

Praj Industries Ltd

INR:71

Short term pain for long term gain

BUY



Price Outlook (INR): 116

Market Data	Oct 21 , 2010
Shares outs (Cr)	18.47
Equity Cap (Rs. Cr)	36.94
Mkt Cap (Rs. Cr)	1311.47
52 Wk H/L (Rs)	122.7/47.4
Avg Vol (1yr avg)	304268
Face Value (Re)	2
Bloomberg Code	PRJIN

Market Info:

SENSEX	20211
NIFTY	6085

Share Holding pattern (%)

Particulars	Sep -10	Jun - 10	Chg
Promoters	22.8	22.8	0.0
Institutions	10.8	11.8	(1.0)
FII	9.7	8.9	0.8
Public/Others	56.7	56.5	0.2
Total	100.0	100.0	-

Analysts :

Shailesh Kumar
shailesh.kumar@krchoksey.com
 ☎ 91-22-6696 5555 Ext-422

www.krchoksey.com

☎ 91-22-6696 5555
 ☎ 91-22-6691 9569

Recently we had the opportunity to meet management of Praj Industries Ltd. We had discussion with Mr Pramod Chaudhary, Executive Chairman of Praj Industries along with his team members to understand current state of business and various measures company is taking to bring itself back on growth track.

The synopsis of our discussion is as follows:

- **On recurring disappointing performance of Praj for last few quarters:** There has been order cancellations both in Europe and North America due to recession and though some orders were not cancelled officially by client, financial commitment was not made towards the same. This is reflected into Rs 150 cr order write-off by the company during September quarter. As on September 30,2010 confirmed order-book of the company stands at Rs 600cr to be executed over 12-14 months period.

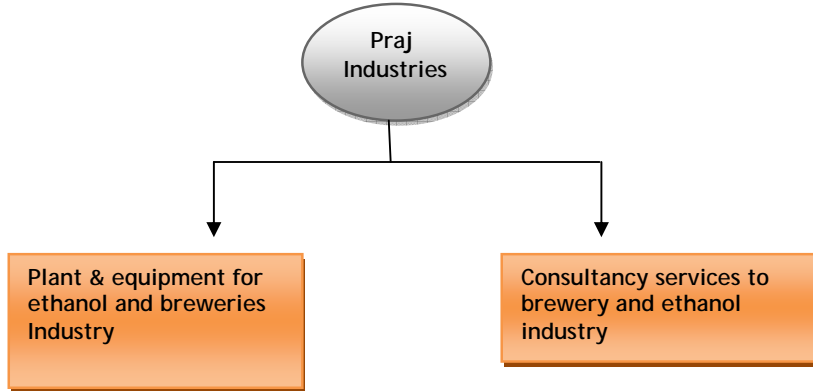
- **US senate has passed the law making 15% ethanol mixing mandatory:** US senate has cleared the bill making it mandatory for Oil companies to mix 15% ethanol. This move by US will create demand for additional bio refinery capacity of approx 4bn gallons per annum. Current benchmark suggests capex requirement of USD 1.75 for each gallon of bio refinery capacity creation. Thus US Government's move will present a business opportunity of USD 7-8 Bn for Praj Industries. Company has informed that they have started receiving enquiries for the same. However, they refused to divulge any further details.

We are of the opinion that this move by US government to allow additional ethanol mix is prompted by motive for employment generation and this business opportunity is very real in nature. Praj will be able to win good chunk of this business.

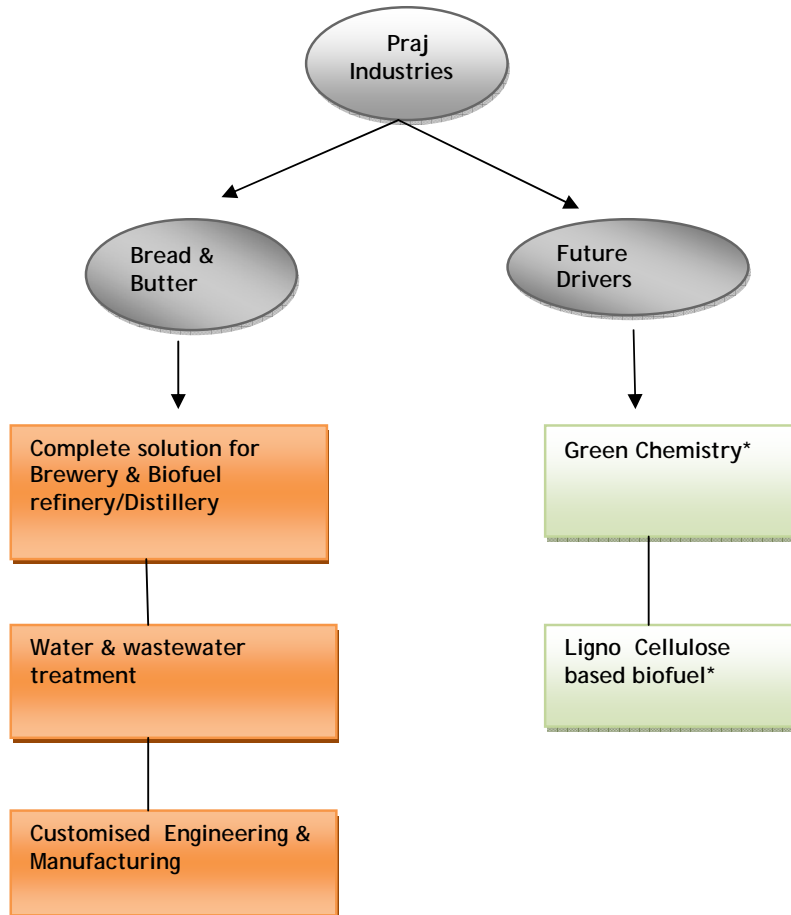
We expect positive announcement on this front during visit of US president in November 2010.

- **Company is taking measures to enhance management bandwidth:** As with most of the small to mid size companies, Praj had limitations on its management bandwidth which was reflecting in muted project execution and lack of new order wins. They had people with good technological background but with limited relevant project execution capability. Recent management shuffling with induction of Mr Prakash Kulkarni (Exec Chairman- Gabriel india, Ex MD- Thermax) can be seen as an effort to address this crucial issue. They have shortlisted another industry stalwart as replacement for Mr shasank Inamdar who is expected to lead the ship with more vigour.
- **Company has chalked out a sustainable long term strategy:** The management has drawn a clear roadmap to sustain momentum in existing stream of business while at the same time nurturing R&D to tap emerging and untapped opportunities to add additional basis points to bottomline. As per the business plan, the newer business verticals will look like as follows.

Existing Business structure:



Proposed Business structure :



As per new strategy The company will be entering into newer business lines to capitalize on its domain expertise developed over decades. Water & waste water treatment and CEM (Customised Engineering & Manufacturing) are two such areas where Praj has established and proven capability . These two businesses will be next growth drivers (so called bread and butter business) for the company in foreseeable future.

At the same time company will step up its R & D effort in area of green chemistry and second and third generation biofuels. These activities are currently restricted to Laboratories and successful commercialization is still two years away.

However, This R& D will be generating substantial revenue in future through patent sale, milestone related payment and income from exclusive sales . Their R&D is being modeled on lines of Pharma R&D model.

Status of proposed Non ethanol Businesses:

- **Water and waste water treatment:** The company has already created a 50 man strong team for this business unit . The team comprises of people with relevant experience in the field . Praj has hired AT Kerney for detailed business plan and the consultant will be handing over the same to the management in next month and half. The company has won small order in water and waste water treatment space but further clarity will be available only after detailed report is put before Board of Directors by AT Kerney. As per estimate current market size in India for water and waste water treatment business is to the tune of USD 1.7bn per annum .
- **Customised Engineering and manufacturing:** Company's facilities are approved by key customers like General Electric inc and Cargill and all their global units can source their requirement from Praj. The company has won a small order in this segment as well. The key thing to be noted here is that there are huge untapped opportunities both domestically as well as globally and estimated market per annum is to the tune of USD 3.5Bn to USD 4 Bn. Key players in this space are L&T, Godrej & Boyce. Praj's advantage lies in customization of equipment as per clients specification.

To tap this opportunity, company is erecting a new facility near Satara Road, approx 30 Km from Pune and they have facility at Kandla SEZ as well. They will be serving overseas market from Kandla facility while domestic market will be serviced from Satara facility. Their Kandla facility has been approved by GE Power, GE Oil , Kargil etc and they have registered themselves with 50 companies and are qualified to supply plants and equipments to them. Company will be spending approx Rs 100 cr to set up Satara facility.

- **Praj Matrix :Partial monetization to start now**

Praj Matrix is the innovation centre of the company where they are developing future centric Bio Ethanol and Bio diesel products and technologies for the same.

key focus areas at Praj Matrix are-

1. Technological advances to support current operation(Process refinement) .
 2. Biofuel from Ligno cellulose (Successful commercialization still couple of years away).
 3. Development of niche biotech products(Bionutrients , niche and commodity chemicals)
- Biotech products under Praj matrix are ready for commmercial exploitation after successfully establishing technical and financial viability of the product and technology. For chemicals the company is abot to decide whether to manufacture those chemicals themselves or lease patent to third party for production of the same.
 - **Bionutrients** are another successful product from Praj Matrix where company has clocked a turnover of Rs 10 cr in FY10 and expects it to grow to Rs 100 crore in next 5 years. The best part of this product is that it commands a very high margin. These Bionutrients find uses in Distillary, Brewery, dairy and Agri Industry.

Financials :

Particulars	FY08	FY09	FY10	FY11E	FY12E
Net Sales	738.01	954.21	734.4	585	750.5
EBITDA	178.59	165.6	143.18	64.4	135.0
PAT	151.32	121.19	119.83	67.64	142.6
EPS	8.18	6.55	6.48	3.66	7.72
P/E	8.68	10.83	10.95	19.39	9.19
OPM (%)	24.19	17.35	19.49	11.01	18.0
NPM (%)	20.50	12.70	16.32	11.56	19.0

Our View:

Though quarterly performance has been muted and below expectation, we have reasons to believe that worst is over for the company. Company is going all out to arrest the fall and new management under able leadership of Mr pramod chaudhary is all geared up to grab various opportunities that are coming in the form of US requirement in terms of Additional Biorefineries or water waste water opportunities in Inida or customized Engineering solution both domestically as well as globally. We believe Praj is offering an excellent opportunity of accumulating in current market.

Valuation & Recommendation:

At the CMP of Rs 71, Praj is trading at 19.39 x FY11e EPS of Rs 3.66 and 9.19 FY12e EPS of Rs 7.30 which looks very attractive.

We are valuing Praj at 15x FY12e EPS of Rs 7.72, which gives 18 month target price of Rs 116, an upside of 63% .

What is green chemistry?

Green chemistry, also called sustainable chemistry, is a philosophy of chemical research and engineering that encourages the design of products and processes that minimize the use and generation of hazardous substances. For example: DuPont developed a process which uses corn - instead of conventional petroleum-based processes - to produce the polymer platform for use in clothing, carpets and automobile interiors.

Praj has plans to do partnership based product and process development using green chemistry. Financial commitment and risk will be shared by all partners and reward can be shared in different ways including exclusive product marketing rights. Possible candidate for such partnership may be Du Pont, Cargill, Wilmar International etc.

Lignocellulose based Biofuel :

Lignocellulosic biomass refers to plant biomass that is composed of cellulose, hemicellulose, and lignin. The carbohydrate polymers (cellulose and hemicelluloses) are tightly bound to the lignin.

Lignocellulosic biomass can be grouped into four main categories:

1. agricultural residues (including corn stover and sugarcane bagasse),
2. dedicated energy crops,
3. wood residues (including sawmill and paper mill discards), and
4. municipal paper waste.

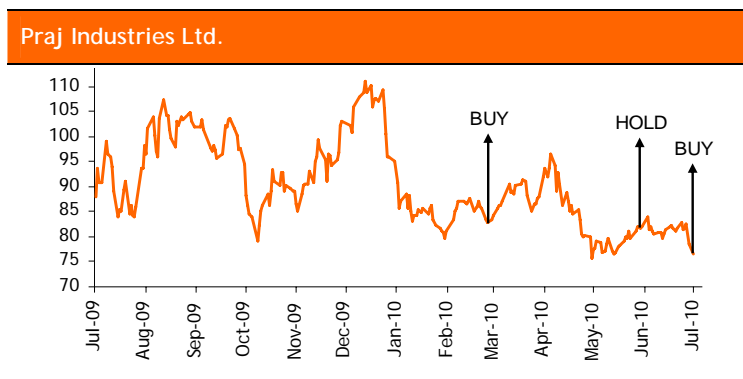
Lignocellulose is a preferred feedstock compared to corn or cane as

1. it requires less land for cultivation,
2. does not compete with human food and
3. is a waste altogether.

However, there are severe limitation in terms of yield and technology is yet to be reach a level that substantial quantity of Biofuel can be produced using Lignocellulose as feedstock in an economically viable manner.

Praj is in the process of developing technology which will make it technically as well as financially viable to produce biofuel from these lignocellulosic products.

Rajiv Choksey	Co-Head Institutional Equities	rajiv.choksey@krchoksey.com	+91-22-6653 5135
Anuj Choksey	Co-Head Institutional Equities	anuj.choksey@krchoksey.com	+91-22-6696 5500
Kunal Dalal	Head Institutional Research	kunal.dalal@krchoksey.com	+91-22-6696 5574



Rating Legend	
Our Rating	Upside
Strong Buy	More than 25%
Buy	15% - 25%
Hold	10% - 15%
Reduce	Nil - 10%
Sell	Less than 0%

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Kisan Ratilal Choksey Shares and Securities Pvt. Ltd.

Registered Office:

1102, Stock Exchange Tower, Dalal Street, Fort, Mumbai - 400 001.
 Phone: 91-22-6633 5000; Fax: 91-22-6633 8060.

Branch Office:

ABHISHEK, 5th Floor, Link Road, Dalia Industrial Estate, Andheri (W), Mumbai - 400 058.
 Phone: 91-22-6696 5555; Fax: 91-22-6691 9576.