SUGAR

Paradise lost

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Companies covered

Bajaj Hindusthan

Balrampur Chini Mills

Dwarikesh Sugar Industries

Sakthi Sugars

Shree Renuka Sugars

Nothing has changed but a lot has…for the worse!

Our expectations of demand-supply dynamics have not changed over the past six months, but falling sugar realisations have started pushing profitability to near 'zero-EBITDA' levels. Lack of encouraging signs on the horizon (till the onset of monsoons in June 2007), however, keeps us watchful of the situation. However, if current sugar realisations continue for a prolonged period, unabated rise in supply is unlikely in SS08E, which could be a silver lining. We expect sugar companies to continue to underperform the broader market over the mid-term (6-12 months) due to lack of any immediate positive triggers. With high sensitivity of sugar realizations in sugar companies' operations and no drivers to push them over medium term, we do not see any enthusiasm returning to sugar stocks.

The global sugar scenario does not look promising in the medium term. We believe that high corn prices in US, strong demand for ethanol in western hemisphere, and potential of sugar acreage swinging to ethanol production in the backdrop of high crude prices could be key in making sugar a pricier commodity, near-term spikes of which are not seen on the horizon.

Estimates pushed lower, lack of catalysts leads us to downgrade sector plays

Our revenue estimates have been pushed down by 10-25% for FY07 and 10-15% for FY08. With sugar segment constituting at least 80% of overall revenues, the impact at net profit levels is likely to be in the 50-75% range for FY07E and 40-60% for FY08E.

We are valuing the sector plays on asset values/replacement cost, in search of attractive buys. Pegged on replacement cost, all sugar companies, except SRSL, are trading at EV to replacement cost of ~ 1x of FY07E-end asset base. With sugar players expanding capacities through till FY08E, current depressing profitability scenario may lead to a tight balance sheet situation, leading to further lower profitability and far lower return ratios. We, therefore, still see downside risk to current valuations of EV at-par/higher than replacement cost.

With sugar players incorporating higher margin and better return co-products businesses, we attempt to telescope through 'fair-value P/E', valuing respective businesses on separate P/E multiples. On such a parameter , we see potential downside in BCML and BHL. On our revised forecasts for FY07, BHL and BCML are trading at relatively higher P/E of 22x and 17x, respectively, vis-à-vis fair value P/E multiple of 10x for both. We do expect such excesses in valuations to correct over the near term. DSIL and SSL are trading at comfortable P/E valuations of 7x and 6x, respectively, yielding potential upside when compared to fair value P/E of 8x and 12x for FY07E. Given the high leverage and softer operating cash flows likely of DSIL and SSL, we do not anticipate any improvement in operating metrics. For SRSL, which trades at 7x P/E for FY07E vis-à-vis fair-value P/E of 9x, the scope for stock performance exists given a versatile business model scaling up in size. But, with negative sentiments surrounding the sector, investors may accumulate the stock in dips rather than pare exposure upon rises.

Considering the above arguments, we recommend investors to reduce exposure to four of the five stocks in our sugar coverage basket at every opportunity at current point of time till we see any 'trend-reversing catalyst' in the form of adverse monsoons. We will take stock of our stance on the sector's outlook at the end of the ongoing crushing season and at the onset of monsoon, which also coincides with the starting of the sugar season of the world's largest sugar (and equivalents) producer, Brazil.

Domestic outlook continues to be gloomy in the medium term

We expect sugar companies to continue to underperform the broader market over the mid-term horizon (6-12 months) due to lack of any immediate positive triggers. With the maximum sensitivity of sugar price realizations in sugar companies' operations and with no signs of sugar price realisations scenario improving over the medium term, we do not see any reason for enthusiasm returning to sugar stocks. Domestic sugar prices have corrected by ~ 20% since the beginning of the ongoing crushing season, depressing profitability of sugar companies, especially for pure cycle plays. Key reasons for such a severe downward pressure in sugar realisations and falling profitability are:

Inventories pile up after bumper crushing season starts

Although UP-based sugar mills started crushing late, from mid-November 2006, we maintain our expectation of 22.4 MMT of domestic sugar production in SS07E on back of better-than-expected recovery and higher acreage. The increased production implies that after three years of demand-supply imbalance, supply will finally outstrip demand. With export shipments (except ALS) looking non-remunerative at current price levels, inventory levels are likely to be at 4.8 MMT, equivalent to ~3 months of domestic consumption. Though such stockpile levels are far lower than historical average of six months, we see no respite in downward pressure on sugar prices due to complete lack of encouraging signs over the medium term, a potential overhang of large inventory pile-up, and ALS exportable sugar staying back in the country, leading to larger than manageable inventory levels at the mill level.

Table 1: Indian sugar scenario

(MMT)

	SS03	SS04	SS05	SS06	SS07E	SS08E
Opening stock	11.3	12.5	8.5	4.5	3.8	4.8
Production	20.1	13.5	12.6	18.9	22.4	24.2
Imports	0.0	0.6	2.0	0.5	-	-
Total supply	31.5	26.6	23.1	23.9	26.2	29.0
Exports	1.5	0.2	-	0.9	1.5	2.0
Consumption	17.5	17.9	18.6	19.2	19.9	20.5
Total demand	19.0	18.1	18.6	20.1	21.4	22.5
Closing stock	12.5	8.5	4.5	3.8	4.8	6.4

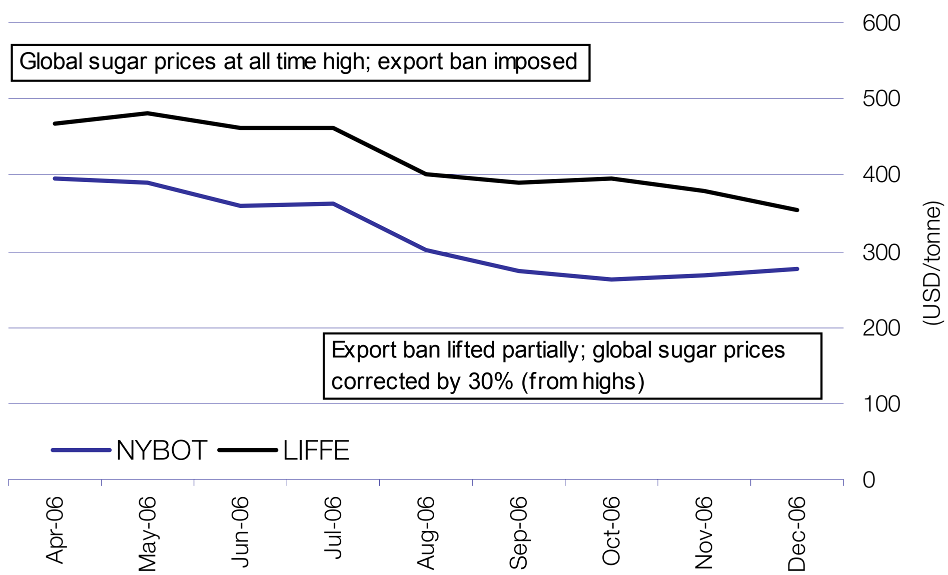
Source: ISMA, Cris Infac

Interestingly, though our expectations of demand-supply dynamics have not changed over the past six months, sugar prices have started nearing 'zero-EBITDA' levels. Lack of encouraging signs on the visible horizon (till the onset of monsoons in June 2007), however, keeps us watchful of the situation. However, if current sugar realisations continue for a prolonged period, unabated rise in supply is unlikely in SS08E, which could be a silver lining. We believe that around ~2 MMT of sugar could likely go out of the system as small and marginal co-operative mills may find it prohibitive to continue operations. Further, except for a bumper monsoon, we do not expect cane acreage to expand significantly or as proportionately in SS08E as in SS07E, which is likely to keep production in line with SS07E levels.

Export ban lifted, but global prices non remunerative

In June 2006, the Indian government, jittery over inflation, despite being a couple of months into a record production season, imposed a ban on sugar exports. Global sugar prices were then quoting close to their near all-time highs of ~ USD 470/tonne. With inflation moderately under control and persistent follow-up from major sugar manufacturers, the government allowed companies, which had re-export obligation under ALS, to resume exports. On January 11, 2007, the cabinet lifted the export ban with immediate effect. While the move was positive, global sugar prices have continued their downwards slide on back of surge in global sugar production. As a result, despite opening up of the export window, major exports are unlikely in the medium term, except re-export obligations under ALS. We believe that such an ad-hoc measure by the government has now increased the probability of the ALS 'exportable' sugar staying in the domestic inventory system for major part of the ongoing season. This will lead to higher carrying cost burden on manufacturers as well as keep sugar realizations depressed in the domestic market.

Chart 1: Global sugar prices



Source: Bloomberg, Cris Infac, Edelweiss research

Another aspect worth noting is that Indian sugar, at ~ 100-110 ICUMSA, trades at a USD 15-20 discount to global sugar prices. In such a scenario, we do not expect exports of more than 1.5 MMT in SS07E (~0.8 – 1.0 MMT under ALS). At current global prices of ~ USD 350/tonne, taking USD 15-20 discount for Indian sugar and adding shipment costs, overall realisations are likely to be close to INR 14,500/tonne (INR/USD @ 44.5). The mills in South India, are most likely to be exporters, if at all, as the exportable realisations are close to what the producers are drawing in the domestic market.

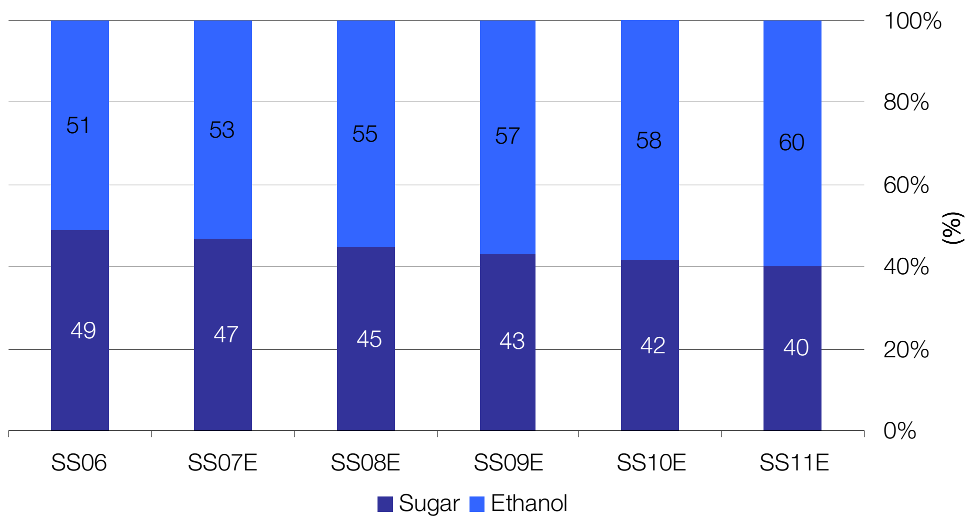
Good times ahead, but not immediately

The global sugar scenario does not point to any comfort in the medium term. We believe that high corn prices in the US, strong demand pull for ethanol in the western hemisphere, and potential of sugar acreage swinging to ethanol production in the backdrop of high crude prices could be key in making sugar a pricier commodity, near-term spikes of which are not seen in the horizon. Though the macro fundamental arguments are in favour of firm sugar prices, lack of any explicit trigger in the medium term hardly makes a case for drawing comfort for Indian millers and producers.

As articulated in our sector report in September 2006, we continue to believe that India, Brazil, China, and the EU will increasingly shape the future of the world sugar market. For this season, USDA estimates put world sugar production at ~155 MMT, up 6 MMT from the earlier estimate of 149 MMT, adding inventory levels of around 4-5 MMT.

The upward revision is mainly due to ~ 15% of new capacities expected to be added in cane-rich centre-south regions of Brazil (sugar season: December to April) and higher production in India. However, in Brazil, which is a pioneer in the use of ethanol as fuel and given large number of government initiatives/blending programs, the gradual shift from sugar in favour of ethanol is likely to continue. According to USDA estimates, of the 427 mn tonne of sugarcane harvest expected in Brazil in SS07E, 53% is expected to be diverted towards ethanol production. This is expected to rise further by 2% Y-o-Y for next couple of years, provided crude prices remain at current levels.

Chart 2: Expect shift towards ethanol production in Brazil

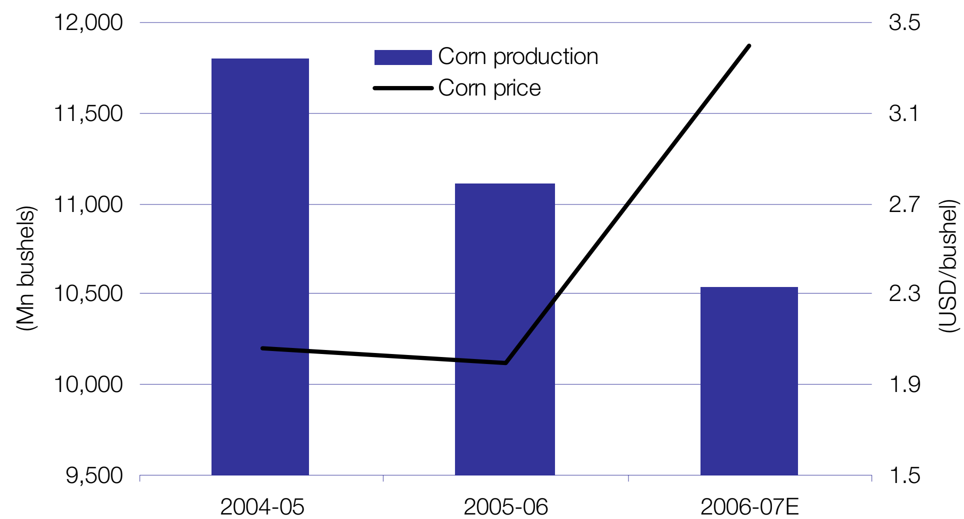


Source: USDA, Edelweiss research

Further, the sustained demand from the US for ethanol will continue to drive the Brazilian flexi model more towards ethanol. In a drive to reduce it's over dependence on oil and to build an alternative source of energy, the US has targeted 35 bn gallons of renewable and alternative fuel by 2017 (7x of current production). In order to utilize naturally available corn, large capacity additions have been made to produce ethanol out of corn. However, with strong ethanol demand straining corn supplies, the crop's prices are at a ten-year high, leading to a political debate in the US whether corn is more important as a source of energy or for human consumption.

Brazil being the key to the export end of the equation, any incremental diversion of sugarcane towards ethanol will mean that raw sugar prices are expected to spike. Given the historical trend of spread between raw and white sugar of at least ~ USD 80, we could likely witness a parallel upward shift in refined sugar as well, but we would wait and watch for progress rather than take an explicit stand at this point of time.

Chart 3: US corn scenario



Source: USDA, Edelweiss research

Crashing realizations shrink margins; scaling up co-products a cushion for integrated players

With excess supply over domestic demand pushing realizations drastically down in six months, unlikely exports (over and above ALS at current export prices), and increased cane procurement prices (especially in UP) are likely to dent sugar profitability in the medium term. Domestic sugar realisations have already dipped by ~ 20% over the past six months, wiping off 80%-plus in sugar EBITDA margins. Further, the UP government increased the state advised price (SAP) for SS07 to INR 1,250/tonne, up 9% from the previous season. However, we expect cane prices for South-based mills (SRSL and SSL) to remain at previous year levels or marginally lower. Currently, sugar realisations for North-based mills range from INR 14,800/tonne to INR 15,000/tonne, while those in South India range from INR 14,200/tonne to INR 14,500/tonne.

With no immediate triggers in sight which could help revive sugar prices as we walk through the stronger part of the production season of SS07, we do not expect realisations to improve dramatically from current levels. Consequently, our revised forecasts at producer level embed a lower sugar realisation estimates by ~20% to INR 14,900/tonne for North India and INR 14,250/ tonne for South India for SS07.

Further, as expected, the UP government has revised the SAP upwards to INR 1,250/tonne from INR 1,150/tonne in the previous season. Also, with majority of the ethanol supply contracts between oil marketing companies and ethanol distilleries being frozen at INR 21.5/ litre, we have factored our ethanol realisation estimates to INR 25 (inclusive of 16% MODVAT credit).

Incorporating the above key changes in our sugar basket, our revenue estimates have been pushed down by 10-25% for FY07 and 10-15% for FY08. With sugar segment constituting at least 80% of overall revenues, the impact at net profit levels stands in the range of 50-75% for FY07E and 40-60% for FY08E.

Table 2: Revised estimates

	Revenue (INR mn)					
	Previous estimates		Revised estimates		% Change	
	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
Bajaj Hindusthan (BHL)	30,805	44,744	22,670	35,223	*(26.4)*	*(21.3)*
Balrampur Chini (BCML)	18,483	23,137	15,830	19,546	*(14.4)*	*(15.5)*
Dwarikesh Sugar (DSIL)	3,269	5,113	2,751	4,315	*(15.9)*	*(15.6)*
Sakthi Sugars (SSL)	11,084	14,276	9,596	13,348	*(13.4)*	*(6.5)*
Shree Renuka sugars (SRSL)	19,214	30,462	13,597	26,758	(29.2)	(12.2)
	PAT (INR mn)					
	Previous estimates		Revised estimates		% Change	
	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
Bajaj Hindusthan (BHL)	4,680	6,250	954	1,818	*(79.6)*	*(70.9)*
Balrampur Chini (BCML)	3,018	3,928	894	1,650	*(70.4)*	*(58.0)*
Dwarikesh Sugar (DSIL)	406	784	179	331	*(55.9)*	*(57.7)*
Sakthi Sugars (SSL)	1,144	1,905	405	1,307	*(64.7)*	*(31.4)*
Shree Renuka sugars (SRSL)	2,432	3,903	985	2,538	(59.5)	(35.0)

Source: Edelweiss research

We continue to believe that integrated sugar models are in better shape as compared to standalone sugar plays. With overhead expenses in case of non-cyclical businesses like ethanol and cogeneration being relatively fixed, we expect possible operating margins of 40%-plus levels. Also, with increasing scale-up in contribution for distillery and power cogeneration business segments, we believe a case of better cushion to operating margins exists.

We also continue to prefer South India-based sugar plays over North Indian sugar mills, as the former have the inherent advantage of being coastal players, operating in a freer market environment. Said that, we do believe that superior set of financial results are unlikely in this financial year due to abrupt weakness in sugar prices globally and domestically, but over a period of time, we do expect the advantage to play through.

Medium term remains cloudy; downgrading sector plays

Given the abrupt change in the fortunes of domestic sugar producers over the past six months and with no medium -term catalysts pointing to a recovery, we are valuing the sector plays on asset values/replacement cost, in search of attractive buys. Pegged on replacement cost, all sugar companies, except SRSL, are trading at EV to replacement cost of ~ 1x of FY07E-end asset base. Most of our sugar basket players are in the midst of expanding capacities through till FY08E and the current depressing profitability scenario may lead to tight balance sheet situation, leading to further lower profitability and far lower return ratios. We, therefore, still see downside risk to current valuations of EV at-par/higher than replacement cost.

Table 3: EV to replacement cost (x) on SS07 capacity

EV to Replacement cost (x) on SS07 capacity	
Bajaj Hindusthan (BHL)	1.1
Balrampur Chini (BCML)	0.9
Dwarikesh Sugar (DSIL)	0.8
Sakthi Sugars (SSL)	1.1
Shree Renuka sugars (SRSL)	0.6

Source: Edelweiss research

Looking at the changing face of traditional sugar businesses incorporating higher margin and better return businesses like ethanol and power cogeneration, we attempt to telescope through 'fair-value P/E', valuing respective businesses on separate P/E multiples. On such a parameter, we see potential downside in BCML and BHL. On our revised forecasts for FY07, BHL and BCML are trading at relatively higher P/E of 22x and 17x, respectively, vis-à-vis fair value P/E multiple of 10x for both. We do expect such excesses in valuations to correct over the medium term.

DSIL and SSL are trading at comfortable P/E valuations of 7x and 6x, respectively, yielding potential upside when compared to fair value P/E multiple of 8x and 12x for FY07E. We believe these two companies lack the operational scale and balance sheet strength to tide over a sustained cyclical downturn in sugar. Also, they carry huge debts in books (debt/equity of ~2:1) and we do not foresee the ratio to improve, given that the operating cash flows would be minimal over the next two years and hence, do not anticipate any improvement in operating metrics, nor any reversion to fair value P/E multiples over the medium term.

With respect to SRSL, which trades at 7x P/E multiple FY07E vis-à-vis fair-value P/E multiple of 9x, we believe that scope for stock price performance exists given a scalable and versatile business model ramping up in size. But, given the negative sentiment surrounding the sector, we expect investors to accumulate the stock in dips rather than pare exposure upon rises.

Table 4: Fair value PE one year forward

Edelweiss sugar basket	One year forward P/E	Fair value P/E
Bajaj Hindusthan (BHL)	23.7	9.9
Balrampur Chini (BCML)	16.3	9.7
Dwarikesh Sugar (DSIL)	6.7	8.2
Sakthi Sugars (SSL)	5.7	11.8
Shree Renuka (SRSL)	7.1	8.9

Source: Edelweiss research

Considering the above arguments, we recommend investors to reduce exposure to four of the five stocks in our sugar coverage basket at every opportunity at current point of time till we see any 'trend-reversing catalyst' in the form of adverse monsoons. We will take stock of our stance on the sector's outlook at the end of the ongoing crushing season and at the onset of monsoon, which also coincides with the starting of the sugar season of the world's largest sugar (and equivalents) producer, Brazil.

With two UP-based largest players in the sector trading at premium valuations (both on EV to replacement cost and FY07E fair-value P/E multiple) and concerns arising over regulated environment and supply gut, we 'DOWNGRADE' BHL to 'SELL' recommendation from our earlier recommendation of 'REDUCE' and 'DOWNGRADE' BCML's stock to 'REDUCE' recommendation from our earlier recommendation of 'BUY'. Despite favouring South India-based sugar players, we see risk in SSL's balance sheet strength and despite the stock quoting at attractive valuations, we downgrade our earlier recommendation of 'BUY' to 'REDUCE' on SSL. Seeing similar concerns in a relatively smaller-sized sugar miller DSIL and especially in the context of a competitive market as UP (North India) we downgrade our earlier recommendation of 'BUY' on the stock to 'REDUCE', not withstanding current attractive valuations. The only stock that we find at relatively better level of comfort is SRSL. But looking at the gloomy sentiment surrounding the sector, we downgrade our previous recommendation of 'BUY' on the stock to 'ACCUMLATE', expecting investors to build exposure on the stock upon dips. SRSL's stock is available at 0.6x EV to replacement cost and is trading at P/E multiple of 7x, which is attractive relative to its North Indian peers as well as vis-à-vis its fair-value P/E multiple.

Bajaj Hindusthan

INR 160

Edelweiss
Ideas create, values protect

Tough times ahead

SELL

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Industry leader faces tough times ahead

Bajaj Hindusthan Ltd. (BHL), the largest domestic sugar producer, is consolidating its position by ramping up its sugar capacity to 136,000 TCD by SS08. BHL is also ramping up its distillery capacity from current 320 KLPD to 800 KLPD and cogen capacity to 90 MW by FY08E. However, due to delay in commissioning of three sugar plants, we expect volumes to be lower than our previous estimates. Though the scale of the business touches new highs, we are uncomfortable on the 'expanding capacity'-based business model, especially in the backdrop of a not-so-bright underlying commodity scenario.

Delayed crushing and margins under pressure in Q1FY07

Lower volume growth due to delayed commissioning of new sugar plants and reduced sugar realisations led to disappointing revenue growth of 10% Y-o-Y in Q1FY07 at INR 2.9 bn. Rising raw material costs and falling sugar realisations wiped off 693bps from EBITDA margins at 10.4% for Q1FY07. Net earnings stood at INR 173 mn, down 29% Y-o-Y. With new sugar and distillery capacities coming on-stream, depreciation expenses shot up by 57%, resulting in ultra-soft net profit margins of 6% in Q1FY07.

Dramatic downward revision in earnings driven by lower prices and project delays

Large capacity ramp-up due, combined with project delays and lower utilizations are likely to reduce BHL's production volumes. Further, a depressed realization scenario has pushed our revenue estimates down by 26% and 21% for FY07E and FY08E, respectively. Higher cane cost is likely to squeeze margins adversely, resulting in 62% and 55% downgrade in our EBITDA estimates for FY07 and FY08, respectively. Consequently, our earnings estimates are pushed downwards by 80% and 71% for FY07 and FY08, respectively.

Increasing risk quotient does not leave any margin of safety; downgrade to 'SELL'

On our revised estimates, BHL trades at P/E of 24x and 12x for FY07 and FY08, respectively. On an EV/replacement cost (FY07E-end) basis, BHL trades at a significant premium to peers, which we believe is unwarranted. Also, potential of increasing debt and equity dilution risk to fund expansion plans is likely to keep return ratios depressed on a sustained basis. Additionally, the ramp-up comes at a time when the commodity cycle is turning adverse. Further, we are yet to see significant de-risking through co-products in BHL despite strong capacity ramp-up and believe that stock valuations do not leave any margin of safety for investors. We downgrade the stock to **'SELL'** from **'REDUCE'** recommendation.

Financials

Year to September	FY05	FY06E	FY07E	FY08E
Revenue (INR mn)	8,368	15,288	22,670	35,223
Rev. growth (%)	*68.2*	*82.7*	*48.3*	*55.4*
EBITDA (INR mn)	2,006	3,132	2,662	4,633
Net profit (INR mn)	1,404	1,886	954	1,818
Shares outstanding (mn)	116	141	141	141
Annualized EPS (INR)	12.1	13.3	6.7	12.9
EPS growth (%)	*72.7*	*10.5* -	*49.4*	*90.6*
P/E (x)	13.2	12.0	23.7	12.4
EV/ EBITDA (x)	21.0	13.4	15.8	9.1
ROACE (%)	20.9	11.4	4.7	8.1

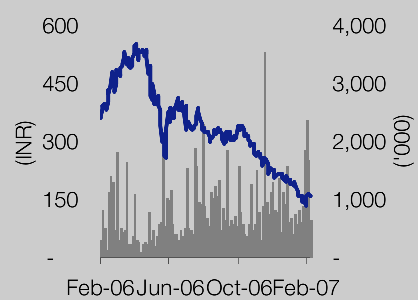
Reuters	:	BJHN.BO
Bloomberg	:	BJH IN

Market Data

52-week range (INR)	:	569 / 134
Share in issue (mn)	:	141.0
M cap (INR bn/USD mn)	:	22.6 / 510.5
Avg. Daily Vol. BSE/NSE ('000)	:	1,484.8

Share Holding Pattern (%)

Promoters	:	37.7
MFs, FIs & Banks	:	6.8
FIIs	:	25.8
Others	:	29.7



✻ We are not enamored by capacity ramp-up as numbers down the line do not look exciting

Over the past couple of years, BHL has been the fastest-growing sugar manufacturer with significant capacity ramp-up. While the expansion continues at a rapid pace, the sugar scenario is not as attractive as it was a year ago. With sugar realisations cracking and raw material costs going up, the current expansion will significantly strain BHL's balance sheet.

Given the huge all-round expansion to be completed in the current season, we have revised our capacity utilisation numbers downwards to factor in likely delays in capacity roll-out and delayed start of the crushing season. On our revised realisations of ~ INR 14,900/tonne, sugar production will be down by 16% in FY07E and 10% in FY08E. With expected lower sugarcane crushing, we have reduced our molasses and bagasse availability estimates leading to lower volumes in both distillery and cogen segments. As cogen revenues have not kicked in in Q1FY07, we have revised our cogen production numbers by 65% in FY07E on account of likely delay in commissioning of facilities. Our earlier cogen assumptions estimated full year operations for SS07.

Table 1: Key production assumptions

	Bajaj Hindusthan - West/Central/East U.P				
September ending	FY04	FY05	FY06E	FY07E	FY08E
Sugar					
Capacity (TCD)	24,000	31,000	56,200	102,000	136,000
Sugarcane crushed (MMT)	2.55	4.30	8.67	12.60	18.84
Blended crushing days	106	139	154	123	139
Blended sugar recovery (%)	10.5	9.2	10.1	10.1	10.1
Sugar production (MMT)	0.27	0.40	0.88	1.27	1.90
Realisations INR per MT	15,001	17,516	18,050	14,900	14,950
Cane procurement price INR per MT	1,091	1,056	1,231	1,339	1,347
Sugar revenues (INR mn)	4,792	8,022	15,463	19,156	28,575
Distillery					
Distillery capacity (KLPD)	160	160	320	640	800
Production - million litres per annum	24	28	47	80	108
Realizations (INR/Litres)	19	23	23	25	25
Distillery revenues (INR mn)	422	592	1,145	2,027	2,718
Cogeneration					
Cogen capacity (MW)	270.0	270.0	270.0	360.0	360.0
Saleable surplus (MW)	-	-	-	90.0	90.0
Total power generation days	106	139	155	102	144
Max. power gen possible (mn units)	-	-	-	879	1,245
Total Power generation (mn units)	-	-	-	615	1,245
Captive consumption (mn units)	-	-	-	492	996
Export (mn units)	-	-	-	123	249
Rate / Kw of power generation	-	-	-	2.83	2.97
Cogen revenues (INR mn)	-	-	-	348	740

Source: Edelweiss research

We expect lower revenues than our previous estimates due to delay in commissioning of three sugar units, expected lower capacity utilization due to higher capacities at each plant, and dip in sugar realisations. Further, we expect lower margins with increase in SAP to INR 125/quintal of sugarcane. Given that BHL is in the capex mode and with high level of leverage, we expect depreciation and interest cost to stay at high levels. Hence, we are revising our earnings estimates downwards by 80% and 71% for FY07 and FY08, respectively.

Table 2: Revised estimates

	Previous estimates		Revised estimates		Remarks
	FY07E	FY08E	FY07E	FY08E	
Revenues (INR mn)	30,805	44,744	22,670	35,223	Revised downwards by 26% in FY07E and 21% FY08E due to lower capacity utilization and dip in sugar realisations
EBITDA (INR mn)	6,996	10,236	2,662	4,633	Due to 15% crackdown in sugar realisations to INR 15,350/tonne and higher raw material cost with SAP revised to INR 1250/tonne in current season.EBIDTA revised downwards by 62% and 55% in FY07E and FY08E respectively.
EBITDA margin (%)	22.7	22.9	11.7	13.2	
PAT (INR mn)	4,680	6,250	954	1,818	Impact of depreciation and interest magnified as expansion capex incurred while operating cash flows get wiped off
Net margin (%)	15.2	14.0	4.2	5.2	
EPS (INR)	33.1	44.2	6.7	12.9	

Source: Edelweiss research

Table 3: Sugar segment dampening profits (INR mn)

	Segmental EBIT estimates		
Particluars	Previous	Revised	% Change
Sugar segment	5,241	986	(81)
Non-sugar segment	1,658	1,013	(39)
Total	6,899	1,998	(71)

Source: Edelweiss research

* Downgrade to 'SELL'

We are concerned over the fact that BHL is ramping up capacity when the commodity scenario is turning adverse. This is likely to negatively impact the company's balance sheet, depending on the working capital involved. We do not expect any upside threat to our revised estimates as we believe that a fast-expanding geographical footprint along with a scale-up in size, hitherto unseen in the country, is not easy to chew in the backdrop of the current inclement sector environment.

We are also uncomfortable with the fact that BHL is expanding into geographies which are strongholds of large mills like Balrampur and Dwarikesh. Such an expansion strategy could, over a period of time, lead to sustained increase in cane and operating costs. Of course, litigation between large mills is a definite fallout, which reminds one of the adage, 'when two elephants fight, the grass dies.'

On our revised EPS estimates of INR 6.7 and INR 12.9 for FY07 and FY08, respectively, BHL trades at P/E of 24x and 12x, respectively. On an EV/replacement cost (FY07E-end) basis, BHL trades at a significant premium to peers, which we believe is unwarranted.

Also, potential of increasing debt and equity dilution risk (from promoters) to fund expansion plans is likely to keep return ratios depressed on a sustained basis. We do not expect any noteworthy improvement in sugar prices in the medium term, while higher cane costs will continue to squeeze margins and hence, dampen profitability.

Further, we are yet to see significant de-risking through co-products in BHL despite strong capacity ramp-up and believe that stock valuations do not leave any margin of safety for investors. We downgrade the stock to **'SELL'** from **'REDUCE'** recommendation.

Company Description

Bajaj Hindusthan Limited (BHL), a Shishir Bajaj promoted company headquartered at Mumbai, is India's largest and the world's leading sugar and ethanol producer. Having a huge presence in western and central cane-rich UP belt and now foraying into eastern UP, BHL is likely to have a pan-UP presence with ~ 30% market share. Its manufacturing facilities are spread across UP and currently it has sugar capacity of 1, 00,000 TCD. In addition, it also has 320 KLPD distillery capacity scalable to 800 KLPD by SS08, and 90 MW of saleable power by SS07.

Post expansion, the BHL group is expected to have 14 operating mills across UP. The Indian giant is also looking for inorganic growth in the South American market, particularly Brazil, to tap opportunities coming from the fuel market.

Investment Theme

At sugar capacity in excess of 1, 00,000 TCD and likely sugar production of 1.3 MMT in SS07, in an unfavorable macro environment, BHL is likely to face tough times ahead. Though the scale of the business touches new highs in the context of domestic capacities, we are uncomfortable on an 'expanding capacity'-based business model, especially in the backdrop of a not-so-bright underlying commodity scenario. BHL trades at a significant premium to peers, which, in our opinion, is unwarranted, given that inherent equity dilution risk and increasing debt levels to fund its expansion plans is likely to keep returns ratios depressed in the medium term.

Key risks to Investment theme

Dramatic improvement in sugar realisations in short to medium term in the domestic market or the International market.

Being an agrarian commodity driven by Natural forces any medium term adverse climatic changes could affect cane availability.

Any subsidy/government incentive could help bail our sugar companies which have not been factored into our estimates.

Financial Statements (consolidated)

Income statement (INR mn)

Year to September	FY04	FY05	FY06E	FY07E	FY08E
Income from operations	4,975	8,368	15,288	22,670	35,223
Direct costs	3,485	5,622	10,682	18,097	27,327
Employee costs	233	297	637	763	1,383
Other expenses	327	443	837	1,148	1,880
Total operating expenses	4,046	6,361	12,156	20,008	30,590
EBITDA	929	2,006	3,132	2,662	4,633
Depreciation and amortisation	191	351	786	1,040	1,376
EBIT	738	1,655	2,347	1,621	3,258
Interest expenses	136	132	557	753	1,018
Other income	177	182	945	512	543
Profit before tax	779	1,705	2,735	1,381	2,783
Provision for tax	169	301	869	423	817
Extraordinary items	-	-	7	-	-
Reported profit before minority interest	610	1,404	1,859	958	1,966
Less: Minority interest	-	-	(20)	4	147
Reported profit	610	1,404	1,879	954	1,818
Adjusted profit	610	1,404	1,886	954	1,818
Shares outstanding	87	116	141	141	141
Dividend per share	0.4	0.5	0.6	0.4	0.4
Dividend payout (%)	5.7	4.3	4.5	5.2	2.8

Common size metrics- as % of net revenues

Year to September	FY04	FY05	FY06E	FY07E	FY08E
Operating expenses	81.3	76.0	79.5	88.3	86.8
Depreciation	3.8	4.2	5.1	4.6	3.9
Interest expenditure	2.7	1.6	3.6	3.3	2.9
EBITDA margins	18.7	24.0	20.5	11.7	13.2
Net profit margins	12.3	16.8	12.3	4.2	5.2

Annualised growth metrics (%)

Year to September	FY04	FY05	FY06E	FY07E	FY08E
Revenues	18.2	68.2	82.7	48.3	55.4
EBITDA	113.1	116.0	56.1	(15.0)	74.1
PBT	114.5	118.9	60.4	(49.5)	101.6
Net profit	104.8	130.1	34.3	(49.4)	90.6
EPS	104.8	72.7	10.5	(49.4)	90.6

Cash flow statement (INR mn)

Year to September	FY04	FY05	FY06E	FY07E	FY08E
Net profit	610	1,404	1,886	954	1,818
Add: Depreciation	191	351	786	1,040	1,376
Add: Deferred tax	140	29	544	144	170
Gross cash flow	941	1,784	3,216	2,138	3,364
Less: Dividends	40	68	97	56	56
Less: Changes in W. C.	(522)	39	3,099	1,669	(594)
Operating cash flow	1,424	1,677	20	413	3,902
Less: Change in investments	(13)	50	0	0	-
Less: Capex	2,531	6,916	12,838	8,400	4,000
Free cash flow	(1,095)	(5,289)	(12,818)	(7,987)	(98)

Balance sheet (INR mn)

As on 30th September	FY04	FY05	FY06E	FY07E	FY08E
Equity capital	87	116	141	141	141
Reserves & surplus	1,290	6,026	13,526	16,790	18,586
Shareholders funds	1,377	6,142	13,668	16,931	18,727
Minority interest	0	0	2	812	1,010
Secured loans	3,202	3,818	5,518	6,418	6,418
Unsecured loans	19	1,282	10,659	15,159	15,259
Borrowings	3,222	5,100	16,177	21,577	21,677
Sources of funds	4,599	11,243	29,846	39,321	41,414
Gross block	4,083	6,552	25,624	31,624	38,024
Depreciation	1,637	1,989	3,072	4,112	5,488
Net block	2,447	4,563	22,553	27,513	32,537
Capital work in progress	1,786	6,234	0	2,400	0
Total fixed assets	4,233	10,797	22,553	29,913	32,537
Goodwill on consolidation	0	0	1,986	3,158	3,146
Investments	1	51	51	51	51
Inventories	774	555	1,735	1,315	1,351
Sundry debtors	278	179	619	954	1,390
Cash and equivalents	40	58	2,627	2,044	2,290
Loans and advances	404	1,030	5,365	6,194	6,728
Total current assets	1,496	1,823	10,346	10,508	11,759
Sundry creditors and others	657	550	1,852	2,561	4,084
Provisions	50	425	1,979	345	422
Total CL & provisions	706	975	3,831	2,906	4,506
Net current assets	790	848	6,515	7,602	7,253
Net deferred tax	(424)	(453)	(1,258)	(1,403)	(1,572)
Uses of funds	4,599	11,243	29,846	39,321	41,414
Book value per share (INR)	16	53	97	120	132

Ratios

Year to September	FY04	FY05	FY06E	FY07E	FY08E
ROAE (%)	47.0	37.3	19.0	6.2	10.2
ROACE (%)	19.4	20.9	11.4	4.7	8.1
Current ratio	2.1	1.9	2.7	3.6	2.6
Debtors (days)	20	8	15	15	14
Fixed assets t/o (x)	1.2	0.8	0.7	0.8	1.1
Average working capital t/o (x)	4.6	10.2	4.2	3.2	4.7
Debt/Equity	2.3	0.8	1.2	1.3	1.2

Valuations parameters

Year to September	FY04	FY05	FY06E	FY07E	FY08E
Annualized EPS (INR)	7.0	12.1	13.3	6.7	12.9
Y-o-Y growth	*104.8*	*72.7*	*10.5*	*(49.4)*	*90.6*
Annualised CEPS (INR)	9.2	15.1	18.9	14.1	22.6
PE (x)	22.8	13.2	12.0	23.7	12.4
Price/BV(x)	10.1	3.0	1.7	1.3	1.2
EV/Sales (x)	8.5	5.0	2.8	1.9	1.2
EV/EBITDA (x)	45.3	21.0	13.4	15.8	9.1

BALRAMPUR CHINI MILLS

INR 59

Edelweiss
Ideas create, values protect

Even the best to face the music

REDUCE

Volumes rise, margins shrink in Q1FY07

Balrampur Chini Mills Limited (BCML), on expanded capacities across business segments, reported 18% Y-o-Y growth in revenue to INR 3.4 bn. Falling sugar realisations and higher cane costs (SAP at INR 125/qtl) wiped off 440bps from EBIDTA margin. The sugar segment, which contributed 83% to topline in the quarter, reported a huge dip in EBIT margins to 4.3%, against 12.9% in Q3FY06. EBITDA was down 9% at INR 515 mn. Poor operational performance percolated to earnings, with net margin down 820bps translating into EPS of INR 0.8 for Q1FY07.

More of cane to cube

BCML's capacity expansion plans stay on track. However, we estimate marginally reduced sugar crushing, given the likely delay in the commissioning of its Kumbhi and Gularia plants. Sugarcane crushing and cogen operations have begun at its recently commissioned 8,000 TCD Mankapur facility. BCML is currently operating at 55,500 TCD sugar capacity, 320 KLPD distillery capacity, and saleable power capacity of 86.2 MW.

Reducing estimates on lower sugar realizations

Incorporating fall in sugar realisations, we have revised down our revenue estimates by 14% plus for both FY07 and FY08. The crackdown in sugar prices and higher cane costs have lead us to revise our EBITDA margins to 12.3% and 15.4% in FY07E and FY08E, respectively. The revised EBITDA stands at INR 2.0 bn for FY07, down 57%, and INR 3.0 bn for FY08, down 49%. We have also revised our earnings estimates downwards by 70% and 58% translating into EPS of INR 3.6 and INR 6.6 in FY07E and FY08E, respectively.

Premium valuations unlikely to sustain; downgrading to REDUCE

BCML continues to trade at significant premium—at 16x and 9x on our revised estimates for FY07E and FY08E, respectively. On EV/replacement cost basis, BCML looks more than fairly valued at 1.1x. In the medium term, we do not foresee significant improvement in sugar prices, while higher raw material prices will continue to squeeze margins and hence, dampen profitability. Given the high sensitivity of earnings to sugar prices, in absence of any short term price/realisation improvement triggers for a North India mill, resulting in further pressure on earnings, we downgrade our recommendation from **'BUY'** to **'REDUCE'**.

Financials

Year to Financials*	FY05	FY06	FY07E	FY08E
Revenue (INR mn)	8,133	18,984	15,830	19,546
Rev. growth (%)	*16.3*	*55.6*	*25.1*	*23.5*
EBIDTA (INR mn)	2,395	4,597	1,953	3,014
Net profit (INR mn)	1,473	2,925	894	1,650
Shares outstanding (mn)	232	248	248	248
Stock split adjusted EPS (INR) (annualised)	6.4	7.9	3.6	6.6
EPS growth (%)	*99.7*	*23.6*	*(54.2)*	*84.6*
P/E (x)	9.2	7.5	16.3	8.8
EV/ EBITDA (x)	8.1	4.2	9.9	6.4
ROACE (%)	24.0	22.5	8.7	13.7

** FY06 is 18 months september ending*

February 22, 2007

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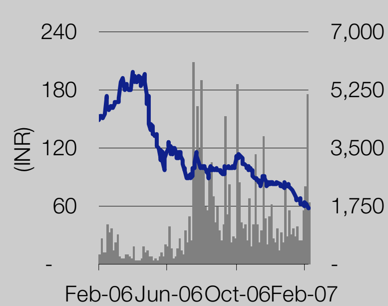
Reuters	:	BACH.BO
Bloomberg	:	BRCM IN

Market Data

52-week range (INR)	:	205 / 57
Share in issue (mn)	:	248.2
M cap (INR bn/USD mn)	:	14.6 / 329.6
Avg. Daily Vol. BSE/NSE ('000)	:	3,688.3

Share Holding Pattern (%)

Promoters	:	31.9
MFs, FIs & Banks	:	10.4
FIIs	:	21.3
Others	:	36.5



Further pain likely in medium term

We have marginally revised our sugar production numbers downwards by ~4% each for FY07E and FY08E to 0.85 MMT and 1.08 MMT, respectively, due to slight delay in commencement of a couple of BCML's expansion projects. The downgrade in sugar production is largely on account of ~15% dip in sugar realisations and likely delay in commencement of Kumbhi and Gularia plants. Further, with the Mankapur distillery plant coming on stream in March 2007, we have muted our distillery production numbers by 17% for FY07E, while keeping FY08E production numbers intact.

Table 1: Key production assumptions

	BCML - Uttar Pradesh				
September ending	FY04	FY05	FY06E*	FY07E	FY08E
Sugar					
Capacity (TCD)	29,000	29,000	47,500	55,500	71,500
Sugarcane crushed (MMT)	5.60	3.86	6.62	8.33	10.68
Crushing days	201	137	159	150	149
Blended sugar recovery (%)	9.7	10.1	10.2	10.2	10.1
Sugar production (MMT)	0.54	0.39	0.68	0.85	1.08
Realisations INR per MT	13,459	16,636	18,461	14,900	14,950
Cane procurement price INR per MT	966	1,168	1,207	1,350	1,356
Sugar revenues (INR mn)	6,250	6,860	17,095	13,136	15,881
Distillery					
Distillery capacity (KLPD)	160	160	160	320	320
Production - million litres per annum	50	55	63	72	86
Realizations (INR/Litres)	25	35	20	25	25
Distillery revenues (INR mn)	1,191	1,906	1,341	1,819	2,158
Cogeneration					
Cogen capacity (MW)	39.8	47.8	77.8	112.8	163.8
Saleable surplus (MW)	32.3	40.2	63.2	86.2	116.2
Total power generation days	305	305	450	270	275
Max. power gen possible (mn units)	291	350	840	731	1,081
Total Power generation (mn units)	182	208	440	672	976
Captive consumption (mn units)	17	18	38	55	79
Export (mn units)	148	169	347	504	732
Rate / Kw of power generation	2.7	2.8	2.9	2.9	3.0
Cogen revenues (INR mn)	400	475	1,002	1,476	2,174

Source: Edelweiss research ** FY06 is 18 months September ending*

Factoring in slight delay in the roll out of BCML's Kumbhi and Guleria plants and falling sugar realisations we have reduced our revenue estimates by 14% and 16% for FY07 and FY08, respectively. Although BCML remains one of the best integrated plays available in North India, the sugar segment still remains the largest contributor to its overall revenues; in FY06, the sugar segment contributed ~ 87% to revenue. As sugar segment margins continue to remain under significant pressure, BCML's overall EBIDTA margins have been revised in excess of 1,000bps for both FY07E and FY08E. The negative impact of financial leverage has further aggravated the effect of poor operational performance leading to a 70% and 58% downgrade in our EPS for FY07E and FY08E, respectively.

Table 2: Revised estimates

	Previous estimates		Revised estimates		Remarks
	FY07E	FY08E	FY07E	FY08E	
Revenues (INR mn)	18,483	23,137	15,830	19,546	Revised downwards by 14% in FY07E and 15.5% in FY08E due to delay in expansion projects and dip in sugar realisations
EBITDA (INR mn)	4,543	5,896	1,953	3,014	Due to 15% crackdown in sugar realisations to INR 15,350/tonne and higher raw material cost with SAP revised to INR 1250/tonne in current season.EBIDTA margins revised downwards by 1224 bps and 1006 bps in FY07E and FY08E respectively.
EBITDA margin (%)	24.6	25.5	12.3	15.4	
PAT (INR mn)	3,018	3,928	894	1,650	Further the negative impact of financial leverage has led to 70% and 58% downgrade in our FY07E and FY08E earnings estimate respectively
Net margin (%)	16.3	17.0	5.6	8.4	
EPS (INR)	12.2	15.8	3.6	6.6	

Source: Edelweiss research

Table 3: Sugar segment dampening profits (INR mn)

	EBIT estimates		
Particluars	Previous	Revised	% Change
Sugar segment	2,523	746	(70)
Non-sugar segment	1,363	933	(32)
Total	**3,885**	**1,679**	**(57)**

Source: Edelweiss research

Downgrading to REDUCE

Although we do not have any operational concerns on BCML, the cyclical downturn is likely to hit even the best in the business. BCML continues to trade at significant premium—at 17x and 9.2x on our revised EPS of INR 3.6 and INR 6.6 for FY07E and FY08E, respectively. On EV/replacement cost basis, BCML looks more than fairly valued at 1.1x. In the medium term, we do not foresee significant improvement in sugar prices, while higher raw material prices will continue to squeeze margins and hence, dampen profitability. Given the high sensitivity of earnings to sugar prices, in absence of any short term price/realisation improvement triggers for a North India mill, resulting in further pressure on earnings, we downgrade our recommendation from **'BUY'** to **'REDUCE'**.

Company Description

UP-based Balrampur Chini Mills Limited (BCML) 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 & marketing of organic manure. The company has six sugar factories located in Eastern UP, having an aggregate crushing capacity of 55,500 tons per day. BCML is likely to have 320 KLPD distillery and 113 MW of power capacity by end SS07. Recently, BCML has taken over the management of Indo Gulf Industries Ltd. after receiving SEBI approval and completion of the open offer.

Investment Theme

BCML continues to be one of the most efficient amongst the UP-based sugar mills. However, it currently finds itself amidst a cyclical downturn which has hit sugar manufacturers in the country. In the medium term, we do not foresee any significant improvement in sugar prices, while the higher-than-expected cane prices will continue to squeeze margins and hence, dampen profitability. Given the high sensitivity of earnings to sugar prices, in absence of any short term price/realisation improvement triggers for a North India mill resulting in further pressure on earnings, we downgrade our recommendation.

Key Risks to Investment Theme

Any positive/sentimental triggers in short to medium term could drive sugar realisations up in domestic markets.

Natural calamities can impact availability of cane, excessive shortage of which although highly unlikely could lead to lower sugar production.

Impact of any subsidy/incentives by the government to help out sugar companies in the medium term have not been factored in our estimates.

Financial Statements

Income statement (INR mn)

Year to Financials*	FY04	FY05	FY06	FY07E	FY08E
Income from operations	6,994	8,133	18,984	15,830	19,546
Direct costs	4,916	4,840	12,764	12,268	14,707
Employee costs	351	350	666	611	717
Other expenses	493	548	957	998	1,109
Total operating expenses	5,760	5,738	14,388	13,877	16,533
EBITDA	1,234	2,395	4,597	1,953	3,014
Depreciation and amortisation	302	373	671	631	743
EBIT	931	2,022	3,926	1,322	2,270
Interest expenses	198	189	345	241	256
Other income	60	30	68	69	65
Profit before tax	793	1,862	3,649	1,151	2,079
Provision for tax	189	389	724	257	429
Extraordinary items	-	223	-	-	-
Reported profit	604	1,250	2,925	894	1,650
Adjusted net profit	604	1,473	2,925	894	1,650
Shares outstanding	190	232	248	248	248
Dividend per share	1.0	1.6	3.5	1.0	1.5
Dividend payout (%)	31.4	25.2	29.7	27.8	22.6

Common size metrics- as % of net revenues

Year to Financials*	FY04	FY05	FY06	FY07E	FY08E
Operating expenses	82.4	70.6	75.8	87.7	84.6
Depreciation	4.3	4.6	3.5	4.0	3.8
Interest expenditure	2.8	2.3	1.8	1.5	1.3
EBITDA margins	17.6	29.4	24.2	12.3	15.4
Net profit margins	8.6	18.1	15.4	5.6	8.4

Annualised growth metrics (%)

Year to Financials*	FY04	FY05	FY06	FY07E	FY08E
Revenues	23.8	16.3	55.6	25.1	23.5
EBITDA	76.0	94.1	28.0	(36.3)	54.3
PBT	112.0	134.8	30.6	(52.7)	80.7
Net profit	104.6	144.0	32.3	(54.2)	84.6
EPS	104.6	99.7	23.6	(54.2)	84.6

Cash flow statement (INR mn)

Year to Financials*	FY04	FY05	FY06	FY07E	FY08E
Net profit	604	1,473	2,916	894	1,650
Add: Depreciation	302	373	671	631	743
Add: Miscellaneous expenditure	1	(14)	(32)	38	3
Add: Deferred tax	128	174	175	58	70
Gross cash flow	1,035	2,006	3,730	1,620	2,466
Less: Dividends	190	371	990	279	419
Less: Changes in W. C.	1,075	223	(1,425)	(189)	(19)
Operating cash flow	(229)	1,412	4,165	1,530	2,066
Less: Change in investments	(3)	443	(451)	-	-
Less: Capex	1,765	446	8,458	1,000	3,136
Free cash flow	(1,991)	522	(3,843)	530	(1,070)

**FY06 is 18months September ending*

Balance sheet

As on Financial year end*	FY04	FY05	FY06	FY07E	FY08E
Equity capital	190	232	248	248	248
Reserves & surplus	2,565	4,688	8,810	9,425	10,656
Shareholders funds	2,755	4,920	9,058	9,673	10,904
Secured loans	3,950	3,864	4,165	4,915	4,915
Unsecured loans	1,388	0	1,309	1,309	1,309
Borrowings	5,338	3,864	5,474	6,224	6,224
Sources of funds	8,093	8,784	14,532	15,897	17,128
Gross block	7,443	7,746	13,386	16,338	17,338
Depreciation	2,003	2,370	3,019	3,650	4,393
Net block	5,440	5,376	10,367	12,689	12,945
Capital work in progress	19	156	2,953	1,000	3,136
Total fixed assets	5,458	5,532	13,319	13,689	16,081
Investments	10	453	2	2	2
Inventories	4,280	4,685	1,983	1,667	2,257
Sundry debtors	219	305	557	465	574
Cash and equivalents	66	176	157	1,436	366
Loans and advances	359	693	2,031	2,031	1,828
Total current assets	4,924	5,860	4,728	5,598	5,025
Sundry creditors and others	1,238	1,635	1,851	1,871	2,247
Provisions	217	424	519	279	419
Total CL & provisions	1,455	2,058	2,371	2,150	2,665
Net current assets	3,468	3,802	2,357	3,448	2,359
Net deferred tax	(844)	(1,017)	(1,193)	(1,251)	(1,321)
Misc. expenditure not w.off	1	15	46	9	6
Uses of funds	8,093	8,784	14,532	15,897	17,128
Book value per share (INR)	15	21	37	39	44

Ratios

Year to Financials*	FY04	FY05	FY06	FY07E	FY08E
ROAE (%)	23.6	38.4	27.9	9.5	16.0
ROACE (%)	13.5	24.0	22.5	8.7	13.7
Current ratio	3.4	2.8	2.0	2.6	1.9
Debtors (days)	11	14	11	11	11
Fixed assets t/o (x)	1.3	1.5	1.4	1.2	1.2
Average working capital t/o (x)	2.4	2.2	4.1	5.5	6.7
Debt/Equity	1.9	0.8	0.6	0.6	0.6

Valuations parameters

Year to Financials*	FY04	FY05	FY06	FY07E	FY08E
Stock split adjusted EPS (INR) (annualisec	3.2	6.4	7.9	3.6	6.6
Y-o-Y growth	*104.6*	*99.7*	*23.6*	*(54.2)*	*84.6*
Stock split adjusted CEPS (INR)) (annualise	4.8	8.0	9.7	6.1	9.6
PE (x)	18.4	9.2	7.5	16.3	8.8
Price/BV(x)	4.0	2.8	1.6	1.5	1.3
EV/Sales (x)	2.8	2.4	1.0	1.2	1.0
EV/EBITDA (x)	15.7	8.1	4.2	9.9	6.4

**FY06 is 18months September ending*

DWARIKESH SUGAR INDUSTRIES

INR 77

Playing the cycle

REDUCE

February 22, 2007

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Short-term relief in Q1FY07

Post disastrous Q4FY06 with reported losses of INR 50 mn, Dwarikesh Sugar India Limited (DSIL) posted profit of INR 43 mn in Q1FY07. DSIL was one of the few companies to register 50% plus Y-o-Y revenue growth. Revenue grew 58% Y-o-Y to INR 641 mn, while EBITDA stood at INR 111 mn, up 4% Y-o-Y. However, due to softer sugar prices, EBITDA margins fell in excess of 900bps. Interest and depreciation charges swelled by 312% and 125% to INR 28 mn and INR 36 mn, respectively, resulting in an EPS of 2.8 for the quarter. Though we see better profitability ahead, we are unlikely to see any significant positive surprises in the context of such depressed sugar prices.

Expansion on track and volume to drive revenue growth

With Dwarikesh Puram facility likely to crush for full season 2007, we expect volume driven growth for DSIL over next few seasons. With capacity expansion plans on-stream, DSIL is likely to crush at 14,000 TCD sugar capacity, producing 0.15 MMT of sugar in SS07. The company is also looking at de-risking its business model, benefits of which are likely to start flowing from SS08, with expansion of power cogen capacity to 86 MW from current 26 MW.

Purer sugar plays see significant downward revisions

Based on delay in crushing and fall in sugar realisations, we have reduced our revenue estimates downwards by 16% for FY07E and FY08E. Lower production and sales volume will continue to squeeze EBITDA margins. At current revised sugar realisations, we have lowered our EPS estimates to INR 11.5 and INR 21.3 for FY07E and FY08E respectively, in the absence of any medium term drivers. Additional cogeneration capacities coming on-stream and stable cane prices will help in improving net margins by 116bps in FY08E.

Immense downside risk, though earnings multiple is attractive

At CMP, DSIL trades at 7x and 4x on our revised earnings estimates for FY07E and FY08E respectively. On SS07 capacity, the stock trades at 0.8x EV/replacement cost. Although the valuation looks compelling, DSIL continues to be more of a cycle play with limited integration benefits; such benefits, if any, are likely to accrue only in FY08E. We expect sugar segment to contribute ~82% to revenues in FY07E. Due to lack of any medium term triggers reviving sugar prices, highly levered balance sheet (D/E of ~2x), and over reliance on sugar segment lead us to downgrade the stock to **'REDUCE'** from **'ACCUMULATE'**.

Financials

Year to September	FY05	FY06E	FY07E	FY08E
Revenue (INR mn)	1,549	2,347	2,751	4,315
Rev. growth (%)	*8.2*	*51.5*	*17.2*	*56.9*
EBITDA (INR mn)	464	442	476	801
Net profit (INR mn)	268	208	179	331
Shares outstanding (mn)	13	16	16	16
Annualized EPS (INR)	21.3	13.4	11.5	21.3
EPS growth (%)	*0.6*	*(37.2)*	*(13.9)*	*84.8*
P/E (x)	3.6	5.7	6.7	3.6
EV/ EBITDA	9.2	9.7	9.0	5.3
ROACE (%)	28.8	13.7	8.8	10.9

Reuters	:	DWAR.BO
Bloomberg	:	DSIL IN

Market Data

52-week range (INR)	:	286 / 74
Share in issue (mn)	:	15,6
M cap (INR bn/USD mn)	:	1,2 / 27.1
Avg. Daily Vol. BSE ('000)	:	212.6

Share Holding Pattern (%)

Promoters	:	44.8
MFs, FIs & Banks	:	3.2
FIIs	:	11.9
Others	:	40.1

No notable changes in estimates except softer sugar realisations

We have marginally softened our sugar production numbers to factor in delayed crushing (second week of November) by ~6% and ~4% in FY07E and FY08E respectively. Our revised sugar production numbers stand at 0.15 MMT and 0.23 MMT for SS07 and SS08 respectively. Post FY06, a key change is the downward revision in the cane cost in FY07E to INR 1,325/tonne as against INR 1,369/tonne that DSIL paid last year. Most UP based mills started crushing early last year, which gave rise to cane procurement concerns, resulting in higher cane costs. However, with SAP freezed at INR 1,250/tonne and abundant cane supply, we do not foresee DSIL paying any premium on cane procurement. Expectations on cogeneration and distillery remain intact.

Table 1: Key production assumptions

	Dwarikesh sugar- West / Central U.P				
September ending	FY04	FY05	FY06E	FY07E	FY08E
Sugar					
Capacity (TCD)	6,500	6,500	14,000	14,000	21,500
Sugarcane crushed (MMT)	0.75	0.80	1.06	1.51	2.27
Blended crushing days	150	162	128	155	155
Blended sugar Recovery (%)	10.3	10.5	10.1	10.3	10.2
Sugar Production (MMT)	0.08	0.08	0.11	0.15	0.23
Realisations INR per MT	14,208	16,968	18,153	14,900	14,950
Cane procurement price INR per MT	1,063	1,110	1,369	1,325	1,330
Sugar revenues (INR mn)	**1,412**	**1,440**	**2,184**	**2,377**	**3,483**
Distillery					
Distillery capacity (KLPD)	-	30	30	30	30
Production - million litres per annum	-	1.7	4.6	4.8	5.1
Realizations (INR/Litres)	-	20	19	25	25
Distillery revenues (INR mn)	**-**	**24**	**96**	**116**	**127**
Cogeneration					
Cogen capacity (MW)	9	17	26	26	86
Saleable surplus (MW)	8	8	8	8	56
Total power generation days	150	162	163	190	190
Max. power gen possible (mn units)	32	66	107	119	392
Total Power generation (mn units)	26	41	51	119	340
Captive consumption (mn units)	19	22	32	82	119
Export (mn units)	7	19	19	36	221
Rate / Kw of power generation	2.71	2.83	2.87	2.91	2.95
Cogen revenues (INR mn)	**18**	**53**	**54**	**106**	**653**

Source: Edelweiss research

Considering a slightly delayed crushing season and falling sugar realisations, we have revised our revenue estimates downwards by 16% for FY07E and FY08E respectively. With core sugar operations (that contributed ~88% to revenue in FY06E) significantly hit in the current sugar season, EBIDTA margins fell 950bps and 1040bps in FY07E and FY08E respectively. Higher depreciation (on account of capex incurred in FY06) and costlier debt financing has lead us to downgrade our EPS by 55% plus to INR 11.5 and INR 21.3 in FY07E and FY08E respectively.

Table 2: Revised estimates

	Previous estimates		Revised estimates		Remarks
	FY07E	FY08E	FY07E	FY08E	
Revenues (INR mn)	3,269	5,113	2,751	4,315	Revised downwards by 16 % for both FY07E and FY08E due to delayed start to the crushing season and dip in sugar realisations
EBITDA (INR mn)	877	1,481	476	801	Due to 15% crackdown in sugar realisations to INR 15,350/tonne and higher raw material cost with SAP revised to INR 1250/tonne in current season.EBIDTA margins revised downwards by 950 bps and 1040 bps in FY07E and FY08E respectively.
EBITDA margin (%)	26.8	29.0	17.3	18.6	
PAT (INR mn)	406	784	179	331	Fixed nature of interest and depreciation cost aggrevates the impact resulting into 55% plus earnings downgrade
Net margin (%)	12.4	15.3	6.5	7.7	
EPS (INR)	26.1	50.4	11.5	21.3	

Source: Edelweiss research

Table 3: Sugar segment dampening profits (INR mn)

	Segmental EBIT estimates		
Particluars	Previous	Revised	% Change
Sugar segment	566	201	(64)
Non-sugar segment	131	135	3
Total	698	336	(52)

Source: Edelweiss research

Downgrade to 'REDUCE'

Since DSIL is a purer sugar player, the impact of softened sugar prices is pronounced in its case, which made us lower our expectations of revenues and profitability. Moreover, the company does not have any non-sugar businesses, which exposes it to the inherent cyclicality of the sugar industry. We believe that continued soft sugar prices could bleed the company into losses and dent its balance sheet over the medium term. With the risk-weightage of a pure sugar player, we downgrade our recommendation from 'ACCUMULATE' to 'REDUCE'.

Company Description

Dwarikesh Sugar Industries Limited (DSIL) is the flagship company of the Gautam Morarka-led Dwarikesh group that has presence in diverse fields like sugar manufacturing, financial services, and information technology. Incorporated in 1993, DSIL currently has a crushing capacity of 14,000 TCD, which it plans to ramp up to 21,000 TCD by SS08. Apart from sugar, DSIL also has a 30 KLPD distillery and 26 MW power generation facility. Both facilities, Dwarikesh Nagar and Dwarikesh Puram, are located in Bijnor district, western UP. The Dwarikesh Nagar complex, which is the oldest plant run by the company, also has a 30 KLPD distillery and a 17 MW power generation setup. Over the last couple of years DSIL has recorded one of the best recovery rates in Uttar Pradesh.

Investment Theme

Although the current valuations look compelling both on earnings multiple as well as replacement cost, we believe the cracking sugar realisation, higher raw material costs, and lack of integration will severely dent DSIL's profitability. Also, given the high sensitivity of earnings with the sugar realisations, there is an immense downside risk to our EPS estimates in case sugar realisations fall further. Given that DSIL is not de-risked through non-sugar businesses in comparison with its peers, we believe that continued soft sugar prices could bleed the company to losses and dent its balance sheet over the medium term. With the risk-weightage of a pure sugar player, we downgrade our recommendation.

Key risks to Investment Theme

With strong correlation between sugar realisations and profitability for cycle plays any medium term improvement in the sugar realisations could swing profits wildly

Any medium term adverse climatic changes could affect cane availability and hence could impact overall sugar production

Government subsidy/incentive if any have not been factored in our estimates

Financial statements

Income statement (INR mn)

Year to September	FY04	FY05	FY06	FY07E	FY08E
Income from operations	1,431	1,549	2,347	2,751	4,315
Direct costs	1,044	950	1,705	1,970	3,084
Employee costs	63	80	121	137	194
Other expenses	40	54	80	167	237
Total operating expenses	1,147	1,084	1,905	2,274	3,514
EBITDA	284	464	442	476	801
Depreciation and amortisation	46	55	122	140	214
EBIT	238	409	320	336	587
Interest expenses	70	59	65	122	187
Other income	4	4	14	18	16
Profit before tax	172	354	269	232	416
Provision for tax	12	86	61	53	85
Extraordinary items	63	2	-	-	-
Reported profit	98	266	208	179	331
Adjusted net profit	160	268	208	179	331
Shares outstanding	8	13	16	16	16
Dividend per share	2.0	6.0	6.0	3.0	3.0
Dividend payout (%)	15.5	28.3	44.8	26.0	14.1

Common size metrics- as % of net revenues

Year to September	FY04	FY05	FY06	FY07E	FY08E
Operating expenses	80.1	70.0	81.2	82.7	81.4
Depreciation	3.2	3.6	5.2	5.1	5.0
Interest expenditure	4.9	3.8	2.8	4.5	4.3
EBITDA margins	19.9	30.0	18.8	17.3	18.6
Net profit margins	11.2	17.3	8.9	6.5	7.7

Annualised growth metrics (%)

Year to September	FY04	FY05	FY06	FY07E	FY08E
Revenues	80.2	8.2	51.5	17.2	56.9
EBITDA	88.2	63.4	(4.9)	7.8	68.2
PBT	351.9	105.8	(24.1)	(13.8)	79.5
Net profit	678.8	67.2	(22.3)	(13.9)	84.8
EPS	678.8	0.6	(37.2)	(13.9)	84.8

Cash flow statement (INR mn)

Year to September	FY04	FY05	FY06	FY07E	FY08E
Net profit	160	268	208	179	331
Add: Depreciation	46	55	122	140	214
Add: Deferred tax	3	55	34	26	38
Gross cash flow	210	379	365	346	583
Less: Dividends	23	87	108	54	54
Less: Changes in W. C.	(300)	25	(187)	107	34
Operating cash flow	487	266	443	185	495
Less: Change in investments	(1)	0	-	-	-
Less: Capex	150	969	1,274	2,016	1,300
Free cash flow	338	(703)	(831)	(1,831)	(805)

Balance sheet (INR mn)

As on 30th September	FY04	FY05	FY06	FY07E	FY08E
Share capital	87	137	167	167	167
- Equity	76	126	156	156	156
- Prefrence	11	11	11	11	11
Reserves & surplus	303	757	1,368	1,493	1,771
Shareholders funds	390	894	1,535	1,660	1,937
Secured loans	587	971	1,235	3,135	3,935
Unsecured loans	1	0	42	42	42
Borrowings	588	971	1,277	3,177	3,977
Sources of funds	977	1,865	2,812	4,837	5,915
Gross block	912	1,183	2,560	3,060	6,610
Depreciation	301	354	473	613	827
Net block	611	828	2,088	2,447	5,783
Capital work in progress	142	838	734	2,250	0
Total fixed assets	753	1,667	2,822	4,697	5,783
Investments	3	3	3	3	3
Inventories	388	471	390	226	205
Sundry debtors	1	8	4	4	7
Cash and equivalents	2	6	7	88	83
Loans and advances	40	124	202	302	452
Total current assets	431	609	603	621	746
Sundry creditors and others	101	150	275	209	284
Provisions	41	141	196	92	113
Total CL & provisions	142	291	471	301	397
Net current assets	288	318	132	320	349
Net deferred tax	(67)	(123)	(157)	(183)	(221)
Uses of funds	977	1,865	2,800	4,837	5,915
Book value per share (INR)	50	70	98	106	124

Ratios

Year to September	FY04	FY05	FY06	FY07E	FY08E
ROAE (%)	42.5	41.8	17.2	11.2	18.4
ROACE (%)	22.1	28.8	13.7	8.8	10.9
Current ratio	3.0	2.1	1.3	2.1	1.9
Debtors (days)	0	2	1	1	1
Fixed assets t/o (x)	1.9	0.9	0.8	0.6	0.7
Average working capital t/o (x)	3.3	5.1	10.4	12.2	12.9
Debt/Equity	1.5	1.1	0.8	1.9	2.1

Valuations parameters

Year to September	FY04	FY05	FY06	FY07E	FY08E
Annualized EPS (INR)	21.2	21.3	13.4	11.5	21.3
Y-o-Y growth	*678.8*	*0.6*	*(37.2)*	*(13.9)*	*84.8*
Annualised CEPS (INR)	27.3	25.7	21.2	20.5	35.0
PE (x)	3.6	3.6	5.7	6.7	3.6
Price/BV(x)	1.5	1.1	0.8	0.7	0.6
EV/Sales (x)	3.0	2.8	1.8	1.6	1.0
EV/EBITDA (x)	15.1	9.2	9.7	9.0	5.3

SAKTHI SUGARS

INR 73

Edelweiss
Ideas create, values protect

South bound

REDUCE

February 22, 2007

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Q2FY07: Disappointing sugar operations, subsidiary saves the day

Sakthi Sugars Limited's (SSL's) net revenues were down 19% Y-o-Y at INR 1.5 bn on account of 26% de-growth in sugar revenues. As sugar realisations continued to dwindle and cane costs increased, EBIDTA margins took a beating and were down 275bps at 19% for Q2FY07. Net profits were down 70% Y-o-Y to INR 62 mn. Revenues of Sakthi Auto Components Limited's (SACL, SSL's subsidiary), were however, up 20% Y-o-Y to INR 363 mn; its net profit stood at INR 3 mn for Q2FY07 as against a loss of INR 5 mn in Q2FY06.

Expansion for an integrated business model on course

Post 1,500 TCD brownfield expansions, SSL is further increasing its sugar capacity by 3,500 TCD through a greenfield project near Sakthinagar, which is likely to be operational from SS08. Further, SSL is also increasing its distillery capacity by 36% to 170 KLPD and cogen capacity by ~4x to 120 MW. With the new capacities on-stream, we believe that non-sugar revenues are likely to form 34% of revenues and 69% of profits in FY08E.

Revising estimates to factor in medium term sector concerns

Medium term sector concerns have compelled us to revise our sugar realisations estimates to INR 14,250/tonne for SS07 and INR 14,500/tonne for SS08. As a result, revenue estimates are downgraded by 13% and 6% for FY07E and FY08E, resulting in 34% and 18% downgrade in EBIDTA, respectively. With high level of leverage, we expect dep. and interest charges to stay at high levels. The fixed nature of these expenses further aggravates the impact of lower operating margins, leading to 65% and 31% downgrade in net profits estimates for FY07E and FY08E respectively. Although sugar outlook remains bleak for the medium term, with higher cogen facilities and improved profitability from auto component in FY08E, we expect the earnings to grow by 3x over FY07E.

Valuation expensive on replacement cost, downgrade to 'REDUCE'

On our revised consolidated estimates, the stock trades at P/E of 6x and 2x for FY07E and FY08E respectively. However, the stock looks expensive on EV to replacement cost of 1.1x, which is on the higher side compared with peers. As earnings decline, lower operating cash flows will further strain a highly levered balance sheet. With no near term visibility of micro and macro triggers, we find SSL's pending export obligation of 0.2 MMT risky and decretive from an earnings perspective. We downgrade our recommendation to **'REDUCE'** from **'BUY'**.

Financials

Year to June	FY05	FY06E	FY07E	FY08E
Revenue (INR mn)	7,304	10,013	9,596	13,348
Rev. growth (%)	*93.1*	*37.1*	*(4.2)*	*39.1*
EBITDA (INR mn)	1,030	2,114	1,713	2,828
Net profit (INR mn)	236	940	405	1,307
Shares outstanding (mn)	31	31	31	31
Annualized EPS (INR)	7.5	30.0	12.9	41.7
EPS growth (%)	NA	*297.7*	*(57.0)*	*223.0*
P/E (x)	9.7	2.4	5.7	1.8
EV/ EBITDA (x)	11.3	5.5	6.8	4.1
ROAE (%)	6.5	22.2	8.4	23.2
ROACE (%)	8.2	14.7	9.8	16.4

Reuters	:	SKSG.BO
Bloomberg	:	STSG IN

Market Data

52-week range (INR)	:	275 / 68
Share in issue (mn)	:	31,4
M cap (INR bn/USD mn)	:	2,3 / 51,8
Avg. Daily Vol. BSE/NSE ('000)	:	629.6

Share Holding Pattern (%)

Promoters	:	38.3
MFs, FIs & Banks	:	8.1
FIIs	:	11,4
Others	:	42.3

Key changes in assumptions, followed by a disastrous last quarter

Assuming 245 days crushing season for the next two seasons and recovery likely at 10%, we expect SSL to produce 0.37 MMT and 0.45 MMT of sugar in SS07 and SS08 respectively. Since cane prices are relatively less regulated in south India, we expect cane prices to be around INR 1,058/ tonne and 1,068/tonne respectively. With additional distillery capacity of 35 KLPD at Sakthinagar, expected to be commissioned by March, 2007, we expect 38 mn litres and 47 mn litres of ENA/ ethanol production for FY07E and FY08E respectively. As cogen capacity is expected to increase to 120 MW in SS08 from 32 MW currently, we expect exportable surplus to increase by 3x to 568 mn units.

Table 1: Key production assumptions

	Sakthi Sugars - Tamil Nadu, Orissa				
June ending	FY04	FY05	FY06	FY07E	FY08E
Sugar					
Capacity (TCD)	11,500	11,500	13,500	15,000	18,500
Sugarcane crushed (MMT)	0.50	0.85	2.75	3.67	4.58
Crushing days	43	74	203	245	248
Blended sugar recovery (%)	10.1	9.2	9.5	10.0	10.0
Sugar production (MMT)	0.12	0.26	0.35	0.37	0.46
Realisations INR per MT	14,143	16,190	17,895	14,250	14,500
Cane procurement price INR per MT	818	933	1,085	1,058	1,068
Sugar revenues (INR mn)	1,781	4,265	6,570	5,494	6,604
Segment revenue mix (%)	58.8	66.7	73.3	71.2	63.6
Distillery					
Distillery capacity (KLPD)	125	125	125	170	170
Production - million litres per annum	31	32	29	38	47
Realizations (INR/Litres)	17	26	22	25	25
Distillery revenues (INR mn)	574	853	801	954	1,141
Segment revenue mix (%)	*18.9*	*13.3*	*8.9*	*12.4*	*11.0*
Cogeneration					
Cogen capacity (MW)	32.0	32.0	32.0	32.0	120.0
Saleable surplus (MW)	22.0	22.0	22.0	22.0	95.3
Total power generation days	345	345	345	310	340
Max. power gen possible (mn units)	265	265	265	238	490
Total power generation (mn units)	123	265	270	238	374
Captive consumption (mn units)	10	20	21	48	56
Export (mn units)	113	245	249	190	550
Rate / Kw of power generation	1.8	3.0	3.1	3.1	3.3
Cogen revenues (INR mn)	206	742	777	590	1,789

Source: Edelweiss research

Though non-sugar products' scale-up is on course, we believe that the depressed sugar realisation scenario is likely to keep overall profitability under pressure. With 24% and 17% of EBIT likely to come from sugar operations in FY07E and FY08E, respectively, we anticipate inadequate coverage from the cyclicality for SSL.

Table 2: Revised estimates (consolidated)

	Previous estimates		Revised estimates		
	FY07E	FY08E	FY07E	FY08E	Remarks
Revenues (INR mn)	11,084	14,276	9,596	13,348	Revenue estimates downwards by ~13% in FY07E and 6% in FY08E due to dip in sugar realisations by ~15%, keeping expected sugar volumes unchanged
EBITDA (INR mn)	2,584	3,443	1,713	2,828	Dip in EBIDTA margins is on account of 15% dip in sugar realisations. We have revised sugar realisations to INR 14,250/tonne and INR 14,500/tonne for FY07E and FY08E respectively. As a result, EBIDTA is revised downwards by 34% and 18% for FY07E and FY08E respectively.
EBITDA margin (%)	23.3	24.1	17.8	21.2	
PAT (INR mn)	1,144	1,905	405	1,307	As depreciation and interest cost remains unchanged, net earnings are further revised downward by 65% and 31% to INR 405 mn and INR 1,307 mn for FY07E and FY08E respectively.
Net margin (%)	10.3	13.3	4.2	9.8	
EPS (INR)	36.5	60.7	12.9	41.7	

Source: Edelweiss research

Table 3: Sugar segment dampening profits (INR mn)

	Segmental EBIT estimates		
Particluars	Previous	Revised	% Change
Sugar segment	1,166	350	(70)
Non-sugar segment	876	876	0
Auto components subsidiary	169	225	33
Total	**2,211**	**1,452**	**(34)**

Source: Edelweiss research

Valuation expensive on replacement cost, downgrade to 'REDUCE'

On a consolidated basis, despite the silver-lining auto-components business, overall leverage levels do not portray a good picture. We believe that SSL is highly exposed to a rising interest rate scenario and do not expect the company to recover from falling profits in the ongoing depressed sugar price scenario. On our revised consolidated EPS of INR 13 and INR 42 in FY07E and FY08E, the stock trades at P/E of 5x and 2x respectively.

However, the stock looks expensive on EV to replacement cost of 1.1x, which is on the higher side as against peers. As earnings decline, lower operating cash flows will further strain a highly levered balance sheet. With no medium term visibility of micro and macro triggers, we find SSL's pending export obligation of 0.2 MMT risky and decretive from an earnings perspective. We downgrade our recommendation to **'REDUCE'** from **'BUY'**.

Company Description

Sakthi Sugars Limited (SSL), part of the Sakthi group, is a leading sugar and ethanol manufacturer in south India. The Sakthi group, promoted by N. Mahalingam, has a diversified presence across sugar, auto components, textiles, transport, finance, beverages, synthetic gems, and plantations. SSL currently has 13,500 TCD sugar facilities in Tamil Nadu and Orissa. Additionally, the company also has a 125 KLPD distillery facility and a 32 MW power generation setup, of which, 22 MW is exportable power currently. SSL also has a 90,000 MT per annum soya division (erstwhile Sakthi Soya Limited), which the company merged into it in 1993. The company is ramping up its sugar capacity to 18,500 TCD, distillery capacity to 170 KLPD, and cogen capacity to 120 MW. The leading south Indian sugar player also has exposure in the auto ancillary business through its 100% subsidiary, Sakthi Auto Components Limited (SACL).

Investment Theme

Bleak sugar outlook in the medium term, resulting in low operating cash flows, coupled with high leverage and rising interest cost scenario is likely to dent profits for SSL. Further, SSL has ~0.2 MMT of pending sugar export obligations under ALS, which at the current global prices are likely to be earnings decretive. The only positive we foresee is the turnaround story and growing profitability of its auto subsidiary.

Key Risks

Given that the overall profitability has a strong correlation with the sugar price movements, any dramatic improvement in domestic sugar prices in the medium term could enhance operating cash flows.

SSL’s business model is complemented by location advantage (proximity to ports); hence, an improvement in global sugar prices by ~15% plus would be a positive for SSL and thereby improve profitability.

Financial Statements

Income statement (INR mn)

Year to June	FY04	FY05	FY06	FY07E	FY08E
Income from operations	3,783	7,304	10,013	9,596	13,348
Direct costs	3,180	5,598	6,999	6,607	8,773
Employee costs	244	281	359	410	512
Other expenses	264	394	541	866	1,235
Total operating expenses	3,688	6,274	7,898	7,884	10,520
EBITDA	95	1,030	2,114	1,713	2,828
Depreciation and amortisation	170	199	219	261	327
EBIT	(75)	831	1,896	1,452	2,500
Interest expenses	642	667	991	1,054	1,016
Other income	214	82	44	58	45
Profit before tax	(502)	246	949	456	1,529
Provision for tax	200	2	-	51	222
Extraordinary items	3	7	9	-	-
Reported profit	(705)	236	940	405	1,307
Adjusted net profit	(702)	243	949	405	1,307
Shares outstanding	28	31	31	31	31

Common size metrics- as % of net revenues

Year to June	FY04	FY05	FY06	FY07E	FY08E
Operating expenses	97.5	85.9	78.9	82.2	78.8
Depreciation	4.5	2.7	2.2	2.7	2.5
Interest expenditure	17.0	9.1	9.9	11.0	7.6
EBITDA margins	2.5	14.1	21.1	17.8	21.2
Net profit margins	(18.6)	3.2	9.4	4.2	9.8

Annualised growth metrics (%)

Year to June	FY04	FY05	FY06	FY07E	FY08E
Revenues	0.7	93.1	37.1	(4.2)	39.1
EBITDA	NA	986.0	105.3	(19.0)	65.1
PBT	NA	NA	286.3	NA	235.5
Net profit	6.5	NA	297.7	(57.0)	223.0
EPS	6.5	NA	297.7	(57.0)	223.0

Cash flow statement (INR mn)

Year to June	FY04	FY05	FY06	FY07E	FY08E
Net profit	(702)	243	949	405	1,307
Add: Depreciation	170	199	219	261	327
Add: E.O.adjustments	43	(1)	10	16	13
Add: Deferred tax	200	1	-	-	-
Gross cash flow	(290)	442	1,177	682	1,647
Less: Changes in W. C.	(90)	840	1,300	(452)	287
Operating cash flow	(200)	(398)	(123)	1,134	1,360
Less: Change in Investments	(4)	0	-	-	-
Less: Capex	2,067	188	211	3,348	740
Free cash flow	(2,263)	(586)	(333)	(2,214)	620

Balance sheet (INR mn)

As on 30th June	FY04	FY05	FY06	FY07E	FY08E
Share capital	397	434	434	419	404
- Equity	277	314	314	314	314
- Preference	120	120	120	105	90
Share application money	157	311	607	607	607
Reserves & surplus	2,900	3,108	3,561	3,966	5,272
Shareholders funds	3,454	3,852	4,601	4,991	6,283
Secured loans	5,009	6,256	6,369	5,844	5,644
Unsecured loans	941	871	3,857	3,873	3,873
Borrowings	5,951	7,127	10,227	9,718	9,518
Sources of funds	9,405	10,980	14,828	14,709	15,800
Gross block	7,488	7,595	7,653	11,246	11,986
Depreciation	550	850	1,160	1,421	1,748
Net block	6,938	6,745	6,493	9,826	10,238
Capital work in progress	12	93	245	0	0
Total fixed assets	6,950	6,838	6,738	9,826	10,238
Intagible assets	32	802	817	655	582
Investments	47	47	47	47	47
Inventories	745	1,135	816	737	634
Sundry debtors	318	572	1,008	986	1,354
Cash and equivalents	128	204	2,848	271	750
Loans and advances	2,684	2,901	3,954	4,148	4,862
Total current assets	3,875	4,812	8,625	6,142	7,600
Sundry creditors and others	1,759	1,779	1,526	2,142	2,664
Provisions	0	0	123	52	223
Total CL & provisions	1,759	1,779	1,649	2,194	2,887
Net current assets	2,116	3,033	6,976	3,947	4,713
Net deferred tax	156	155	155	155	155
Others	103	105	95	79	66
Uses of funds	9,405	10,980	14,828	14,709	15,800
Book value per share (INR)	120	119	143	156	197

Ratios

Year to June	FY04	FY05	FY06	FY07E	FY08E
ROAE (%)	(19.6)	6.5	22.2	8.4	23.2
ROACE (%)	(0.8)	8.2	14.7	9.8	16.4
Current ratio	2.2	2.7	5.2	2.8	2.6
Debtors (days)	31	29	37	37	37
Fixed assets t/o (x)	0.5	1.1	1.5	1.0	1.3
Average working capital t/o (x)	1.8	2.8	2.0	1.8	3.1
Debt/Equity	1.7	1.9	2.2	1.9	1.5

Valuations parameters

Year to June	FY04	FY05	FY06	FY07E	FY08E
Annualized EPS (INR)	(25.4)	7.5	30.0	12.9	41.7
Y-o-Y growth	*6.5*	NA	*297.7*	*(57.0)*	*223.0*
Annualised CEPS (INR)	(19.3)	13.9	36.9	21.2	52.1
PE (x)	NA	9.7	2.4	5.7	1.8
Price/BV(x)	0.6	0.6	0.5	0.5	0.4
EV/Sales (x)	3.1	1.6	1.2	1.2	0.9
EV/EBITDA (x)	123.2	11.3	5.5	6.8	4.1

Shree Renuka Sugars

INR 293

Edelweiss
Ideas create, values protect

Silver lining

ACCUMULATE

February 22, 2007

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Q1FY07 - delayed crushing season disappoints

Shree Renuka Sugars (SRSL's) standalone revenues stood at INR 1.2 bn, down 28% Y-o-Y. De-growth in revenues was due to delayed crushing season and lower sugar realisations. Sugar production for Q1FY07 was at 51,922 MT vis-à-vis 64,036 MT in Q1FY06. EBITDA margin declined by 308bps Y-o-Y to 12.1% on account of sugar segment reporting 15% EBIT margin as against 20% in Q1FY06. Standalone PAT stood at INR 78 mn, down 53% Y-o-Y with net margins at 6.4% compared with 9.7% in Q1FY06.

Revising estimates to reflect crashing realisations

Post a soft Q1FY07 results, we are downgrading our full year estimates. With sugar prices declining by ~15% in last six months and no medium term triggers, we are revising our sugar prices to INR 14,250/tonne for SS07 and INR 14,500/tonne for SS08. As a result of price revision and slight delay in commissioning of one of the plants, we are downgrading our revenue estimates by 29% and 12% for FY07 and FY08, resulting in 53% and 36% downgrade in EBIDTA, respectively. Further, with static interest and dep. charges, we are downgrading our net profit estimates by 59% and 35% for FY07E and FY08E, respectively.

Expansion on track, despite minor project delays

SRSL's versatile and scalable business model is undergoing a massive ramp-up in sugar and co-products capacities. It is expanding its sugar facility from 7,500 TCD in SS06 to 28,250 TCD by SS08 in a phased manner. As a value-addition strategy, SRSL is also scaling up its distillery facility by ~2x to 450 KLPD (second largest in the country) and cogen facility by 2x to 104 MW by SS08. We believe that higher integration of co-products is likely to drive operating revenues and earnings, especially when sugar prices are falling.

Compelling valuations, downgrade to 'ACCUMULATE' on mid-term sector concerns

At CMP, the stock trades at P/E of 7x and 3x FY07E and FY08E consolidated earnings, respectively. On an EV to replacement cost, SRSL trades at 0.8x SS07E-end capacities. The stock is available at relative peer discount on both the above parameters. The stock has corrected by ~80% from the peak valuations. We believe the sharp correction vis-à-vis peers is uncalled for, given the versatile and scalable business model and inherent locational advantage. Despite compelling valuations and decent growth outlook, in the absence of any significant medium-term catalyst to lead to buoyant valuations, we downgrade the stock to **'ACCUMULATE'** from **'BUY'**. We recommend investors with long term investment horizon to buy at dips.

Financial

Year to September	FY05	FY06	FY07E	FY08E
Revenue (INR mn)	7,955	11,046	13,597	26,758
Rev. growth (%)	*251.9*	*38.9*	*23.1*	*96.8*
EBITDA (INR mn)	849	1,598	1,742	3,679
Net profit (INR mn)	488	1,198	985	2,538
Shares outstanding (mn)	20.0	23.8	23.8	23.8
Fully diluted EPS (INR)	20.5	50.3	41.4	106.6
EPS growth (%)	*234.3*	*145.4*	*(17.8)*	*157.7*
ROACE (%)	52.3	35.6	17.1	31.2

Reuters	:	SRES.BO
Bloomberg	:	SHRS IN

Market Data

52-week range (INR)	:	1,667 / 291
Share in issue (mn)	:	23.8
M cap (INR bn/USD mn)	:	7.9 / 179.6
Avg. Daily Vol. BSE ('000)	:	149.6

Share Holding Pattern (%)

Promoters	:	40.4
MFs, FIs & Banks	:	2.8
FIIs	:	16.2
Others	:	40.6

Positive surprises unlikely, key metrics change in our forecasts

We have reduced our sugar production assumption for SS07 to 0.48 MMT on account of delay in crushing season and capacity commissioning including the east coast refinery. However, with incremental capacities coming on stream in SS08, we expect SRSL to produce 0.66 MMT of sugar SS08 onwards. Since cane prices are relatively less regulated in south India, we expect cane prices of INR 1,000/ tonne. Currently, SRSL has distillery capacity of 240 KLPD, which it is likely to improve to 450 KLPD by SS08. The distillation unit is expected to produce 61 MLPD and 101 MLPD of ethanol for FY07E and FY08E respectively. As cogen capacity is expected to increase by 2x to 103 MW in SS08 from the current 51 MW, we expect exportable power to increase by 3x to 439 mn units in FY08E.

Table 1: Key production assumptions

	Shree Renuka Sugar - Maharashtra/Karnataka				
September ending	FY04	FY05	FY06	FY07E	FY08E
Sugar					
Capacity - sugar crushing (TCD)	2,500	5,000	7,500	25,250	28,250
Capacity - sugar refining (TCD)	-	-	-	2,000	2,000
Sugarcane crushed (MMT)	0.58	0.89	1.80	4.26	5.69
Blended crushing days	171	203	230	215	225
Blended sugar Recovery (%)	10.6	10.6	11.3	11.2	11.6
Sugar Production (MMT)	0.06	0.09	0.20	0.48	0.66
Sugar refining (MMT)	0.04	0.15	0.08	-	0.50
Realisations INR per MT	11,500	16,300	16,608	14,250	14,500
Cane procurement price INR per MT	1,117	1,100	1,200	1,000	1,000
Gross sugar revenues (INR mn)	**2,062**	**7,881**	**11,166**	**12,631**	**24,582**
Distillery					
Distillery capacity (KLPD)	60	60	60	240	450
Production - million litres per annum	12	14	12	61	101
Realizations (INR/Litres)	16	23	18	22	22
Distillery revenues (INR mn)	**300**	**478**	**358**	**1,526**	**2,525**
Cogeneration					
Cogen capacity (MW)	20.5	20.5	20.5	50.5	103.5
Total power generation days	320	320	320	320	320
Total Power generation in MW	58,220	85,810	98,268	261,411	612,457
Captive consumption in MW	27,100	40,900	39,800	112,208	173,143
Export in MW	31,120	44,910	58,468	149,203	439,314
Rate / Kw of power generation	3.5	3.7	3.7	3.3	3.3
Net cogen revenues (INR mn)	109	166	216	495	1,459

Source: Edelweiss research

We remain positive on SRSL's management and believe that the company is on track to be the perfect example of a de-risked and integrated business model in the domestic sugar industry. The premise of our revision of estimates in SRSL is lower sugar realisations and delay in commissioning of production facilities. SRSL is one of the few companies in the listed universe who are likely to report near-flat profits in SS07 over a record SS06.

Table 2: Revised estimates (consolidated)

	Previous estimates		Revised estimates		Remarks
	FY07E	FY08E	FY07E	FY08E	
Revenues (INR mn)	19,214	30,462	13,597	26,758	Revised downwards by ~29% in FY07E and 12% in FY08E due to dip in sugar realisations and delay in commissioning of one unit
EBITDA (INR mn)	3,724	5,745	1,742	3,679	Lower EBIDTA margins is on account of 15% dip in sugar realisations to INR 14,250/tonne. As a result, EBIDTA is revised downwards by 53% and 36% for FY07E and FY08E respectively
EBITDA margin (%)	19.4	18.9	12.8	13.7	
PAT (INR mn)	2,432	3,903	985	2,538	As a result of lower EBIDTA and with interest and depreciation remaining unchanged, net earnings are revised downwards by 59% and 35% to INR 985 mn and INR 2,538 mn for FY07E and FY08E respectively
Net margin (%)	12.7	12.8	7.2	9.5	
EPS (INR)	102.1	163.9	41.4	106.6	

Source: Edelweiss research

Table 3: Segmental profit scenario (INR mn)

	Segmental EBITDA estimates		
Particluars	Previous	Revised	% Change
Sugar segment	2,584	1,620	(37)
Non-sugar segment	1,525	954	(37)
Total	4,109	2,574	(37)

Source: Edelweiss research

Compelling valuations, downgrade to 'ACCUMULATE' with medium term sector concerns

At CMP, the stock trades at P/E of 7x and 3x FY07E and FY08E consolidated earnings, respectively. On an EV to replacement cost, SRSL trades at 0.8 x SS07E-end capacities. Compared with its peers, the stock is available at relative discount on both the above parameters. The stock has corrected by ~45% from our initiating coverage on the sector and 80% from the peak valuations. We believe the sharp correction vis-à-vis peers (BCML, SSL and DSIL) is uncalled for, given the versatile and scalable business model and inherent locational advantage SRSL has over its north Indian peers. Despite compelling valuations and decent growth outlook over the next two seasons, in the absence of any significant medium-term catalyst to lead to buoyant valuations, we downgrade the stock to 'ACCUMULATE' from 'BUY'. We recommend investors with long term investment horizon to buy at dips.

Company Description

Shree Renuka Sugars Limited (SRSL) primarily manufactures sugar, but is also engaged in producing allied products such as power and ethanol. Based in Karnataka, the company has sugar units in Munoli, Athani, and Havalgah in Karnataka, and in Ajara and Arag in Maharashtra.

Incorporated in October 1995, it acquired a 1,250 TCD sick unit from the Government of Andhra Pradesh in 1998. This unit was moved to Munoli, Karnataka and the capacity was expanded to 2,500 TCD with an 11.2 MW cogen plant. In 2004, SRSL acquired on lease a loss-making co-operative sugar mill in Ajara, Maharashtra with a 2,500 TCD plant. With a mix of greenfield and brownfield expansion, SRSL's current sugar capacity for sugar season 2007 stands at 25,250 TCD with 50.5 MW of cogen and 240 KLPD of distillation capacities.

Investment Theme

In the absence of any significant medium-term catalyst to improve sugar realisations, we are likely to see lower than expected profitability. However, due to better coproducts integration, we believe the sugar cycle impact on earnings tends to be reduced to a certain extent. Further, valuation looks compelling on both the parameters (P/E and EV to replacement cost) vis-à-vis peers. We therefore recommend investors with a long term investment horizon to buy at dips and downgrade the stock to 'ACCUMULATE' from 'BUY'.

Key Risks

Given that the overall profitability has a strong correlation with the sugar price movements, any fall in sugar prices (global as well as domestic) from current levels in medium term can dent profitability further.

Given that SRSL is in the expansion phase, any significant delays in commissioning of units can lead to lower volumes, thereby impacting the volume growth of the company.

SRSL's profits could be undermined by its sugar trading business, given that sugar trading business is a high risk and high return business.

Financial Statements (Consolidated)

Income statement (INR mn)

Year to September	FY04	FY05	FY06	FY07E	FY08E
Sugar revenues	2,062	7,881	11,166	12,631	24,582
Co-generation revenues	276	438	396	1,168	2,497
Distillery revenues	300	478	358	1,526	2,525
Bio-fertilizer revenues	4	7	12	28	39
Gross operating revenue	2,642	8,804	11,932	15,354	29,643
Less: Excise	138	335	330	617	1,224
Less: Intersegmental revenues	243	514	556	1,140	1,661
Net operating revenue	2,261	7,955	11,046	13,597	26,758
Raw material	1,320	6,520	8,398	10,301	18,675
Operating expenses	619	586	1,050	1,554	4,405
Total operating expenses	1,939	7,106	9,448	11,855	23,079
EBITDA	322	849	1,598	1,742	3,679
Depreciation and amortisation	71	80	87	360	360
EBIT	251	769	1,511	1,382	3,319
Interest and financial expenses	113	149	189	300	310
Other income	14	23	57	86	129
Less: Deferred & prelim exp. w/off	-	73	-	-	-
Profit before tax	152	571	1,379	1,167	3,138
Provision for tax	29	83	181	183	600
Current tax	9	76	165	183	600
Defered tax	20	7	16	-	-
Profit after tax	123	488	1,198	985	2,538
CEPS (INR)	14.5	28.8	54.7	56.5	121.7
Fully diluted EPS (INR)	6.1	20.5	50.3	41.4	106.6
Shares outstanding (mn)	14.7	20.0	23.8	23.8	23.8
Equity dividend	13.6	47.7	47.6	59.5	59.5
Preference dividend	0.2	0.1	-	42.0	42.0

Common size metrics - as % of net revenues

Year to September	FY04	FY05	FY06	FY07E	FY08E
Operating expenses	85.8	89.3	85.5	87.2	86.3
Depreciation	3.1	1.0	0.8	2.6	1.3
Interest expenditure	5.0	1.9	1.7	2.2	1.2
EBIDTA margin	14.2	10.7	14.5	12.8	13.7
Net profit margin	5.4	6.1	10.8	7.2	9.5

Growth metrics (%)

Year to September	FY04	FY05	FY06	FY07E	FY08E
Revenues	(21.3)	251.9	38.9	23.1	96.8
EBITDA	45.6	163.8	88.2	9.0	111.2
PBT	255.3	276.4	141.5	(15.4)	168.8
Net profit	339.1	297.9	145.4	(17.8)	157.7
EPS	222.9	234.3	145.4	(17.8)	157.7

Balance sheet (INR mn)

As on 30th September	FY04	FY05	FY06	FY07E	FY08E
Equity capital	147	200	238	238	238
Preference capital	8	-	-	600	600
Share premium	-	-	1,048	1,048	1,048
Other reserves & surplus	157	591	1,734	2,603	5,025
Shareholders funds	313	791	3,020	4,489	6,910
Secured loans	680	710	3,544	4,659	4,812
Unsecured loans	224	152	167	152	152
Borrowings	904	863	3,711	4,811	4,964
Deferred tax liability	33	40	57	57	57
Total funds employed	1,250	1,694	6,788	9,357	11,932
Gross block	1,223	1,403	1,630	7,901	7,901
Depreciation	261	348	436	796	1,155
Net block	962	1,055	1,194	7,105	6,745
Capital work in progress	-	76	3,313	-	-
Total fixed assets	962	1,131	4,507	7,105	6,745
Investments	0	1	1	1	1
Inventories	493	1,123	1,122	844	857
Receivables	83	198	538	689	1,561
Loans and advances	165	237	808	1,048	4,640
Cash and equivalents	322	786	973	2,233	2,716
Total current assets	1,063	2,344	3,440	4,815	9,774
Payables	748	1,625	917	2,439	4,050
Provisions	27	157	319	124	538
Total CL & provisions	775	1,783	1,236	2,564	4,589
Net current assets	288	562	2,205	2,252	5,186
Miscellaneous expenditure	-	-	76	-	-
Uses of funds	1,250	1,694	6,788	9,357	11,932
Book value per share (INR)	21	40	127	189	290

Cash flow statement (INR mn)

Year to September	FY04	FY05	FY06	FY07E	FY08E
Net profit	123	488	1,198	985	2,538
Add: Depreciation	71	80	87	360	360
Add: E.O.Adjustments	-	73	-	-	-
Add: Deferred tax	20	7	16	-	-
Gross Cash Flow	214	648	1,302	1,345	2,898
Less: Dividends	14	48	48	102	102
Less: Changes in W. C.	(246)	(190)	1,456	(1,214)	2,452
Operating cash flow	446	790	(201)	2,457	345
Less: Change in investments	-	1	-	-	-
Less: Capex	147	256	3,463	2,958	-
Free cash flow	298	533	(3,664)	(501)	345

Ratios

Year to September	FY04	FY05	FY06	FY07E	FY08E
ROAE (%)	48.9	88.5	62.9	26.2	44.5
ROACE (%)	21.1	52.3	35.6	17.1	31.2
Current ratio (x)	1.4	1.3	2.8	1.9	2.1
Debtors (days)	13	9	18	18	21
Inventory (days)	80	52	37	23	12
Fixed assets t/o (x)	2.4	7.0	2.5	1.9	4.0
Average working capital turnover (x)	7.8	14.2	5.0	6.0	5.2
Debt/Equity (x)	2.9	1.1	1.2	1.1	0.7

Valuations parameters

				32.23	39.21
Year to September	FY04	FY05	FY06	FY07E	FY08E
Fully diluted EPS (INR)	6.1	20.5	50.3	41.4	106.6
Y-o-Y growth (%)	*222.9*	*234.3*	*145.4*	*(17.8)*	*157.7*
CEPS (INR)	14.5	28.8	54.7	56.5	121.7
PE (x)	47.8	14.3	5.8	7.1	2.7
Price/BV(x)	13.8	7.4	2.3	1.6	1.0
EV/Sales (x)	4.3	1.2	0.9	0.7	0.4
EV/EBITDA (x)	30.2	11.4	6.1	5.6	2.6

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INDIA RESEARCH			SECTOR	INSTITUTIONAL SALES		
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Gautam Roy	-	2286 4305	Airlines, Textile	Rajesh Makharia	-	2286 4202
Ashutosh Goel	-	2286 4287	Automobiles, Auto Components	Shabnam Kapur	-	2286 4394
Vishal Goyal, CFA	-	2286 4370	Banking & Finance	Amish Choksi	-	2286 4201
Revathi Myneni	-	2286 4413	Cement	Balakumar V	-	(044) 4263 8283
Sumeet Budhraja	-	2286 4430	FMCG	Monil Bhala	-	2286 4363
Harish Sharma	-	2286 4307	Infrastructure, Auto Components, Mid Caps	Ashish Agrawal	-	2286 4301
Priyanko Panja	-	2286 4300	Infrastructure, Engineering, Telecom	Nikhil Garg	-	2286 4282
Hitesh Zaveri	-	2286 4424	Information Technology	Swati Khemani	-	2286 4266
Parul Inamdar	-	2286 4355	Information Technology	Neha Shahra	-	2286 4276
Priyank Singhal	-	2286 4302	Media, Retail	Priya Ramchandran	-	2286 4389
Prakash Kapadia	-	2286 4432	Mid Caps	Anubhav Kanodia	-	2286 4361
Niraj Mansingka	-	2286 4304	Oil & Gas, Petrochemicals	Tushar Mahajan	-	2286 4439
Nimish Mehta	-	2286 4295	Pharmaceuticals, Agrochemicals	Harsh Biyani	-	2286 4419
Manika Premsingh	-	4019 4847	Economist	Nirmal Ajmera	-	2286 4258
Sunil Jain	-	2286 4308	Alternative & Quantitative	Ankit Doshi	-	2286 4671
Yogesh Radke	-	2286 4328	Alternative & Quantitative	Ravi Pilani	-	4009 4533
				Dipesh Shah	-	2286 4434

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period