

PRAJ INDUSTRIES

INR 470

Equinox

REDUCE



Praj's Q4FY07 results were in line with our expectations in terms of revenue growth and marginally above our expectations in terms of net profit. Revenues, at ~INR 2 bn, were up ~111% Y-o-Y, while overall FY07 revenues grew ~121% Y-o-Y, to ~INR 6 bn. The Q4FY07 EBITDA grew ~116% Y-o-Y to INR 276 mn; it grew ~227% Y-o-Y, to ~INR 1 bn, on an annual basis. Net profit, at INR 270 mn, was up ~158% Y-o-Y in Q4FY07, while for FY07 it grew ~272% Y-o-Y to 865 mn.

EBITDA margin was at 17.3% in FY07, up 558bps Y-o-Y, driven by exceptionally strong margins of 24.5% in Q2FY07. Road to improvement in EBITDA margin was not smooth with significant volatility in the second half of FY07. EBITDA margins were up by 40bps Y-o-Y to 13.7% in the quarter. However, on a sequential basis, EBITDA margin was down by 1078bps. The other income component in the quarter grew significantly by ~161% Y-o-Y to INR 50 mn, driving net margin ahead of our expectation to 13.4% for the quarter. Net margin was at 14.2%, up 556bps Y-o-Y for FY07. We expect stable EBITDA margins going forward but expect net level profitability to be softer.

* Buoyancy in numbers to continue

We expect the current buoyancy in numbers to continue on back of ramp up in the US corn ethanol capacity and greater acceptance of ethanol as a blending additive and fuel globally, driving demand. Additionally, Praj announced its venture into the European and Brazilian geographies through JV and acquisition routes respectively and is also foraying to address the bio-diesel market demand and provide machinery for bio-diesel plants. We see these near-term forays as adding more margin of comfort to growth.

* Outlook and Valuations

We expect Praj's revenues and EBITDA to grow at ~53% and ~55% CAGR, respectively, for the FY07-FY09E period. We believe that the strong growth in the revenues is likely to be driven by increase in penetration in the already expanding corn ethanol market in the US and additional geographies of Europe, and Brazil. However, we believe, the current valuations capture the improved business outlook and strong growth scenario, leaving little room for any upside. On our current EPS estimates of INR 15.3 and INR 21.9 for FY08E and FY09E, the stock trades at 30.7x and 21.5x FY08E and FY09E earnings, respectively. At current price of INR 470, the implied terminal growth rate is ~14.4%, implying ~97% of the total equity value in the terminal value. In the backdrop of stronger than expected growth seen, we upgrade our recommendation to 'REDUCE' from 'SELL', and expect investors to trim exposures to the positive stock price action.

Financials

Year to September	Q4FY07	Q4FY06	% change	Q3FY07	% change	FY07UA	FY08E
Revenues (INR mn)	2,015	955	110.9	1,779	13.3	6,075	10,037
EBITDA (INR mn)	276	127	116.2	435	(36.6)	1,048	1,757
Net profit (INR mn)	270	104	158.4	336	(19.8)	865	1,285
EPS (INR)	3.2	1.3	149.8	4.0	(19.9)	10.3	15.3
PE (x)						45.5	30.7
EV/EBITDA (x)						37.2	21.9
ROAE (%)						114.6	96.8

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Market Data

52-week range (INR) : 481.6 / 123.9
Share in issue (mn) : 83.7
M cap (INR bn/USD mn) : 39.3 / 942.9
Avg. Daily Vol. BSE ('000) : 1,315.2

Share Holding Pattern (%)

Promoters : 30.2
MFs, Fls & Banks : 8.4
Fls : 8.8
Others : 52.6

* Financials

Driven by near term triggers, inorganic growth strategies, orders wins, and increasing penetration in the US geography, we are revising our estimates upwards for FY08E and FY09E. Key changes are listed in the table below:

Table 1: Revised estimates

	Previous estimates		Revised estimates		Remarks
	FY08E	FY09E	FY08E	FY09E	
Revenues (INR mn)	8,352	10,951	10,037	14,255	Upgrading revenues on back of increase in ethanol capacity uptake in the US, consequently resulting in higher order intake. Additional growth coming from inorganic forays.
EBITDA (INR mn)	1,382	1,808	1,757	2,506	Higher margins as engineering part of the project increases
EBITDA margin (%)	16.5	16.5	17.5	17.6	
PAT (INR mn)	1,040	1,385	1,285	1,835	
Net margin (%)	12.5	12.6	12.8	12.9	
EPS (INR)	12.4	16.5	15.3	21.9	

Source: Edelweiss research

* Valuations

We believe the current valuations capture the improved business outlook and strong growth scenario, and leave little room for upside.

As per our DCF valuation methodology, the implied terminal growth at current prices is ~14.4%. We believe that for the market opportunity that Praj is addressing, a 12% terminal growth rate is optimum which yields a fair value of INR 180 per share. The key features of our DCF (WACC: 15.8%) valuation assumptions are illustrated below:

Table 2: DCF valuation

NPV of cash flows	1,001	1,001	1,001
Terminal growth (%)	10.0	12.0	14.4
Implied Exit FCF multiple (X)	17.3	26.5	73.5
PV of terminal value	8,485	13,210	37,502
Enterprise value	9,487	14,212	38,503
Terminal value as % of EV	89.4	93.0	97.4
Net debt	903	903	903
Equity value	10,390	15,115	39,406
Number of shares	84	84	84
Equity value/share (Rs)	124	180	470

Source: Edelweiss research

In the backdrop of strong growth, we upgrade our recommendation to 'REDUCE' from 'SELL' and expect investors to trim exposures in the context of positive stock price movement.

Financials snapshot									(INR mn)
Year to March	Q4FY07	Q4FY06	% change	Q3FY07	% change	FY06	FY07UA	% change	FY08E
Revenues (net)	2,015	955	110.9	1,779	13.3	2,744	6,075	121.4	10,037
Raw material	1,544	699	121.1	1,184	30.4	2,059	4,399	113.6	7,358
Staff cost	91	71	28.4	80	13.8	181	286	58.2	250
Other operating expenses	104	59	76.7	80	30.5	184	341	85.9	672
Total expenditure	1,739	828	110.0	1,344	29.4	2,424	5,026	107.4	8,280
EBITDA	276	127	116.2	435	(36.6)	320	1,048	227.2	1,757
Depreciation	6	8	(25.2)	7	(24.0)	27	32	17.4	91
EBIT	270	120	125.1	428	(36.9)	294	1,017	246.4	1,666
Interest	1	1	(28.2)	0	277.8	5	3	(52.6)	2
Other income	51	19	160.5	20	148.2	25	89	259.4	30
Extraordinary items	-	-	NM	-	NM	-	-	NM	-
PBT	320	138	131.0	448	(28.6)	313	1,104	252.5	1,694
Tax	50	34	47.0	111	(55.1)	80	238	196.2	409
Adjusted net profit	270	104	158.4	336	(19.8)	233	865	272.0	1,285
Reported net profit	270	104	158.4	336	(19.8)	233	865	272.0	1,285
Equity capital(FV:INR 2)	168	162	3.4	168	0.1	162	168	3.4	168
# of shares (mn)	84	81	3.4	84	0.1	81	84	3.4	84
EPS (INR) (adj for split)	3.2	1.3	149.8	4.0	(19.9)	2.9	10.3	259.7	15.3
Market cap. (INR mn)						39,395	39,395		39,395
PE (x)						163.8	45.5		30.7
EV/EBITDA (x)						120.8	37.2		21.9
Market cap / Revenues (x)						14.4	6.5		3.9
as % of net revenues									
Raw material	76.7	73.1	4.9	66.6	15.1	75.0	72.4	(3.5)	73.3
Staff costs	4.5	7.4	(39.1)	4.5	0.5	6.6	4.7	(28.5)	3.4
Other operating expenses	5.2	6.2	(16.2)	4.5	15.2	6.7	5.6	(16.0)	6.7
EBITDA	13.7	13.3	2.5	24.5	(44.1)	11.7	17.3	47.8	17.5
Adjusted net profit	13.4	10.9	22.5	18.9	(29.2)	8.5	14.2	68.1	12.8
Tax rate	15.6	24.6	(36.4)	24.9	(37.1)	25.7	21.6	(16.0)	24.1

Financial Statements

Income statement					(INR mn)
Year to March	FY05	FY06	FY07UA	FY08E	FY09E
Income from operations	2,421	2,744	6,075	10,037	14,255
Direct costs	1,874	2,059	4,399	7,358	10,470
Employee costs	129	181	286	250	322
Other expenses	155	184	341	672	957
Total operating expenses	2,158	2,424	5,026	8,280	11,749
EBITDA	263	320	1,048	1,757	2,506
Depreciation and amortisation	20	27	32	91	146
EBIT	243	294	1,017	1,666	2,360
Interest expenses	2	5	3	2	-
Other income	33	25	89	30	59
Profit before tax	275	313	1,104	1,694	2,419
Provision for tax	62	80	238	409	583
Extraordinary items	-	-	-	-	-
Reported profit	213	233	865	1,285	1,835
Adjusted net profit	213	233	865	1,285	1,835
Shares outstanding	81	81	84	84	84
Dividend per share	1.1	1.3	3.7	6.2	8.8
Dividend payout (%)	41.1	43.9	35.9	40.3	40.2

Common size metrics- as % of net revenues

Year to March	FY05	FY06	FY07UA	FY08E	FY09E
Operating expenses	89.1	88.3	82.7	82.5	82.4
Depreciation	0.8	1.0	0.5	0.9	1.0
Interest expenditure	0.1	0.2	0.0	0.0	0.0
EBITDA margins	10.9	11.7	17.3	17.5	17.6
Net profit margins (adjusted)	8.8	8.5	14.2	12.8	12.9

Growth metrics (%)

Year to March	FY05	FY06	FY07UA	FY08E	FY09E
Revenues	110.8	13.4	121.4	65.2	42.0
EBITDA	152.1	21.9	227.2	67.6	42.6
PBT	168.3	14.0	252.5	53.5	42.8
Net profit	180.0	9.2	272.0	48.5	42.8
EPS	180.0	9.2	259.7	48.5	42.8

Cash flow statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net profit	213	233	865	1,285	1,835
Add: Depreciation	20	27	32	91	146
Add: E.O.adjustments	-	-	-	-	-
Add: Deferred tax	1	6	-	-	-
Gross cash flow	234	265	897	1,377	1,982
Less: Dividends	100	117	350	583	831
Less: Changes in W. C.	(111)	(341)	4	6	(173)
Operating cash flow	245	490	544	788	1,324
Less: Change in investments	268	-	-	-	-
Less: Capex	63	91	750	307	732
Free cash flow	(86)	399	(206)	480	592

Balance sheet					(INR mn)
As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Equity capital	81	162	168	168	168
Reserves & surplus	340	376	803	1,516	2,531
Shareholders funds	421	538	971	1,684	2,699
Secured loans	-	-	-	-	-
Unsecured loans	-	5	-	-	-
Borrowings	-	5	-	-	-
Sources of funds	421	544	971	1,684	2,699
Gross block	303	403	1,174	1,461	2,192
Accumulated depreciation	94	121	179	271	417
Net block	208	283	995	1,190	1,776
Capital work in progress	4	20	0	0	0
Total fixed assets	212	303	995	1,190	1,776
Investments	103.4	371	371	371	371
Inventories	300	204	448	819	1,166
Sundry debtors	246	418	975	1,638	2,331
Cash and equivalents	209	321	21	532	1,135
Loans and advances	114	136	400	683	971
Other current assets	59	109	240	410	583
Total current assets	928	1,188	2,084	4,081	6,186
Sundry creditors and others	729	1,161	2,158	3,413	4,857
Provisions	69	124	320	546	777
Total CL & provisions	798	1,286	2,478	3,959	5,634
Net current assets	130	(98)	(395)	122	552
Add / (Less): Def. tax asset/ liability	(24)	(30)	0	0	0
Others	0	(2)	0	0	0
Uses of funds	421	544	971	1,684	2,699
Book value per share (BV)	5	7	12	20	32

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROAE (%)	58.5	48.5	114.6	96.8	83.8
ROACE (%)	62.7	60.8	134.2	125.5	107.7
Current ratio	1.2	0.9	0.8	1.0	1.1
Debtors (Days)	37	56	59	60	60
Fixed assets t/o (x)	12.9	11.2	9.5	9.2	9.6
Average working capital t/o (x)	(30.9)	(11.0)	(14.5)	(24.3)	(28.7)
Average capital t/o (x)	6.2	5.7	8.0	7.6	6.5
Net debt/Equity	(0.7)	(1.3)	(0.4)	(0.5)	(0.6)
Gross debt/Equity	-	0.01	-	-	-

Valuations parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (INR)	2.6	2.9	10.3	15.3	21.9
Y-o-Y growth (%)	180.0	9.2	259.7	48.5	42.8
CEPS (INR)	5.7	3.2	10.7	16.4	23.6
PE (x)	178.8	163.8	45.5	30.7	21.5
Price/BV(x)	90.4	70.7	40.6	23.4	14.6
EV/Sales (x)	16.1	14.1	6.4	3.8	2.7
EV/EBITDA (x)	148.7	120.8	37.2	21.9	15.1

Company Background

Praj Industries was established in 1984 and became a public limited company in 1993. It is a technology and solution provider for ethanol, brewery and related bio-cycle solutions. The company is in the business of design, manufacture, supply and commissioning of fermentation and distillation equipment for manufacture of alcohol. Praj has a manufacturing facility with floor area of 40,000 square feet near Pune. Also, there is a manufacturing facility spread over 18,300 square feet focusing exclusively on exports. It manufactures ethanol plants for different types of feed stocks.

Investment Rationale

We believe that ramp-up in ethanol distillation capacity is a two-three years phenomenon and beyond that the visibility is lacking. Further Praj is looking at the stage beyond where it extends its capability to cater to the 'cellulose-to-ethanol' market. If the proposed move takes off, we believe that the future growth curve is likely to explode, but we are guarded to assign probabilities to the success at such an initial stage of planning.

Key Risks

Presently US is the key international market for Praj. If Praj can successfully enter markets in other international geography we believe the revenue visibility is likely to increase. Additionally if the company is successful in developing the technology for cellulosic ethanol the future growth curve is likely to explode.

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INDIA RESEARCH

SECTOR

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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

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