# EID Parry

**Rs 288**

29th May 2006

## *De-risked model*

**Accumulate**

EID Parry (India) recently held its analyst meet to discuss the year gone by and the future prospects for the Company. Excerpts from the meet follow.

### Results decent, as sugar prices rule near all time highs

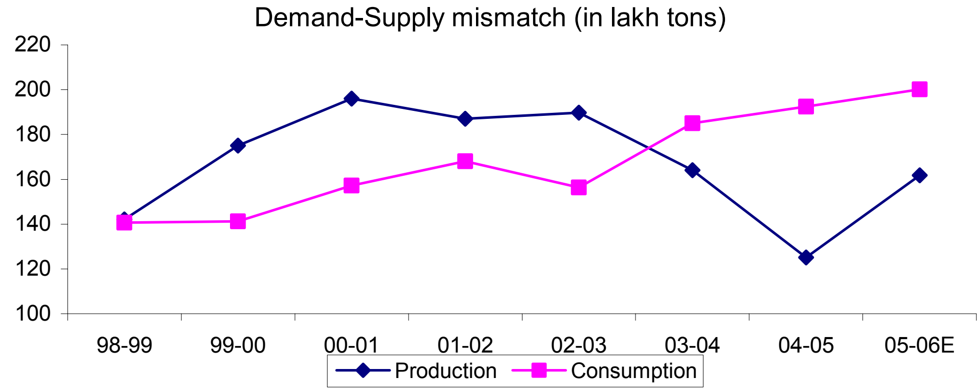
- EID Parry's topline improved by 28% in the last quarter, on the back of some good performances by its sugar division, to Rs 341 crores over previous year's Rs 267 crores. For FY06, the Company's sales grew by 29% to Rs 926 crores.
- Despite high sugar prices, the Company's operating margin for the last quarter went down by 40 bps, to 15.6%, and by 110 bps for the year, to 13.6%. The main reason for this was the decrease in inventory levels by Rs 83.2 crores in the last quarter, as against Rs 19.2 crores for the same period. Operating profit consequently grew by 24%, to Rs 53 crores for Q4 and by 19%, to Rs 126 crore for FY06.
- The modest growth in the profit margin was also due to the fact that its *Parryware* division has been transferred to its subsidiary, Parryware Glamourooms Ltd, on 1st March, 2006 and therefore financials are for 11 months for FY06.
- Other income fell by 64% for Q4, to Rs 3.3 crores and by 4%, to Rs 29.2 crores for FY06, which further restricted the gross profit margin.
- Interest cost for FY06 was up by 111%, to Rs 7.4 crores, on account of higher interest cost on working capital borrowings and withdrawal of buffer stock interest subsidy scheme.
- Net profit for the quarter and for the year grew by 20%, to Rs 44 crores and by 11%, to Rs 116 crores, respectively.
- The Company has declared a dividend of 225% (Rs 4.5 a share) for the full year.

| (in Rs crores) | Q4FY06 | Q4FY05 | Chg (%) | FY06 | FY05 | Chg (%) |
|---|---|---|---|---|---|---|
| Net Sales | 340.8 | 266.8 | 27.7 | 926.2 | 717.2 | 29.1 |
| EBIDTA | 53.2 | 42.8 | 24.4 | 125.7 | 105.4 | 19.3 |
| PBT | 48.8 | 43.9 | 11.2 | 141.1 | 127.3 | 10.9 |
| PAT | 43.7 | 36.5 | 19.5 | 115.9 | 104.3 | 11.1 |
| EPS (Rs) | 4.9 | 20.5 | -76.1 | 13.0 | 58.4 | -77.8 |
| OPM (%) | 15.6 | 16.0 | | 13.6 | 14.7 | |

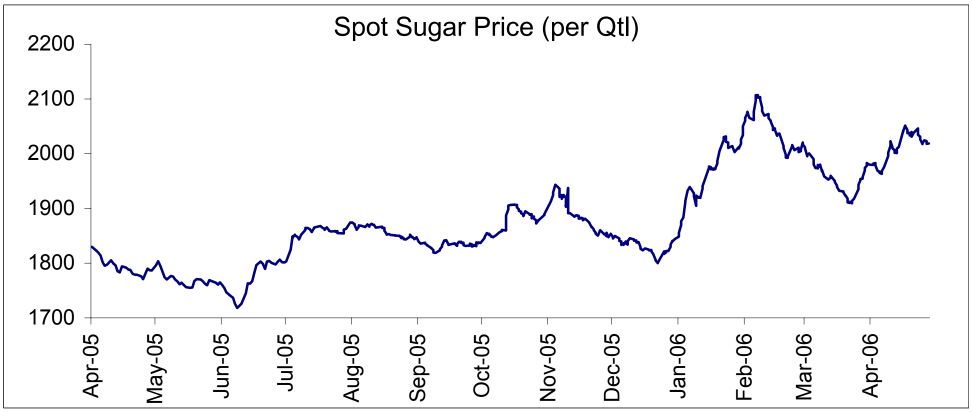
### Sugar Division – sweetened times

Sugar scenario in India has undergone a sea change over the past two years, reviving the fortunes of this ailing industry. A confluence of factors - failure of crops in certain states, inadequate rains in cane-rich pockets and diversion of land for other remunerative crops - led to a steep fall in sugar production. The sugar output was down, from 165 lakh tonnes in 2003-04 to 125 lakh tonnes in 2004-05. As against this, the consumption continues to grow at a steady 4.5% yearly rate, and has tilted the situation in favour of the industry.

After witnessing two years of wide deficit, this year, the performance was quite healthy, as production went up by 29%, thus narrowing the difference between production and consumption. Sugar production went up, from 125 lakh tons in 2004-05 to about 161 lakh tons in 2005-06. Overall, the sugar situation in the country is expected to remain balanced in the coming years due to the fact that EU has eliminated subsidised exports of white sugar in view of the WTO ruling.




The interesting turnaround of events caused sugar prices to shoot-up, in the current year. Brazil's holding-up its production for converting into ethanol, droughts in cane-rich states, demand constantly growing at 4.5% p.a. and fall in production in the last two years, have been the main reasons for escalating sugar prices. Yet, sugar being a regulated commodity, the government acted swiftly to cool-off surging prices, and thereby restore some sanity.




## Global situation - Unbalanced

Globally, sugar prices have escalated, as consumption continued to outstrip production for the third year running, even as Brazil, the largest producer of sugar, has not been releasing much stock lately to benefit from the strong domestic demand. And due to declining stocks in China, India and the Russian Federation, world sugar prices will continue to rise after increasing by 35% last year.

In the foreseeable future, the global outlook remains upbeat for sugar manufacturers, as international prices are expected to rise due to the WTO ruling against EU export subsidies. Further, a lot of cane will be diverted towards ethanol, which is expected to be widely favoured in coming times, due to spiralling crude prices and impending implications of the Kyoto protocol.

## EID Parry – an integrated advantage

EID Parry, based in South India, is amongst the largest producers of sugar in the country, with a crushing capacity of 14,300 TCD, spread across its four plants. The Company's plants are located at Nellikuppam in the Cuddalore district, Pugalur in the Karur district, Pudukottai in the Pudukottai district and Pettavaithallai in the Trichy district. EID is at an advantage, due to its integrated business model, which de-risks it from the vagaries of cyclical sugar prices. Also, South India experiences two monsoons every year, thus giving a higher product yield. The Company being South India-based, due to this, gets a longer crushing period, as compared to the mills in the North. This more-than takes care of the slight under-recovery of sugar, lower by 0.3-0.5 percentage points over mills in North.

For the current crushing season, the government has declared the SMP (Statutory Minimum Price) for sugar at Rs 79.50 a quintal, against Rs.74.50 for FY05. However, now it is linked to basic recovery of 9%, instead of peak recovery. This is a very positive development for the South India-based mills, and EID Parry in particular, due to a longer crushing period. For EID Parry, the average recovery is 9.7%, while its peak recovery is about 10.2%.

| Sugar Segment | Q4FY06 | Q4FY05 | Chg (%) | FY06 | FY05 | Chg (%) |
|---|---|---|---|---|---|---|
| | | | | | | |
| Revenues | 305.1 | 228.7 | 33.4 | 729.1 | 556.3 | 31.1 |
| PBIT | 46.6 | 33.6 | 38.7 | 79.7 | 70.1 | 13.6 |
| Segment margins (%) | 15.3 | 14.7 | | 10.9 | 12.6 | |
| *Segment share (%)* | *85.3* | *78.3* | | *70.8* | *67.9* | |

- The sugar division posted an impressive revenue growth, of 33% and 31%, for the quarter and the year ended, respectively, mainly due to increase in prices, which have risen by more than Rs 200 a quintal over its previous year, touching an all-time high of Rs 2,107.05 a quintal in February.
- However, margins went down by 170 bps, mainly on account of higher exports, i.e. margins from the activity of export of sugar, that has been imported in raw-form, are lower.
- Average realisation in the last quarter has been around Rs 1,670-1,680 a quintal.
- Total crushing capacity has increased to 14,300 TCD, with the expansion in crushing capacity at Pudukottai. Sugar production has gone up from 2.33 lakh tons in 04-05 to 3.06 lakh tons in 05-06. The Company was also able to achieve good realisation on its sales, which went up, from Rs 15,237 to Rs 16,291 a ton.

The management cited that despite higher sugar production, the country, as a whole, would feel the supply crunch, as consumption would be higher than production. This would ultimately result in better realisations for the Company, thus improving its profitability. The Management also expects prices to remain within the Rs 1,830-1,840 per quintal range, for the next year. The Company is targeting a short-term growth rate of 7% and a long-term growth rate of 4%. The sugar division will be further encouraged, as and when the government deregulates it and the prices are market-determined. Also, the government has been encouraging ethanol blending, which is proposed to increase, from the current 5% to 10%.

### Sanitary-ware division – booming prospects

This division of EID Parry manufactures products such as seat covers, polymer cisterns, bathtubs, electronic flushing devices, taps and fittings, et cetera. The products are marketed under the brand names 'Parryware' & 'Johnson Pedder'. The Parryware brand includes premium and upper segment products and enjoys strong brand equity, while the Johnson Peddar caters to the lower-end segment and competes with the unorganised market. The Parryware brand has been awarded the “Superbrand” status by the *Superbrand Council of India.*

EID Parry has improved its market share, from 38% in 2003-04 to 42% in 2005-06, of the Rs 350 crore organised sanitary-ware sector. The unorganised market amounts to Rs 400 crores. Thus, the sanitary-ware industry as a whole is valued at around Rs 700 crores.

| Parryware Segment | Q4FY06 | Q4FY05 | Chg (%) | FY06 | FY05 | Chg (%) |
|---|---|---|---|---|---|---|
| | | | | | | |
| Revenues | 41.8 | 50.8 | -17.8 | 232.5 | 196.0 | 18.6 |
| PBIT | 4.6 | 7.4 | -37.8 | 29.6 | 23.0 | 28.6 |
| Segment margins (%) | 11.1 | 14.6 | | 12.7 | 11.8 | |
| *Segment share (%)* | *11.7* | *17.4* | | *22.6* | *23.9* | |

- The Parryware segment recorded revenues of Rs 232.5 crores in FY06, being 23% of the overall turnover.
- However, in the last quarter, revenues fell by 18% on account of a slump-sale transfer of Parryware business to its subsidiary Parryware Glamourooms Pvt. Ltd. on 1st March 2006, in order to focus efficiently on the division. Therefore, the results represent an 11-month period, ended 28th February 2006. Accordingly, segment margins fell by 360 bps to 11.1%, resulting in a 38% fall in PBIT, to Rs 4.6 crores.



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- The market share of the Company in the organised sector improved, from 40% to 42%, with the launch of 12 new products across all categories.
- Parryware focused on the emerging retail trend by investing in large-scale branding & display across the country. The institutional business recorded an impressive win against key builders.

*Hiving-off Parryware business*

In order to focus efficiently on the division, the Company has decided to hive-off its Parryware business to its wholly owned subsidiary, Parryware Glamourooms Pvt. Ltd. (PGPL), on 1st March 2006. For the same purpose, the Company has decided to partner with *Roca* of Spain in a 50:50 JV. *Roca* is the world leader in sanitaryware products. The JV will entail significant growth of the Parryware business through better technology, improved manufacturing practices, better product offerings and increased presence in the international market, thus improving overall business value. *Roca* will also introduce its own products into India through this JV and the products manufactured in India would be exported through *Roca*'s international network. The agreement will become effective on receipt of the FIPB approval. *Roca* will become a 50% shareholder in PGPL through a combination of direct subscription and transfer from the EID. For these, *Roca* will be investing € 50 million, i.e. Rs 275 crores, for its 50% stake. Also, the assets, being transferred to PGPL at book values, profits will be booked in 2006-07.

With the Parryware business being hived-off, the Company will now no longer be able to reap benefits from it. However, this was done to effectively concentrate on the lucrative business of Parryware that has got huge potential.

## Bio-Products fuelling growth

EID Parry is the world's largest producer of neem-based bio products, and has an installed annual capacity of 7,500 kg. The products include crop protection agents (Neemazal Formulations), neem cake & insect screens, which are utilised in organic agricultural activities. Over 70% of the revenues of this division are accounted for by exports, of which US and Europe command a larger pie. The bio-product business is considered to be a high-margin business and is currently growing at a CAGR of 15%.

Growing awareness, in the medical world across the globe, for safer farm produce, organic options and bio products, creates a favourable outlook for the division, which currently accounts for just 2.5% of the topline. The Management is very upbeat on the growth opportunities and is working towards diversifying into public health applications. Patent protection in addressable markets and regulatory clearances in target markets further induces confidence about this business.

| Bio-Products Segment | Q4FY06 | Q4FY05 | Chg (%) | FY06 | FY05 | Chg (%) |
|---|---|---|---|---|---|---|
| Revenues | 11.2 | 8.7 | 28.9 | 25.7 | 20.3 | 26.7 |
| PBIT | 3.1 | 4.1 | -23.7 | 4.2 | 3.9 | 8.2 |
| Segment margins (%) | 27.8 | 46.9 | | 16.4 | 19.2 | |
| *Segment share (%)* | *3.1* | *3.0* | | *2.5* | *2.5* | |

- Revenues for the quarter and for the year-ended increased by 29% and 27%, to Rs 11.2 crores and Rs 25.7 crores, respectively.
- However, for the quarter, margins went down from 47% to 28%, respectively, resulting in a fall in PBIT by 24%, to Rs.3.10 crores.
- The products of this division continued to grow in all the markets serviced by it. Sales in the domestic market grew by 13%, with channel sales recording a growth of over 110%.

*Acquisition of Parry Neutraceuticals*

The Company has decided to acquire Parry Neutraceuticals Ltd. (PNL) for Rs 32 crores and make it a wholly owned subsidiary. The Company has identified the neutraceuticals business as an opportunity for profitable growth and therefore acquired PNL that already has presence in developed countries and whose products cater mainly to the export markets.



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## Future Plans – Sweet times ahead

The Company has some ambitious expansion plans to increase the capacities of sugar, cogeneration and distillery over the next three-year period. It has recently announced large investments, of about Rs 850 crores, towards expansion of the existing sugar plants and making these into fully integrated units by value-adding Power cogeneration and Distilleries to convert all molasses into alcohol. Acquisitions and establishment of Greenfield plants are also on the Company cards.

### Sugar

As a consequence of various restructuring initiatives, EID Parry is now a sugar-focused company. This is seen from the fact that sugar contributes around 85% to the Company's topline. The sugar division currently has a crushing capacity of 14,300 TCD. The Company intends to increase it to 24.500 TCD, with an investment of around Rs 229 crores. With this investment, sugar production will increase from the present 3.06 lakh tons to around 8 lakh tons in 2008-09.

*JV with Cargill*

The Company has signed a joint venture with Cargill International, a leading global sugar major, to set up a sugar refinery in Kakinada, Andhra Pradesh, with an investment outlay of Rs 300 crores. EID Parry will hold 51% stake and Cargill will hold the remaining 49%. The facility, which would be an export-oriented unit or be located in a Special Economic Zone, would start operations by December07 with an initial capacity of 6,00,000 tons a year (2,000 TCD) and later expand it to a million tons. The project involves processing of imported raw sugar and exporting refined whites in international markets. It will have an integrated cogeneration system to take care of its steam and power requirements. The Project is expected to bring net foreign exchange, to the tune of Rs 150 crores a year, into the country. This move comes on the back of the EU's decision to curtail subsidised exports of white sugar. Debt-equity ratio would be 1:1. Parrys Sugars Refineries Pvt. Ltd. will be the vehicle for the proposed joint venture, and it will receive Rs 72.5 crores as initial equity from EID Parry, which expects an ROCE of 26% and an IRR of 24% from the Project.

### Co-generation

The co-generation will experience the maximum impact in the expansion plan, as the Company expects capacities to grow, from the current 24.5 MW to around 127 MW by 2008-09. This would entail an investment of Rs 471 crores.

### Distillery

Going ahead, with all the four units working as an integrated complex, the production in ethanol / alcohol will see huge improvement. From the current 40 kilolitres per day (KLPD), it will go up to 240 KLPD post expansion plan. On an annual basis, the increase will be from the current 12 million litres to 72 million litres (assuming that the plant will operate for 300 days). This would entail an investment of Rs 150 crores.

### Financing aspect

The Company expects to finance its Rs 850 crore expansion project through the following:

- Banks → Rs 280 crores, of which Rs 125 crores has already been availed of
- Sugar Development fund → Rs 150 crores.
- Internal Accruals → Rs 420 crores, which includes cash from dilution in the Parryware JV, amounting to Rs 275 crores.

EID Parry expects to keep the debt-equity ratio below 1. On the above investment, the Company expects the payback period to be five years, ROCE to be around 20% and IRR to be about 25%.


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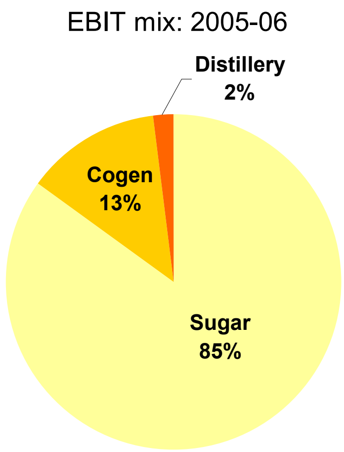
*Summary of the Financing Plan*

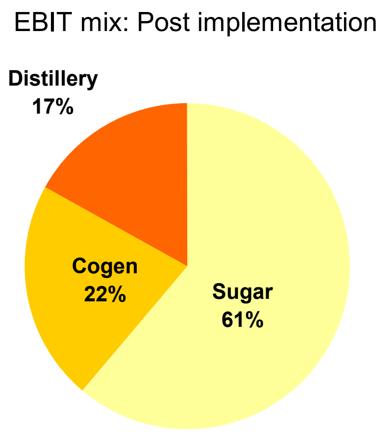
| | Capacity | | | | |
|---|---|---|---|---|---|
| | Units | Existing | Proposed | Incremental | Investment (Rs crores) |
| Sugar | TCD | 14,300 | 24,500 | 10,200 | 229 |
| Cogen | MW | 24.5 | 127 | 103 | 471 |
| Distillery | KLPD | 40 | 240 | 200 | 150 |
| Total | | | | | **850** |

In addition to the above, an investment in the sugar refinery project, amounting to Rs 73 crores and an investment in Parry Nutraceuticals, amounting to Rs 30 crores will make the total investments of the Company worth Rs 953 crores by 2008-09. The Company's debt-equity ratio would be:

| | 2005-06 (actual) | 2006-07 (Est.) | 2007-08 (Est.) | 2008-09 (Est.) |
|---|---|---|---|---|
| Debt-equity ratio | 0.35 | 0.70 | 0.74 | 0.57 |

With this expansion plan, the Company intends to prevent the business from seasonal vagaries that are related to a typical sugar business. The EBIT mix of the Company will be as under:




Thus, from a concentrated model, the Company will now have a *de-risked model* that will prevent itself from the cyclicality in the sugar business.

### Additional Benefits Estimated from Proposed Projects

Additionally, the Company also expects certain additional benefits to accrue from the expansion project. This includes interest savings of Rs 7 crore a year and total interest savings of Rs 50 crores, on account of financial assistance availed from the Sugar Development fund at some attractive terms. The Company is also estimated to earn Green credit, worth Rs 40 crores, till 2011-12 (Rs 8 crore a year), as Green credits are available for bagasse based cogeneration projects. Furthermore, the Company will have section 80 IA (Income Tax) benefits, which are estimated at Rs 180 crores (Rs 8 crore a year), in consequence of setting up infrastructure projects, as these projects enjoy tax holidays. In addition, earnings from cogeneration projects are eligible under this section. Thus, the total benefits that the Company would accrue, over a period of several years, are:

| | Rs crores |
|---|---|
| SDF Loan interest savings on borrowings (till 2018-19) | 50 |
| Green credit (till 2011-12) | 40 |
| 80IA benefit on Cogen profits (10 years) | 180 |
| **Total** | **270** |



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## Conclusion & Investment Argument

Sugar prices are expected to remain firm even in the current year, as supplies still lag behind the demand and this imbalance augurs well for the Company, as nearly 70% of sales is still contributed by this division. The Company has managed to lower its sensitivity to sugar prices by expanding its cogen and ethanol capacities, both of which will guarantee stable revenues even in a weak sugar scenario. However, the Company will be able to reap the benefits from the expansion plan over a period of 3-5 years. Also, the Company sees a lot of opportunities in raw sugar imports, processing it and exporting it to sugar deficit countries like Sri Lanka, Bangladesh, Indonesia and Malaysia, which it plans to exploit by setting up the JV with Cargill in Kakinada. At the current price, the stock is available at 22x its historic earnings of Rs 13 (standalone) and 15x its consolidated EPS of Rs 19. With strong growth visibility in the near future, a clear management outlook and execution capabilities in terms of future direction and strategy, and attractive consolidated valuations, one can consider investing in the stock with a medium to long-term outlook.

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