

Rising cane cost could hurt



RESEARCH

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Maintain Underperform on rising cane cost & import threat

Recent rally in stock price of Balrampur captures strong earnings reported for quarter ending Dec08 on the back of higher sugar price and inventory liquidation. We maintain Underperform as we expect company to be impacted by (1) recent decision to offer higher price for cane than govt rate and (2) duty free import of raw sugar that could benefit Renuka (SHRS IN), our top pick, than Balrampur, that could see price pressure. We have raised our PO by 19% to Rs51, owing to 30% hike in earnings, driven by higher sugar price. Our PO is based on 6x EBITDA.

Higher cane price partly offset +ve surprise in sugar price

Balrampur recently increased cane price by Rs150/t, over and above state advised price of Rs1400/t to Rs1,550/t. It is also facilitating seed procurement by farmers at a cost of Rs200/t. Higher cane cost and lower availability has partly offset the benefit of higher sugar price. We expect earnings growth to moderate to 18% in FY10 and fall 34% in FY11.

Raw sugar import by port based refiners is a threat

According to unconfirmed media reports govt is likely to allow duty free import of raw sugar to moderate the rise in sugar price on account of 37% decline in sugar production in FY09 (Sep end). We estimate Balrampur Chini, based out of UP, to have 12-15% higher cost of processing raw sugar and lose out to port based standalone raw sugar refiners like Renuka Sugar and other sugar mills in coastal states.

Higher sugar price key upside risk to Underperform rating

Balrampur FY09E EPS could rise 3.3% for every 1% rise in sugar price. We however, don't see significant upside to our sugar price forecast of 35% rise in FY09 and 8% in FY10, as Brazil, the largest producer of sugar globally could increase its sugar production as sugar is more profitable than ethanol now.

Stock Data

Price	Rs56.70
Price Objective	Rs 43.00 to Rs51.00
Date Established	17-Feb-2009
Investment Opinion	C-3-7
Volatility Risk	HIGH
52-Week Range	Rs29.30-Rs109.90
Mrkt Val / Shares Out (mn)	US\$308 / 265.5
Average Daily Volume	3,694,221
ML Symbol / Exchange	BMPRF / BSE
Bloomberg / Reuters	BRCM IN / BACH.BO
ROE (2009E)	12.0%
Net Dbt to Eqty (Sep-2008A)	128.4%
Est. 5-Yr EPS / DPS Growth	NA / NA
Free Float	64.3%



Estimates (Sep)

(Rs)	2007A	2008A	2009E	2010E	2011E
Net Income (Adjusted - mn)	(419)	970	1,353	1,608	1,060
EPS	(1.69)	3.80	5.10	6.05	3.99
EPS Change (YoY)	NM	NM	34.2%	18.8%	-34.1%
Dividend / Share	0	0.500	0.500	1.00	2.00
Free Cash Flow / Share	(29.61)	(4.14)	5.43	15.60	9.61

Valuation (Sep)

	2007A	2008A	2009E	2010E	2011E
P/E	NM	14.93x	11.13x	9.36x	14.20x
Dividend Yield	0%	0.882%	0.882%	1.76%	3.53%
EV / EBITDA*	31.70x	8.95x	7.39x	7.45x	9.61x
Free Cash Flow Yield*	-48.81%	-7.03%	9.57%	27.51%	16.96%

* For full definitions of *iQmethod*SM measures, see page 6.

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Refer to important disclosures on page 7 to 9. Analyst Certification on Page 5. Price Objective Basis/Risk on page 5.

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*iQprofile*SM Balrampur Chini Mills Ltd.

Key Income Statement Data (Sep)	2007A	2008A	2009E	2010E	2011E
(Rs Millions)					
Sales	13,917	14,635	16,000	19,728	19,630
Gross Profit	3,243	5,730	6,462	6,646	5,534
Sell General & Admin Expense	(753)	(820)	(860)	(875)	(876)
Operating Profit	88	1,982	2,642	2,610	1,759
Net Interest & Other Income	(442)	(755)	(950)	(600)	(400)
Associates	0	0	0	0	0
Pretax Income	(354)	1,226	1,692	2,010	1,359
Tax (expense) / Benefit	(65)	(256)	(338)	(402)	(299)
Net Income (Adjusted)	(419)	970	1,353	1,608	1,060
Average Fully Diluted Shares Outstanding	248	256	266	266	266

Key Cash Flow Statement Data

Net Income	(419)	970	1,353	1,608	1,060
Depreciation & Amortization	803	1,172	1,180	1,180	1,180
Change in Working Capital	(1,105)	(2,616)	(893)	1,854	813
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	56	218	0	0	0
Cash Flow from Operations	(665)	(255)	1,641	4,642	3,053
Capital Expenditure	(6,683)	(803)	(200)	(500)	(500)
(Acquisition) / Disposal of Investments	0	0	0	0	0
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(6,683)	(803)	(200)	(500)	(500)
Shares Issue / (Repurchase)	0	770	828	0	0
Cost of Dividends Paid	0	(149)	(155)	(311)	(621)
Cash Flow from Financing	0	621	673	(311)	(621)
Free Cash Flow	(7,348)	(1,059)	1,441	4,142	2,553
Net Debt	12,697	13,155	11,750	7,750	5,749
Change in Net Debt	NA	NA	NA	NA	NA

Key Balance Sheet Data

Property, Plant & Equipment	19,200	18,831	17,851	17,171	16,491
Other Non-Current Assets	66	73	781	612	542
Trade Receivables	462	490	526	649	645
Cash & Equivalents	164	351	250	250	251
Other Current Assets	6,729	7,925	8,260	6,743	6,190
Total Assets	26,622	27,669	27,667	25,424	24,119
Long-Term Debt	12,862	13,507	12,000	8,000	6,000
Other Non-Current Liabilities	1,232	1,426	1,426	1,426	1,426
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	3,886	2,494	1,973	2,432	2,689
Total Liabilities	17,980	17,427	15,398	11,858	10,115
Total Equity	8,642	10,243	12,269	13,566	14,004
Total Equity & Liabilities	26,622	27,669	27,667	25,424	24,119

*iQmethod*SM - Bus Performance*

Return On Capital Employed	0.4%	6.5%	8.3%	8.6%	6.2%
Return On Equity	-4.7%	10.3%	12.0%	12.4%	7.7%
Operating Margin	0.6%	13.5%	16.5%	13.2%	9.0%
EBITDA Margin	6.4%	21.5%	23.9%	19.2%	15.0%

*iQmethod*SM - Quality of Earnings*

Cash Realization Ratio	NM	-0.3x	1.2x	2.9x	2.9x
Asset Replacement Ratio	8.3x	0.7x	0.2x	0.4x	0.4x
Tax Rate (Reported)	NM	20.9%	20.0%	20.0%	22.0%
Net Debt-to-Equity Ratio	146.9%	128.4%	95.8%	57.1%	41.1%
Interest Cover	0.2x	2.2x	2.6x	3.7x	3.5x

Key Metrics

* For full definitions of *iQmethod*SM measures, see page 6.

Company Description

Balrampur Chini is the second largest and one of the oldest sugar producer of India contributing to 3% of India's FY08 production. The company is based in eastern part of Uttarpradesh and boasts of good relation with farmers. It is fully integrated and has the exportable electricity capacity. The company has grown its capacity through a combination of acquisition and organic expansion.

Investment Thesis

We expect Balrampur to underperform as the company could see rising cost pressure following sugarcane shortsupply and lack of commensurate rise in sugar price due to duty free import of raw sugar. There is also an additional risk from high debt levels.

Stock Data

Price to Book Value 1.2x

Rising sugarcane cost a concern

Balrampur recently started paying additional Rs150/tonne for sugarcane compared to Rs1,400/tonne paid till end Jan 2009. The company now expects to crush 5mn tonne of cane compared to 5.5mn tonne expected earlier. The company's decision to pay higher than state advised price of Rs1400/t for sugarcane is on account of sharper than expected decline in availability of sugarcane and rise in bargaining power of alternative sweeteners. The additional price is likely to affect 20% of total sugarcane being procured in the current season. The company is also paying Rs200/tonne to farmers towards procurement of seed for forthcoming planting season. We expect the company to be adversely impacted by such rise in input cost. Balrampur could get squeezed as sugar price faces import threat while sugarcane does not.

Upgrading earnings on higher sugar price and inventory liquidation

We have increased FY09E and FY10E EPS by 30% and 43% respectively driven by 17%-19% increase in sugar price assumption. We have raised our assumption of sugar price due to higher than estimate shortfall in domestic sugar supply. Higher cost of cane, however has partially neutralized the benefit of higher sugar price.

Table 1: Change in earnings estimate and assumptions

	FY09E	FY10E
Sugar sales (Mn Kg)		
Old	700	700
New	600	700
% Chg	-14%	0%
Sugar price (Rs/kg)		
Old	18.00	18.54
New	21.00	22.00
% Chg	17%	19%
Sugar cane cost (Rs/tonne)		
Old	1,460	1,550
New	1,580	1,750
% Chg	8%	13%
EBITDA (Rs Mn)		
Old	3,549	3,650
New	3,822	3,790
% Chg	8%	4%
EPS (Rs/sh)		
Old	3.92	4.22
New	5.10	6.05
% Chg	30%	43%

Source: Banc of America Securities - Merrill Lynch

Upside risk to earnings from further rise in sugar price

Balrampur FY09E EPS could rise 3.3% for every 1% rise in sugar price. Further rise in sugar price could accrue due to (1) lower than estimated sugar production globally (2) lesser than estimated import in raw sugar due to risk aversion towards re-export obligation.

Table 2: EPS could rise 3.3% for every 1% rise in sugar price

	FY09E	FY10E
Sugar sales (Mn Kg)	600.0	700.0
Base price of sugar (Rs/kg)	21.0	22.0
Incremental net sales on 1% higher sugar price	126.0	154.0
Incremental pre tax profit on 1% high sugar price	126.0	154.0
Marginal tax rate	35%	35%
No of shares outstanding (mn)	265.5	265.5
Base case EPS (Rs/sh)	5.10	6.05
Incremental EPS on 1% higher sugar price	0.17	0.20
% Chg in base case EPS for 1% chg in sugar price	3.3%	3.4%

Source: Banc of America Securities - Merrill Lynch

Q1FY09 surprised on higher sugar price and inventory valuation

Balrampur Q1FY09 ending Dec08 PAT at Rs512.9mn is 67% higher than estimated. The company's decision to sell 64% of its opening inventory of sugar in the quarter and the decision to value current quarter's production remaining as part of its closing inventory at Rs19.05/kg led to positive surprise. We had expected the company to liquidate only 45% of its opening inventory due to rising price and value its closing stock at Rs17.7/kg equivalent to price realized by the company during the quarter.

Price objective basis & risk

Balrampur Chini (BMPRF)

Our PO for Balrampur Chini of Rs51/sh is based on 6x FY09E EV/EBITDA, equivalent to the long-term average EV/EBITDA of the sector since 1996 excluding periods of very low (or negative) profit. Upside risks to our PO are (1) restoration of capital subsidy scheme, (2) successful capital restructuring, and (3) higher than estimated increase in sugar prices. Downside risks to our PO are (1) sharper rise in sugar import, and (2) higher than estimate rise in sugar cane cost.

Analyst Certification

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	Exide Indus Ltd	XEDRF	CHLR IN	Sanjaya Satapathy
	Motherson Sumi	XMSUF	MSS IN	Sanjaya Satapathy
	Renuka Sugars	SRNKF	SHRS IN	Sanjaya Satapathy
	Tata Chemicals Ltd	TTCXF	TTCH IN	Prasad Deshmukh
	Triveni Engg	TVIEF	TRE IN	Sanjaya Satapathy
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India - General Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
UNDERPERFORM				
	ABG Shipyard	ABSHF	ABGS IN	Sanjaya Satapathy
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	Bajaj Hindusthan	BJJHF	BJH IN	Sanjaya Satapathy
	Balrampur Chini	BMPRF	BRCM IN	Sanjaya Satapathy
	Grasim	GRSJF	GRASIM IN	Reena Verma Bhasin, CFA
	Grasim -G	GRSJY	GRAS LX	Reena Verma Bhasin, CFA
	HDIL	XGHSF	HDIL IN	Gagan Agarwal
	Hotel Leelaventure	HLEEF	LELA IN	Kerry Billman
	India Cements	INIAF	ICEM IN	Reena Verma Bhasin, CFA
	India Cements -G	IAMZY	ICEM LX	Reena Verma Bhasin, CFA
	Nagarjuna Fertilizers & Chemicals Ltd	NFACF	NFCL IN	Prasad Deshmukh
	Omaxe Limited	XOMXF	OAXE IN	Gagan Agarwal
	Puravankara Projects Ltd	XPJVF	PVKP IN	Gagan Agarwal
	Shree Cements	SREEF	SRCM IN	Reena Verma Bhasin, CFA
	Unitech Ltd	UTKIF	UT IN	Gagan Agarwal

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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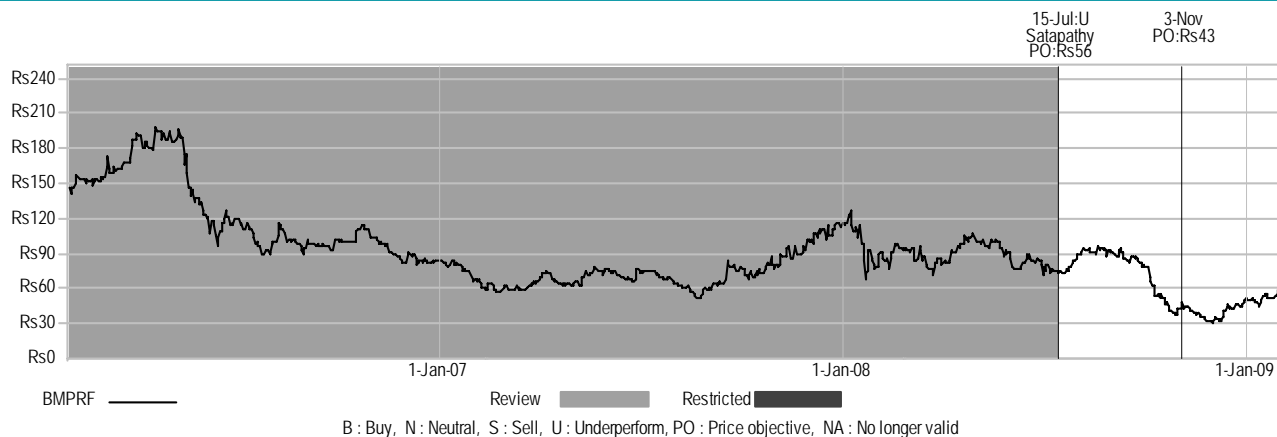
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BMPRF Price Chart



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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	18	31.03%	Buy	2	11.76%
Neutral	17	29.31%	Neutral	0	0.00%
Sell	23	39.66%	Sell	0	0.00%

Investment Rating Distribution: Global Group (as of 01 Jan 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1297	38.46%	Buy	314	26.81%
Neutral	859	25.47%	Neutral	210	28.23%
Sell	1216	36.06%	Sell	229	20.71%

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