

## Industry Flash

19 December 2006 | 6 pages

# Indian Sugar

## Government Lifts Export Ban on Sugar

- Government lifts export ban, partially** — According to Bloomberg, the Indian government has allowed sugar companies that have imported sugar in earlier years under advanced licenses to export sugar. These companies are under a re-export obligation, which we estimate would be about 1m-1.5m tons.
- Implications for domestic industry** — Sugar prices in domestic market that have been coming off post the ban was effected are likely to stabilize to some extent. We expect North Indian realizations to stabilize around Rs17/kg.
- Global prices could weaken further** — Global white sugar prices that have corrected by about 35% over last few months could weaken further on expectation of new supply from India. A further global price correction is unlikely to deter exports from India, as those under the advanced licenses have a compulsory re-export obligation.
- UP cane price fixed** — Government of UP also recently fixed the cane price for the current season at Rs1250 per ton, Rs100 higher than last season. This is as per our expectations, and we do not expect Western UP based sugar companies to be impacted much, as they paid a similar price last year due to a perceived shortage of cane.
- Sugar stocks have under-performed** — BJH and BRCM have underperformed over the last few months and are down almost 40%-50%. At current valuations, the worst seems to be in the price.

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**Figure 1. Sugar Stocks Valuation Summary**

Company	RIC	P/E (x)		EV/EBITDA (x)		ROE (%)	Div. Yld. (%)
		FY07E	FY08E	FY07E	FY08E	FY07E	FY07E
Bajaj Hindustan	BJHN.BO	7.4	6.5	5.0	4.0	29.3%	1.0%
Balrampur Chini	BACH.BO	8.4	6.5	5.7	4.5	27.0%	4.5%

Source: Company Reports and CIR Estimates

See page 4 for Analyst Certification and important disclosures.

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<sup>1</sup>Citigroup Global Market India Private Limited

## **Bajaj Hindusthan (BJHN.BO - Rs225.95; 1M)**

### **Valuation**

Our target price of Rs467 is based on an FY07E P/E of 13x. We maintain our 15% premium to the global peer group, accounting for BJH's superior growth profile and given that demand for sugar in India is growing at 2x the global average. BJH looks set to emerge as a strong industry leader by 2008, with global-scale capacities, a strong balance sheet and a richer product mix. Further, we expect BJH to expand beyond its already stated expansion plans, and we do not rule out a sizeable international acquisition. With its leadership position likely to gain further strength and its capital-efficiency ratios high, we believe BJH should trade at a premium to the global average. We are using P/E as our primary valuation methodology given the strong visibility of earnings. We believe benchmarking BJH against its historical valuations is not relevant given that the stock has historically been illiquid. Over a cycle, a more liquid name such as Balrampur Chini has traded in a P/E range of 4-15x. Our 13x target multiple is at a discount to the historical peak cycle multiple of 15x, factoring in a weakening sugar price cycle. On an EV/EBITDA basis, we ascribe a target multiple of 7.0-7.5x, at par with the global peer group average on a one-year forward basis. This gives us a target price of Rs450.

### **Risks**

Although our quantitative risk-rating system assigns a High Risk to the stock, we rate it as Medium Risk given that the company has successfully completed its first phase of capacity expansion. The sugar industry in general and BHL in particular, faces significant risks, some of which are structural in nature. The key downside risks include: (1) regulations and the possibility of government intervention in an industry with little pricing power; (2) sugarcane output is governed by various agro-climatic factors; an adverse climate could lead to crop failures, affecting raw-material availability; and (3) specific to BJH is execution risk, as the company is aggressively expanding capacity. If the impact of these risks is greater than we expect, the share price will likely have difficulty reaching our target price.

## **Balrampur Chini Mills (BACH.BO - Rs82.30; 1M)**

### **Valuation**

Our Rs130 target price for Balrampur Chini (BRCM) is based on 12x FY07E P/E. We maintain our 10% discount to the market leader BJH. We are using P/E as our primary valuation methodology given BRCM's strong earnings visibility. Expected capacity expansion drives our earnings estimates for BRCM; we expect volume-driven earnings growth over the next three years. On a one-year forward EV/EBITDA basis, we ascribe BRCM a multiple of 6.5x-7.0x, in-line with the global peer group average of 7.0x-7.5x. This gives us a fair value range of Rs125, which supports our P/E-based target price. We are using EV/EBITDA as our second valuation methodology, given the commoditized nature of the sugar business and BRCM's large debt position (in order to fund growth).

### **Risks**

We rate BRCM Medium Risk given that the company has already successfully completed part of its capacity expansion and has recently raised capital for the remaining capital expenditure. We believe execution and financial risks stand mitigated to a large extent. The following risks could impede the stock from reaching our target price:

- 1) Regulations and the possibility of government intervention in pricing in an industry that has little pricing power.
- 2) Sugarcane output is governed by various agro-climatic factors. An adverse climate could lead to crop failures, affecting raw-material availability.
- 3) The company is aggressively expanding capacity and any delay could hurt its near-term profitability. BRCM is looking at investing in power generation, which is a highly regulated industry. Any changes in government regulations could hurt business prospects.

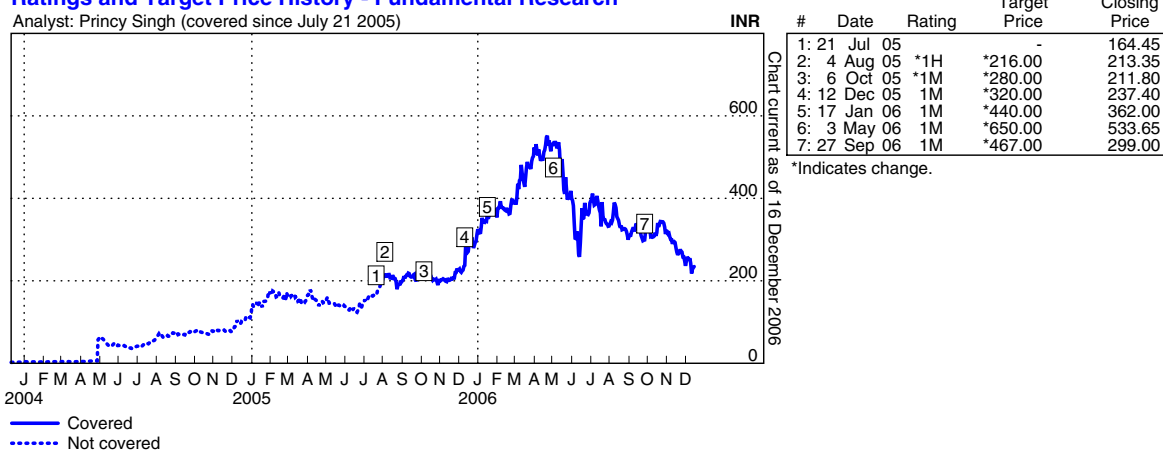
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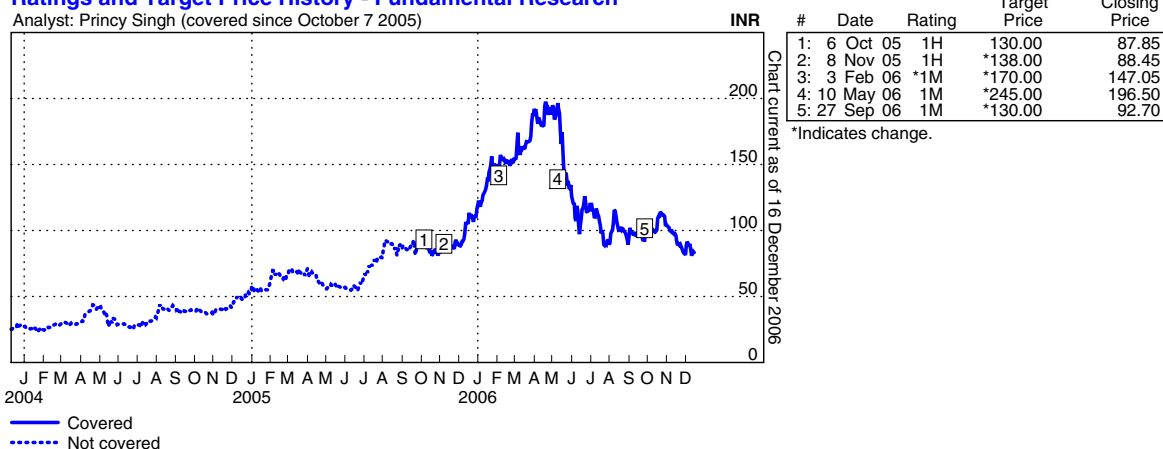
#### Bajaj Hindustan Ltd (BJHN.BO) Ratings and Target Price History - Fundamental Research

Analyst: Princy Singh (covered since July 21 2005)



#### Balrampur Chini Mills Ltd (BACH.BO) Ratings and Target Price History - Fundamental Research

Analyst: Princy Singh (covered since October 7 2005)



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