

BALRAMPUR CHINI MILLS

INR 104

Integration advantage

BUY



Balrampur Chini's (BRCM) Q2FY08 earnings of INR 657 mn, positively surprised us and is the second set of strong quarterly numbers reported by sugar bellwethers in a week [earlier Bajaj Hindusthan (BJH) reported earnings of INR 431 mn]. The sugar segment, which contributed 63% to Q2FY08 revenues, reported strong 17.8% EBIT margins (way ahead of estimates, ~5% EBIT expected). In the backdrop of the improving demand-supply outlook, we expect India's stock-to-consumption ratio to hit the sub-0.3x (in SS09) or SS05-level, the kick up point in sugar prices during the previous upturn. We believe, stock prices will start discounting the positive scenario from H2FY08 and hence, we are upgrading our recommendation on BRCM from 'UNDER REVIEW' to 'BUY'.

* **Bumper sugar margins at 17.8%, co-products too chip in**

Despite 28% Q-o-Q decline in revenues to INR 3 bn (due to lower sugar sales volumes), there were operational positives in the Q2FY08 results. The sugar segment reported bumper profitability of 17.8% on better sugar realization and better spread of fixed costs on higher production base. Co-products clocked yet another strong quarter with cogeneration reporting 61% Y-o-Y growth in revenues to INR 947 mn and 52% EBIT margins. Distillery revenues remained flat Y-o-Y at INR 498 mn. Strong performance across segments meant EBITDA margins tripled to 43%, while EBITDA grew 135% Y-o-Y to INR 1.3 bn. Despite higher fixed expenses in Q2FY08, (interest at INR 231 mn vis-à-vis INR 150 mn last year, depreciation at INR 306 mn vis-à-vis INR 194 mn a year ago), earnings grew 229% Y-o-Y to INR 657 mn.

* **Sugar to turn sweeter; higher integration may pep up earnings**

Most sugar companies suffered last year as the sugar segment (~70% plus of revenues) reported losses. However, we expect this trend to reverse. On the back of expected lower production of 26 MT in SS08 and 21 MT in SS09, we expect the stock-to-consumption ratio to hit sub-0.3x (in SS09) or SS05-level, at which the upward movement in sugar prices had begun during the previous upturn. To add to this, better levels of integration this time around, compared to SS05, will stabilise business models and lead to richer valuations.

* **Outlook and valuations: Best integrated play; upgrade to 'BUY'**

Factoring in the improving sugar scenario, we are upgrading our EPS estimate to INR 4.3 for FY08 and INR 6.6 for FY09. The upgrade primarily stems from improving sugar realization to INR 15,430/tonne for SS08 and INR 17,680/tonne for SS09 (including excise), while we are maintaining our cane cost of INR 110/quintal for SS08 and increasing it to INR 125/quintal for SS09. We value BRCM on EV/EBITDA of 13.4x (average EV/EBITDA of previous sugar cycle SS04-06 of BJH and BRCM) for FY09, thereby implying fair value of INR 150/share (FY09-end). BRCM, being one of better integrated plays in the space, we are upgrading our recommendation from 'UNDER REVIEW' to 'BUY'.

Financials

Year to September	Q2FY08	Q2FY07	% change	Q1FY08	% change	FY07	FY08E
Rev. (INR mn)	3,080	3,969	(22.4)	4,275	(27.9)	13,917	15,475
EBITDA (INR mn)	1,314	559	135.0	332	295.5	891	2,870
Adj. net profit (INR mn)	657	200	228.7	(1)	N.A	(418)	1,132
EPS (INR)	2.6	0.8	228.7	(0.0)	N.A	(1.7)	4.3
P/E (x)						NA	24.3

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Market Data

52-week range (INR) : 127 / 49
Share in issue (mn) : 255.5
M cap (INR bn/USD mn) : 26.4 / 656.7
Avg. Daily Vol. BSE/NSE ('000) : 6,787.0

Share Holding Pattern (%)

Promoters : 35.7
MFs, Fls & Banks : 19.2
Fls : 24.2
Others : 20.9

* **Segmental snapshot: Powering ahead**

The bumper quarter by the power segment, revenue up 61% Y-o-Y to INR 947 mn, was the key turnover highlight in BRCM's Q2FY08 results. Despite a strong quarter by the power segment, overall revenues declined 22% Y-o-Y, as sugar revenues fell 34% Y-o-Y, while distillery revenues remained flat. The lower sugar revenues Q-o-Q were primarily on account of lower sugar sales (0.12 MT in Q2FY08 vis-à-vis 0.24 MT in Q1FY08), despite improving realisation.

All three core segments reported strong profitability with margins of 17.8% in sugar and in excess of 30% for the co-products. With the next couple of quarters being off-crushing we expect the sugar segment profitability to dip in H2FY08.

Table 1: Segmental performance

<u>Year to September</u>	<u>Q2FY08</u>	<u>Q1FY08</u>	<u>Q2FY07</u>	<u>FY07</u>
Segment revenue mix (%)				
Sugar	63.0	80.6	77.4	78.6
Distillery	12.7	7.4	10.3	9.6
Cogeneration	24.2	11.8	12.1	11.7
Others	0.1	0.1	0.1	0.1
EBIT margin (%)				
Sugar	17.8	(4.8)	(1.9)	(8.5)
Distillery	34.2	42.1	34.2	32.6
Cogeneration	51.8	44.5	47.1	46.3
Others	(152.3)	(30.8)	(40.7)	(29.9)
EBIT mix (%)				
Sugar	40.1	(84.7)	(19.6)	(364.2)
Distillery	15.6	69.2	45.8	171.2
Cogeneration	44.9	116.3	74.3	294.9
Others	(0.6)	(0.8)	(0.6)	(1.9)

Source: Company, Edelweiss research

* **Sugar to turn sweeter; higher integration may pep up earnings**

Post FY07, one of the toughest operational years till date for the sugar industry, we expect sugar companies to hit a green patch this year. Based on recent improvements in sugar realisations, we are increasing our sugar price assumption to INR 15,430/tonne and INR 17,680/tonne (including excise) for SS08 and SS09, respectively, for BRCM. Also, we have lowered our sugar production estimates to 0.76 MT and 0.73 MT for SS08 and SS09, respectively, to factor in lower availability of cane.

Table 2: Revised production estimates

September ending	BCML - Uttar Pradesh					
	FY04	FY05	FY06*	FY07	FY08E	FY09E
Sugar						
Capacity (TCD)	29,000	29,000	47,500	55,500	76,000	76,000
Sugarcane crushed (MMT)	5.60	3.86	6.62	9.22	7.65	7.32
Implied Crushing days	201	137	159	159	101	96
Blended sugar recovery (%)	9.7	10.1	10.2	9.9	10.0	10.0
Sugar production (MMT)	0.5	0.4	0.7	0.9	0.8	0.7
Realisations INR per MT	13,459	16,636	18,461	15,378	15,430	17,680
Cane procurement price INR per MT	966	1,168	1,207	1,362	1,210	1,375
Sugar revenues (INR mn)	6,250	6,860	17,095	11,589	13,028	13,987
Distillery						
Distillery capacity (KLPD)	160	160	160	320	320	320
Distillery operation days (adjusting to capacity utilisatio	311	343	392	232	255	255
Production - million litres per annum	50	55	63	72	82	82
Realizations (INR/Litres)	25	35	20	19	21	24
Distillery revenues (INR mn)	1,191	1,906	1,341	1,349	1,719	1,956
Cogeneration						
Cogen capacity (MW)	39.8	47.8	77.8	112.8	181.0	181.0
Saleable surplus (MW)	32.3	40.2	63.2	86.2	126.0	126.0
Total power generation days	305.0	305.0	450.0	300.0	275.0	275.0
Max. power gen possible (mn units)	291.3	349.9	840.2	812.2	1,194.6	1,194.6
Total Power generation (mn units)	182.1	208.1	439.9	676.8	896.0	896.0
Captive consumption (mn units)	17.1	18.0	38.0	55.0	291.5	291.5
Export (mn units)	148.1	169.2	347.0	492.6	537.6	537.6
Rate / Kw of power generation	2.7	2.8	2.9	3.0	3.0	3.0
Cogen revenues (INR mn)	400	475	1,002	1,449	2,715	2,715

* FY06 is 18 months September ending

Source: Edelweiss research

Financials snapshot								(INR mn)
Year to September	Q2FY08	Q2FY07	% change	Q1FY08	% change	FY06*	FY07	FY08E
Total revenues (net)	3,080	3,969	(22.4)	4,275	(27.9)	18,984	13,917	15,475
Direct cost	850	2,609	(67.4)	3,347	(74.6)	12,764	10,674	9,885
Staff cost	252	217	16.1	196	28.2	666	753	921
Other operating expenses	665	584	13.8	399	66.8	957	1,600	1,799
Total expenditure	1,766	3,410	(48.2)	3,942	(55.2)	14,388	13,027	12,605
EBITDA	1,314	559	135.0	332	295.5	4,597	891	2,870
Depreciation	306	194	57.5	248	23.5	671	802	1,006
EBIT	1,008	365	176.3	85	N.A	3,926	88	1,864
Interest	231	150	53.7	186	24.1	345	544	880
Other income	31	22	41.0	103	(69.5)	68	102	274
PBT	809	237	241.3	1	N.A	3,649	(354)	1,258
Tax	152	37	308.3	2	N.A	724	65	126
Reported net profit	657	200	228.7	(1)	N.A	2,925	(418)	1,132
Adjusted net profit	657	200	228.7	(1)	N.A	2,925	(418)	1,132
Equity capital(FV:INR 1)	248	248	0.0	248	0.0	248	248	265
# of shares (mn)	248	248	0.0	248	0.0	248	248	265
EPS (INR)	2.6	0.8	228.7	(0.0)	N.A	11.8	(1.7)	4.3
as % of net revenues								
Direct cost	27.6	65.7		78.3		67.2	76.7	63.9
Staff cost	8.2	5.5		4.6		3.5	5.4	6.0
Other operating expenses	21.6	14.7		9.3		5.0	11.5	11.6
EBITDA	42.7	14.1		7.8		24.2	6.4	18.5
Adjusted net profit	21.3	5.0		(0.0)		15.4	(3.0)	7.3
Tax rate	18.8	15.7		146.2		19.9	(18.3)	10.0

* FY06 is 18 months September ending The % change for FY06 on FY05 is annualised

Company Description

UP-based Balampur Chini Mills (BRCM) is one of the largest integrated sugar manufacturing companies in India headed by the Saraogis. Its allied business consists of manufacturing and marketing of ethyl alcohol and ethanol, generation and selling of power, and manufacturing and marketing of organic manure. The company has 10 sugar factories pre-dominantly located in eastern UP, having an aggregate crushing capacity of 76,000 tpd. BRCM is likely to have a 320 KLPD distillery and 126 MW of saleable power capacity by end-SS07. Recently, BRCM has taken over the management of Indo Gulf Industries after receiving SEBI approval and completion of the open offer.

Investment Theme

On the back of expected lower production of 26 MT in SS08 and 21 MT in SS09, we expect the stock-to-consumption ratio to hit sub-0.3x (in SS09) or SS05-level, at which the upward movement in sugar prices had begun during the previous upturn. In H1FY08, we have already seen ~INR 1,500/tonne improvement in sugar realization to INR 15,000/tonne, currently, in North India. With sugar economics turning favourable at cane cost of INR 110/quintal this year, we expect BRCM to turn profitable this year. We expect sugar realisations to improve further from this level, and prefer BRCM, being the better-integrated play in the space.

Key Risks

Inflationary Pressure: With the central government in the final year of its term, the current high level of inflation is of prime concern. As we have seen historically, the government could take drastic steps like banning export of sugar or removing the export subsidy, which could be a negative for the sector.

Higher cane costs: With the elections round the corner, next year cane prices could be populist in nature and farmer-friendly due to the huge vote bank at stake in U.P. For SS09, we have assumed cane costs at INR 125/quintal, a cane cost higher than this could negatively affect the profitability of BRCM.

Financial Statements

Income statement					(INR mn)
Year to September	FY05	FY06	FY07	FY08E	FY09E
Income from operations	8,133	18,984	13,917	15,475	16,695
Direct costs	4,840	12,764	10,674	9,885	10,037
Employee costs	350	666	753	921	994
Other expenses	548	957	1,600	1,799	1,941
Total operating expenses	5,738	14,388	13,027	12,605	12,971
EBITDA	2,395	4,597	890	2,870	3,724
Depreciation and amortisation	373	671	802	1,006	1,022
EBIT	2,022	3,926	88	1,864	2,702
Interest expenses	189	345	544	880	750
Other income	30	68	102	274	227
Profit before tax	1,862	3,649	(354)	1,258	2,179
Provision for tax	389	724	65	126	436
Extraordinary items	223	0	0	0	0
Reported profit	1,250	2,925	(418)	1,132	1,743
Adjusted net profit	1,473	2,925	(418)	1,132	1,743
Shares outstanding	232	248	248	265	265
Dividend per share	1.6	3.5	0.0	0.5	1.0
Dividend payout (%)	25.2	29.7	0.0	11.7	15.2

Common size metrics- as % of net revenues

Year to September	FY05	FY06	FY07	FY08E	FY09E
Operating expenses	70.6	75.8	93.6	81.5	77.7
Depreciation	4.6	3.5	5.8	6.5	6.1
Interest expenditure	2.3	1.8	3.9	5.7	4.5
EBITDA margins	29.4	24.2	6.4	18.5	22.3
Net profit margins	18.1	15.4	(3.0)	7.3	10.4

Annualised growth metrics (%)

Year to September	FY05	FY06	FY07	FY08E	FY09E
Revenues	16.3	55.6	10.0	11.2	7.9
EBITDA	94.1	28.0	(70.9)	222.3	29.8
PBT	134.8	30.6	N.A	N.A	73.2
Net profit	144.0	32.3	N.A	N.A	54.0
EPS	99.7	23.6	N.A	N.A	54.0

Cash flow statement

Cash flow statement					(INR mn)
Year to September	FY05	FY06	FY07	FY08E	FY09E
Net profit	1,473	2,916	(418)	1,132	1,743
Add: Depreciation	373	671	802	1,006	1,022
Add: Miscellaneous expenditure	(14)	(32)	14	0	0
Add: Deferred tax	174	175	40	0	0
Gross cash flow	2,006	3,730	438	2,138	2,765
Less: Changes in W. C.	223	(1,425)	1,104	679	526
Operating cash flow	1,783	5,155	(666)	1,459	2,239
Less: Change in investments	443	(451)	32	0	0
Less: Capex	446	8,458	6,687	500	250
Free cash flow	893	(2,853)	(7,385)	959	1,989

Balance sheet					(INR mn)
As on 30th September	FY05	FY06	FY07	FY08E	FY09E
Equity capital	232	248	248	265	265
Reserves & surplus	4,688	8,810	8,394	10,951	12,396
Shareholders funds	4,920	9,058	8,642	11,216	12,661
Secured loans	3,864	4,165	12,106	10,106	8,606
Unsecured loans	0	1,309	756	756	756
Borrowings	3,864	5,474	12,862	10,862	9,362
Sources of funds	8,784	14,532	21,503	22,078	22,023
Gross block	7,746	13,386	19,703	23,525	23,775
Depreciation	2,370	3,019	3,825	4,831	5,853
Net block	5,376	10,367	15,878	18,694	17,922
Capital work in progress	156	2,953	3,322	0	0
Total fixed assets	5,532	13,319	19,200	18,694	17,922
Investments	453	2	34	34	34
Inventories	4,685	1,983	4,330	3,084	2,093
Sundry debtors	305	557	462	641	691
Cash and equivalents	176	157	164	566	756
Loans and advances	693	2,031	2,399	4,099	6,099
Total current assets	5,860	4,728	7,355	8,389	9,640
Sundry creditors and others	1,635	1,851	3,504	3,536	3,610
Provisions	424	519	382	305	764
Total CL & provisions	2,058	2,371	3,886	3,840	4,374
Net current assets	3,802	2,357	3,469	4,549	5,266
Net deferred tax	(1,017)	(1,193)	(1,232)	(1,232)	(1,232)
Misc. expenditure not w.off	15	46	32	32	32
Uses of funds	8,784	14,532	21,503	22,078	22,023
Book value per share (INR)	21	37	35	42	48

Ratios

Year to September	FY05	FY06	FY07	FY08E	FY09E
ROAE (%)	38.4	27.9	(4.7)	11.4	14.6
ROACE (%)	24.0	22.5	0.5	8.6	12.3
Current ratio	2.8	2.0	1.9	2.2	2.2
Debtors (days)	14	11	12	15	15
Fixed assets t/o (x)	1.5	1.4	0.7	0.8	0.9
Average working capital t/o (x)	2.2	4.1	4.8	3.9	3.4
Debt/Equity	0.8	0.6	1.5	1.0	0.7

Valuations parameters

Year to September	FY05	FY06	FY07	FY08E	FY09E
Stock split adj. EPS (INR) (annualised)	6.4	7.9	(1.7)	4.3	6.6
<i>Y-o-Y growth</i>	<i>99.7</i>	<i>23.6</i>	N.A	N.A	<i>54.0</i>
Stock split adj. CEPS (INR) (annualised)	8.0	9.7	1.5	8.1	10.4
P/E (x)	16.3	13.2	N.A	24.3	15.8
Price/BV(x)	4.9	2.8	3.0	2.4	2.2
EV/Sales (x)	4.6	2.0	2.7	2.4	2.3
EV/EBITDA (x)	15.8	8.2	42.4	13.1	10.1

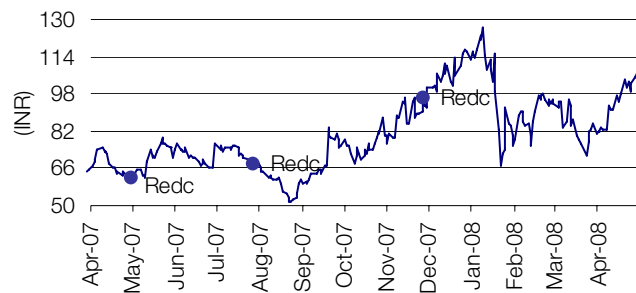
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Coverage group(s) of stocks by primary analyst(s): Sugar:

Bajaj Hindusthan, Balrampur Chini, and Shree Renuka Sugars

Balrampur Chini Mills



Recent Research

Date	Report	Title	Price (INR)	Recos
23-Apr-08	Bajaj hindustan	Light at the end of the tunnel; <i>Result Update</i>	235	Buy
23-Apr-08	Sugar	The worst is over; <i>Sector Update</i>		
04-Feb-08	Balrampur Chini Mills	Uncertainty continues; <i>Result Update</i>	89	Under Review
01-Jan-08	Bajaj Hindustan	Judgemental respite; <i>Result Update</i>	289	Sell

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	104	57	10	1	192
* 15 stocks under review / 5 rating withheld					
	> 50bn	Between 10bn and 50 bn	< 10bn		
Market Cap (INR)	85	76	31		

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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