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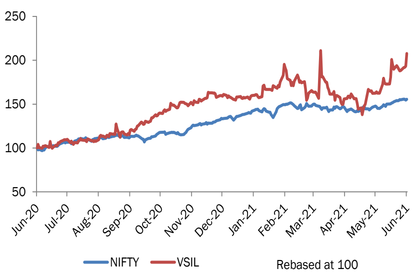
Vishwaraj Sugar Industries Limited

11 June 2021

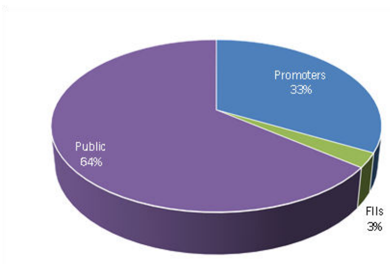
From a sweet spot to high spirits! BUY

Sector	: Agriculture – Sugar
Target Price	: ₹211
Last Closing Price	: ₹159
Market Cap	: ₹599 crore
52-week High/Low	: ₹170/72
Daily Avg Vol (12M)	: 82,955
Face Value	: ₹10
Beta	: 0.50
Pledged Shares	: 0.0%
Year End	: March
BSE Scrip Code	: 542852
NSE Scrip Code	: VISHWARAJ
Bloomberg Code	: VISHWARA IN
Reuters Code	: VNSS.NS
Nifty	: 15,738
BSE Sensex	: 52,300
Analyst	: Research Team

Price Performance



Shareholding Pattern



Initiating Coverage

Investment Summary

- Vishwaraj Sugar Industries Limited (VSIL), a Karnataka-based integrated sugar company producing sugar, power, ethanol and alcohol-based vinegar. The company's production facility is located at Bellad Bagewadi, Belgaum District in Northwest Karnataka, which is classified as a high recovery zone for sugar.
- VSIL has a cane crushing capacity of 10,500 tonnes/day. Low-cost proprietary sugar-refining process will enable VSIL move up the product value chain as expanded facilities are expected to operate at full capacity over the next couple of years.
- VSIL replaced its older 35 klpd distillery with a new facility of 100 klpd, which came online in December 2020. Enabled by the higher distillation capacity and ethanol supply contract, we believe ethanol will be the main value driver for VSIL going forward. We expect FY22 and FY23 distillery revenues to grow exponentially to average ~3x FY21 levels as its share of total revenues increase from 14% to an average of ~35%.
- Sugar production is expected to remain robust in SS21 with high levels of sugarcane planting expected in SS22 driven by a good monsoon in CY21. Droughts in Brazil and Thailand present opportunities for Indian sugar while the short supply will keep international sugar prices buoyant in the near term.
- If implemented effectively, the advancing of 20% ethanol-blending target to 2025 could be a game-changer for the Indian sugar sector in the mid-to-long term while the current domestic demand-supply dynamics and sugar prices present a favourable scenario for increased diversion to ethanol in the near term.
- The VSIL stock currently trades at an attractive forward P/E level of 26.4x FY23E EPS. At 35.0x FY23E EPS, we rate VSIL a BUY with a target price of Rs 211 and an upside potential of 33%.

Key Financial Metrics

Rs lakh	FY19A	FY20A	FY21E	FY22E	FY23E
Net operating revenue	28,635	37,034	42,646	50,709	53,456
Growth		*29.3%*	*15.2%*	*18.9%*	*5.4%*
EBITDA	2,473	3,836	6,202	6,777	7,323
EBITDA margin	*8.6%*	*10.4%*	*14.5%*	*13.4%*	*13.7%*
PAT	(1,762)	(788)	829	1,560	2,267
PAT margin	*-6.2%*	*-2.1%*	*1.9%*	*3.1%*	*4.2%*
Diluted EPS (Rs)	(5.10)	(2.19)	2.11	4.15	6.04

Source: Company data; Khambatta Research

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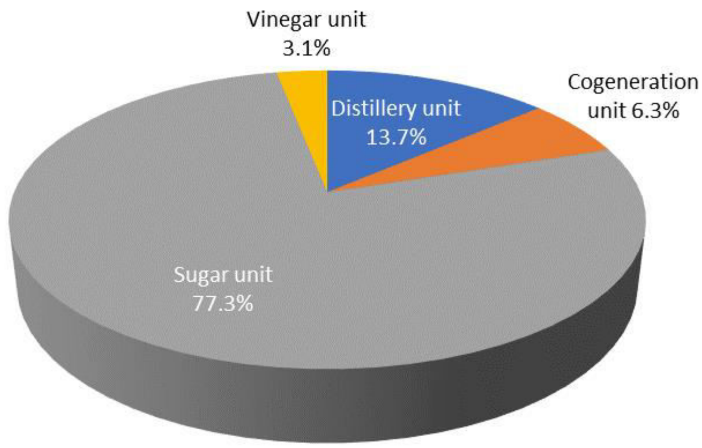
Company Profile

VSIL operates a single-location sugar unit with licensed crushing capacity of 10,500 tonnes/day

Vishwaraj Sugar Industries Limited (VSIL), a Karnataka-based integrated sugar company producing sugar, power, ethanol and alcohol-based vinegar, was incorporated in 1995. The company's production facility is located at Bellad Bagewadi, Belgaum District in Northwest Karnataka, which is classified as a high recovery zone for sugar by the Government of India (GoI). VSIL operates a single-location sugar unit with licensed crushing capacity of 10,500 tonnes/day. VSIL commenced operations of manufacture of distillery products such as ethanol, rectified spirit and extra neutral spirit (ENS) in 2001. In 2006, the company implemented backward integration and began commercial operations for sugar manufacture from sugarcane along with cogeneration capabilities. VSIL began bottling of Indian-made liquor (IML) in 2008, which was discontinued from FY21 as the company's distillery unit with a installed capacity of 100 klpd focuses on ethanol production, given the increasing demand for ethanol blending in fuel. Currently the company's integrated unit processes sugarcanes to produce sugar while the by-products are used to generate electricity for captive use and commercial sale as well as to manufacture ethanol and vinegar.

Revenue split by business unit, FY21



Source: Company

Management Profile

VSIL is led by a top leadership team comprising promoters with robust experience in the agriculture/sugar/distillery sectors, politics, legislation, public policy and public administration.

Chairman Mr. Umesh Katti is a sugar industry veteran and former MLA and minister

Umesh Katti, Chairman & Non-Executice Director: Mr. Umesh Katti is the founding promoter of VSIL. He has over 16 years' experience in the sugar industry and has been elected as an MLA of the Karnataka Legislature six times from Hukkeri. Mr. Umesh Katti was a Cabinet Minister in the

Government of Karnataka between 1996 and 1999 when he held the portfolio of the Sugar Ministry and Public Works. He has held various positions in the Government of Karnataka over the years such as Minister-in-Charge of Belgaum District, Minister-in-charge of Prisons and Horticulture Minister. Mr. Umesh Katti completed his pre-university degree from KLE Society's Lingaraj College, Belgaum.

Nikhil Katti, Managing Director: Serving on the Board of VSIL since 2009, Mr. Nikhil Katti has over 8 years' experience in the sugar industry, leading growth and development initiatives for all business segments of VSIL. He also provides leadership in marketing and was instrumental in the brand positioning and expansion of the company's IML products in the past. A member of Zilla Panchayat Ammanagi, Mr. Nikhil Katti holds a Bachelors degree in Business Administration from Karnataka University, Dharwad and an MBA in International Marketing from the University of Wales.

Lava Katti, Whole-time Director: Mr. Lava Katti has been serving on the Board of VSIL since 2013. He has experience in management of distillery/cogeneration operations and agriculture. Mr. Lava Katti is associated with various social development initiatives in Hukkeri Taluka and neighbouring villages. He is on the advisory panel of a century-old financial institution named Prathamika Krishi Patin Sahakari Sangh Limited, Bellad Bagewadi which caters to thousands of farmers. Mr. Lava Katti holds a Bachelors degree in Business Administration from Karnataka University, Dharwad and an MBA from Cardiff Metropolitan University.

Kush Katti, Whole-time Director: Serving on the Board of VSIL since 2009, Mr. Kush Katti plays an instrumental role in maintaining cordial relations with farmers and ensuring sugarcane supply to the factory. He is actively associated with Bellad Bagewadi Urban Souhard Bank located in Bellad Bagewadi. He is also engaged in various social development initiatives in the region and takes an active part in managing Shri VM Katti Educational Trust, which runs primary, secondary, PU college and ITI colleges. Mr. Kush Katti is an MBA from ESC Pau Business School, France.

ED Mr. Mukesh Kumar has more than 3 decades' experience in the petroleum, distillery and sugar industries

Mukesh Kumar, Executive Director: Mr. Mukesh Kumar has more than 3 decades' experience in the petroleum, distillery and sugar industries including approximately 13 years at VSIL from 2003 to 2016. He was a Whole-time Director of of VSIL from 2009 to 2016 and has been instrumental in achieving various milestones for the company. Subsequently after a gap of approximately 3 years, he was re-appointed as a Director at VSIL. Mr. Kumar has a Bachelor of Science degree in Chemical Engineering from Ranchi University.

Industry Overview

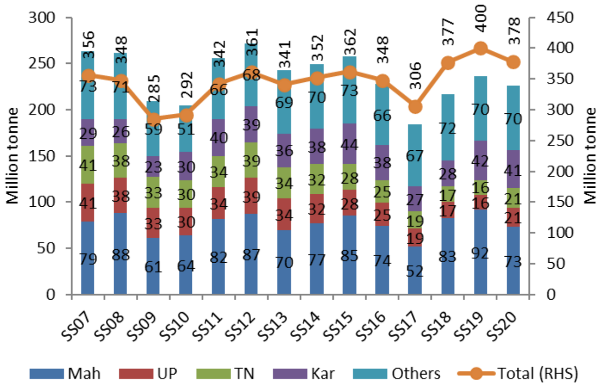
Sugar: India is the world's largest sugarcane-producing country. After being the world's second-largest producer of sugar for the last many years, India ended up being the largest producer in the last two years. As Brazil diverts more of its sugarcane to ethanol production, Indian sugar producers have been producing relentlessly, supported by better prices. With new regulatory policies and amendments in older ones, farmers and millers have a greater chance to increase their efforts toward cane-sugar production and processing. The sugar industry supports an estimated 12% of the rural population in the nine Indian states of Punjab, Uttar Pradesh, Maharashtra, Andhra Pradesh, Bihar, Gujarat, Haryana, Karnataka and Tamil Nadu through direct or indirect employment. Sugarcane production in India is set to increase from a seven-year low as the area planted with cane may increase and rains may boost yields in the world's top consumer. Sugarcane production was robust in from 2017-18 to 2019-20 with an annual production of 377/400/378 million tonnes.

Sugarcane production was robust in from SS18 to SS20 with an annual production of 377/400/378 million tonnes

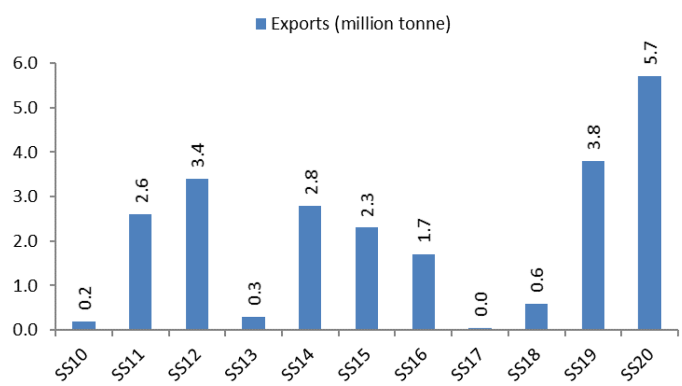
Sugar follows a unique seasonal cycle that stretches from October to September the following year. Sugar output for the sugar season (SS) of 2019-20 was 27.4 million tonnes. While supply and demand for sugar was largely balanced in the last 10-12 years, sugar production was highest during SS18 and SS19 (32.3/33.2 million tonnes). SS20 production stood at 27.4 million tonnes.

A brief analysis of the latest data available with the Indian Sugar Mills Association (ISMA) reveals the distribution of sugar-producing farmers is not uniform across the country, nor are they entirely dependent on natural sugarcane growing conditions available locally. This implies the need for robust freight and transportation systems in the country. However, given how the Indian sugar industry is distributed and the massive gap between farmer and industry, the lack of infrastructure is proving to be detrimental to sugarcane producers as well as the associated forthcoming ethanol production.

Sugarcane production

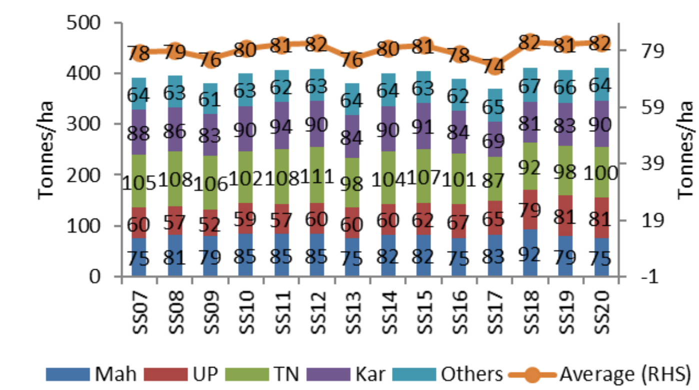


Sugar export



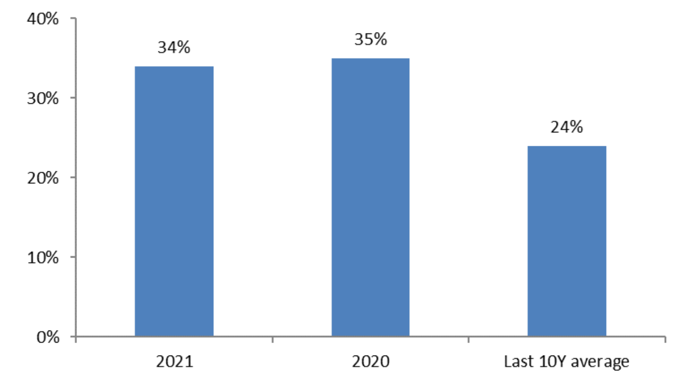
Source: Industry sources

Sugarcane yield



Source: Industry sources

Karnataka reservoir position



The FRP for sugarcane has been raised by Rs 10 to Rs 285 for SY21

The minimum selling price (MSP) of sugar was last revised two years ago when the fair & remunerative price (FRP) for sugarcane was Rs 275 a quintal. Subsequently, the Indian government increased the FRP by Rs 10 to Rs 285 for SY21. The MSP of white/refined sugar was raised from Rs 29/kg to Rs 31/kg in February 2019.

The government has fixed sugarcane prices to support farmers' revenues. The current price is well above that of alternative crops. This policy has a broader social objective that goes beyond the rationale of sugar markets. Moreover, when combined with fixed minimum domestic sugar prices well above international levels, it means that acreage sown with sugarcane will be high and immune to international price signals.

Indian millers are bound by law to crush all the sugarcane in the area they cover, which guarantees revenues for farmers. The introduction of higher-yielding sugarcane varieties in some key producing states has taken production in those regions to fresh heights. Those gains will most probably be maintained as farmers also have a strong incentive to raise yields, given their payment depends on sucrose levels in the cane. It is amazing to see that the hurdle of having small parcels of land did not in the end constrain the adoption of new varieties and subsequent rises in yields.

Nearly 60% of sugar demand in India comes from industrial demand from service outlets such as restaurants, cafes and fast-food joints. This sub-segment suffered due to closure of malls and restaurants. Sugar demand also comes from confectioners, cola makers, beverage companies, biscuits makers, etc. While industrial production is returning to pre-Covid levels, the three months of production shutdown is a sunk cost. It is estimated that the industrial sub-segment could contract 13% to 14% in SY2019-20.

Household consumption accounts for 35% of demand. On one hand, lower income levels reduced monthly sugar consumption. At the same time, lockdowns led to people spending more time at home. This triggered greater

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demand for sugar-related beverages and snacks. The net effect has been that demand contraction in household segment will be about 2%. However, both industrial and household sub- demand for sugar are likely recover sharply from the last quarter of 2020.

In SS20, India exported a record 5.7 million tonnes of sugar, the best exports for the Indian sugar sector in the last 12 years. In the last two years, the Indian government has been providing sugar subsidies to Indian sugar exporters to counter the cost advantage other countries enjoy. However, several sugar-exporting countries have objected to India's sugar-export subsidies.

The Indian cane sugar market is projected to register a 4.3% CAGR during SS20 to SS25. Favourable government policies and increasing crop areas will enable sugar production to peak in the next 5 years *(source: Mordor Intelligence)*.

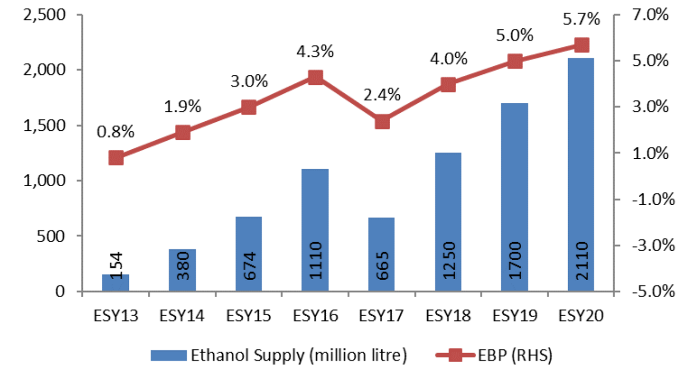
In December 2020, the target year for achieving 20% EBP was advanced to 2025

Ethanol: In June 2018, India's Ministry of Petroleum and Natural Gas published its "National Policy on Biofuels - 2018" in which it proposed a 20% target ethanol blending rate for petrol by 2030. Previously, India had a 10% ethanol-blended petrol (EBP) target for 2022. Subsequently in December 2020, the target year for achieving 20% EBP was advanced to 2025. The Niti Aayog has recommended setting the target for 10% EBP coverage all over the country by April 2022 and a phased roll-out of 20% EBP starting from April 2023. To raise its ethanol blending rate, the Indian government announced that it would allow sugar mills and distilleries to expand its feedstock from C-heavy molasses to include sugarcane juice, B-heavy molasses, and damaged food grain while raising ethanol procurement prices.

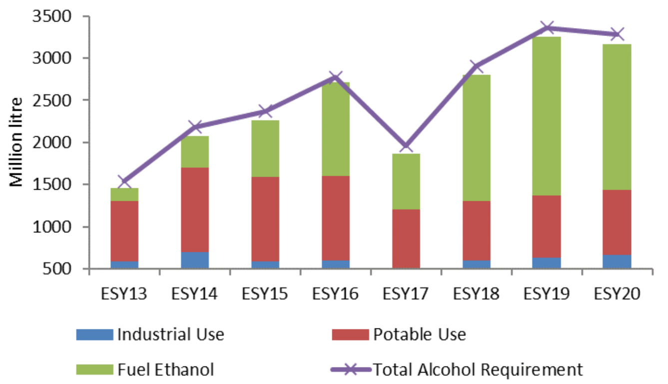
India achieved 5.7% EBP in the ethanol supply year December 2019 to November 2020 (ESY20). The domestic ethanol supply during ESY20 was 2,110 million litres while fuel ethanol use stood at 1,730 million litres. The government forecasts 900 crore litres of ethanol requirement to achieve a 20% EBP by 2025 with sugar mills supplying 610 crore litres and the remainder 390 crore litres coming from grain-based distilleries. The average ethanol blending is expected to be 8.5% in ESY21 with 283 crore of the total 325 crore litres required supplied by sugar mills.

The Indian sugar sector is upbeat about ethanol production during SS21 as mills are expected to divert more cane for ethanol. For the past two years, the central government has been prompting sugar mills to diversify operations from sugar to ethanol. Higher prices for ethanol made from sugar syrup or cane juice and from B-heavy ethanol were announced as well as an interest subvention scheme for mills that desire to expand or install new distilleries. ISMA predicts a fall of up to 15 lakh tonnes in sugar production in order to produce higher volumes of ethanol with most of it expected to be manufactured from B heavy molasses besides cane juice or sugar syrup.

Ethanol supply and EBP achievement



Application of ethanol in India



Source: Industry sources

The central government has extended the interest-subvention scheme, which will help in extension and construction of distilleries. First launched in September 2018, the subvention scheme had 326 proposals submitted by sugar mills. Only 60 projects were sanctioned and 36 had loans disbursed. Sugar mills, especially those in Maharashtra whose balance sheets are intrinsically weak, have had difficulties in raising loans from banks. As a way out, the government allowed tripartite agreements among mills, oil marketing companies (OMCs) and banks for such projects. In the last two years, ethanol manufacturing capacity in the country had risen from 270-275 crore litres to 425 crore litres. OMCs are set to procure 283 crore litres of ethanol from mills for blending of up to 10% with petrol in ESY21 compared to 167 crore, 179 crore and 151 crore litres in the preceding three supply years and only 38 crore litres in ESY14. Of the 283 crore litres, 59.7 crore litres comprise ethanol produced from C-molasses, the leftover cane syrup after most of the sugar has been extracted and crystallised. The balance supply will come from fermentation of whole sugarcane juice (42.2 crore litres) and the intermediate B-heavy molasses (181 crore litres). Mills will be paid more for ethanol produced from B-heavy molasses (Rs 57.61/litre) and cane juice (Rs 62.65/litre) compared to ethanol produced from C-molasses (Rs.45.69/litre). Total projected ethanol purchases by OMCs in 2020-21 is Rs 15,800 crore.

OMCs are set to procure 283 crore litres of ethanol from mills in ESY21

(Source: Government and industry sources)

Investment Thesis

Low-cost proprietary sugar-refining process will enable VSIL move up the product value chain as expanded facilities are expected to operate at full capacity over the next couple of years. VSIL has a cane crushing capacity of 10,500 tonnes/day, expanded from 8,500 tonnes/day over FY19 and FY20. Unlike most of its competitors, VSIL's facilities are in a single location as opposed to multiple locations. The company is amongst the lowest consumers of energy across the sugar industry, enabled by the technology and processes it employs, which requires minimum human intervention. In FY21, the company's sales volume for sugar was 9,40,725 qtl while alcohol

VSIL sold 9,40,725 qtl of sugar in FY21

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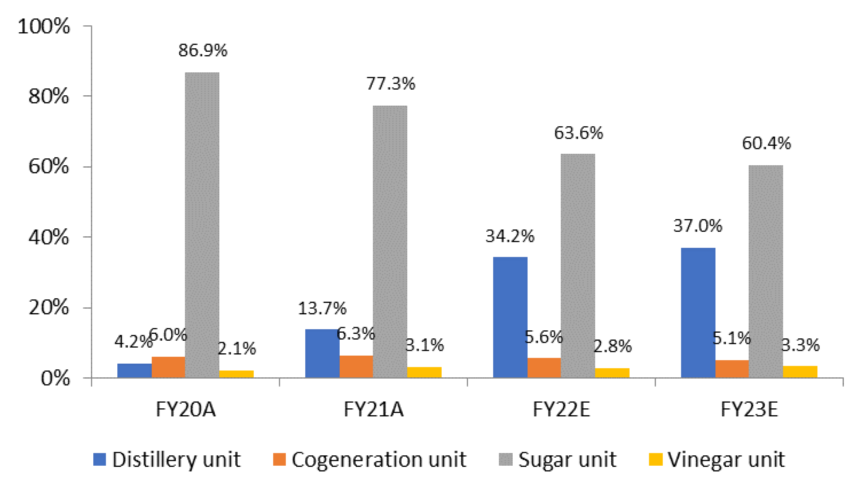
volume was 9,555 kl. In addition, the company sold 9,539 kl of alcohol-based vinegar. VSIL's cogeneration unit supplied 566 lakh KWh of power to the grid during FY21. IML has been discontinued from FY21 and the company will not be diverting any distillery output for IML going forward as demand for fuel ethanol from OMCs is set to rise, driven by the new accelerated EBP mandate. After increasing vinegar production by 60% in the last year, the company is looking to enhance production by a further 30% to 40% this year. VSIL has two vinegar units with a total installed capacity of 70,000 litres/day. VSIL's initiative to upgrade its output from unrefined to refined and pharma-grade sugar has already commenced and is underway. With the company using a proprietary low-cost technology to manufacture refined and pharma-grade sugar which does not require setting up a refinery, it is able to keep the production cost low. VSIL employs a single-step process where the sugarcane juice is refined directly and the output produced from this refined juice is refined sugar. Normally in a sugar refinery, after raw sugar is produced from the juice (first step), it goes through a refining process in a second step. VSIL's budgeted capex for setting up the process to enhance the quality of sugar (to refined and pharma-grade) is approximately Rs 20 crore. In comparison, the minimum capex required for a refinery setup with a capacity of 10K tonnes/day is Rs 60-65 crore. Further, regular refinery opex is higher than VSIL's proprietary process. Going forward, sugar and distillery capacities are expected to operate at maximum utilisation levels like in the last season, driven by buoyant demand for sugar and ethanol.

VSIL has two vinegar units with a total installed capacity of 70,000 litres/day

Change in revenue mix



Source: pmksy.gov.in

Ethanol revenues are expected to grow exponentially, enabled by new distillery with higher capacity and OMC contract for ethanol supply. VSIL replaced its older 35 klpd distillery with a new facility of 100 klpd capacity. The company received permission from the regulatory authorities for commencing operations at the new distillery in February 2020 and subsequently received OMC contract for supply of ethanol in August 2020.

With the new distillery coming online in December 2020, its full potential was not realised in FY21. Armed with higher distillation capacity and ethanol supply contract, we believe ethanol will be the main value driver for VSIL going forward. We expect FY22 and FY23 distillery revenues to grow exponentially to average ~3x FY21 levels as its share of total revenues increase from 14% to an average of ~35%.

Sugar production is expected to remain robust in SS21 with high levels of sugarcane planting expected in SS22 driven by a good monsoon in CY21. After encountering roadblocks during the initial outbreak of the covid-19 pandemic and consequent lockdowns/restrictions, the sugar sector got back on track subsequently. According to ISMA, 502 sugar mills across the country started operations from 01-Oct-20 to 28-Feb-21, producing 23.4 million tonnes of sugar, a significant jump from the 19.5 million tonnes by 453 mills last season till 29th February 2020. As of 15-Apr-21, sugar production stood at 29.1 million tonnes, an increase of 17% y-o-y. At the state level, Karnataka produced 4.1 million tonnes at 66 mills during the Oct-20 to Feb-21 period, up from the 3.26 million tonnes produced by 63 sugar mills last year. With a good monsoon predicted this year, sugarcane planting is expected to be healthy in SS22. The India Meteorological Department (IMD) revised its 2021 monsoon forecast upward to 101% of the Long Period Average (LPA) from its earlier April forecast of 98%. The forecast suggests that most parts of the country can expect to get normal to above-normal rainfall this year.

As of 15-Apr-21, Indian sugar production stood at 29.1 million tonnes, an increase of 17% y-o-y

Droughts in Brazil and Thailand present opportunities for Indian sugar while the short supply will keep international sugar prices buoyant in the near term. In SS20, Brazil allocated 46% of its sugarcane crop to sugar production (with the remainder utilised to produce ethanol). The covid-19 pandemic and lockdown severely affected Brazil's sugar sector as the country lost its position as the world's largest sugar exporter. Labour-related delays at Brazil's largest port, Santos, also affected the country's sugar industry. Now Brazil is facing a severe drought as a result of which sugar production is seen to decline by 15% to 20% during the current SS while SS22 too is expected to be negatively affected. The world's third-largest sugar producer Thailand recorded a 10-year low sugarcane output in 2019-20 due to drought as the country's sugar output this year is expected to see a sharp fall. By March 2021, cane volumes crushed in Thailand were 66.5 million tonnes, 13% lower than for the same period last year. India has benefited from Thailand's decline in production with some of the latter's traditional sugar buyers like Vietnam, Indonesia, Bangladesh, Iran and Kenya looking to India to meet their domestic demand. Enabled by surplus production and lower production by other major sugar exporters, Indian sugar exports are expected to be buoyant in SS21 and seen to continue into SS22. However, with higher production costs and the WTO allowing export subsidies only until December 2023, Indian sugar exports will primarily be driven by opportunities arising from a domestic demand-supply situation and global sugar prices as opposed to an export-focused strategy in the medium-to-longer term. As a matter of fact, it is the ethanol-blended fuel policy as opposed to export

Thailand recorded a 10-year low sugarcane output in 2019-20 due to drought

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opportunities that will be amongst the most prominent drivers for the Indian sugar industry in the medium-to-long term.

Ethanol-blended fuel policy and advancing of 20% ethanol-blending target to 2025 could be a game-changer for the Indian sugar sector if implemented effectively. The Government of India (GoI) has been implementing the Ethanol Blended Petrol (EBP) programme across the country under which OMCs sell petrol blended with 10% ethanol. In June 2018 under the EBP programme, a target of 20% EBP by 2030 was laid out in the National Policy on Biofuels (NPB) – 2018. Subsequently in December 2020, the target year for achieving 20% EBP was advanced to 2025. The Niti Aayog has recommended setting the target for 10% EBP coverage all over the country by April 2022 and a phased roll-out of 20% EBP from April 2023 onwards to enable all stakeholders including oil marketing companies (OMCs), auto OEMs, service stations, distilleries and entrepreneurs to work towards meeting the 2025 target in line with a detailed roll-out plan. The current ethanol production capacity in India includes 426 crore litres at sugar-based distilleries and 258 crore litres at grain-based distilleries. With an estimated average EBP 8.5% in ESY21, 283 crore out of the total 325 crore litres requirement is expected to be met by sugar mills. The government projects an ethanol requirement of 900 crore litres for achieving 20% EBP by 2025 with sugar mills supplying 610 crore litres and grain-based distilleries the remainder 390 crore litres. To achieve this target, 60 lakh tonnes of sugar and 165 lakh tonnes of grains per annum in ESY25 will be required to be diverted towards EBP.

The current sugar-based ethanol production capacity in India stands at 426 crore litres

The current domestic demand-supply dynamics and sugar prices present a favourable scenario for increased diversion to ethanol. With sugar mills typically crushing cane with 13.5% to 14% total fermentable sugar (TFS) content, the sugar recovered from every tonne of cane is approximately 115 kg or 11.5%. The 2% to 2.5% non-recovered TFS yields uncrystallised C-molasses that generates about 10.7 litres of ethanol from a tonne of cane. Alternatively, capping the extraction at 10% sugar (100 kg) and diverting the 1.5% extra TFS to B-molasses can increase the yield of ethanol up to 19.4 litres. There is a third option involving the diversion of the entire TFS to produce up to 76 litres of ethanol per tonne of cane. Current ex-factory sugar realisations of Rs 32 per kg make it viable for many mills to produce a higher quantity of ethanol through the B-molasses route. ISMA estimates a diversion of 20.1 lakh tonnes of sugar for ethanol production from B-molasses and cane juice during 2020-21 with 6.74 lakh tonnes to come from UP, 6.55 lakh tonnes from Maharashtra and 5.41 lakh tonnes from Karnataka. India's average annual sugar production of 300 lakh tonnes outstripping domestic consumption of 255-260 lakh tonnes presents further diversion potential. Besides meeting the EBP mandate, higher ethanol will also help mills make timely payments to cane farmers.

ISMA forecasts a diversion of 20.1 lakh tonnes of sugar for ethanol production from B-molasses and cane juice during 2020-21

Peer Comparison

There are as many as 30 listed sugar companies in India. We compare VSIL with some of its listed peers operating in Karnataka and other parts of southern/western India.

Peer Comparison: Key Financials Metrics, FY21

Rs crore	Vishwaraj Sugar	EID Parry*	Shree Renuka Sugars*	Bannari Amman Sugars	Ugar Sugar Works
Net operating revenue	426.5	13,710.8	4,881.2	1,561.2	1,118.0
EBITDA	62.0	1,999.1	192.4	210.6	67.8
EBITDA margin	*14.5%*	*14.6%*	*3.9%*	*13.5%*	*6.1%*
PAT	8.3	467.9	2,099.2	92.1	17.1
PAT margin	*1.9%*	*3.4%*	*43.0%*	*5.9%*	*1.5%*
Diluted EPS (Rs)	2.11	26.34	10.95	73.48	1.52
ROCE	14.4%	23.5%	N/A	8.2%	41.0%
ROE	3.7%	14.1%	N/A	7.0%	23.7%
Current market cap	599	7,757	5,065	2,307	367

**FY20 financials as the company has not reported FY20 results*
Source: Company data; Bloomberg; Khambatta Research

Valuation

The VSIL stock currently trades at an attractive forward P/E level of 26.4x FY23E EPS

At 35.0x FY23E EPS, we rate VSIL a BUY with a target price of Rs 211 and an upside potential of 33%. From seesawing between a net importer and a marginal exporter, the Indian sugar sector recorded consistent exports in the past 2 sugar seasons. Exports are expected to remain strong in SS21 and SS22, driven by healthy production and amidst drought conditions in Brazil and Thailand. We believe the advancing of 20% EBP target to 2025 will be a game-changer for the Indian sugar sector in the medium-to-long term while current domestic demand-supply dynamics and sugar prices present a favourable scenario for increased diversion to ethanol in the near term. Enabled by the new distillery with higher capacity of 100 klpd and OMC ethanol supply contract, ethanol will be the main value driver (presenting exponential growth to average ~3x FY21 levels as ethanol's share of total revenues increase from 14% to an average of ~35%). The VSIL stock currently trades at an attractive forward P/E level of 26.4x FY23E EPS.

Relative Valuation: Price-to-Earnings

	High	Low	Average	Current
Vishwaraj Sugar	72.2	48.0	58.2	72.2
EID Parry	146.1	5.0	35.6	16.8
Shree Renuka Sugars	10.5	3.0	5.2	3.6
Bannari Amman Sugars	80.9	10.7	28.3	25.0
Ugar Sugar Works	42.0	6.5	16.1	21.4

Note: Multiples since FY17 or listing
Source: Bloomberg; Khambatta Research

Profit & Loss Account

Rs lakh	FY19A	FY20A	FY21A	FY22E	FY23E
Net revenue from operations	**28,635**	**37,034**	**42,646**	**50,709**	**53,456**
Growth		*29.3%*	*15.2%*	*18.7%*	*14.2%*
Cost of goods sold	23,444	29,858	33,634	40,737	42,764
Gross profit	5,191	7,176	9,012	9,971	10,691
Gross margin	*18.1%*	*19.4%*	*21.1%*	*19.7%*	*20.0%*
Operating cost	2,718	3,340	2,810	3,195	3,368
EBITDA	**2,473**	**3,836**	**6,202**	**6,777**	**7,323**
EBITDA margin	*8.6%*	*10.4%*	*14.5%*	*13.4%*	*13.7%*
Depreciation & amortization	1,334	1,457	1,475	1,490	1,475
PBIT	1,247	2,520	4,789	5,363	5,928
Interest expense	3,636	4,174	3,566	3,374	3,181
PBT	(2,389)	(1,654)	1,223	1,989	2,747
Tax expense	(627)	(866)	394	429	480
PAT	**(1,762)**	**(788)**	**829**	**1,560**	**2,267**
PAT margin	*-6.2%*	*-2.1%*	*1.9%*	*3.1%*	*4.2%*
Diluted EPS (Rs)	**(5.10)**	**(2.19)**	**2.11**	**4.15**	**6.04**

Source: Company data; Khambatta Research

Abridged Balance Sheet

Rs lakh	FY19A	FY20A	FY21A	FY22E	FY23E
Total shareholders' equity	21,150	22,183	22,601	23,785	25,677
Long-term debt	6,541	9,266	10,243	10,252	6,105
Short-term debt	25,386	23,909	24,655	21,000	22,000
Current liabilities (ex short-term debt)	17,930	11,648	13,349	16,766	17,192
Total equity & liabilities	**71,955**	**67,202**	**71,202**	**72,107**	**71,294**
Fixed assets	26,441	28,837	28,218	30,218	28,743
Inventory	32,435	29,035	28,572	30,692	31,048
Trade receivables	3,836	2,526	2,997	3,334	3,515
Cash & cash equivalents	184	770	4,886	1,148	1,210
Total assets	**71,955**	**67,202**	**71,202**	**72,107**	**71,294**

Source: Company data; Khambatta Research

Ratio Analysis

	FY19A	FY20A	FY21A	FY22E	FY23E
ROA	-2.4%	-1.2%	1.2%	2.2%	3.2%
ROCE	4.4%	8.0%	14.4%	15.6%	18.5%
ROE	-8.3%	-3.6%	3.7%	6.6%	8.8%
Debt-to-equity ratio	1.51x	1.50x	1.54x	1.31x	1.09x

Source: Company data; Khambatta Research

Key Risks

- Sugar is a highly regulated and policy-driven sector. Any significant changes in policy, regulations or administered prices can potentially affect our outlook and forecast.
- Sugar is an agro-commodity and is subject to crop yield and produce, which in turn is dependent on seasonal rainfall, water availability and other natural phenomenon.
- Our outlook for the sugar sector is strongly driven by the advanced EBP target and consequently its implementation is a key driver of our expectations.
- Further severe waves of COVID-19 or it remaining around for an extended period of time, especially in rural India can potentially have a negative impact on sugarcane and sugar/ethanol production.

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Guide to Khambatta's research approach

Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

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Buy recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

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