,462)**	**(3,634)**	**(231)**	**(291)**	**(279)**
Financing					
Equity issues	310	—	7,421	567	—
Net proceeds from borrowings	20,518	6,248	(9,466)	(6,341)	(9,006)
Dividends paid (incl. tax)	(97)	(98)	(99)	(124)	(134)
Cash flow from financing	**20,731**	**6,150**	**(2,145)**	**(5,898)**	**(9,140)**
Net change in cash and cash equivalents	362	(934)	288	1,599	(288)
Forex fluctuation on consolidation	—	—	—	—	—
Beginning cash	2,311	2,673	1,740	2,027	3,627
Ending cash	**2,673**	**1,740**	**2,027**	**3,627**	**3,339**
Free cash flow	**(20,369)**	**(7,083)**	**2,432**	**7,497**	**8,853**

Source: Company, Kotak Institutional Equities estimates

Exhibit 51: Sugar to continue to be the main revenue driver
Segmental revenue break-up, September fiscal year-ends, 2007-11E (Rs mn)

	2007	2008	2009E	2010E	2011E
Sugar	14,692	13,998	16,093	37,138	37,590
Distillery	1,970	3,009	1,554	1,685	2,810
Co-generation	23	332	231	280	514
Others	446	223	276	323	307
Total standalone	**17,130**	**17,563**	**18,154**	**39,426**	**41,221**
Sugar	662	2,423	3,635	3,652	5,304
Distillery	8	540	408	464	567
Co-generation	0	17	69	62	94
Others	4	8	10	11	14
Total BHSIL	**675**	**2,987**	**4,121**	**4,189**	**5,978**
Ecotec and others	0	152	1,011	1,772	2,032
Total consolidated	**17,805**	**20,701**	**23,286**	**45,387**	**49,232**

Source: Company, Kotak Institutional Equities estimates

Pending SAP judgments can have adverse impacts

Indian sugar manufacturing companies have filed a petition in the Supreme Court challenging the process of determination of the SAP price by various state governments. The matter is subjudice and a final decision is expected soon. BJH has paid and accounted for the sugarcane liability based on the announced SAP or the interim price announced by the Supreme Court. Final adjustment will be made as per the court's decision.

Exhibit 52: Impact of court ruling on SAP price to be made after Supreme Court decision
Status of the sugarcane arrears for past three years

Sugar season	SAP	SC adjudicated price	BJH price paid	accounted price	Likely future impact	Comment
2007	125	118	Mostly at Rs118	81 (SMP)	Negative Rs4821 mn	Recongized as contingent liability, will decide on final judgement
2008	125	110	110	110	Negative Rs1223 mn	Recognized as contingent liability, to be decided on final judgement
2009	140	n/a	140	140	Nil	Under litigation but paying as per SAP

Source: Company, Kotak Institutional Equities

COMPANY OVERVIEW

BJH is the largest sugar company in India based on crushing capacity. Its mills are primarily located in Uttar Pradesh in north India, which is a major sugarcane growing region in the country. BJH has a total capacity of 136,000 TCD of sugar production along with 350 MW of co-generation and 800 KLPD distillery capacity. BJH's subsidiary—BHSIL is also looking for the merger of Phenil Sugars Private Ltd with itself, which will further add 12,000 TCD sugar capacity to the BJH group.

Capacity overview

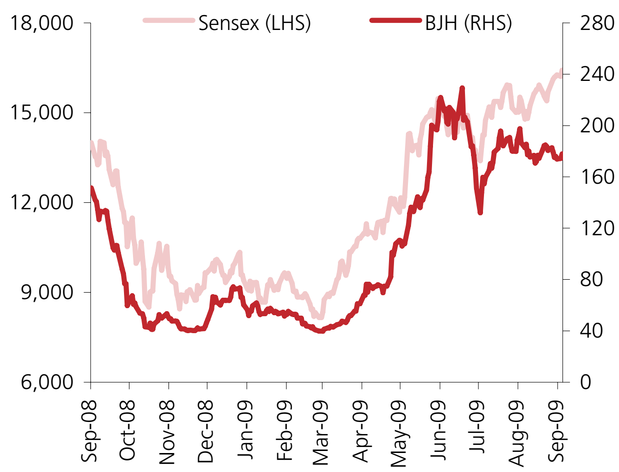
Exhibit 53: Capacity overview
Location wise capacities for BJH

	Sugar (TCD)	Distillery (KLPD)	Cogeneration (MW)
Golagokarannath	13,000	100	30
Palia Kalan	11,000	60	40
Khambarkhera	10,000	160	35
Barkhera	7,000	—	35
Maqsudpur	7,000	—	30
Kinauni	12,000	160	35
Bilai	9,000	—	35
Thana Bhawan	9,000	—	35
Budhana	9,000	—	40
Gangauli	9,000	160	25
Bajaj Hindusthan	**96,000**	**640**	**340**
Pratappur	6,000	—	13
Kunderki	15,000	—	44
Utraula	12,000	—	21
Rudauli	7,000	160	17
BHSIL	**40,000**	**160**	**95**
Consolidated	**136,000**	**800**	**435**

Source: Company

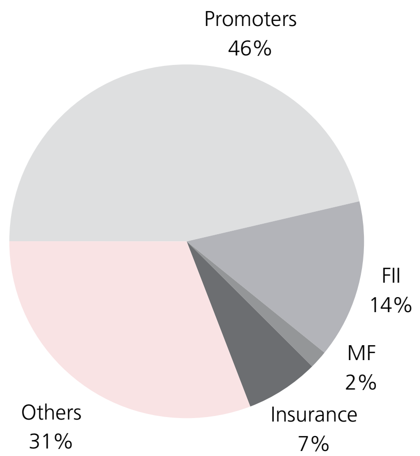
Market and ownership data

Exhibit 54: Relative stock performance
Performance of BJH stock versus Sensex, 2004-2009



Source: Bloomberg

Exhibit 55: Shareholding pattern
Shareholding pattern for BJH



Source: BSE

kotak Institutional Equities

Balrampur Chini (BRCM)

Sugar

ADD

September 16, 2009

INITIATING COVERAGE

Sector view: Attractive

Price (Rs): 125

Target price (Rs): 140

BSE-30: 16,677

Sweet spot. We believe Balrampur—India's second biggest sugar producer—is well placed to benefit from the strong sugar up-cycle. We expect strong earnings growth and large free cash flows to strengthen its balance sheet. We find current valuations reasonable considering the strong earnings growth potential over the next two years. We expect higher sugar prices to further drive stock performance. Any problems with cane supply or government intervention could pose risks.

Initiate with ADD and target price of Rs140

We initiate coverage on Balrampur with an ADD rating and target price of Rs140 based on 6X FY2011E EBITDA. We believe the stock is currently reasonably valued at 5.5X and 9.6X FY2011E EBITDA and EPS, respectively, in line with global peers. We believe the current stock price factors in most of the expected peak cycle earnings growth expected over the next two years. Further upside is likely to be driven by higher-than-expected sugar prices.

Strong earnings growth and large operating cash flows to strengthen the balance sheet

We expect high sugar prices over the next two years to result in strong earnings growth and large operating cash flows for Balrampur. We estimate Rs15.5 bn of free-cash-flow generation over FY2009-11E, which is likely to result in a net cash position of Rs1.7 bn at end-FY2011E from a net debt of Rs13.4 bn at end-FY2008.

Large integrated capacity is a key strength

We view Balrampur's large integrated capacity as a key strength to better sustain cyclicality in the sugar industry. Higher crushing capacity enables higher sugar production in a good crop season, while integration benefits from distillery and co-generation operations are likely to reduce the earnings concentration in a single segment—sugar. We expect higher sugar volumes to drive earnings growth in FY2011E to negate the impact of a possible lower realization, further supported by lower interest costs.

Key risks—patchy monsoon and government action

Balrampur, like other sugar companies, is susceptible to risks from scanty rainfall and adverse government intervention. A poor monsoon in Eastern Uttar Pradesh, which is its primary command area, is likely to impact the availability of sugarcane which will result in low sugar production for a second consecutive year. Further government intervention to control the rise in sugar prices and adverse judgments in ongoing litigation (for determining the SAP of earlier years) can have a negative impact on cash flows and earnings.

Company data and valuation summary

Company data	Stock data	High	Low
Rating: ADD	52-week range (Rs)	129	29
	Yield (%)		0.4
Current price (Rs)	Priced at close of:	September 16, 2009	
125	**Capitalization**		
	Market cap (Rs bn)		31.9
	Net debt/(cash) (Rs bn)		13.4
	Free float (%)		63.1
	Shares outstanding (mn)		255.5

Price performance	1M	3M	12M
Absolute (%)	4.2	19.3	47.1
Rel. to BSE-30 (%)	(4.0)	7.8	23.7

Forecasts/valuation	2008	2009E	2010E
EPS (Rs)	3.1	10.0	13.4
P/E (X)	40.5	12.5	9.3
RoAE (%)	7.4	20.2	22.1
EV/EBITDA (X)	14.4	7.4	5.7

Source: Company data, Kotak Institutional Equities estimates

VALUATIONS REASONABLE, SUPPORTED BY STRONG EARNINGS GROWTH

We find Balrampur reasonably valued at 9.6X and 5.5X FY2011E EPS and EBITDA despite the recent run-up in the stock price supported by strong earnings growth and a robust balance sheet. We value Balrampur at Rs140 based on 6X FY2011E EBITDA in line with global peers. We believe Balrampur is amongst the better placed companies in the sector due to its (1) large capacity, (2) high integration, (3) robust balance sheet and (4) strong earnings growth over the next two years. We expect further upsides to be driven by higher-than-expected sugar prices

We value Balrampur at Rs140/share

We value Balrampur at Rs140/share based on 6X FY2011E EBITDA in line with global peers. We use a lower target multiple than for SHRS due to its lower RoCE, higher dependency on domestic cane crop and higher risks from adverse government regulations. We believe a DCF-based valuation is difficult considering the high volatility in sugar and cane prices and uncertainty about the crop pattern and availability. We prefer an enterprise-level valuation to negate the impact of (1) different capital structures of various companies and (2) varying tax rates on account of brought forward losses and (3) high sensitivity of EPS to small change in sugar prices.

Exhibit 56: We value Balrampur at Rs140/share
Valuation table for Balrampur

	2010E	2011E
EBITDA	5,873	5,556
EV/EBITDA (X)	6.0	6.0
EV	**35,240**	**33,334**
Net debt	1,487	(1,668)
Equity Value	**33,754**	**35,002**
Fully diluted shares (mn)	256	256
Value per share (Rs)	**132**	**137**

Source: Kotak Institutional Equities estimates

Exhibit 57: Trading range for Balrampur has been very volatile
One-year forward rolling EV/EBITDA trend for Balrampur

Note: Intermediate valuations were substantially high due to low profitability hence excluded from the scale.

Source: Bloomberg, Kotak Institutional Equities

Sensitivity to sugar prices very high

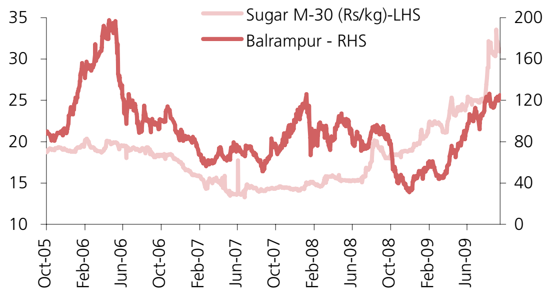
Balrampur's stock price performance and valuation are highly sensitive to sugar price. A Re1 change in average realization impacts our target price by Rs15, whereas a reduction of 5 days in total crushing days impacts our fair value by Rs2. The high correlation of the stock price performance with sugar prices also indicates the sensitivity of valuation and earnings to sugar prices.

Exhibit 58: Valuation highly sensitive to sugar price
Sensitivity of target price to sugar price (Rs/share)

		Average realisation (Rs/kg)-FY2011E				
		27.4	**28.4**	**29.4**	**30.4**	**31.4**
Crushing days (no.)	**105**	103	118	134	149	164
	110	105	120	135	151	166
	115	106	122	**137**	152	168
	120	108	123	139	154	169
	125	109	125	140	156	171

Source: Kotak Institutional Equities estimates

Exhibit 59: Stock price performance highly correlated to sugar price
Comparative performance of sugar price versus Balrampur stock price



Source: Bloomberg

FINANCIALS—STRONG EARNINGS GROWTH AND FREE CASH GENERATION

We expect Balrampur to report strong earnings and generate substantial free cash flows over the next two years as it benefits from a very strong up-cycle in sugar prices. We estimate EPS to grow 4X to Rs13 in FY2011E from Rs3.1 in FY2008 led by higher operating profits and lower interest cost. We expect Balrampur to generate Rs15.5 bn of free cash over FY2009-11E, which will result in a net cash position of Rs1.7 bn at end-FY2011E against a net debt of Rs13.4 bn at end-FY2008. The price realization for sugar and the recovery rate could pose upside risks to our estimates if they surpass expectations, whereas a lower supply of cane or higher costs present downside risks.

High sugar prices to drive earnings and cash flows

We expect high sugar prices to drive earnings and cash flows for Balrampur over the next two years. We currently estimate an EPS of Rs13.4 and Rs13 for FY2010E and FY2011E, respectively, based on an average sugar realization of Rs31.5 and Rs29.4 per kg for FY2010E and FY2011E.

Key operating assumptions

Exhibit 60: Key operating assumptions for Balrampur, September year-ends, 2007-2011E

	2008	2009E	2010E	2011E
Sugar segment				
Sugarcane crushed (mn tons)	8.1	4.8	4.7	6.8
Average recovery ratio (%)	10.2	9.1	9.4	9.8
Sugar produced ('000 tons)	819	442	440	666
Sugar sold (mn tons)	0.7	0.7	0.6	0.7
Average realisation (Rs/kg)	15.9	23.5	31.5	29.4
Sugarcane cost (Rs/ton)	1,209	1,560	1,950	1,950
Raw sugar imports (mn tons)	—	—	0.1	0.1
Landed cost of raw sugar ($/ton)	—	—	15	22
Distillery segment				
Alchohol produced (mn ltrs)	91	60	52	74
Alchohol sold (mn ltrs)	86	64	52	75
Average realisation (Rs/ltr)	22	27	29	26
Co-generation segment				
External sales (mn units)	574	359	340	493
Average realisation (Rs/unit)	3.0	3.4	4.0	4.1

Source: Company, Kotak Institutional Equities estimates

Earnings highly sensitive to sugar prices and recovery rate

We highlight that Balrampur's EPS estimate is highly sensitive to sugar price realization and recovery rate (sugar produced/cane crushed), which are the key earnings drivers. Lower-than-expected cane availability or higher cane cost can have a negative impact on our estimates.

Exhibit 61: EPS highly sensitive to sugar prices and recovery rate
Balrampur, sensitivity of EPS to sugar price and recovery rate (Rs/share)

		Average realisation (Rs/kg)-FY2010E				
		29.5	**30.5**	**31.5**	**32.5**	**33.5**
Recovery rate (%)	**9.0**	8.8	10.4	12.0	13.6	15.2
	9.2	9.5	11.1	12.7	14.3	15.9
	9.4	10.2	11.8	**13.4**	15.0	16.6
	9.6	10.9	12.5	14.1	15.7	17.3
	9.8	11.7	13.3	14.9	16.5	18.1

Source: Kotak Institutional Equities estimates

Exhibit 62: EPS highly sensitive to sugar price and cane cost
Balrampur, sensitivity of EPS to sugar price and cane cost (Rs/share)

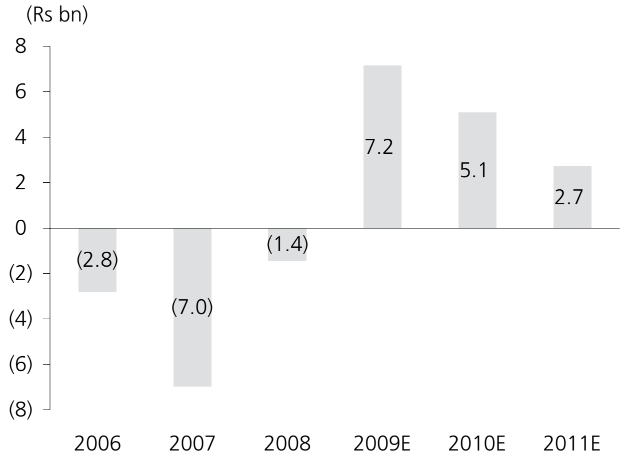
		Average realisation (Rs/kg)-FY2010E				
		29.5	**30.5**	**31.5**	**32.5**	**33.5**
Cane cost (Rs/ton)	**1,850**	11.8	13.4	15.0	16.6	18.2
	1,900	11.0	12.6	14.2	15.8	17.4
	1,950	10.2	11.8	**13.4**	15.0	16.6
	2,000	9.4	11.0	12.7	14.3	15.9
	2,050	8.7	10.3	11.9	13.5	15.1

Source: Kotak Institutional Equities estimates

Strong free cash generation to reduce leverage

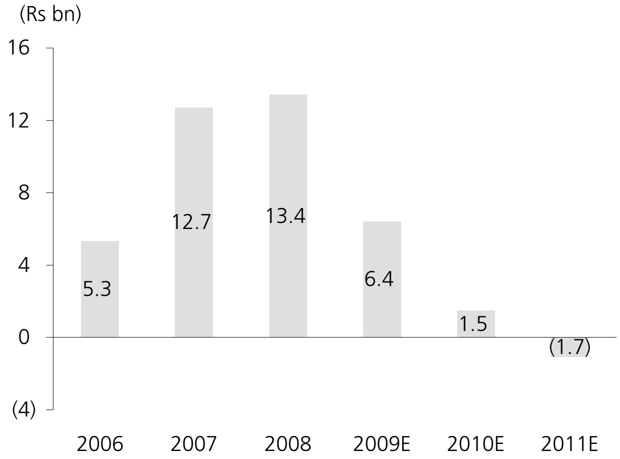
We estimate Balrampur to generate free cash of Rs15.5 bn over FY2009-11E as it has no major capex plans and is likely to use the cash to reduce its debt. We expect inventory levels to remain significantly low over the next two years, resulting in substantial reduction in working capital investment. We estimate strong cash generation to result in a net cash position of Rs1.7 bn at end-FY2011E versus a net debt position of Rs13.4 bn at end-FY2008.

Exhibit 63: Strong cash generation to substantially reduce leverage
Free cash flow for Balrampur, September fiscal year-ends, 2006-11E (Rs bn)



Source: Company, Kotak Institutional Equities estimates

Exhibit 64: Strong cash generation to substantially reduce leverage
Net debt for Balrampur, September fiscal year-ends, 2006-11E (Rs bn)



Source: Company, Kotak Institutional Equities estimates

Exhibit 65: Sugar will continue to be the key revenue driver for Balrampur
Revenue break-up for Balrampur, September fiscal year-ends, 2007-11E (Rs mn)

	2007	2008	2009E	2010E	2011E
Sugar	11,064	10,997	15,162	17,110	19,213
Distillery	1,349	1,863	1,696	1,508	1,950
Co-generation	1,449	1,739	1,221	1,360	2,020
Others	56	19	41	96	101
Total standalone	**13,917**	**14,618**	**18,120**	**20,074**	**23,285**
Indogulf	31	290	588	884	1,029
Consolidated	**13,948**	**14,909**	**18,709**	**20,958**	**24,314**

Source: Company, Kotak Institutional Equities estimates

Exhibit 66: Balrampur, Profit and loss model (consolidated), September fiscal year-ends, 2005-11E (Rs mn)

	2005	2006	2007	2008	2009E	2010E	2011E
Net revenues	**8,127**	**18,984**	**13,948**	**14,909**	**18,709**	**20,958**	**24,314**
Operating expenses							
Material and manufacturing cost	(4,341)	(12,191)	(10,710)	(9,062)	(11,211)	(12,430)	(15,453)
Employee cost	(363)	(719)	(738)	(864)	(959)	(909)	(1,055)
Manufacturing expense	(667)	(964)	(1,169)	(1,195)	(897)	(1,089)	(1,264)
Selling expense	(101)	(104)	(87)	(115)	(136)	(151)	(175)
Other costs	(255)	(388)	(452)	(532)	(331)	(507)	(645)
Operating expenses	**(5,728)**	**(14,366)**	**(13,157)**	**(11,768)**	**(13,533)**	**(15,085)**	**(18,591)**
(% of revenues)	70.5	75.7	94.3	78.9	72.3	72.0	76.5
EBITDA	**2,399**	**4,618**	**791**	**3,141**	**5,175**	**5,873**	**5,722**
Depreciation and amortisation	(373)	(671)	(877)	(1,253)	(1,136)	(1,151)	(1,166)
EBIT	**2,027**	**3,947**	**(85)**	**1,888**	**4,040**	**4,723**	**4,556**
Net finance (cost)/income	(194)	(367)	(600)	(1,001)	(1,026)	(783)	(642)
Other income	30	68	115	152	50	190	258
Profit before tax	**1,862**	**3,649**	**(571)**	**1,039**	**3,063**	**4,130**	**4,173**
Exceptional items	(223)	—	—	—	—	—	—
Reported PBT	**1,639**	**3,649**	**(571)**	**1,039**	**3,063**	**4,130**	**4,173**
Current tax	(215)	(549)	(19)	(56)	(480)	(701)	(713)
FBT	—	(9)	(6)	(6)	(3)	—	—
Deferred tax	(174)	(175)	(40)	(193)	(31)	—	—
Reported net profit	**1,251**	**2,916**	**(635)**	**783**	**2,549**	**3,429**	**3,461**
Adjusted PAT	**1,427**	**2,916**	**(635)**	**783**	**2,549**	**3,429**	**3,461**
EPS							
Primary	7.0	12.2	(2.6)	3.1	10.0	13.4	13.5
Diluted	**7.0**	**12.2**	**(2.6)**	**3.1**	**10.0**	**13.4**	**13.5**
Shares outstanding (mn)							
Year end	231.8	248.2	248.2	255.5	255.5	255.5	255.5
Primary (weighted avg.)	203.2	239.2	248.2	253.6	255.5	255.5	255.5
Fully diluted	203.2	239.2	248.2	253.8	255.5	255.5	255.5
Margins (%)							
EBITDA margin	29.5	24.3	5.7	21.1	27.7	28.0	23.5
EBIT margin	24.9	20.8	(0.6)	12.7	21.6	22.5	18.7
PBT margin	22.9	19.2	(4.1)	7.0	16.4	19.7	17.2
Net profit margin (w/o extra-ordinary)	15.4	15.4	(4.6)	5.3	13.6	16.4	14.2
Cash tax rate (%)	**11.5**	**15.0**	**(3.3)**	**5.4**	**15.7**	**17.0**	**17.1**
Effective tax rate (%)	**20.9**	**19.9**	**(10.2)**	**24.0**	**16.7**	**17.0**	**17.1**
Growth yoy (%)							
Revenues	—	133.6	(26.5)	6.9	25.5	12.0	16.0
EBITDA	—	92.5	(82.9)	296.9	64.8	13.5	(2.6)
PBT	—	95.9	(115.6)	(282.2)	194.8	34.8	1.1
Net profit (w/o extra-ordinaries)	—	133.1	(121.8)	(223.3)	225.4	34.5	0.9
Diluted EPS	—	**73.5**	**(121.0)**	**(220.6)**	**223.2**	**34.5**	**0.9**

Source: Company, Kotak Institutional Equities estimates

Exhibit 67: Balrampur, Balance sheet model (consolidated), September fiscal year-ends, 2005-11E (Rs mn)

	2005	2006	2007	2008	2009E	2010E	2011E
Equity							
Equity share capital	232	248	248	256	256	256	256
Reserves & surplus	4,688	8,810	8,343	9,659	12,151	15,431	18,742
Convertible warrants	—	—	—	92	—	—	—
Deferred tax liability	1,017	1,193	1,232	1,426	1,457	1,457	1,457
Net worth	**5,937**	**10,251**	**9,823**	**11,433**	**13,863**	**17,143**	**20,455**
Secured debt	3,864	4,165	12,106	12,773	9,564	8,088	6,824
Unsecured debt	—	1,309	784	1,031	231	31	31
Total debt	**3,864**	**5,474**	**12,891**	**13,804**	**9,795**	**8,119**	**6,855**
Current liability and provisions	2,058	2,371	4,008	2,626	2,973	3,228	3,194
Total sources of funds	**11,859**	**18,096**	**26,722**	**27,863**	**26,631**	**28,490**	**30,504**
Assets							
Cash and cash equivalents	176	157	181	378	3,376	6,632	7,933
Inventory	4,670	1,983	4,410	5,841	2,219	1,383	2,729
Sundry debtors	305	557	461	517	615	689	799
Loans and advances	709	2,031	1,754	1,646	1,794	2,010	2,132
Other current assets	—	—	—	—	—	—	—
Current assets	**5,860**	**4,727**	**6,805**	**8,383**	**8,004**	**10,714**	**13,593**
Gross block	7,746	13,386	20,820	24,881	25,181	25,481	25,781
Less: accum. depreciation & impairment	2,370	3,019	4,279	5,516	6,651	7,802	8,968
Net fixed assets	**5,376**	**10,367**	**16,542**	**19,365**	**18,529**	**17,678**	**16,813**
Capital -WIP	156	2,953	3,337	82	82	82	82
Net fixed assets (incl. C-WIP)	**5,532**	**13,319**	**19,879**	**19,447**	**18,611**	**17,760**	**16,894**
Investments	453	2	6	16	16	16	16
Miscellaneous expenditure not written (	15	47	32	18	—	—	—
Total uses of funds	**11,859**	**18,096**	**26,722**	**27,863**	**26,631**	**28,490**	**30,504**
Leverage and return ratios (%)							
Debt/Equity	65.2	53.6	131.7	120.9	70.7	47.4	33.5
Debt/Capitalization	39.5	34.9	56.8	54.7	41.4	32.1	25.1
Net debt/Equity	62.3	52.1	129.8	117.6	46.3	8.7	(5.3)
Net debt/Capitalization	38.4	34.3	56.5	54.0	31.6	8.0	(5.6)
Net debt/EBITDA (X)	1.5	1.2	16.1	4.3	1.2	0.3	(0.2)
RoAE	24.1	28.6	(6.5)	6.9	18.4	20.0	16.9
RoACE	16.1	25.1	0.1	6.4	13.9	16.7	15.2
CRoCI	17.1	20.7	2.9	8.9	16.7	19.2	17.5

Source: Company, Kotak Institutional Equities estimates

Exhibit 68: Balrampur, Cash flow model (consolidated), September fiscal year-ends, 2005-11E (Rs mn)

	2005	2006	2007	2008	2009E	2010E	2011E
Operating							
Pre-tax and pre extra-ordinary income	1,862	3,649	(571)	1,039	3,063	4,130	4,173
Depreciation & amortization	373	671	877	1,253	1,136	1,151	1,166
Taxes paid	(320)	(487)	336	(128)	(483)	(701)	(713)
Dividend and other income	17	13	(31)	(36)	(50)	(190)	(258)
Interest expense	194	367	600	1,001	1,026	783	642
Interest paid	(173)	(354)	(582)	(1,051)	(1,026)	(783)	(642)
Extra-ordinary	(610)	—	—	—	—	—	—
Other non-cash items	27	32	(293)	124	18	—	—
Working capital changes	(364)	1,328	(419)	(2,829)	3,723	801	(1,613)
Cash flow from operations	**1,006**	**5,218**	**(82)**	**(627)**	**7,407**	**5,191**	**2,756**
Operating, excl. working capital	**1,370**	**3,890**	**337**	**2,202**	**3,684**	**4,390**	**4,368**
Investing							
Capital investment	(466)	(8,475)	(6,890)	(828)	(300)	(300)	(300)
Purchase/sale of asset/business	—	—	—	—	—	—	—
Investment changes	(450)	451	—	(7)	—	—	—
Loans and advances	—	—	—	—	—	—	—
Interest/dividend received	2	3	1	20	50	190	258
Cash flow from investing	**(914)**	**(8,021)**	**(6,889)**	**(816)**	**(250)**	**(110)**	**(42)**
Financing							
Equity issues	1,704	2,154	—	770	—	—	—
Net proceeds from borrowings	(1,474)	1,610	7,413	875	(4,009)	(1,676)	(1,263)
Dividends paid (incl. tax)	(215)	(989)	(424)	—	(149)	(149)	(149)
Cash flow from financing	**16**	**2,775**	**6,989**	**1,644**	**(4,159)**	**(1,825)**	**(1,413)**
Net change in cash and cash equivalents	108	(27)	17	201	2,998	3,256	1,301
Forex fluctuation on consolidattion	—	—	—	2	—	—	—
Beginning cash	53	162	134	152	354	3,353	6,608
Ending cash	**162**	**134**	**152**	**354**	**3,353**	**6,608**	**7,909**
add: unavailable cash	15	22	29	24	24	24	24
Cash and bank balances as per Balance she	**176**	**157**	**181**	**378**	**3,376**	**6,632**	**7,933**
Free cash flow	**93**	**(2,803)**	**(6,972)**	**(1,443)**	**7,157**	**5,081**	**2,714**

Source: Company, Kotak Institutional Equities estimates

Pending SAP judgments can have adverse impact

Indian sugar manufacturing companies have filed a petition in the Supreme Court challenging the process of determination of the SAP price by various state governments. The matter is subjudice and a final decision is expected soon. Balrampur has paid and accounted for the sugarcane liability based on the announced SAP or the interim price announced by the Supreme Court. A final adjustment will be made in keeping with the court's decision.

Exhibit 69: Impact of court ruling on SAP price to be made after Supreme Court decision
Status of the sugarcane arrears for past three years

Sugar season	SAP	adjudicated price	BRCM price paid	BRCM accounted price	Likely future impact	Comment
2007	125	118	Mostly Rs125, some Rs118	125	Rs110-150 mn positive	BRCM has paid higher than SC price, hence will writeback amount on final judgement
2008	125	110	110	110	Rs946 mn negative	Recognized as contingent liability, to be decided on final judgement
2009	140	n/a	140	140	Nil	Under litigation but paying as per SAP

Source: Company, Kotak Institutional Equities

COMPANY OVERVIEW

Balrampur is the second largest sugar company in India based on crushing capacity. Its mills are primarily located in eastern Uttar Pradesh in north India, which is a main sugarcane growing region in the country. Balrampur has expanded its crushing capacity by 2.5X over the past four years and has also added significant distillery and co-generation capacities which will stabilize its earnings and reduce the impact of cyclicality.

Capacity overview

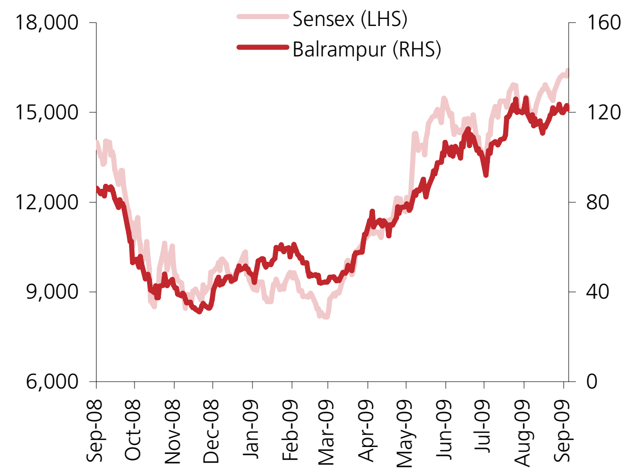
Exhibit 70: Capacity overview
Location wise capacities for Balrampur

	Sugar (TCD)	Distillery (KLPD)	Cogeneration (MW)
Balrampur	12,000	160	25
Babhnan	10,000	60	3
Tulsipur	7,000	—	—
Haidergarh	5,000	—	23
Akbarpur	7,500	—	18
Rauzagaon	8,000	—	26
Mankapur	8,000	100	34
Kumbhi	8,000	—	20
Gularia	8,000	—	31
Indogulf	3,000	—	—
Total	**76,500**	**320**	**180**

Source: Company

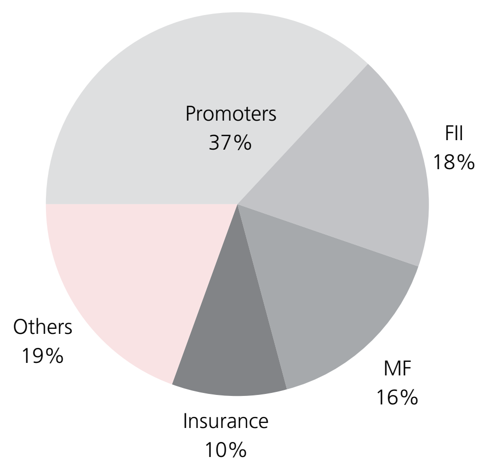
Market and ownership data

Exhibit 71: Relative stock performance
Performance of Balrampur stock versus Sensex, 2004-2009



Source: Bloomberg

Exhibit 72: Shareholding pattern
Shareholding pattern for Balrampur



Source: BSE

kotak Institutional Equities

Shree Renuka Sugars (SHRS)

Sugar

BUY

September 17, 2009

INITIATING COVERAGE

Sector view: Attractive

Price (Rs): 203

Target price (Rs): 235

BSE-30: 16,677

Sugar-coated insulation. We believe SHRS' expansion strategy—setting up new refineries—could effectively reduce cyclicality in earnings and protect it from the vagaries of fluctuating crop patterns. The company's new refineries in coastal regions are part of a long-term expansion strategy focused on global markets. It is also planning co-generation units with co-operative mills which will further stabilize earnings. Current valuations are attractive with strong growth in earnings expected from new capacities.

Initiate with BUY and target price of Rs235

We initiate coverage on SHRS with a BUY rating and target price of Rs235 based on 6.5X FY2011E EBITDA. The stock is attractively valued at 10.1X and 5.3X FY2011E EPS and EBITDA, respectively, and we expect further stock performance to be driven by higher sugar prices and growth from new refining and co-generation capacities. We expect SHRS to use its strong cash flows to further expand capacities through both organic and inorganic routes.

Differentiated approach—focused on refining rather than crushing

SHRS has adopted a differentiated approach—adding standalone refining capacities instead of investing in crushing mills like its peers. We believe this will help protect it from uncertainties in sugarcane supply and also from government regulation of sale quotas. SHRS is likely to focus on the domestic market in the medium-term as the government has allowed duty free import of sugar to meet domestic shortage. In the long term, we expect the company to cater to neighboring export markets as well.

High sugar prices and new capacities to drive growth

We estimate SHRS' revenues to grow at 50% CAGR over FY2008-11E, primarily driven by high sugar prices and new refining capacities. We estimate EPS of Rs24.2 and Rs20.4 in FY2010E and FY2011E, respectively, versus Rs4.3 in FY2008. Higher raw sugar cost in FY2011E will negate the benefits of higher volumes, resulting in lower EPS. Higher-than-expected sugar prices pose upside risks to our estimates, whereas higher cane cost resulting from poor rainfall can negatively impact our estimates.

Key risks—government intervention and poor rainfall

The key risks faced by SHRS are (1) adverse government regulations relating to the import of raw sugar, if any, and (2) poor rainfall. Sharp fluctuations in the price of raw sugar can also impact margins due to a possible disparity between the domestic sugar prices and the converted cost of imported sugar.

Company data and valuation summary

Company data	Stock data	High	Low	Price performance	1M	3M	12M
Rating: BUY	52-week range (Rs)	214	41	Absolute (%)	14.1	43.0	91.6
	Yield (%)		0.1	Rel. to BSE-30 (%)	5.9	31.5	68.2
Current price (Rs)	Priced at close of:		September 16, 2009				
203	**Capitalization**			**Forecasts/valuation**	**2008**	**2009E**	**2010E**
	Market cap (Rs bn)		68.0	EPS (Rs)	4.3	8.1	24.2
	Net debt/(cash) (Rs bn)		8.9	P/E (X)	47.2	25.0	8.4
	Free float (%)		49.4	RoAE (%)	17.2	20.7	34.9
	Shares outstanding (mn)		334.9	EV/EBITDA (X)	30.4	13.6	5.0

Source: Company data, Kotak Institutional Equities estimates

VALUATIONS ATTRACTIVE DRIVEN BY DIFFERENTIATED BUSINESS MODEL

We find SHRS attractively valued at 10.1X and 5.3X FY2011E EPS and EBITDA supported by strong earnings growth and a robust balance sheet. We value SHRS at Rs235 based on 6.5X FY2011E EBITDA, ahead of the global average due to its differentiated business model, which helps it generate higher RoCEs. SHRS' earnings are largely driven by sugar refining, which protects it from the vagaries of adverse crop patterns and government regulations. We like SHRS as a long-term play in the sector due to its (1) differentiated business model, (2) high integration, (3) strong balance sheet and (4) earnings growth through capacity addition.

We value SHRS at Rs235/share

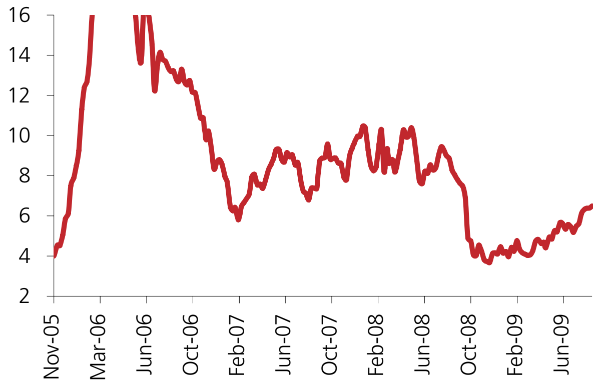
We value SHRS at Rs235/share based on 6.5X FY2011E EBITDA, higher than the global average due to its higher RoCE and less risky business model. We do not use a DCF-based valuation approach since it is difficult to make a reasonable long-term estimate for earnings and cash flows due to high volatility in sugar prices and uncertainty about the crop pattern. We prefer enterprise level valuation over P/E-based valuation in order to negate the impact of (1) different capital structures of various companies and (2) varying tax rates on account of brought forward losses and (3) high sensitivity of EPS to volatility in sugar prices.

Exhibit 73: We value SHRS at Rs235/share based on 6.5X FY2011E EBITDA
Valuation table for SHRS

	2010E	2011E
EBITDA	13,337	11,119
EV/EBITDA (X)	6.5	6.5
EV	**86,689**	**72,274**
Net debt	(1,425)	(6,491)
Equity Value	**88,114**	**78,765**
Fully diluted shares (mn)	335	335
Value per share (Rs)	**263**	**235**

Source: Kotak Institutional Equities estimates

Exhibit 74: Trading range for SHRS has been very volatile
One-year forward rolling EV/EBITDA trend for SHRS



Note: Intermediate valuations were significantly high due to low profitability, hence excluded from the scale.

Source: Bloomberg, Kotak Institutional Equities

Highly sensitive to sugar price fluctuations

SHRS's stock price performance and valuation are highly sensitive to sugar price. A Re1 change in average realization impacts our target price by Rs41; whereas a change of US$ c 25/lb in raw sugar price impacts our fair value by Rs11. The high correlation between the stock price performance and the price of sugar also indicates the sensitivity of valuation and earnings to sugar prices.

Exhibit 75: Valuation highly sensitive to sugar price
Sensitivity of target price to sugar price and crushing days (Rs/share)

Crushing days (no.)	Average realisation (Rs/kg)-FY2011E				
	27.1	**28.1**	**29.1**	**30.1**	**31.1**
165	158	196	233	270	308
170	159	197	234	272	309
175	160	198	**235**	273	310
180	161	199	236	274	311
185	162	200	237	275	312

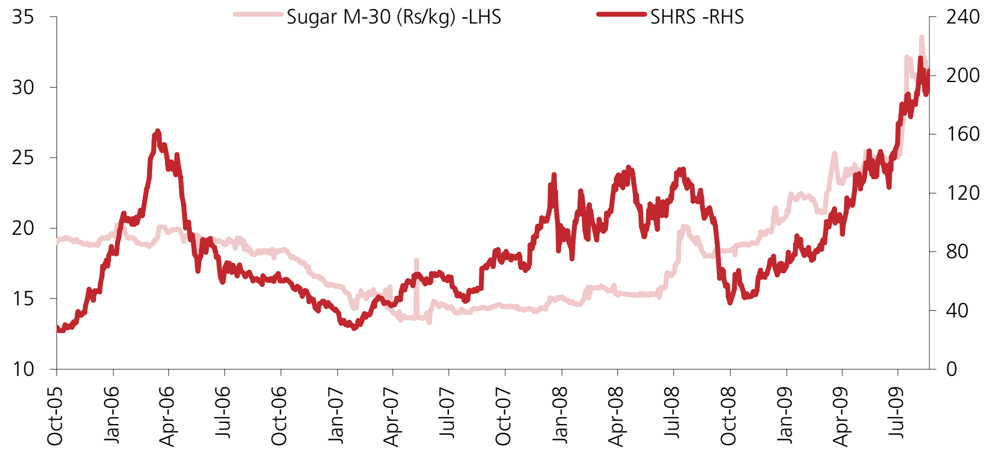
Source: Kotak Institutional Equities estimates

Exhibit 76: Valuation highly sensitive to sugar price
Sensitivity of target price to domestic and raw sugar price (Rs/share)

Raw sugar (US$ c/lb)	Average realisation (Rs/kg)-FY2011E				
	27.1	**28.1**	**29.1**	**30.1**	**31.1**
20.5	179	216	254	291	329
20.8	170	207	244	282	319
21.0	160	198	**235**	273	310
21.3	151	188	226	263	301
21.5	142	179	217	254	292

Source: Kotak Institutional Equities estimates

Exhibit 77: SHRS stock performance closely linked to sugar prices
Comparative performance of SHRS stock price and sugar price



Source: Bloomberg

FINANCIALS—SUGAR PRICES AND REFINING CAPACITY TO DRIVE GROWTH

We estimate SHRS' revenues to grow at 50% CAGR over FY2008-11E to Rs71.6 bn in FY2011E primarily driven by high sugar prices and increased refining capacity. SHRS is planning to add 5,000 TPD of refining capacity and 90 MW of co-generation capacity (in collaboration with co-operative sugar mills) over the next two years. We estimate EPS to increase to Rs24.2 and Rs20.4 in FY2010E and FY2011E, respectively, from Rs4.3 in FY2008. We expect strong earnings and free cash flow of Rs8.7 bn over FY2009-11E to result in a net cash position of Rs6.5 bn at end-FY2011E against a net debt of Rs8.9 bn at end-FY2008. The price realization for sugar and the recovery rate could pose upside risks to our estimates if they surpass expectations, whereas a lower supply of cane or higher costs present downside risks.

Strong growth in earnings from higher realization and new capacities

We expect SHRS' EPS to grow to Rs24.2 and Rs20.4 in FY2010E and FY2011E, respectively, from Rs4.3 in FY2008 mainly driven by higher sugar realization and new refining capacities. SHRS has already contracted around 1.2 mn tons of raw sugar imports at significantly lower than current price hence we expect it to make substantial margins in FY2010E. However, in FY2011E, benefits of higher volumes will be negated by an increase in raw sugar costs, resulting in a lower EPS.

Key operating assumptions

Exhibit 78: Key operating assumptions for SHRS, September year-ends, 2008-2011E

	2008	2009E	2010E	2011E
Sugar segment				
Sugarcane crushed (mn tons)	4.6	3.5	3.9	4.6
Average recovery ratio (%)	11.4	10.7	10.8	11.0
Sugar produced ('000 tons)	524	376	416	511
Refined sugar ('000 tons)	68	601	1,126	1,548
Total sugar produced (lac tons)	**592**	**976**	**1,542**	**2,060**
Sugar sold ('000 tons)	480	940	1,600	2,025
Average realisation (Rs/kg)	13.4	23.0	30.1	29.1
Sugarcane cost (Rs/ton)	1,097	1,700	2,100	2,050
Raw sugar cost(US$ c/lb)	11.3	15.2	18.1	21.0
Co-generation segment				
External sales (mn units)	154	247	384	564
Average realisation (Rs/unit)	6.5	6.5	6.8	7.2
Distillery segment				
Alchohol produced (mn ltrs)	47	92	111	121
Alchohol sold (mn ltrs)	51	75	115	125
Average realisation (Rs/ltr)	26.0	25.0	28.0	27.0

Source: Company, Kotak Institutional Equities estimates

Earnings highly sensitive to sugar realization and raw sugar cost

We highlight that SHRS's EPS estimate is highly sensitive to sugar price realization and price of imported raw sugar. A Re1 change in realization can impact EPS by Rs2.8, whereas a change of US$ c0.5/lb in the raw sugar price can impact EPS by Rs1.3.

Exhibit 79: Earnings highly sensitive to sugar price fluctuation
FY2010E EPS sensitivity to sugar realization and raw sugar price (Rs/share)

Raw sugar (US$ c/lb)	Average realisation (Rs/kg)-FY2010E				
	28.1	**29.1**	**30.1**	**31.1**	**32.1**
17.1	21.1	23.9	26.7	29.5	32.4
17.6	19.8	22.6	25.4	28.3	31.1
18.1	18.5	21.3	**24.2**	27.0	29.8
18.6	17.2	20.1	22.9	25.7	28.5
19.1	15.9	18.8	21.6	24.4	27.3

Source: Kotak Institutional Equities estimates

Exhibit 80: Earnings highly sensitive to sugar price fluctuation
FY2010E EPS sensitivity to sugar realization and recovery rate (Rs/share)

Recovery rate (%)	Average realisation (Rs/kg)-FY2010E				
	28.1	**29.1**	**30.1**	**31.1**	**32.1**
10.4	17.7	20.6	23.4	26.2	29.0
10.6	18.1	21.0	23.8	26.6	29.4
10.8	18.5	21.3	**24.2**	27.0	29.8
11.0	18.9	21.7	24.5	27.4	30.2
11.2	19.2	22.0	24.9	27.7	30.5

Source: Kotak Institutional Equities estimates

KBK margins to improve on account of lower input costs

We expect lower material prices to help increase operating margins for KBK in FY2010E. The engineering subsidiary reported low single-digit margins in FY2009E due to sharp fluctuations in material costs and fixed price execution contracts. However, management guides for better performance in FY2010E supported by lower material costs and more flexible pricing mechanism adopted to safeguard against any adverse movements in input prices. SHRS, through its 80.3% stake in KBK Chem-Engineering, provides turnkey solutions in the field of distilleries, ethanol plants and bio-fuels in the domestic as well as international markets. It has an outstanding order book of Rs2 bn to be executed over next 12-15 months.

Exhibit 81: We expect margins for KBK to improve in FY2010E
Summary financials for KBK, September fiscal year-ends, 2008-11E (Rs mn)

	2008	**2009E**	**2010E**	**2011E**
Revenues	1,465	2,400	2,670	3,100
revenue growth (%)		63.8	11.3	16.1
EBITDA	82	168	280	341
EBITDA (%)	5.6	7.0	10.5	11.0
PAT	54	105	179	220
PAT (%)	3.7	4.4	6.7	7.1

Source: Company, Kotak Institutional Equities estimates

Strong free cash generation to reduce leverage

We estimate SHRS to generate free cash of Rs8.7 bn over FY2009-11E after incurring a capex of Rs9 bn over the same period. We expect inventory levels to remain significantly low over the next two years, resulting in substantial reduction in working capital investment. Strong cash generation will result in a net cash position of Rs6.5 bn at end-FY2011E versus a net debt position of Rs8.9 bn at end-FY2008.

Exhibit 82: SHRS plans to spend Rs9 bn over FY2010-11E for capacity expansion
Capex schedule for SHRS, September fiscal year-ends, 2009-11E (Rs mn)

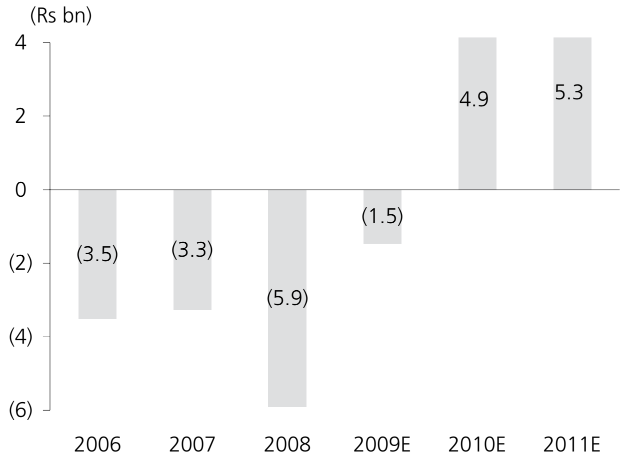
Project	**Planned**	**2009E**	**2010E**	**2011E**
2000 TPD refinery (Karnataka)	800	400	400	—
3000 TPD refinery (Gujarat)	4,000	667	2,667	667
30 MW co-operative power plant	1,200	1,200	—	—
60 MW co-operative power plants	2,400	—	1,800	600
Others (maintainence)	774	163	294	316
Total	**9,174**	**2,430**	**5,161**	**1,583**

Source: Company, Kotak Institutional Equities estimates

Evaluating acquisition opportunities in Brazil

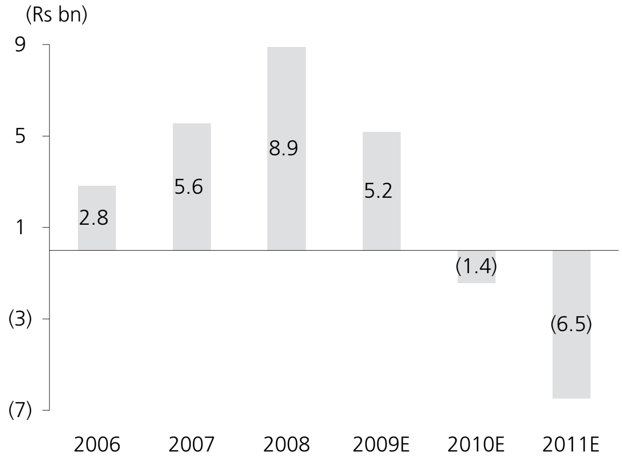
Media reports indicate that the SHRS is evaluating acquisition opportunities in Brazil that will provide it with a secure and stable source of raw sugar for its refineries in India. We expect the company to utilize its cash flows to acquire a sugarcane farm and crushing mill in Brazil as part of its backward integration process. Since sugar companies are not allowed to own sugarcane farms in India, Brazil, which is the world's largest sugarcane producer, is the best destination to secure raw material sources.

Exhibit 83: Strong cash generation to substantially reduce leverage
Free cash flow for SHRS, September fiscal year-ends, 2006-11E (Rs bn)



Source: Company, Kotak Institutional Equities estimates

Exhibit 84: Strong cash generation to substantially reduce leverage
Net debt for SHRS, September fiscal year-ends, 2006-11E (Rs bn)



Source: Company, Kotak Institutional Equities estimates

Exhibit 85: Sugar will continue to be the key revenue driver for SHRS
Revenue break-up for SHRS, September fiscal year-ends, 2007-11E (Rs mn)

	2007	2008	2009E	2010E	2011E
Sugar	4,467	5,971	20,210	45,014	55,182
Distillery	499	1,328	1,875	3,220	3,375
Co-generation	152	995	1,604	2,621	4,045
Trading	1,638	9,102	1,980	3,006	2,328
Others	568	846	200	200	200
Total standalone	**7,324**	**18,242**	**25,869**	**54,061**	**65,129**
Subsidiaries					
Domestic sugar	—	—	—	1,133	1,510
Dubai trading	2,183	1,584	1,694	1,779	1,868
KBK	—	1,465	2,400	2,670	3,100
Consolidated	**9,506**	**21,291**	**29,963**	**59,643**	**71,607**

Source: Company, Kotak Institutional Equities estimates

Exhibit 86: SHRS , Profit and loss model (consolidated), September fiscal year-ends, 2005-11E (Rs mn)

	2005	2006	2007	2008	2009E	2010E	2011E
Net revenues	**7,955**	**11,047**	**9,506**	**21,143**	**29,963**	**59,643**	**71,607**
Operating expenses							
Material cost	(6,519)	(8,384)	(6,864)	(15,767)	(21,440)	(40,661)	(53,516)
Employee cost	(92)	(151)	(239)	(419)	(501)	(1,026)	(1,306)
Manufacturing expense	(237)	(339)	(523)	(1,214)	(1,396)	(2,775)	(3,321)
Selling expense	(164)	(432)	(222)	(777)	(784)	(1,180)	(1,410)
Other costs	(94)	(142)	(339)	(440)	(460)	(666)	(935)
Operating expenses	**(7,105)**	**(9,447)**	**(8,187)**	**(18,617)**	**(24,581)**	**(46,307)**	**(60,488)**
(% of revenues)	89.3	85.5	86.1	88.1	82.0	77.6	84.5
EBITDA	**850**	**1,599**	**1,320**	**2,526**	**5,382**	**13,337**	**11,119**
Depreciation and amortisation	(80)	(88)	(249)	(369)	(636)	(859)	(1,082)
EBIT	**770**	**1,511**	**1,070**	**2,157**	**4,746**	**12,478**	**10,037**
Net finance (cost)/income	(149)	(188)	(180)	(701)	(995)	(805)	(525)
Other income	23	64	176	152	230	326	495
Profit before tax	**644**	**1,388**	**1,066**	**1,608**	**3,981**	**11,999**	**10,007**
Exceptional items	—	—	—	—	—	—	—
Reported PBT	**644**	**1,388**	**1,066**	**1,608**	**3,981**	**11,999**	**10,007**
Current tax	(76)	(164)	(88)	(159)	(549)	(1,972)	(2,341)
FBT	(0)	(2)	(2)	(5)	(1)	—	—
Deferred tax	(7)	(16)	(145)	(263)	(695)	(1,883)	(802)
Profit after tax	**561**	**1,205**	**830**	**1,181**	**2,736**	**8,144**	**6,864**
Minority interest	—	—	—	(25)	(21)	(35)	(43)
Consolidated profit	**561**	**1,205**	**830**	**1,156**	**2,716**	**8,109**	**6,821**
EPS							
Primary	3.3	5.1	3.5	4.3	9.2	24.9	20.4
Diluted	**3.3**	**5.1**	**3.5**	**4.3**	**8.1**	**24.2**	**20.4**
Shares outstanding (mn)							
Year end	200.0	238.1	248.1	276.0	316.9	334.9	334.9
Primary (weighted avg.)	171.2	234.7	238.9	268.5	296.4	325.9	334.9
Fully diluted	171.2	234.7	238.9	268.5	334.9	334.9	334.9
Margins (%)							
EBITDA margin	10.7	14.5	13.9	11.9	18.0	22.4	15.5
EBIT margin	9.7	13.7	11.3	10.2	15.8	20.9	14.0
PBT margin	8.1	12.6	11.2	7.6	13.3	20.1	14.0
Net profit margin (w/o extra-ordinary)	7.1	10.9	8.7	5.5	9.1	13.6	9.5
Cash tax rate (%)	**11.8**	**11.8**	**8.3**	**9.9**	**13.8**	**16.4**	**23.4**
Effective tax rate (%)	**12.9**	**13.0**	**21.9**	**26.2**	**31.2**	**32.1**	**31.4**
Growth yoy (%)							
Revenues	—	38.9	(13.9)	122.4	41.7	99.1	20.1
EBITDA	—	88.3	(17.5)	91.4	113.1	147.8	(16.6)
PBT	—	115.4	(23.2)	50.9	147.6	201.4	(16.6)
Net profit (w/o extra-ordinaries)	—	114.8	(31.1)	39.3	134.9	198.6	(15.9)
Diluted EPS	—	**56.7**	**(32.3)**	**23.9**	**88.3**	**198.6**	**(15.9)**

Source: Company, Kotak Institutional Equities estimates

Exhibit 87: SHRS, Balance sheet model (consolidated), September fiscal year-ends, 2005-11E (Rs mn)

	2005	2006	2007	2008	2009E	2010E	2011E
Equity							
Equity share capital	200	238	248	276	317	335	335
Equity warrants	—	—	63	231	206	—	—
Reserves & surplus	591	2,782	4,128	7,829	15,704	25,696	32,379
Deferred tax liability	40	57	202	467	1,162	3,045	3,847
Net worth	**831**	**3,077**	**4,641**	**8,803**	**17,388**	**29,076**	**36,562**
Minority interest	—	—	—	533	554	589	633
Secured debt	712	3,544	6,211	8,331	8,063	5,063	3,063
Unsecured debt	152	167	259	264	264	264	264
Total debt	**864**	**3,711**	**6,470**	**9,128**	**8,880**	**5,916**	**3,959**
Current liability and provisions	1,782	1,249	1,218	2,786	2,888	3,669	4,017
Total sources of funds	**3,477**	**8,037**	**12,329**	**20,717**	**29,157**	**38,660**	**44,537**
Assets							
Cash and cash equivalents	659	899	917	227	3,709	7,340	10,450
Inventory	1,123	1,122	1,002	2,252	4,637	3,942	3,817
Sundry debtors	320	615	861	1,603	1,888	3,268	4,512
Loans and advances	119	775	1,334	2,727	2,873	3,758	4,905
Other current assets	118	33	323	853	853	853	853
Current assets	**2,339**	**3,444**	**4,436**	**7,663**	**13,960**	**19,162**	**24,538**
Goodwill on consolidation	—	—	—	255	255	255	255
Gross block	1,403	1,630	6,314	8,146	14,721	15,815	22,373
Less: accum. depreciation & impairment	348	436	691	884	1,520	2,379	3,461
Net fixed assets	**1,055**	**1,194**	**5,623**	**7,262**	**13,201**	**13,436**	**18,912**
Capital -WIP	82	3,323	2,087	5,212	1,067	5,133	158
Net fixed assets (incl. C-WIP)	**1,137**	**4,517**	**7,710**	**12,728**	**14,522**	**18,824**	**19,325**
Investments	1	1	161	310	675	675	675
Miscellaneous expenditure not written o	1	76	22	16	—	—	—
Total uses of funds	**3,477**	**8,037**	**12,329**	**20,717**	**29,157**	**38,660**	**44,537**
Leverage and return ratios (%)							
Debt/Equity	104.0	123.7	140.1	103.9	51.1	20.3	10.8
Debt/Capitalization	51.0	55.3	58.3	51.0	33.8	16.9	9.8
Net debt/Equity	24.6	93.7	120.2	101.3	29.7	(4.9)	(17.8)
Net debt/Capitalization	19.8	48.4	54.6	50.3	22.9	(5.2)	(21.6)
Net debt/EBITDA (X)	0.2	0.9	1.2	1.0	0.3	(0.0)	(0.2)
RoAE	67.5	62.9	21.8	17.2	20.7	34.9	20.8
RoACE	40.7	32.3	10.9	11.5	15.4	28.3	19.0
CRoCI	54.3	22.5	10.1	10.7	16.7	31.8	24.2

Source: Company, Kotak Institutional Equities estimates

Exhibit 88: SHRS, Cash flow model (consolidated), September fiscal year-ends, 2005-11E (Rs mn)

	2005	2006	2007	2008	2009E	2010E	2011E
Operating							
Pre-tax and pre extra-ordinary income	644	1,388	1,066	1,608	3,981	11,999	10,007
Depreciation & amortization	80	88	249	369	636	859	1,082
Taxes paid	(71)	(180)	(56)	(152)	(550)	(1,972)	(2,341)
Dividend and other income	(15)	(4)	(29)	(30)	(230)	(326)	(495)
Interest expense	149	188	180	701	995	805	525
Interest paid	(142)	(182)	(180)	(701)	(995)	(805)	(525)
Extra-ordinary	—	—	—	—	—	—	—
Other non-cash items	23	14	91	(12)	16	—	—
Working capital changes	(40)	(1,365)	(1,049)	(2,377)	(2,760)	(835)	(1,898)
Cash flow from operations	**627**	**(52)**	**271**	**(594)**	**1,094**	**9,725**	**6,355**
Operating, excl. working capital	**668**	**1,312**	**1,321**	**1,783**	**3,853**	**10,560**	**8,253**
Investing							
Capital investment	(258)	(3,479)	(3,400)	(5,205)	(2,430)	(5,161)	(1,583)
Purchase/sale of asset/business	—	—	—	—	—	—	—
Investment changes	(1)	(0)	(160)	(149)	(365)	—	—
Loans and advances	—	—	—	—	—	—	—
Interest/dividend received	16	15	27	30	230	326	495
Cash flow from investing	**(242)**	**(3,464)**	**(3,533)**	**(5,323)**	**(2,565)**	**(4,835)**	**(1,088)**
Financing							
Equity issues	44	1,010	688	2,717	5,286	1,853	—
Net proceeds from borrowings	(78)	2,794	2,674	2,120	(268)	(3,000)	(2,000)
Dividends paid (incl. tax)	(14)	(48)	(83)	(54)	(65)	(111)	(157)
Others	—	—	—	444	—	—	—
Cash flow from financing	**(47)**	**3,756**	**3,279**	**5,227**	**4,953**	**(1,258)**	**(2,157)**
Net change in cash and cash equivalent	337	240	17	(690)	3,482	3,631	3,110
Beginning cash	322	659	899	916	227	3,709	7,340
Ending cash	**659**	**899**	**916**	**227**	**3,709**	**7,340**	**10,450**
Free cash flow	**385**	**(3,517)**	**(3,262)**	**(5,917)**	**(1,471)**	**4,890**	**5,267**

Source: Company, Kotak Institutional Equities estimates

COMPANY OVERVIEW

With its differentiated business model, SHRS is the best integrated sugar company in the country. Its sugar mills are located in the states of Maharashtra and Karnataka. SHRS has a mix of both owned and leased sugar mills hence its capital investment is lower resulting in higher return ratios. It has also set up additional refining capacities at two of its mills in Karnataka and a standalone refinery in Haldia, West Bengal. The company plans to further increase its refining capacity and also set up standalone co-generation units at various co-operative mills in Maharashtra.

Capacity overview

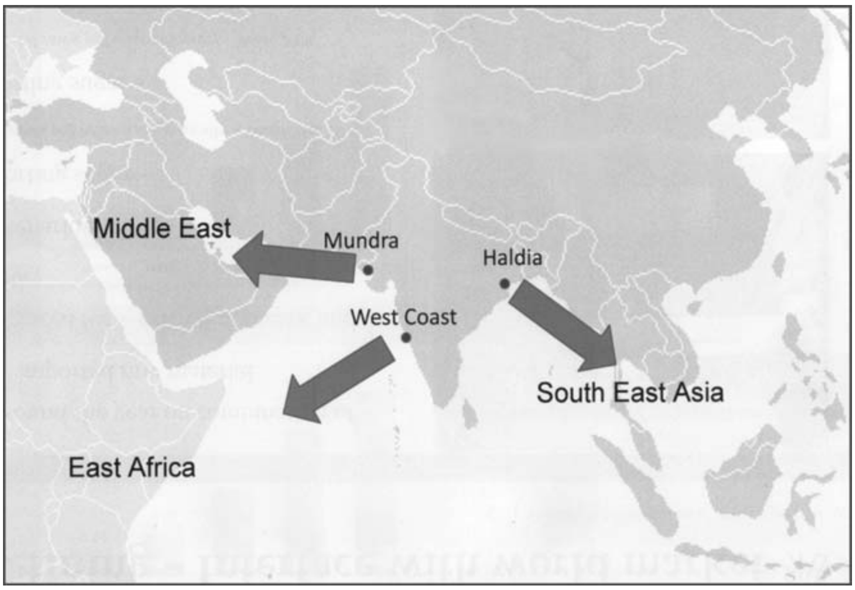
Exhibit 89: Capacity overview
Location-wise capacities for SHRS

City	State	Ownership	Lease Period	Sugar (TCD)	Distillery (KLPD)	Cogeneration (MW)	Refinery (TPD)
Existing							
Munoli	Karnataka	Owned		7,500	150	36	1,000
Athani	Karnataka	Owned		8,000	300	38	1,000
Havalga	Karnataka	Owned		8,000	150	26	—
Pathri	Maharashtra	Subsidiary		1,250	30	—	—
Gokak	Karnataka	Subsidiary		2,500	—	14	—
Aland	Karnataka	Leased	SY2006-11	1,250	—	—	—
Arag	Maharashtra	Leased	SY2005-10	4,000	—	15	—
Raibag	Karnataka	Leased	SY2008-38	2,500	—	—	—
Khopoli	Maharashtra	Owned		—	2,000	—	—
Haldia	West Bengal	Owned		—	—	15	2,000
Total				**35,000**	**2,630**	**143**	**4,000**
Expansion plans							
Mundra	Gujarat	Owned		—	—	20	3,000
Athani	Karnataka	Owned		—	—	—	1,000
Havalga	Karnataka	Owned		—	—	—	1,000
Co-operative power plants				—	—	90	—
Total expanded capacity				**35,000**	**2,630**	**253**	**9,000**

Source: Company

Port-based refining capacities to focus towards export market in long term

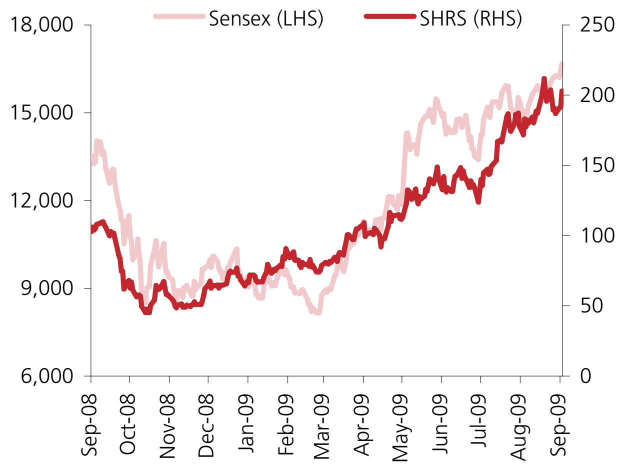
Exhibit 90: SHRS's port-based refining capacities to focus on key export markets
Geographical location of SHRS refining capacities



Source: Company

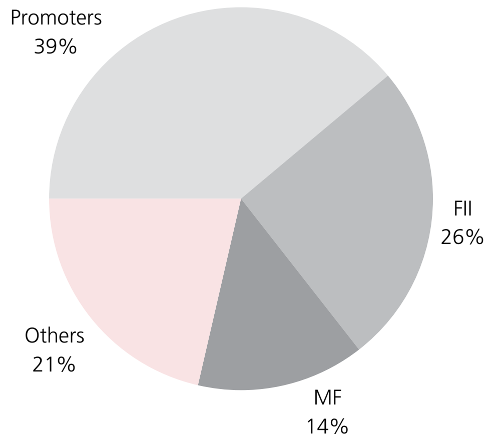
Market and ownership data

Exhibit 91: Relative stock performance
Performance of SHRS stock versus Sensex, last 12 months



Source: Bloomberg

Exhibit 92: Shareholding pattern
Shareholding pattern for SHRS

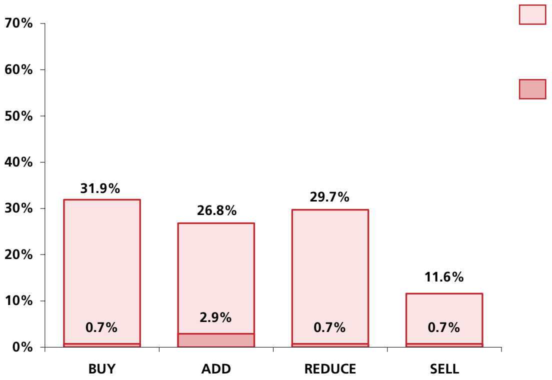


Source: BSE

"I, Augustya Somani, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report."

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



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Source: Kotak Institutional Equities

As of June 30, 2009

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Source: Kotak Institutional Equities Research

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