

PRAJ INDUSTRIES

INR 202

*Strong quarter, valuations remain expensive*

SELL

Praj Industries' Q2FY07 results were ahead of our expectations. Net revenues grew by 157% Y-o-Y to INR 1.4bn, while EBITDA grew by 205% Y-o-Y to INR 227mn. Net profit grew by 275% Y-o-Y to INR 175mn. At the EBITDA level, margins expanded by 240bps Y-o-Y to 15.3%, mainly on account of lower staff costs and operating expenses as a share of sales. Net margins increased by 370bps Y-o-Y to 11.8%, primarily because of higher other income and lower tax rates for the quarter. At our EPS estimates of INR 5.4 and INR 9.7 for FY07E and FY08E respectively, the stock is trading at 37.6x and 20.8x times FY07E and FY08E earnings respectively. Despite attractive earnings growth and return profile, we believe that all possible near-term positives are factored in valuations. We continue to maintain our 'SELL' recommendation.

- ♦ **Growth trajectory continues in Q2FY07:** Although Q2FY07 numbers were exceptionally strong, we note that Q2FY06 results were disappointing with net revenues falling by 1% and net profits by 19%, Y-o-Y. Hence, due to a low base effect, the growth numbers in Q2FY07 may appear inflated when compared on a Y-o-Y basis. On a half-yearly basis, revenue numbers were in line with our expectations, while profitability numbers were slightly ahead of our expectations. The margin expansion at the EBITDA level in Q2FY07 was driven by lower staff costs as a percentage of sales; low staff costs accounted for 82% of the margin expansion.
- ♦ **Near term growth outlook positive:** Currently, revenues are being driven by ethanol capacity expansion taking place in the US and to a lesser extent in Europe. The US market had a total ethanol production capacity of 16.9bn litres and 7.1bn litres of capacity was under construction in CY05. This translates into ~INR 80bn market in the US. While the capacity under construction will decrease compared with CY05, we believe the near term outlook remains positive and are confident that Praj will meet our estimates of INR 4.5bn in net revenues and INR 434mn in net profit in FY07E, a growth of 65.6% and 86.6% Y-o-Y respectively. We believe the chances of Praj penetrating the US market successfully are bright and believe that the next two years of earnings (FY08 and FY09) will be determined primarily by contract wins.
- ♦ **Ripe valuations leave little room for upside:** We believe that all possible near-term positives are factored in current market valuation of the stock.. Despite the strength in revenues and earnings in recent times, we hold on to our estimates for the next two years. We look for signs of paradigm shift in order and execution profile before we shift our estimates to factor in accelerated growth momentum. At current EPS estimates of INR 5.4 and INR 9.7 for FY07E and FY08E respectively, the stock is trading at 37.2x and 20.6x times FY07E and FY08E earnings respectively. We continue to maintain our 'SELL' recommendation.

Financials

Year to September	Q2FY07	Q2FY06	% change	Q1FY07	% change	FY06	FY07E
Revenues (INR mn)	1,477	575	156.6	805	83.5	2,744	4,544
EBITDA (INR mn)	227	74	205.3	111	103.5	320	609
Net profit (INR mn)	175	47	275.2	84	108.3	233	434
EPS (INR)	2.1	0.6	264.3	1.0	108.3	2.9	5.4
PE (x)						70.2	37.6
EV/EBITDA (x)						25.7	25.7
ROAE (%)						48.5	59.0

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Market Data

52-week range (INR) : 212 / 80
Share in issue (mn) : 83.5
M cap (INR bn/USD mn) : 16.8 / 369.7
Avg. Daily Vol. BSE ('000) : 975.4

Share Holding Pattern (%)

Promoters : 30.3
MFs, Fls & Banks : 20.5
Fls : 5.4
Others : 43.8

Financials snapshot								(INR Mn)
Year to March	Q2FY07	Q2FY06	% change	Q1FY07	% change	FY06	FY07E	% change
Revenues (net)	1,477	575	156.6	805	83.5	2,744	4,544	65.6
Raw material	1,092	423	157.9	578	88.7	2,059	3,434	66.7
Staff cost	69	38	79.4	47	45.5	181	195	7.9
Other operating expenses	90	40	127.2	68	32.8	184	306	66.9
Total expenditure	1,250	501	149.4	693	80.3	2,424	3,935	62.4
EBITDA	227	74	205.3	111	103.5	320	609	90.1
Depreciation	11	7	55.4	8	35.0	27	58	116.9
EBIT	216	67	220.6	103	108.7	294	551	87.7
Interest	1	2	(61.3)	1	(42.6)	5	9	63.1
Other income	11	1	652.4	7	46.8	25	25	0.8
Extraordinary items		-	NM		NM			NM
PBT	226	67	236.6	110	106.0	313	567	81.2
Tax	51	21	149.1	26	98.5	80	133	65.6
Adjusted net profit	175	47	275.2	84	108.3	233	434	86.6
Reported net profit	175	47	275.2	84	108.3	233	434	86.6
Equity capital(FV:INR 2)	167	162	3.0	167	-	162	162	-
# of shares (mn)	84	81	3.0	84	-	81	81	-
EPS (INR) (adj for split)	2.1	0.6	264.3	1.0	108.3	2.9	5.4	86.6
Market cap. (INR mn)						16,320	16,320	
PE (x)						70.2	37.6	
EV/EBITDA (x)						48.8	25.7	
Market cap / Revenues (x)						5.9	3.6	
as % of net revenues								
Raw material	73.9	73.6	0.5	71.9	2.8	75.0	75.6	0.7
Staff costs	4.6	6.7	(30.1)	5.9	(20.7)	6.6	4.3	(34.9)
Other operating expenses	6.1	6.9	(11.5)	8.4	(27.7)	6.7	6.7	0.8
EBITDA	15.3	12.9	18.9	13.8	10.9	11.7	13.4	14.8
Adjusted net profit	11.8	8.1	46.2	10.4	13.5	8.5	9.6	12.7
Tax rate	22.6	30.6	(26.0)	23.5	(3.6)	25.7	23.5	(8.6)

Financial Statements

Income statement					(INR Mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Income from operations	2,421	2,744	4,544	7,248	10,667
Direct costs	1,874	2,059	3,434	5,478	8,082
Employee costs	129	181	195	250	322
Other expenses	155	184	306	486	716
Total operating expenses	2,158	2,424	3,935	6,213	9,120
EBITDA	263	320	609	1,035	1,547
Depreciation and amortisation	20	27	58	83	100
EBIT	243	294	551	952	1,447
Interest expenses	2	5	9	14	21
Other income	33	25	25	84	176
Profit before tax	275	313	567	1,022	1,602
Provision for tax	62	80	133	239	373
Extraordinary items	-	-	-	-	-
Reported profit	213	233	434	783	1,229
Adjusted net profit	213	233	434	783	1,229
Shares outstanding	81	81	81	81	81
Dividend per share	1.1	1.3	0.5	3.9	6.2
Dividend payout (%)	41.1	43.9	10.3	40.8	40.6

Common size metrics- as % of net revenues

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Operating expenses	89.1	88.3	86.6	85.7	85.5
Depreciation	0.8	1.0	1.3	1.1	0.9
Interest expenditure	0.1	0.2	0.2	0.2	0.2
EBITDA margins	10.9	11.7	13.4	14.3	14.5
Net profit margins (adjusted)	8.8	8.5	9.6	10.8	11.5

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Revenues	110.8	13.4	65.6	59.5	47.2
EBITDA	152.1	21.9	90.1	69.9	49.5
PBT	168.3	14.0	81.2	80.1	56.8
Net profit	180.0	9.2	86.6	80.4	56.9
EPS	180.0	9.2	86.6	80.4	56.9

Cash flow statement					(INR Mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net profit	213	233	434	783	1,229
Add: Depreciation	20	27	58	83	100
Add: E.O.adjustments	-	-	-	-	-
Add: Deferred tax	1	6	-	-	-
Gross cash flow	234	265	492	866	1,329
Less: Dividends	100	117	51	367	574
Less: Changes in W. C.	(111)	(341)	(255)	(407)	(515)
Operating cash flow	245	490	696	906	1,270
Less: Change in investments	268	-	-	-	-
Less: Capex	63	91	750	74	82
Free cash flow	(86)	399	(54)	832	1,188

Balance sheet					(INR Mn)
As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Equity capital	81	162	162	162	162
Reserves & surplus	340	376	771	1,202	1,876
Shareholders funds	421	538	933	1,364	2,039
Secured loans	0	0	0	0	0
Unsecured loans	0	5	0	0	0
Borrowings	0	5	0	0	0
Sources of funds	421	544	933	1,364	2,039
Gross block	303	403	1,153	1,227	1,309
Accumulated depreciation	94	121	179	262	364
Net block	208	283	974	965	945
Capital work in progress	4	20	20	20	20
Total fixed assets	212	303	995	985	965
Investments	103.4	371.2	371.2	371.2	371.2
Inventories	300	204	343	551	813
Sundry debtors	246	418	674	1,081	1,596
Cash and equivalents	209	321	241	1,089	2,298
Loans and advances	114	136	306	492	726
Other current assets	59	109	184	295	435
Total current assets	928	1,188	1,749	3,508	5,868
Sundry creditors and others	729	1,161	1,937	3,106	4,586
Provisions	69	124	245	393	580
Total CL & provisions	798	1,286	2,182	3,500	5,166
Net current assets	130	(98)	(433)	8	702
Add / (Less): Def. tax asset/ liability	(24)	(30)	0	0	0
Others	0	(2)	0	0	0
Uses of funds	421	544	933	1,364	2,039
Book value per share (BV)	5	7	12	17	25

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROAE (%)	58.5	48.5	59.0	68.2	72.2
ROACE (%)	62.7	60.8	74.6	82.9	85.0
Current ratio	1.2	0.9	0.8	1.0	1.1
Debtors (Days)	37	56	54	54	55
Fixed assets t/o (x)	10.2	8.0	4.0	6.3	9.4
Average working capital t/o (x)	14.7	170.9	(17.1)	(34.1)	30.0
Gross debt/Equity	0.0	0.0	0.0	0.0	0.0

Valuations parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (INR)	2.6	2.9	5.4	9.7	15.2
Y-o-Y growth (%)	180.0	9.2	86.6	80.4	56.9
CEPS (INR)	28.7	16.0	30.4	53.4	82.0
PE (x)	76.6	70.2	37.6	20.8	13.3
Price/BV(x)	38.7	30.3	17.5	12.0	8.0
EV/Sales (x)	6.6	5.7	3.4	2.2	1.5
EV/EBITDA (x)	60.9	48.8	25.7	15.1	10.1

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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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