

PRAJ INDUSTRIES

Poor show; 2G ethanol to spur revival

India Equity Research | Engineering and Capital Goods

Praj Industries (Praj) extended dismal performance for the second successive quarter - Q1FY18 revenue and order intake declined 10%/41% YoY respectively, as ethanol business grappled with a challenging environment (both international and domestic). Domestic market is expected to see some revival on: 1) Favourable monsoon; 2) Rise in import duty on sugar from 40% to 50%; and 3) Higher international prices, which could propel downstream ethanol investments. While near-term headwinds persist, we expect Praj's focus on scalable businesses like 2G ethanol, high purity and critical process equipment to be key growth drivers over next 2-3 years. Maintain 'BUY'.

Revenue hit by tepid ethanol business, H1FY18 to remain subdued

Revenue fell 9%, primarily impacted by the 7% dip in ethanol business (mainly exports). In domestic ethanol market, blending is still at ~2.5-3% versus the 10% mandate. The INR2.7bn Petrobras order is at final bidding (Praj is a confirmed subcontractor irrespective of the winner) stage and management expects the project to restart in H2FY18. Emerging businesses and high purity are expected to gain traction, riding stringent FDA norms/compliance and domestic refinery expansion & modification. We estimate these businesses to clock 20% revenue CAGR over FY17-19.

Hopes pinned on 2G ethanol ordering

IOCL and BPCL recently selected Praj as their technology partner for setting up two 2G ethanol plants in India worth INR6.5-7.0bn each, wherein Praj's scope is pegged at INR3.5-4.0bn each. Once these translate into firm orders, we estimate the company's order book to double to ~INR19bn. We have built in 1 order worth INR4bn in our order intake assumptions.

Outlook and valuations: 2G ordering key; maintain 'BUY'

We trim FY18/19E EPS by 7%/10% in FY18E/FY19E as we anticipate delays in execution of the Petrobras order (20% of OB) and margin pressure in ethanol business. Key downside risks to our earnings estimates remain deletion of Petrobras order from OB and delayed ordering in 2G ethanol space. However, over next 2-3 years, we envisage Praj to focus on scalable businesses like high purity, critical process equipment and 2G ethanol which would drive future growth. At CMP, stock trades at 17x FY19E. Maintain 'BUY' with revised TP of INR85 (INR94 earlier), based on 20x FY19E.

Financials

(INR mn)

Year to March	Q1FY18	Q1FY17	% Chg	Q4FY17	% Chg	FY17	FY18E	FY19E
Net revenues	1,859	2,049	(9.3)	3,016	(38.4)	9,150	9,633	11,188
EBITDA	10	68	(85.9)	383	(97.5)	732	778	1,089
Adjusted Profit	4	41	(90.0)	228	(98.2)	446	525	735
Diluted EPS (INR)		0.2	(90.0)	1.3	(98.2)	2.5	3.0	4.1
Diluted P/E (x)						28.6	24.3	17.4
EV/EBITDA (x)						14.7	13.9	9.9
ROAE (%)						6.5	7.3	10.0

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	None

MARKET DATA (R: PRAJ.BO, B: PRJ IN)

CMP	: INR 72
Target Price	: INR 85
52-week range (INR)	: 95 / 63
Share in issue (mn)	: 179.8
M cap (INR bn/USD mn)	: 13 / 200
Avg. Daily Vol. BSE/NSE ('000)	: 655.7

SHARE HOLDING PATTERN (%)

	Current	Q4FY17	Q3FY17
Promoters *	33.6	33.6	33.7
MF's, FI's & BKs	22.0	20.4	20.8
FII's	9.6	9.8	8.0
Others	34.8	36.2	37.5
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	0.6	(13.0)	(13.6)
3 months	1.6	(13.0)	(14.6)
12 months	19.8	(15.6)	(35.5)

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Q1FY18 conference call: Key highlights

Order Intake stood at INR 1.65 bn with 38% from the domestic market; 32% came from bioenergy; 18% from Hipurity and the balance 50% from engineering business

Order Backlog is INR 9150 mn out of which domestic is 53% and Exports is 47%

Breakup: Bioenergy is 52% , Praj Hipurity 10% and engineering business is 38%

Outlook

- Domestic market is still challenging but the management is seeing traction from international markets like Asia Pacific, South America and America
- Ethanol blend ratio is expected to be around 2.5% in FY18 against 4.15% in FY17
- The management believes that by next sugar year (Oct 2017) the demand will be much better and the margins will get evened out during the year

HiPurity

- Praj Hipurity won a large order for an integrated modular process system from an American pharmaceutical company

Engineering Segment

- Praj has received two orders from one US Client for specialized skids for production of high performance environmental friendly polymers and chemicals and another order from a leading consumer from Africa
- Petrobas related orders continue to be part of order book

Other Highlights

- Capex for FY18 stands at INR 150 mn
- Cash on Hand stood at INR 2080 mn
- HiPurity has reached maturity and facing good traction
- Early monsoon caused early closing of sugar crushing season
- Karnataka has eliminated the requirement of permits from excise department for ethanol production
- Brewery contributed INR 200 mn to the order book and INR 150 mn to the top-line

Gevo & Praj Arrangement

- They have successfully developed Biobutanol from molasses
- Praj will make bio butanol available from FY19 and Gevo will start putting it into jet fuel for commercial airlines
- Commercial discussions with Gevo will close by the end of the quarter
- Gevo will buyback 100% of biobutanol if it is produced from Molasses in India and will claim rate benefit advantage from the US

Second generation ethanol plants

- The government of India is planning to increase the blending mix to 10% and higher
- The OMC's have been given direction by the ministry of Oil and Gas to set up 12 projects. Out of the 12 projects each one has been given a particular territory to set up the project. All of them have approached EIL as consultant; some sites are getting cleared and by the end of Q2FY18 should get more clarity
- The company expects a steady state of orders from this segment

Engineering and Capital Goods

Financial snapshot

(INR mn)

Year to March	Q1FY18	Q1FY17	% change	Q4FY17	% change	FY17	FY18E	FY19E
Net revenues	1,859	2,049	(9.3)	3,016	(38.4)	9,150	9,633	11,188
Raw material costs	905	983	(7.9)	1,632	(44.5)	4,671	4,846	5,617
Staff costs	366	384	(4.8)	333	9.9	1,480	1,516	1,587
Other operating expenses	579	615	(5.9)	668	(13.3)	2,266	2,493	2,896
Total expenditure	1,850	1,981	(6.7)	2,633	(29.7)	8,418	8,855	10,100
EBITDA	10	68	(85.9)	383	(97.5)	732	778	1,089
Depreciation	58	58	(0.5)	54	7.6	221	255	265
EBIT	(48)	10	NA	330	NA	511	523	823
Other income	55	44	27.4	40	38.8	177	189	216
Interest	2	4	(45.5)	2	20.0	13	12	19
Add: Exceptional items								
Profit before tax	5	49	(90.0)	368	(98.7)	675	700	1,020
Tax	1	8	(89.9)	140	(99.4)	229	175	286
Minority interest								
Reported net profit	4	41	(90.0)	228	(98.2)	446	525	735
Adjusted Profit	4	41	(90.0)	228	(98.2)	446	525	735
Equity capital(FV INR 2)	356	356		356		356	356	356
No. of shares (mn)	177	177		177		178	178	178
Diluted EPS (INR)	-	0.2	(90.0)	1.3	(98.2)	2.5	3.0	4.1
Diluted P/E (x)	-	-		-		28.6	24.3	17.4
EV/EBITDA (x)	-	-		-		14.7	13.9	9.9
ROAE (%)	-	-		-		6.5	7.3	10.0
Raw material	48.7	47.9		54.1		51.1	50.3	50.2
Employee cost	19.7	18.7		11.0		16.2	15.7	14.2
Other expenses	31.1	30.0		22.1		24.8	25.9	25.9
EBITDA	0.5	3.3		12.7		8.0	8.1	9.7
Depreciation	3.1	2.8		1.8		2.4	2.6	2.4
Other income	3.0	2.1		1.3		1.9	2.0	1.9
Adjusted net profit	0.2	2.0		7.6		4.9	5.5	6.6
Tax rate	16.3	16.1		38.0		33.9	25.0	28.0

Change in Estimates

	FY18E			FY19E			Comments
	New	Old	% change	New	Old	% change	
Net Revenue	9,633	9,839	(2.1)	11,188	11,658	(4.0)	Building in delays in Petrobras execution
EBITDA	778	825	(5.7)	1,089	1,207	(9.8)	
EBITDA Margin	8.1	8.4		9.7	10.4		Building in poor Q1
Adjusted Profit	525	559	(6.1)	735	809	(9.1)	
After Tax							
Net Profit Margin	5.5	5.7		6.6	6.9		
Capex	260	260	0.0	260	260	0.0	

Company Description

Praj, since inception in 1984, has evolved from a dominant, single business enterprise into a global organisation driven by technology innovation and integration capabilities in process engineering and industrial biotechnology domains. As its core business, the company offers innovative technology solutions and project implementation and management services to the bio-ethanol industry. It is also involved in two major growth platforms—one focusing on industrial solutions for water & waste water management and critical process equipment & systems and the other on bio-based products. A globally leading company with over 600 references in more than 60 countries across five continents, Praj has acquired an international repute for responsible and reliable solutions. Having established a global leadership in first generation ethanol technology, Praj has initiated a project to expand its 2G Cellulosic Ethanol Program to demo scale. Praj has well equipped manufacturing facilities—one in Pune and two at Kandla (Gujarat) port of India and another at Wada near Mumbai.

Investment Theme

Diversification to high growth segments imparts scalability

Praj has diversified its revenue base over the past four-five years with core business contribution moving from 100% to 72% currently; emerging businesses—critical process equipment, waste water, Neela—contribute the balance. The company aims to further improve overall revenue mix to 50:50 by FY18E led by stable growth in conventional and high growth (25% CAGR) in emerging businesses.

Core business steady; brewery business gaining traction

Led by global references and ethanol blending mandates in key export regions like US, Brazil, Columbia, Peru, Thailand, Malaysia etc, Praj has sustained a steady position in the global ethanol market. Its brewery business recently bagged two large projects overseas and expects to sustain the increased momentum.

Key Risks

Regulatory mandate: A large part of Praj's business (70% ethanol business) comes from regulatory mandate. Any delay or change in the decision of the government could impact the business adversely.

Slowdown in industrial capex: Any slowdown in industrial capex and consumption may impact revenue and hence the company's profit.

Letdown of the 2G plant: While we have not built any financial impact of 2G plant commercialisation, we believe a lot of hopes have been pinned around the success of 2G plant. Any failures to compete with the global players might dampen the investor's sentiments.

Financial Statements

Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.0	67.5	66.0	66.0
Company				
A) Ethanol business	21.7	(19.3)	5.8	19.9
B) Brewery business	(23.1)	(1.6)	(38.2)	(31.6)
C) Emerging business	(22.4)	12.6	19.7	20.6
A) Ethanol business	(9.3)	5.2	20.0	5.0
B) Brewery OI growth	12.6	(34.4)	-	10.0
C) Emerging business	(31.6)	(1.6)	5.0	5.0
Excise duty as % of rev	3.4	3.4	3.4	3.4
Tax rate (%)	23.7	33.9	25.0	28.0
Dep. (% gross block)	6.6	5.6	6.0	5.9

Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Income from operations	10,158	9,150	9,633	11,188
Materials costs	4,670	4,671	4,846	5,617
Employee costs	1,544	1,480	1,516	1,587
Other mfg expenses	2,868	2,266	2,493	2,896
Total operating expenses	9,082	8,418	8,855	10,100
EBITDA	1,076	732	778	1,089
Depreciation	250	221	255	265
EBIT	826	511	523	823
Add: Other income	170.4	177.4	189.38	216.5
Less: Interest Expense	20	13	12	19
Profit Before Tax	976	675	700	1,020
Less: Provision for Tax	231	229	175	286
Less: Minority Interest	-	-	-	-
Reported Profit	745	446	525	735
Adjusted Profit	745	446	525	735
Shares o/s (mn)	177	177	177	177
Adjusted Basic EPS	4.2	2.5	3.0	4.1
Diluted shares o/s (mn)	177	177	177	177
Adjusted Diluted EPS	4.2	2.5	3.0	4.1
Adjusted Cash EPS	5.4	4.0	4.4	5.6
Dividend per share (DPS)	1.6	1.8	2.0	2.2
Dividend Payout Ratio(%)	46.6	82.7	77.3	60.8

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	89.4	92.0	91.9	90.3
Materials costs	46.0	51.1	50.3	50.2
Staff costs	15.2	16.2	15.7	14.2
Other mfg expenses	28.2	24.8	25.9	25.9
Depreciation	2.5	2.4	2.6	2.4
Interest Expense	0.2	0.1	0.1	0.2
EBITDA margins	10.6	8.0	8.1	9.7
Net Profit margins	7.3	4.9	5.5	6.6

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	0.4	(9.9)	5.3	16.1
EBITDA	16.2	(32.0)	6.2	40.0
Adjusted Profit	(2.3)	(40.1)	17.7	39.9

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	356	359	359	359	
Reserves & Surplus	6,197	6,738	6,857	7,145	
Shareholders' funds	6,553	7,096	7,216	7,504	
Minority Interest	3	3	3	3	
Short term borrowings	159	43	143	243	
Long term borrowings	1	1	1	1	
Total Borrowings	160	43	144	244	
Long Term Liabilities	130	158	159	159	
Deferred tax (net)	(134)	(109)	(109)	(109)	
Sources of funds	6,712	7,192	7,412	7,800	
Gross Block	3,959	4,018	4,268	4,518	
Net Block	2,097	1,936	1,930	1,915	
Capital work in progress	8	315	325	335	
Intangible Assets	626	626	626	626	
Total Fixed Assets	2,731	2,876	2,881	2,876	
Non current investments	237	137	147	157	
Cash and Equivalent	2,035	2,079	2,108	2,249	
Inventories	1,008	1,045	1,062	1,231	
Sundry Debtors	3,671	2,949	3,279	3,808	
Loans & Advances	72	62	69	77	
Other Current Assets	1,679	2,617	2,748	2,885	
Total current assets	6,430	6,673	7,158	8,002	
Trade payable	2,072	2,134	2,217	2,570	
Other Current Liab	2,650	2,439	2,665	2,914	
Total Current Liab	4,721	4,574	4,883	5,484	
Net current assets	1,709	2,100	2,276	2,519	
Uses of funds	6,712	7,192	7,412	7,800	
BVPS (INR)	36.9	40.0	40.7	42.3	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	745	446	525	735	
Add: Depreciation	250	221	255	265	
Interest (Net of Tax)	15	9	9	14	
Others	(102)	(9)	(9)	(14)	
Less: Changes in WC	392	407	176	243	
Operating cash flow	516	260	604	758	
Less: Capex	125	367	260	260	
Free Cash Flow	391	(106)	344	498	

Cash flow metrics				
Year to March	FY16	FY17	FY18E	FY19E
Operating cash flow	516	260	604	758
Investing cash flow	(14)	(267)	(270)	(270)
Financing cash flow	(678)	(483)	(306)	(347)
Net cash Flow	(176)	(489)	28	141
Capex	(125)	(367)	(260)	(260)
Dividend paid	(688)	(369)	(406)	(447)
Share issue/(buyback)	36	3	-	-

Profitability and efficiency ratios				
Year to March	FY16	FY17	FY18E	FY19E
ROAE (%)	11.2	6.5	7.3	10.0
ROACE (%)	14.7	9.9	9.8	13.8
Inventory Days	78	80	79	75
Debtors Days	116	132	118	116
Payable Days	150	164	164	156
Cash Conversion Cycle	44	48	33	35
Current Ratio	1.8	1.9	1.9	1.9
Gross Debt/EBITDA	0.1	0.1	0.2	0.2
Gross Debt/Equity	-	-	-	-
Debt/Equity (x)	-	-	-	-
Interest Coverage Ratio	40.7	39.0	42.9	42.5

Operating ratios				
Year to March	FY16	FY17	FY18E	FY19E
Total Asset Turnover	1.5	1.3	1.3	1.5
Fixed Asset Turnover	4.7	4.5	5.0	5.8
Equity Turnover	1.5	1.3	1.3	1.5

Valuation parameters				
Year to March	FY16	FY17	FY18E	FY19E
Adj. Diluted EPS (INR)	4.2	2.5	3.0	4.1
Y-o-Y growth (%)	(2.3)	(40.1)	17.7	39.9
Adjusted Cash EPS (INR)	5.4	4.0	4.4	5.6
Diluted P/E (x)	17.2	28.6	24.3	17.4
P/B (x)	1.9	1.8	1.8	1.7
EV / Sales (x)	1.1	1.2	1.1	1.0
EV / EBITDA (x)	10.1	14.6	13.8	9.8
Dividend Yield (%)	2.3	2.5	2.7	3.0

Additional Data

Directors Data

Mr. Pramod Chaudhari	Executive Chairman	Mr. Gajanan Nabar	CEO & MD
Mr. Berjis Desa	Non Executive Director	Mr. Rajiv Maliwal	Non Executive Director
Mr. Kishore Chaukar	Non Executive Director	Mr. Prakash Kulkarni	Non Executive Director
Mr. Utpal Sheth	Non Executive Director	Mr. Sivaramakrishnan S Iyer	Non Executive Director
Mrs. Parimal Chaudhari	Non Executive Director		

Auditors - B. K. Khare & Co

Holding – Top10

	Perc. Holding		Perc. Holding
Chaudhari pramod m	21.53	Chaudhari pramod m	21.53
Chaudhari parimal	12.01	Chaudhari parimal	12.01
Hdfc asset managemen	8.91	Hdfc asset managemen	8.91
Tata cap financial s	7.47	Tata cap financial s	7.47
Sundaram asset manag	5.4	Sundaram asset manag	5.4

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
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No Data Available

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
02 May 2017	Vikram pandit	Sell	39000.00
17 Apr 2017	ANIRUDDHA PHADKE	Sell	17884.00
09 Nov 2016	Dattatraya NimbolkarDATTATRAYA NIMBOLKAR	Sell	33330.00

**as per last available data*

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Coverage group(s) of stocks by primary analyst(s): Engineering and Capital Goods

ABB India, Bharat Heavy Electricals, Bharat Forge, CG Power and Industrial Solutions, Engineers India Ltd, Greaves Cotton, KEC International, Cummins India, Kalpataru Power, Larsen & Toubro, Praj Industries, Ramkrishna Forgings, Siemens, TD Power Systems, Techno Electric & Engineering, Thermax, Triveni Turbine, VA Tech Wabag

Recent Research

Date	Company	Title	Price (INR)	Recos
16-Aug-17	CG Power & Industrial Solutions	Higher costs lead to losses; earnings stability key; <i>Result Update</i>	81	Hold
14-Aug-17	Ramkrishna Forgings	Delivers on expectations; momentum to sustain; <i>Result Update</i>	538	Buy
14-Aug-17	Techno Electric and Engineering	Stellar quarter; poised for robust growth; <i>Result Update</i>	373	Buy

Distribution of Ratings / Market Cap

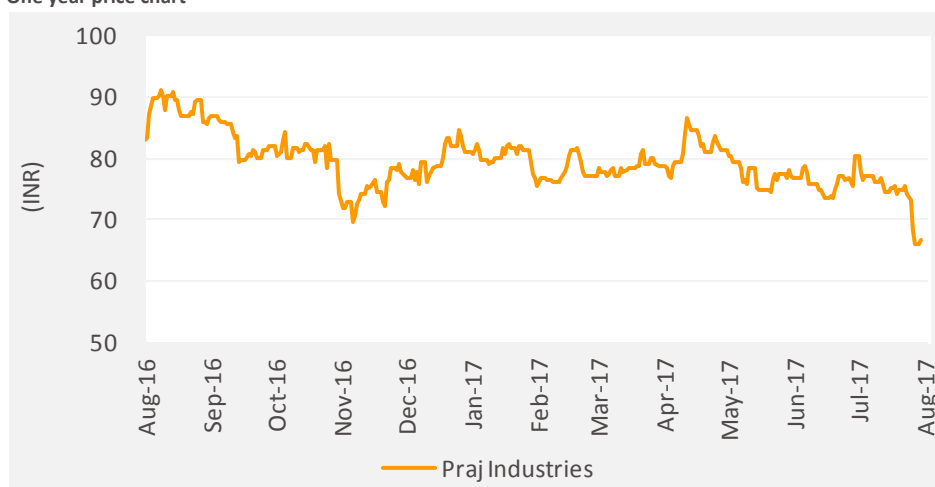
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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