Dated: 1st April 2002

Praj Industries Ltd.

Company visit report

Person Met: **Mr. D.G. Mogal**
Designation: Finance Controller & Company Secretary

Person Met: **Vinati Moghe**
Designation: Assoc. Vice President – Corporate Comm.

Date of visit: 21st March 2002. Friday
Analyst: Rusmik Oza

We met up with the officials of Praj Industries to ascertain the future outlook of the company in the light of the government allowing mixing of 5% Ethanol with Petrol. Praj Industries has tied up with Delta-T Corporation of the USA for providing Ethanol plants to Distilleries and Sugar industry. Company has secured seven contracts for supplying Ethanol plants to various entities in India as well as abroad.

Praj Industries: Background
Praj Industries Ltd., promoted by Mr.Pramod Chaudhari, Shashank Imandar and Associates went public in 1994. The company is in the business of design, manufacture, supply and commissioning of fermentation and distillation equipment. The major customers of the company in this regards is the Sugar factories and Breweries. Alcohol industry accounts for 60-65% of the company's revenue while breweries account for around 20-25%. The remaining 10-15% come from the food processing, dairy and other industries. The company's revenue in FY97 was Rs.52 cr and that in FY01 was Rs.36 cr. Revenues of the company have been very volatile in the last five years due to uneven demand from the end users.

Highlights of our meet:

- The main focus of our meet was to ascertain the future potential that is likely to come from Ethanol. To reduce the import bill Government has allowed mixing of 5% ethanol with Petrol. By mixing 5% Ethanol with Petrol we would be saving around Rs.800 cr annually from imports. In Brazil, Ethanol content in petrol is 20-24%. The Government in Brazil varies the proportion from time to time to influence the sugar market. In the US usage of Ethanol has been increasing rapidly in the recent past.

- At current consumption levels of 7,200 mn litres of petrol, India would require 360 mn litres of fuel ethanol for blending 5% with petrol. According to company officials the average capacity of Fuel Ethanol plants in India would be in the region of 30,000-40,000 litres per day. Thus we would require 50-60 Fuel Ethanol plants to capture the potential market of 360 mn litres. Praj has secured seven contracts till date to set up Fuel Ethanol plants in India and abroad.

- Praj has secured four orders in India and one each in Thailand, Nepal and Malawi. Around 50% of the sugar factories in India have their own distilleries that manufactures ethanol (not Fuel ethanol). Demand for Fuel Ethanol plants would come from two areas. The existing sugar companies/distilleries or from companies setting up green field units. The time and cost of upgrading an existing distillery is more economical and most of the demand would come from this source. The existing distilleries would require add on machineries that can produce Fuel grade Ethanol.

- Praj has tied up with Delta-T Corporation for designing, engineering and supplying entire Fuel Ethanol plants based on New Molecular Seive Dehydration (MSDH) Technology. Delta-T is the single largest supplier of MSDH plants in the world for anhydrous/Fuel Ethanol. In Dehydration process, water is removed from the alcohol and the driest form of ethanol, up to 99.8% purity is derived. Fuel ethanol calls for 98% purity / ethanol content.

- The economic viability of Fuel Ethanol will depend on availability and prices of the raw material. Molasses is the major raw material for producing Ethanol and Fuel Ethanol. Prices of Molasses are volatile and supplies are uneven. Praj is working on alternate feedstock such as secondary juice from sugar mills, tropical sugar beet, sweet sorghum (Jowahar) and tapioca. Praj officials expect pricing of Fuel Ethanol to be in the vicinity of Rs.18-19 per litre. For Fuel Ethanol to succeed, international crude prices should be above US$25 per barrel. Fuel Ethanol breaks even at around US$ 25 per barrel crude prices. This means the government will have to provide fiscal incentives for the manufacturing of fuel Ethanol.

- In the recent Union Budget for fiscal 2002-03 the Finance Minister has announced some incentive for mixing Ethanol with Petrol. The surcharge on Petrol mixed with 5% Ethanol would be Rs.5.25 per litre as compared to Rs.6 per litre for Petrol. Other incentives in the form of lower excise duty and tax holiday would be required to give impetus for manufacturing of fuel ethanol.

- The main competitor of Praj in Fuel Ethanol plants would be Alfa Laval. The later has tied up with US based Katzan Inc. Praj officials expect other players to enter the field because of the huge opportunity available. We expect Praj to maintain a market share of around 50% because of the first mover advantage and its technology tie-up with Delta-T Corp.

Financials

Last three years have been very bad for the company. Net sales has remained stagnant while most of the earnings has come from other income. Praj being an engineering company works on wafer thin margins. The company's operating margins have been in the range of 4-10% in the last five years. Company's balance sheet is very weak and needs to be cleaned. Provision for doubtful debts to the tune of Rs.6 cr has not been provided and needs to be written off. Similarly around Rs.2 cr worth of Loans and advances given by the company are considered doubtful and will be required to be written off.

In FY02 the company expects to show gross sales of Rs.55 cr, that is a 38% higher than FY01 figure. Operating margins in FY02 should be around 8.5% as compared to 4.1% in FY01. We expect the company to write-off around Rs.2 cr in FY02 towards doubtful debts. This will give a Net profit of Rs.1.4 cr in FY02 (Rs.0.94 cr in FY01).

Company expects to grow at a CAGR of 30% in the next three years. We expect the company to grow at a CAGR of 38% in the next two years. We expect the company's existing business (excl. Fuel Ethanol) to grow at a CAGR of 18-20% in FY03 & FY04. We expect the company to commission 11 Fuel Ethanol plants in FY03 and FY04 each.

Praj Ind.: Financial Summary

Rs. in cr	FY01	FY02 P	FY03 P	FY04 P
Sales (excl. Fuel Ethanol)	40.2	51.0	61.2	71.0
Sales Fuel Ethanol	--	5.0	36.5	35.0
Total	**40.2**	**56.0**	**97.7**	**106.0**
Less: Excise duty	3.7	5.3	9.3	10.1
Net Sales	36.5	50.7	88.4	95.9
% increase	-18%	39%	74%	8%
Operating profit	1.5	4.3	8.3	9.0
OPM (%)	4.1%	8.5%	9.4%	9.3%
Interest Exp.	2.3	2.2	2.5	2.8
Depreciation	1.0	0.8	1.1	1.1
Other income	2.9	2.3	2.3	2.6
Write offs	0.1	2.0	3.0	2.6
Profit before Tax	1.0	1.5	4.2	5.1
Prov. for tax	0.0	0.2	1.2	1.5
Profit after Tax	**0.9**	**1.4**	**3.0**	**3.6**
EPS (Rs.)	**1.4**	**2.1**	**4.6**	**5.6**
% increase	-59%	46%	119%	21%

We expect the company to write-off the entire Rs.7.6 cr in stages over the next three years. In line with this we have assumed Rs.2 cr write-off in FY02, Rs.3 cr write-off in FY03 and Rs.2.6 cr write-off in FY04. In FY03 we expect the company to achieve RONW Of 14% and ROCE of 25%.

Valuation

The management has not been able to fulfill on its past promises. For example in 1999 the company had portrayed 'Praj' as a 'Knowledgeware' company having a blend of IT. Then in 2000 the company created the image of a Biotechnology company. The performance of the company in the last two years has been poor with almost the entire earnings coming from other income. We think the management needs to build investor confidence by taking the right steps and improving the company's image. The cleaning up of balance sheet will be the first step in this direction.

At current price of Rs.13.5 the stock is trading at 2.9x FY03 earnings. The earnings for FY03 would double from our estimates if we exclude the write-offs. But it is appropriate to take a view only after considering the write-offs. Going by the past track record of the management we would not be comfortable assigning a higher PE multiple to the stock. We expect the stock to trade in the range of 5x-to-6x. Thus potential price discounting at 5x-6x works to around Rs.25-28.

The government initiatives would lead to many positive triggers coming up in the next four to six months. We have just done a preliminary study on the company and would like to go further deep into it. This would lead to revision in earnings numbers as and when we update it. The outlook is definitely positive. We recommend investors to accumulate the stock from current levels of Rs.13.5 to around Rs.15.

Latest Shareholding pattern

Promoters, Directors & Relatives.	:	60%
FIs	:	10-12%
Public	:	28-30%

Karvy Stock Broking Limited
Private Client Group
7 Andheri Industrial Estate, Off Veera Desai Road, Andheri (W), Mumbai – 400 053. India.
Tel : (91-22) 695 0204 - 7, 636 7226 /9044.