

Praj Industries Ltd.

INR 101

*Fuel-up with the Future***BUY**

Gateway to Prosperity

Aug 28, 2009

Company Background

Praj Industries Ltd (Praj) was established in 1985. The company has transformed itself into a global technology provider for bio-ethanol, bio-diesel & beer production. It has presence in over 450 centres across 45 different countries. Praj possesses technology for ethanol production from different feedstock like corn, beet sugar & cane or molasses. It has been taking innovative steps for the development of second generation technology for ethanol production, which will help it to command a large section of the market. The company has set up an R&D unit, which is doing research on various feedstock for ethanol production. Its Kandla facility is in SEZ. Till date, Praj has filed 7 process patents domestically.

Investment Rationale

➔ Financial performance (Standalone basis)

For Q1FY10, Praj reported Net Sales of INR 1264 mn, which declined by 19%, while it reported Net profit of INR 253 mn as against INR 247.5 mn, during the same period a year ago. The company has a current order book of INR 8000 mn which is to be executed in the next 12 months. Its Other Income was almost good to INR 116 mn vs 20 mn, whereas its Total Income was at 1380 mn. It reported an Operating Profit Margin of 26.36%, while on the other hand its Net Profit Margin was 20.04%.

➔ JV & subsidiaries to increase footprints

Praj's 50% revenues comes from the international markets & to increase its footprints & its revenues kit, its has formed a JV in Europe, Brazil & has formed a subsidiary in USA. This would help the company to serve better to its valuable clients & to increase its market share.

➔ Ethanol to act as a trigger point

Fuel ethanol production has seen an uptrend in the last few months due to surge in the global crude prices, which has touched almost high to USD 148/barrel. Not only the developed countries like USA, EU are following the ethanol route but developing countries like India & Brazil are following the same. It is expected that the ethanol production is likely to get double in USA & EU by FY12. Praj, with operational presence in all these countries is expected to get benefitted by the trend, as it possesses process technology for the different types of feedstock for ethanol production.

➔ Key Positives

- ➔ EU Parliament has adopted mandate of 10% biofuels blending in all transport fuels by the year 2020, thereby entailing opportunity of additional 12-14 bn litres capacity for ethanol.
- ➔ USA has pre-poned its Renewable Fuels targets of 11 bn gallons from 2012 to 2009. This move is expected to support the capacity build-up.
- ➔ Even Indian government is working on a strategy to increase blending of Ethanol from the current situation of 5% to almost 10% by October 2009, along with blending of 20% by 2017.

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Info Codes

Reuters	: PRAJ.BO
Bloomberg	: PRJ@IN
NSE	: PRAJIND
BSE	: 522205

Market Data

52 Wk Range (INR)	: 179 / 45
Shares in Issue (mn)	: 183.45
Mkt. Cap (INR bn)	: 18.57
BSE 2 Wk Avg Vol	: 1466035

Share Holding Pattern (%)

Promoters	: 23.02
MFs, FIs & Banks	: 12.78
FIIs	: 8.19
Others	: 56.01

Investment Theme

Praj Industries Ltd, is a global technology provider for bio-ethanol, bio-diesel & beer production. The company's order book stands at INR 8000 mn, consists orders to the tune of 50% from international markets & 50% from the domestic markets, thus acquiring orders of INR 1200 mn this quarter. 60% of the orders are sugar based, while the remaining 40% are from starch based. Buoyed by firm alcohol prices in the domestic market, the company also witnessed robust demand on the grain based beverage alcohol distillery front, thereby enabling the company to sustain healthy order book growth momentum in the domestic market, along with healthy revenues.

Time to Blend it in your Portfolio

Outlook of Ethanol Industry

Globally, it is witnessed that there is an increase in Ethanol production in the last few years, which has been driven by the steep increase in the prices of crude oil worldwide. Ethanol-producing countries are evaluating this as an alternative to reduce their dependency on crude oil imports, which has affected their domestic economy due to rising their oil bills. This steps would result in ethanol production, which would boost the overall industry. During 2000-2007, ethanol production almost doubled globally & is expected to reach 116 bn liters a year by 2012.

2008 World Fuel Ethanol Production

Country	Lts(Mn)	Percent
USA	34,065	51.92%
Brazil	24,497	37.34%
EU	2,777	4.23%
China	1,900	2.90%
Canada	900	1.37%
Other	486	0.74%
Thailand	340	0.52%
Colombia	300	0.46%
India	250	0.38%
Australia	100	0.15%
Total	65,614	100.00%

(Source: World Ethanol Conference 2008)

Ethanol Blending Requirement

Countries	Blending requirement
Brazil	Between 20-25% blending in Gasoline
Canada	5% blending by 2010
France	10% in 2010
Thailand	10% blending
India	5% blending
China	10% blending in 5 provinces
Colombia	10% blending in cities

➔ Ethanol scenario in India

In India, Ethanol is procured mainly from molasses, a by-product of sugar production, while the ethanol demand in India is driven mainly by the industrial segment. As crude prices are moving up, the Indian Government adopted a National Policy on Biofuels which targets 20% blending by 2017, meanwhile 10% blended fuel would be supplied from October 2009. Currently, 5% blending of ethanol is effective but it is not mandatory & the oil marketing companies decide about the blending considering the logistic costs & the price of ethanol. Meanwhile the blending is followed in 9 States & 4 Union Territories. According to the biofuel policy, at 5% blending the ethanol requirement would be around 965.3 mn ltrs. But the policy states, to reach a blending requirement of 10%, the ethanol requirement will increase four-fold to 3860mn ltrs. This reflects the demand from the segment, which may turn out to be positive for ethanol producers due to increasing demand. Apart from ethanol, the demand from potable alcohol is expected to reach to 1028 mn ltrs (a CAGR of 1.48%) & industrial alcohol will reach a level of 1003 mn ltrs (CAGR of 1.74%).

Ethanol in USA

In USA, ethanol production stood at ~34 bn gallons in 2008 & and together with Brazil, both countries accounted for 89% of the world's production in that year. Ethanol fuel is mainly used in the U.S. as an oxygenate to gasoline in the form of low-level blends, and to a lesser extent, as fuel for E85 flex-fuel vehicles. Most ethanol fuel in the U.S. is produced using corn as feedstock. Till 2008, the country was operating with 139 bio refineries in 21 states. It presently blends up to 10% in gasoline and is evaluating the option of blending 20% in the near future. Presently, ethanol is blended in approx 50% of the total gasoline sold in the US. In December 2007, the US government came out with the Energy Independence & Security Act (EISA), where it would focus on the expansion of the Renewable Fuels Standard (RFS). RFS requires that 21bn gallons of the standard fuel come from advanced biofuels by 2022, which would further boost the domestic ethanol industry. as per the US department of Agriculture, Ethanol production, which amounted to only 1 bn gallons in 2005, has already surpassed the 2012 target of 7.5 bn gallons & is expected to reach 10 bn gallons in 2009. In a drive to reduce dependence on foreign oil, the US government is providing subsidies and tax breaks to encourage the production of corn-based ethanol, which is being blended by law into gasoline.

Business Operations

➔ Ethanol Plants

Praj is the leading player in the process technology for ethanol production, as approx 85% of the revenue comes from this segment. It has the technology for processing both types of feedstock i.e. starch-based & sugar based. This gives Praj a flexibility in operating in different geographical regions, as globally the feedstock differs from region to region. It is also looking into some other feedstock for the production of ethanol. Out of this, the major breakthrough the company achieved is in sweet sorghum.

➔ Bio-Diesel Plants

Praj also has the process technology for bio-diesel procurement from feedstock like Jatropha & Safflower. Since the crop maturity period is long, this segment is not yet popular & Praj is not able to clock much revenues from this segment, even though it has launched the technology one & half years back. But, as the food versus fuel debate is catching on, the company is expecting to clock some revenue from this segment.

➔ Brewery Plants

Praj commands ~50% of the Indian brewery equipment market & the company is building up this segment as the industry is expected to grow at 15% in the next 2-3 years. Also, with new MNCs entering the domestic market, there are lot of opportunities for brewery equipment & process technology in India. Praj's value proposition in breweries lies in their ability of integrated engineering, be it existing or greenfield brewery. The company has been consistently working with the top beer producers in the country.

➔ Ethanol, an value added fuel

With the crude oil in a range of around USD 72/barrel after toughing a high of USD 148/barrel recently, there is a need for alternate energy resource. Ethanol blending with fuel is a well-accepted technology & has turned out to be a good alternative to fuel. The demand for this alternate energy resource would likely to increase in the near future as many countries are looking for blended fuel, which would led to boost the ethanol production, while production in US & EU are likely to double by FY12. Also, South Asian countries are also mulling over the blending option to get away from the crude shock. In the domestic market, the 5% blending guideline is in place & the government is mulling over the option of a mandatory blending of 10% by October 2009.

World Ethanol Production Forecast 2008-12 (Gallons in Mn)

Countries	2008	2009	2010	2011	2012	CAGR(%)
Brazil	4988	5238	5489	5739	5990	2.8%
U.S	6198	6858	7518	8178	8838	5.7%
China	1075	1101	1128	1154	1181	1.4%
India	531	551	571	591	611	2.2%
France	285	301	317	333	349	3.2%
Spain	163	184	206	227	249	6.9%
Germany	319	381	444	506	569	9.7%
Canada	230	276	322	368	414	9.9%
Indonesia	76	84	92	100	108	5.6%
Italy	50	53	55	58	60	2.8%
ROW	2302	2548	2794	3040	3286	5.7%
World	16215	17574	18934	20293	21653	4.6%

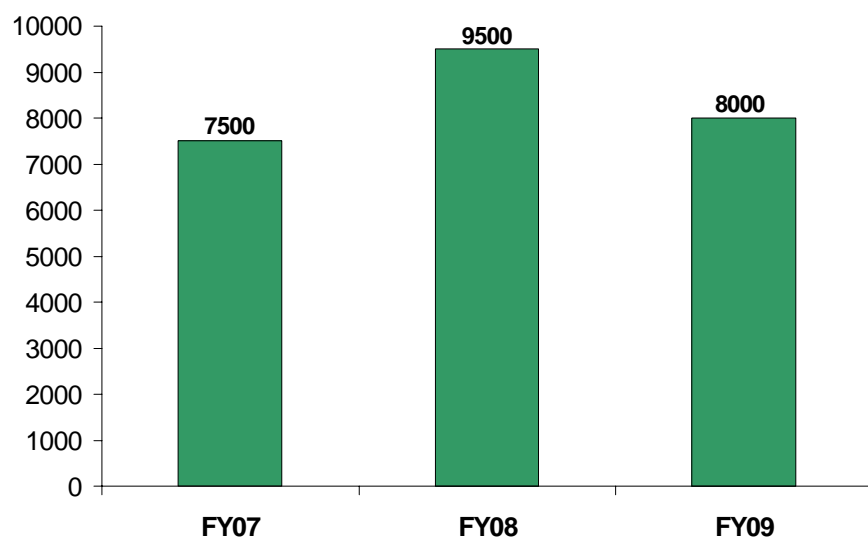
Ethanol In Brazil

Brazil is the second largest producer of ethanol in the world & also the biggest exporter. Its ethanol production is expected to reach 10 bn gallons in 2012-13, thus growing at a CAGR of 2.8% Brazil is one of the leading sugarcane producer in the world & produces ethanol from sugarcane, which is the cheapest feedstock for the production. The ethanol blending ratio is around ~20%-25% in Brazil, which results in meeting approx ~45% of the automobiles & light commercial vehicles fuel consumption. Brazil's ethanol industry is expected to grow at a consistent rate & its ethanol exports are expected to increase as many countries are opting for ethanol blending. The industry is expecting an investment of approx USD 33 bn in the sugar industry by 2012 & the foreign participation is expected to grow from the present 7% to approx 12%. This shows an enormous opportunity for the ethanol segments. Also, the ethanol produced from sugarcane is cheaper than other feedstock, which gives it an added cost advantage. Brazilian ethanol is much greener than the corn-based US ethanol. According to the Woodrow Wilson Center, it packs 8.2 times as much energy that is used in production as compared to 1.5 times from the corn. This gives further visibility for ethanol production in Brazil. According to Brazilian sources, sugarcane planted acreage's expected to increase to over 25 mn acres by 2012-13, while the number of sugar ethanol plants are expected to increase from 325 in FY06-07 to 410 FY12-13.

► Declining orders, but still confident

Praj Industries has established itself as a prominent technology provider for ethanol production & growth in the ethanol industry will drive the growth of Praj. The company has solutions for both types of feedstock starch-based & sugar-based. This has helped the company to market its technology in different countries where feedstock are different. In India, at a 10% blending requirement, the demand for ethanol is expected to be approx 1.1bn ltr against the current capacity of approx 220mn ltr, which would result in an additional capacity to build up. Praj has an 80% market share in India, which gives further visibility for its business in the domestic market.

Praj's Order book (INR Mn)



► Innovation of new technology

Praj has set up R&D facility-Matrix & is constantly working on a strategy for newer technologies for the fuel ethanol production process. The company covers approx 5000 sqft area & has a Research team of ~ 50 scientists for extensive research in the field of ethanol. Projects under taken by Matrix includes enhancing sugarcane to ethanol & has achieved a significant achievement in 2 technologies. One is the non-food biomass to produce ethanol & second is high energy content ethanol. Praj's dedicated approach towards building up R&D unit & its focus on creating process technology for ethanol production, would be visible in its order book.

Key Financials

Year Ended Mar 31 st	FY 07	FY 08	FY 09
Revenue (INR mn)	6164.1	7450.1	7960.6
Rev. growth (%)	133.24	20.86	6.85
EBITDA (INR mn)	1137.8	1799.4	1693.6
Net profit (INR mn)	865.3	1535.4	1297.5
Shares outstanding (mn)	83.9	183.15	183.45
EPS (INR)	10.3	8.4	7.1
EPS growth (%)	242.66	(18.72)	(15.63)
P/E (x)	18.4	16.2	8.2
EV/ EBITDA	139.4	138.4	62.6
ROCE (%)	85.17	61.53	32.67

Ethanol Production In Europe

Though a late entrant, the European Union (EU) is looking at biofuel options aggressively. It plans to introduce a minimum 10% blending by 2020. This will create a lot of potential for ethanol production in the Union. European biofuel market is small as compared to USA & Brazil, while 80% of the market is still dominated by bio-diesel production. According to the eBIO- European Ethanol Association, the present installed capacity of ethanol production is 4 bn liters & 3.5 bn liters capacity is under construction. The top ethanol producers in Europe are France, Germany, Spain & Poland. Biofuel policy has started very late in Europe & presently most of the states are behind their ethanol targets, but EU is taking serious steps to track the inefficiencies in the system, biofuel production is expected to go up in line with the consumption demand. The Ethanol Producer states that ethanol producer plants in Europe produced 56% more ethanol in 2008 as against 2007. Producers in the European Union made 2.8 bn ltrs of ethanol in 2008, up from 1.8 bn ltrs in 2007. The increase is due in large part to growth in French production, which nearly doubled in 2008 to 1 bn ltrs, up from 539 mn ltrs in 2007. The increase occurred despite declining production in some producing member states.

Financial Statements

Income Statement

(INR mn)

Year end Mar 31 st	FY 07	FY 08	% Chg	FY 09	% Chg
Total Sales	6455.5	7322.9	13.44	7934.5	8.35
Other Income	89.4	433.9	385.35	241.8	(44.27)
Change in Stocks	110.2	(147.3)	(233.67)	0.0	(100.00)
Raw Material Con.	3996.3	3674.4	(8.05)	3835.2	4.38
Employee Exp.	286.3	497.5	73.77	630.4	26.71
Excise	380.8	306.7	(19.46)	215.7	(29.67)
Other Exp.	853.9	1331.5	55.93	1801.4	35.29
Operating Exp.	5407.1	5957.4	10.18	6482.7	8.82
Operating Profit	1048.4	1365.5	30.25	1451.8	6.32
Total Interest	2.5	0.3	(88.00)	3.9	1200.00
Gross Profit	1135.3	1799.1	58.47	1689.7	(6.08)
Net Dep.	31.6	55.3	75.00	81.7	47.74
Total Taxation	238.4	208.4	(12.58)	310.5	48.99
Net Profit/Loss	865.3	1535.4	77.44	1297.5	(15.49)

4 Years Balance Sheets

(INR mn)

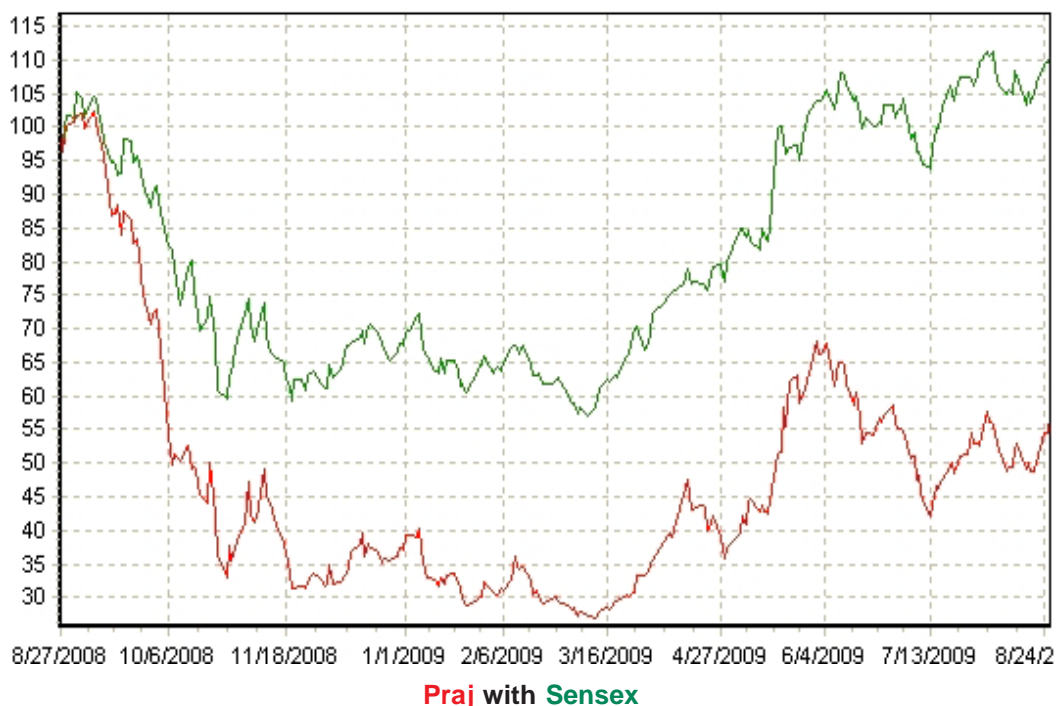
Balance Sheet as on 31 st	Mar 2006	Mar 2007	Mar 2008	Mar 2009
SOURCES OF FUNDS	549.5	1572.8	3508.3	4562.0
Equity Share capital	162.2	167.8	366.3	366.9
Share Application Money	0.0	0.0	0.0	0.0
Preference Share Capital	0.0	0.0	0.0	0.0
Reserves & Surplus	387.3	1314.7	3142.0	4067.7
Loan Funds	0.0	90.3	0.0	127.4
Unsecured Loans	0.0	0.0	0.0	0.0
USES OF FUNDS	549.5	1572.8	3508.3	4562.0
Gross Block	1389.8	520.9	1045.3	1595.8
Less : Revaluation Reserves	0.0	0.0	0.0	0.0
Less : Accumulated Depreciation	118.8	149.4	181.0	261.7
Net Block	271.0	371.5	864.3	1334.1
Capital Work in Progress	8.1	90.4	195.4	137.4
Investments	387.6	1807.0	2684.3	2161.4
Current Assets	1293.3	3208.7	3583.3	5393.3
Less : Current Liabilities	1410.5	3904.8	3819.0	4464.2
Net Current Assets	(117.2)	(696.1)	(235.7)	929.1
Misc. Expenses not written	0.1	0.0	0.0	0.0
NOTE				
Bk Val Unquoted Investments	16.5	232.5	265	303.5
Mkt Val. Quoted Investments	371.7	1610.8	2073.1	1975.4
Contingent Liabilities	27.2	157	305	142.3
Dividend (%)	63	135	99	90

Quarterly Income Sheets

(INR mn)

Quarter Ended	Sep 08	Dec 08	Mar 09	Jun 09
Net Sales	2002.0	2100.5	2092.8	1264.2
Cost Of Sales	1244.8	1371.8	926.0	781.1
Operating Profit	757.2	728.7	1166.8	483.1
Recurring Income	55.4	153.6	(11.6)	70.0
Adjusted PBDIT	812.6	882.3	1155.2	553.1
Financial Expenses	0.0	0.8	3.1	1.9
Depreciation	19.3	22.0	23.1	24.0
Other Write Offs	0.0	0.0	0.0	0.0
Adjusted PBT	793.3	859.5	1129.0	527.2
Tax Charges	55.7	71.2	130.0	54.0
Adjusted PAT	737.6	788.3	999.0	473.2
Non Recurring Items	0.0	0.0	(111.7)	24.4
Other Non Cash Adjust	435.8	315.2	612.2	244.3
Net Profit	301.8	473.1	275.1	253.3

52 Week Index Relative Percentage Appreciation



Risks Associated

Slow growth in order book

Any slowdown in the order book growth of the company may result in a lower growth in the revenue and profitability. This may negatively affect their growth projection & any further new capex plans

Increase in raw material cost

Raw material cost is a very significant part of the total cost, any increase in the cost component may put pressure on the operating profit margins of the company.

Delay in the blending guideline

The Indian government is mulling over a 10% blending scenario from October 2009. Any significant change in the policy & timeline may have a negative impact on the investment scenario of the sector.

In a Nutshell

Praj is a global Indian company that offers innovative solutions to significantly add value in bio-ethanol, bio-diesel, brewery plants & process equipment & systems for customers, worldwide. Praj is a knowledge based company with expertise & experience in Bioprocesses & Engineering. It has one of the largest resource bases in the industry with over 450 references across all five continents. Praj possesses technology for ethanol production from different feedstock like corn, beet sugar & cane or molasses. It has been taking innovative steps for the development of second generation technology for ethanol production, which will help it to command a large section of the market. The company has current order book of INR 8000 mn, which is to be executed in next 12 months. With the increasing crude prices & worldwide increase in usage of Ethanol as an alternate energy resource, it is expected that Praj would be one of the beneficial company due to its increase in usage & Governments steps of increasing blending in the next few years.

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Rating Interpretation

Buy	: Expected to appreciate 20% or more over 12-months	Reduce	: Expected to depreciate up to 10% over 12-months
Accumulate	: Expected to appreciate up to 20% over 12-months	Sell	: Expected to depreciate 10% or more over 12-months
Trade Buy	: Expected to appreciate more than 10% over 45-days	Trade Sell	: Expected to depreciate more than 10% over 45-days

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