SUGAR – SWEETER THAN EVER BEFORE

24th July, 2009

Latest Sugar Up-Cycle :

- **Significantly lower production of 14.6mn tonnes(a 45% decline YoY) against a expected consumption of around 23 mn tonnes in the current sugar season 2008-09 drove the sugar prices substantially higher .**
- **Even highest ever imports of around 3 mn tonne and a significant increase in acreage for sugar-cane cultivation in FY2009-10E may not ease the tightness in demand-supply situation in sugar market, such is the intensity of the present upcycle.**
- **Farmers moving from sugar cane to more profitable crops like wheat, paddy resulted in a significant decrease of 17% in land under sugar cane cultivation. This is due to the high cane arrears in the down-cycle SS2006-08. The sugar cane thus produced is further directed towards more profitable alternate sweetners like gur, khandsari .This resulted in a YoY decline of 44% in the sugar-cane crushed in the current sugar season.**
- **But the domestic demand is intact and is expected to grow at a CAGR of 3.1% as against the deficit in supply which is expected to keep the prices higher atleast for the next two years.**

Global Sugar Scenario :

- **Even the global sugar scenario seems tight. The decline in production in India, Thailand, Bangladesh and Pakistan increased global demand for sugar which may sustain the international sugar prices at higher levels. Brazil which is already running at full capacity in sugar production is not expected to add more than an additional 4.5 mn tonne to the international markets which will hardly suffice the boiling sugar demand.**
- **A large chunk of cane is diverted to direct ethanol production which is used as a prominent fuel there. So new capacities in Brazil were designed to directly produce ethanol from cane. This will act as a constraint to brazil in ramping up it's sugar production to match the international sugar demand.**
- **The above facts about the international sugar scenario indicates that even a duty free import of sugar that Indian government presently is allowing may not prevent the surge in the commodity's price as the international prices themselves are hovering at higher levels.**

Positives for the Domestic Sugar Players :

- **Rapid capacity expansion in the Indian sugar industry has occured during the last down-cycle which added to the woes of the sugar industry. So going forward no further cap-ex is expected, atleast in the recent future. That would ensure free cash flows for the companies operating in the sugar space thus strengthening their balance sheets.**
- **The by-product integration programmes like building up alchohol, ethanol and power generation capacities undertaken by the sugar companies would limit the downside risk for these companies over the future down cycles.**
- **Recently the Indian government has increased the Minimum support price (MSP) for cane from Rs.81 to Rs.107.76/quintal for 2009-10 sugar season which the mills have to pay to the farmers. All the mills are supposed to sell 10% of sugar produced to government at subsidized prices (levy price) based on the MSP. So, as the MSP rises this levy price will also be raised. This would benefit UP**

based sugar mills as they are already paying cane prices at around Rs.150 quintal considerably higher than the MSP and an increase in levy price would add to their bottom line.

- The recoveries from cane in the present sugar season are pretty lower at 9% for the UP based mills and going forward, the recoveries are expected to improve on the back of improved monsoon and good weather conditions which would improve the profitability of the sugar mills.

Mn tonnes	SS 2003-04	SS 2004-05	SS 2005-06	SS 2006-07	SS 2007-08	SS 2008-09E	SS 2009-10E
Opening Inventory	12.5	8.5	4.8	3.7	9.9	9.8	3.6
Sugar Production	13.5	12.7	19.3	28.3	26.3	14.6	19
Imports	0.4	2.1	0	0	0	2.2	3
Total availability	**26.4**	**23.3**	**24.1**	**32**	**36.2**	**26.6**	**25.6**
Consumption	17.7	18.5	19.3	20.4	21.4	23	23.2
Exports	0.2	0	1.1	1.7	5	0	0
Total offtake	17.9	18.5	20.4	22.1	26.4	23	23.2
Year end closing stock	8.5	4.8	3.7	9.9	9.8	**3.6**	**2.4**
No of months the stock can manage demand	5.70	3.11	2.18	5.38	4.45	**1.88**	**1.24**

**SS refers to sugar season from oct 1st to sep 30th .

As shown in the above table, the closing inventory of SS2009-10 would be 2.4 mn tonnes which equals 1.24 months of consumption. This is historically the lowest closing inventory in terms of consumption despite a 3mn tonne import of sugar in the same season, which is one of the highest imports of sugar. With sugar inventory reaching such low levels by SS2009-10, the cycle is expected to last for atleast two years and the sugar prices are expected to sustain at higher levels for the same time period. Even though the sugar-cane (raw material) prices may rise over the next two years, the expected high rise in retail sugar prices would ensure rich operating profit margins for the sugar companies.

Company Name	Price	B.V Rs	PE	*TTM EPS	P/BV	Mkt Cap	52 W - H	52 W – L
Sh.Renuka Sugar	147.2	22.9	58.4	2.5	6.4	4121.6	153.0	41.0
Bajaj Hindusthan	165.0	95.1	-	0.0	1.7	2333.1	234.0	38.0
Balrampur Chini	**106.9**	**40.1**	**18.2**	**5.9**	**2.7**	**2731.3**	**115.0**	**30.0**
Triven.Engg.Ind.	101.5	29.7	23.2	4.4	3.4	2616.4	122.0	30.0
EID Parry	278.1	111.9	22.2	12.5	2.5	2394.4	289.0	124.0
Bannari Amm.Sug.	1008.0	484.4	9.6	104.7	2.1	1153.1	1200.0	370.0
Dhampur Sugar	59.4	83.0	9.3	6.4	0.7	313.0	77.0	20.0

**TTM refers to trailing twelve months. Price is the closing price on July 20,2009.

Among the sugar pack , we are bullish on UP based mills considering their leverage to sugar prices. Balrampur Chini (PE=18.2 and P/BV=2.7) is our top pick among the sugar pack as it is the best integrated player and with a debt equity ratio of 1.39, it proves to be a safer bet compared to it's peers. Also it's presence in eastern UP gives it the advantage of higher recovery and lower competition from alternate sweeteners like Gur, Khandsari. Bajaj Hindusthan (P/BV=1.7) being the largest cane sugar manufacturer in Asia also looks good but it's high debt component is the only cause of concern. Triveni engg (PE= 23.2 and P/BV=3.4) can also be considered in case we intend to diversify our investment in the sugar space.

BALRAMPUR CHINI MILLS-The Sweetest

CMP : Rs.106.55 **Target :Rs.140**

Rating : BUY **Duration : 8-10 months**

- **Balrampur Chini is the second largest sugar player in India with it's crushing capacity increased 2.6 times to 76500 TCD and with a distillation capacity of 320kl/day and co-generation power capacity of 126 mw.**
- **Based in UP, it's leverage to sugar prices i.e, it's EPS accretion to rise in sugar prices in retail market is very high. Every 1% increase in sugar prices may move the EPS by 3%, also factoring imminent rise in raw-material prices.**
- **It's debt to equity ratio of 1.39 of SS2007-08 is quite lower comparatively and makes Balrampur financially healthier compared to other larger sugar players. As it's capacities were more than doubled in the last down cycle, no further capex is planned for the future sugar seasons. This would lower the interest burden and improve the free cash flows for the company going forward.**
- **Balrampur Chini is the best integrated player in the Indian sugar industry with it's distillation capacity and co-generation power capacities perfectly poised to support the company during the down-cycle. It's power producing capacities from bagasse would act as a hedge when cane availability increases significantly and sugar prices fall in the upcoming down cycles.**
- **Balrampur has recently sold it's power at Rs.4/unit to the UP govt for the peak 3 months in SS2008-09 and revision of power tariffs further is expected. So, incremental revenues from it's by-product facilities would add more value to the company's topline.**
- **As Balrampur Chini's presence is more in eastern UP, it can gain on the higher recovery rates from cane compared to mills located in other parts of UP.**

In Rs.mn	SS 200809	SS200909	SS201009	SS2010-11
Net Sales	1463.5	1646.0	1956.0	2119.3
% increase in sales	5.2%	12.5%	18.8%	8.4%
EBITDA	327.4	467.5	571.2	597.6
EBITDA Margins	22.4%	28.4%	29.2%	28.2%
Change in EBITDA	271.4%	42.8%	22.2%	4.6%
PAT	97.0	212.4	296.9	324.5
Change in PAT	-331.9%	118.9%	39.8%	9.3%
EPS (Unit Curr.)	3.8	8.0	11.2	12.2
P/E ratio		13.3	9.5	8.7

**SS refers to sugar season from oct 1st to sep 30th

24th July, 2009

Stock Information:

Market Capitalisation	Rs.2723.6 cr
Book value per share	Rs.40.1
Latest Equity	Rs.25.6 cr
52 Week high/Low	Rs.115/29.7
Current Market Price	Rs.106.6

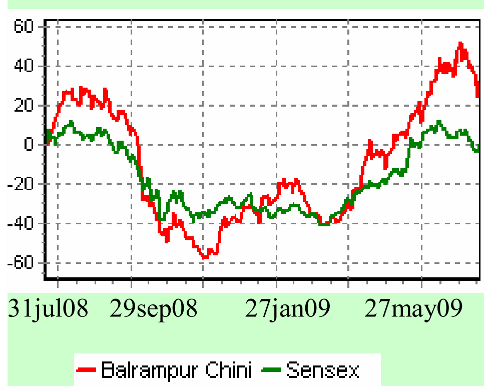
Stock Performance:

	1M	**6M**	**12M**
Returns	4.8%	108.8%	43.9%

Share Holding Pattern:

Foreign	17.08%
Institutions	26.3%
Govt Holding	0%
Non Promoter Corp	3.68%
Promoters	36.85%
Public & others	16.1%
Totals	100%

Price Performance :



Company details :

Balrampur Chini Mills Ltd is one of the largest integrated sugar manufacturing companies in India . Its allied business consists of manufacturing and marketing of Ethyl Alcohol & Ethanol, generation and selling of power and manufacturing and marketing of organic manure. Company has nine sugar factories located in Eastern U.P having an aggregate crushing capacity of 73,500 tons per day. BCML has taken over the management of Indo Gulf Industries Ltd (IGIL) which has since then become the subsidiary of the company. IGIL has a sugar cane crushing capacity of 3000 TCD and it is located at Maizapur.

The historic segment wise contribution to the revenues is detailed below :

in Rs.mn	SS 2007-08	% Contribution	SS 2006-07	% contribution	SS 2005-06	% contribution	SS 2004-05	% contribution
Sugar	11480.6	77	11267.6	80.7	17542.6	88.2	6564.5	80.4
Alchohol	1675	11.2	1223.7	8.8	1341.5	6.7	1101.8	13.5
Power	1739.4	11.7	1449.1	10.4	1002.4	5	480.2	5.9
Others	14.4	0.1	7.7	0.1	11.5	0.1	16.6	0.2
Total	14909.4		13948.1		19898		8163	

**SS 2005-06 values are calculated for 18 months (march 2005- sep 2006) and therefore not comparable.

Valuation view :

- **The sugar stocks especially Balrampur Chini has outperformed the market in the past few months and the prices stood firm even in the recent short term market-fall. At the present price of Rs.106.6, the stock trades at 9.5 X SS2009-10 EPS and 8.7 X SS2010-11 EPS, which makes it attractive enough for us to go long . Even it's debt/equity ratio of 1.39 makes it a safe bet among the sugar pack.**
- **We valued Balrampur Chini at an EV/EBITDA multiple of 7.2 X SS2010-11 EBITDA. Therefore, we arrived at a target of Rs.140, an upside of 30% for balrampur chini within a period of 8-10 months. (The EV/EBITDA multiple is taken at a discount to the EV/EBITDA multiple Balrampur traded in the last upcycle i.e, SS2004-05).**
- **As the present up cycle in India is going to last for the next two years. The closing stock at the end of SS2010-11 is expected to be 2.4 mn tonnes that can sustain demand only for 1.2 months which is historically the lowest. This indicates the tightness of the present up cycle and ensures a high retail sugar price for the next two years.**
- **This sugar up-cycle would significantly increase the operating profit margins for the sugar players and especially Balrampur chini.**

Projected Income statement :

In Rs.crs	FY 200503	SS 2005-06	SS 2006-07	SS 2007-08	SS 2008-09E	SS 2009-10E	SS 2010-11E
Net Sales	812.7	1898.4	1391.7	1463.5	1646.0	1956.0	2119.3
% increase in sales	**16.2%**	**133.6%**	**-26.7%**	**5.2%**	**12.5%**	**18.8%**	**8.4%**
Other Income	2.9	6.8	11.1	2.1	3.0	3.0	3.0
Total Income	815.7	1905.2	1402.9	1477.7	1649.0	1959.0	2122.3
Total Expenditure	595.6	1438.8	1303.6	1148.2	1181.5	1387.8	1521.7
PBIDT	220.1	466.5	99.3	329.5	470.5	574.2	600.6
EBITDA	217.2	459.7	88.2	327.4	467.5	571.2	597.6
EBITDA Margins	**26.7%**	**24.2%**	**6.3%**	**22.4%**	**28.4%**	**29.2%**	**28.2%**
Change in EBITDA	**76.0%**	**111.7%**	**-80.8%**	**271.4%**	**42.8%**	**22.2%**	**4.6%**
Interest	18.9	34.5	54.4	89.7	95.0	90.0	80.0
Depreciation	37.3	67.1	80.2	117.2	110.0	113.0	115.0
PBT	163.9	364.9	-35.4	122.6	265.5	371.2	405.6
Tax	38.9	73.3	6.5	25.6	53.1	74.2	81.1
Reported Profit After Tax	125.1	291.6	-41.8	97.0	212.4	296.9	324.5
Change in PAT	**106.7%**	**133.2%**	**-114.3%**	**-331.9%**	**118.9%**	**39.8%**	**9.3%**
Equity	23.2	24.8	24.8	25.6	26.6	26.6	26.6
EPS (Unit Curr.)	6.2	12.2	0.0	3.8	8.0	11.2	12.2
P/E ratio					**13.3**	**9.5**	**8.7**

**** SS refers to sugar season from October 1st to September 30th . FY refers to financial yr from April to march. SS 2005-06 values are for 18 months, so not comparable**

Downside Risks :

- **Sharper than expected increase in acreage under cultivation of sugarcane in SS2009-10 and SS2010-11.**
- **A steep decline in international prices making it cheaper for the government to import historically highest ever quantities.**
- **If sugar-cane prices are hiked beyond expected, the profitability of the companies may get affected.**