

# Ethanol JV with HPCL +Ve


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## New distillery joint venture MOU with HPCL signed

Renuka Sugar has signed MOU with HPCL for formation of joint venture company that will set up an integrated sugar plant with associated facilities for production of ethanol in the state of Maharashtra. We understand that this is part of the company's 450KLPD new distillery project and may come up in FY10.

## Hosts of advantages from the proposed JV

In our opinion, the proposed expansion through JV addresses the key issues of 1) marketing of ethanol as HPCL could use up the entire output for 10% blending with the 55mnltr of petrol it process at it Mumbai based refinery and 2) it will also help reduce purchase of molasses and substitute with sugarcane which is cheaper. The integrated plant could have EBITDA margin of 25% at current ethanol price of Rs21.5/ltr, which is at 40% discount to current petrol price.

## Renuka to take advantage of thrust on bio fuel

We believe Renuka is better placed now to take advantage of the proposed biofuel policy of India which got cabinet approval on 11<sup>th</sup> Sep 08. The new biofuel policy envisages biofuel including ethanol to contribute to 20% of petrol/diesel demand of India by 2017 compared to less than 5% now. This is because the new JV is likely to convert most part of sugarcane to produce ethanol.

## Maintain Buy on Renuka with a PO of Rs162

Renuka is currently trading at a PE of 11.4x FY09E EPS of Rs10.3 per share. The company is likely to double its earnings in FY09, largely driven by an expected doubling of ethanol and sugar production and an estimated 40% increase in power production. The new JV should increase FY10 earnings visibility and could have more meaningful contribution from FY11 onwards. We believe the stock is currently attractively valued given its strong growth prospects.

## Stock Data

Price	Rs117.15
Price Objective	Rs162.00
Date Established	15-Jul-2008
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs52.74-Rs142.40
Mrkt Val / Shares Out (mn)	US\$720 / 280.0
Average Daily Volume	8,377,883
ML Symbol / Exchange	SRNKF / BSE
Bloomberg / Reuters	SHRS IN / SRES.BO
ROE (2008E)	28.8%
Net Dbt to Eqty (Sep-2007A)	183.6%
Est. 5-Yr EPS / DPS Growth	40.0% / 55.0%
Free Float	59.6%



## Estimates (Sep)

(Rs)	2006A	2007A	2008E	2009E	2010E
Net Income (Adjusted - mn)	563	544	1,456	3,099	5,121
EPS	2.36	2.19	4.55	10.33	17.07
EPS Change (YoY)	16.0%	-7.3%	107.6%	127.0%	65.3%
Dividend / Share	0.228	0.258	0.250	0.500	0.500
Free Cash Flow / Share	(13.65)	(9.66)	(13.21)	(6.45)	6.45

## Valuation (Sep)

	2006A	2007A	2008E	2009E	2010E
P/E	49.57x	53.44x	25.74x	11.34x	6.86x
Dividend Yield	0.195%	0.221%	0.213%	0.427%	0.427%
EV / EBITDA*	41.96x	38.94x	14.98x	7.89x	5.21x
Free Cash Flow Yield*	-9.91%	-7.31%	-11.27%	-5.90%	5.90%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 4.

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Refer to important disclosures on page 5 to 6. Analyst Certification on Page 3. Price Objective Basis/Risk on page 3.

# *iQprofile*<sup>SM</sup> Shree Renuka Sugars Ltd.

## Key Income Statement Data (Sep)

(Rs Millions)	2006A	2007A	2008E	2009E	2010E
Sales	8,016	7,324	12,919	25,918	37,871
Gross Profit	2,019	2,240	3,749	7,780	11,391
Sell General & Admin Expense	(122)	(238)	(407)	(502)	(697)
Operating Profit	883	797	2,255	4,628	7,198
Net Interest & Other Income	(138)	(18)	(435)	(440)	(370)
Associates	0	0	0	0	0
Pretax Income	746	779	1,820	4,188	6,828
Tax (expense) / Benefit	(183)	(236)	(546)	(1,089)	(1,707)
Net Income (Adjusted)	563	544	1,456	3,099	5,121
Average Fully Diluted Shares Outstanding	238	248	280	300	300

## Key Cash Flow Statement Data

Net Income (Reported)	563	544	1,274	3,099	5,121
Depreciation & Amortization	88	249	465	536	623
Change in Working Capital	(1,457)	(600)	(2,436)	(1,571)	(1,810)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	1,020	853	0	0	0
Cash Flow from Operations	213	1,046	(697)	2,064	3,934
Capital Expenditure	(3,463)	(3,443)	(3,000)	(4,000)	(2,000)
(Acquisition) / Disposal of Investments	0	0	0	0	0
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(3,463)	(3,443)	(3,000)	(4,000)	(2,000)
Shares Issue / (Repurchase)	0	0	2,203	2,239	0
Cost of Dividends Paid	(54)	(64)	(82)	(176)	(176)
Cash Flow from Financing	(54)	(64)	2,121	2,063	(176)
Free Cash Flow	(3,250)	(2,397)	(3,697)	(1,936)	1,934
Net Debt	3,540	6,163	7,750	7,750	5,750
Change in Net Debt	NA	NA	NA	NA	NA

## Key Balance Sheet Data

Property, Plant & Equipment	4,506	7,700	10,235	13,700	15,077
Other Non-Current Assets	81	189	200	327	85
Trade Receivables	539	387	708	1,420	2,075
Cash & Equivalents	172	307	250	250	250
Other Current Assets	1,929	2,659	5,686	8,681	11,801
Total Assets	7,228	11,241	17,078	24,377	29,288
Long-Term Debt	3,711	6,470	8,000	8,000	6,000
Other Non-Current Liabilities	57	202	202	202	202
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	1,235	1,212	2,124	4,260	6,225
Total Liabilities	5,003	7,884	10,326	12,462	12,427
Total Equity	2,224	3,357	6,753	11,915	16,861
Total Equity & Liabilities	7,228	11,241	17,078	24,377	29,288

## *iQmethod*<sup>SM</sup> - Bus Performance\*

Return On Capital Employed	17.7%	6.9%	12.6%	19.5%	25.0%
Return On Equity	39.3%	19.5%	28.8%	33.2%	35.6%
Operating Margin	11.0%	10.9%	17.5%	17.9%	19.0%
EBITDA Margin	12.1%	14.3%	21.1%	19.9%	20.7%

## *iQmethod*<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	0.4x	1.9x	-0.5x	0.7x	0.8x
Asset Replacement Ratio	39.4x	13.8x	6.5x	7.5x	3.2x
Tax Rate (Reported)	24.5%	30.2%	30.0%	26.0%	25.0%
Net Debt-to-Equity Ratio	159.1%	183.6%	114.8%	65.0%	34.1%
Interest Cover	4.7x	6.0x	4.1x	8.3x	14.4x

## Key Metrics

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 4.

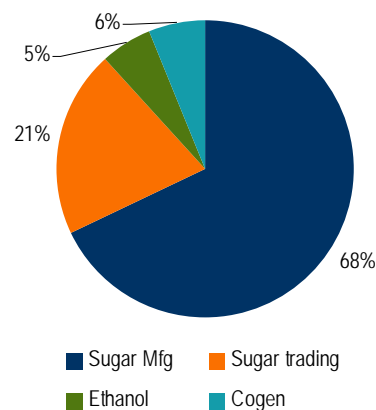
## Company Description

Renuka Sugar is the fifth largest sugar manufacturer and largest trader of sugar of India. It has manufacturing base in Maharashtra and Karnataka, close to western coast of India. The company is also the largest manufacturer of ethanol blended with gasoline in India. Renuka has expanded its presence in recent times into setting up of ethanol plant with the acquisition of KBK Engineering.

## Investment Thesis

We believe Renuka Sugar, as a leading producer of ethanol, is an attractive play on rising demand for ethanol in India driven by government initiatives to promote biofuel. The company is also likely to benefit from higher capacity utilisation at a time of rising profitability. This has been prompted by adequate availability of sugarcane as a result of sharing business upside with farmers.

Chart 1: Renuka FY07 revenue mix



Source: Company

## Stock Data

Price to Book Value 4.9x

## Price objective basis & risk

### Renuka Sugars (SRNKF)

Our PO for Renuka at Rs162/sh is based on the sum of the value of its sugar business at Rs150/sh and its engineering business at Rs12/sh. Renuka is currently trading at a discount to the sector average. We are valuing Renuka's sugar business at a 14.4x FY09E PE, i.e. a 10% premium to the sector average. We expect Renuka to have higher ROE than the sector average driven by lower cane costs due to its presence in Maharashtra and Karnataka and higher capacity utilization due to its refinery capacity. We have captured the value of Renuka's 67% stake in KBK Engineering, an engineering company specializing in distillery construction, by adding its value to the sugar business. We have valued KBK at a PE of 16.3x, similar to the average PE of comparable mid cap engineering companies. Key risks are a lower than estimated price for sugar and higher than estimated cost of sugarcane. Also delays in the commissioning of new facilities could hurt. By our calculation, the company's FY09 EPS would be 19% lower than estimated if sugar price realization is 10% lower than we currently expect.

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	APIL	ANSFF	APIL IN	Amit Agarwal
	Bharati Shipyard	BSYDF	BHSL IN	Sanjaya Satapathy
	DLF Limited	XVDUF	DLFU IN	Amit Agarwal
	Exide Indus Ltd	XEDRF	CHLR IN	Sanjaya Satapathy
	HDIL	XGHSF	HDIL IN	Amit Agarwal
	Motherson Sumi	XMSUF	MSS IN	Sanjaya Satapathy
	Puravankara Projects Ltd	XPJVF	PVKP IN	Amit Agarwal
	Renuka Sugars	SRNKF	SHRS IN	Sanjaya Satapathy
	Triveni Engg	TVIEF	TRE IN	Sanjaya Satapathy
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	Unitech Ltd	UTKIF	UT IN	Amit Agarwal
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	Ambuja Cem-GDR	XAAJF	ABUJ LI	Reena Verma Bhasin, CFA
	Assoc. Cement	ADCLF	ACC IN	Reena Verma Bhasin, CFA
	Bajaj Hindusthan	BJJHF	BJH IN	Sanjaya Satapathy
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	Indiabulls Real	IBELF	IBREL IN	Amit Agarwal

**iQmethod<sup>SM</sup> Measures Definitions**

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
	Amortization	Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Sales	
	Other LT Liabilities	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

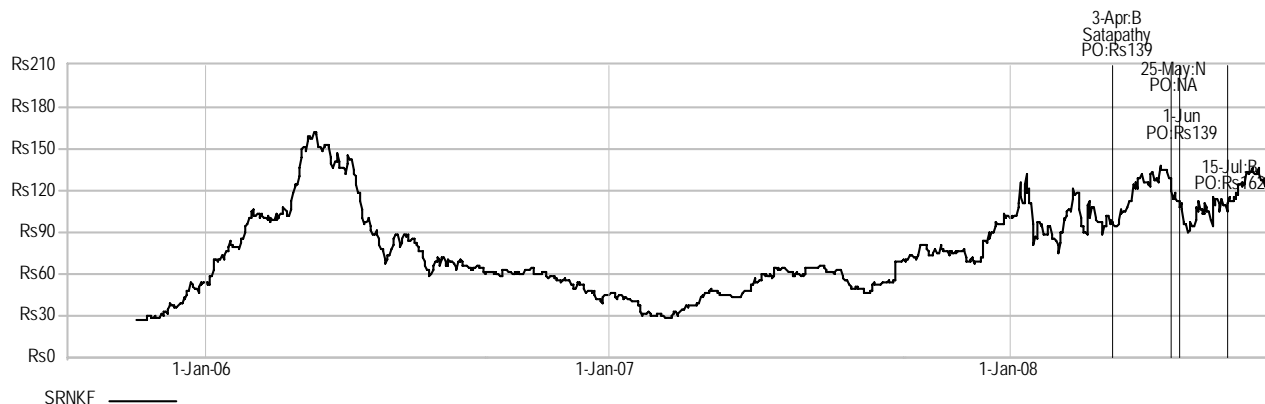
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B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of August 31, 2008 or such later date as indicated.

### Investment Rating Distribution: Food Group (as of 01 Jul 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	39	52.00%	Buy	7	21.21%
Neutral	16	21.33%	Neutral	2	15.38%
Sell	20	26.67%	Sell	2	10.53%

### Investment Rating Distribution: Global Group (as of 01 Jul 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1664	47.42%	Buy	441	29.46%
Neutral	803	22.88%	Neutral	224	31.46%
Sell	1042	29.70%	Sell	217	22.84%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
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Neutral	≥ 0%	≤ 30%
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