Praj Industries Limited

05 July 2022

Plant Visit Note

PLANT VISIT UPDATE

Sector: Capital Goods **CMP: Rs 392**

Stock Info

Sensex/Nifty	54,166/16,141
Bloomberg	PRJ IN
Equity shares (mn)	183.7
52-wk High/Low	448/289
Face value	Rs 2
M-Cap	Rs 70bn/USD 0.89bn
3-m Avg turnover	USD 0.37mn

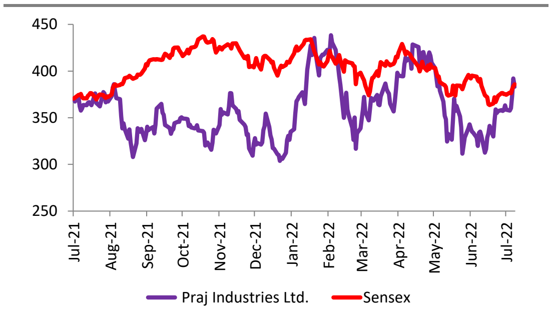
Financial Snapshot (Rs mn)

Y/E Mar	FY20	FY21	FY22
Net sales	11,024	13,047	23,333
EBITDA	781	1,124	1,938
PAT (adj.)	705	811	1,502
EPS (adj.) (Rs)	4	4	8
PE (x)	88	78	42
P/B (x)	8	7	6
EV/EBITDA (x)	72	48	27
RoE (%)	9	9	15
RoCE (%)	12	14	21
D/E (x)	0	0	0
OPM (%)	7	9	8
DPS (Rs)	1.6	2.2	3.0
Dividend Yield (%)	1	1	1
Dividend payout (%)	44	53	39

Shareholding Pattern (%)

	Mar'22	Dec'21	Sep'21
Promoter	32.8	32.8	32.8
- Pledged			
FII	13.8	15	15
DII	8.2	8.3	6.7
Others	45.1	43.9	45.5

Stock Performance (1-year)



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We Visited Praj Industries Ltd (PRJ) R&D center at Pune. Key takeaways from our visit:

- **Praj Industries (PRJ IN**) is responsible for all the basic and detailed engineering as well as fabrication work, but the company does not engage in the civil construction activity itself. PRJ is responsible for the manufacturing most of the equipment, however, some of it is contracted out.
- **Carbon Emission:** Carbon emission is the most significant trend that is taking place and will drive the demand for ethanol. Other factors driving the growth in the demand for ethanol include rural employment and the strengthening of the rural economy. The difference in the amount of carbon emissions produced by gasoline and ethanol is ~40%. Carbon trading is becoming more common in both Europe and the United States. Since carbon emissions have become a primary focus in the context of climate change, there has been a significant increase in the demand for 2G ethanol in both Europe and the United States.
- **Policy:** According to recent policy announcements, states like (Maharashtra and Karnataka) that have biofuel infrastructure in excess can send their excesses to states like (Telangana and Tamilnadu) that have biofuel infrastructure that is in lower supply. The government will assist the states by transferring any excess with an extra Rs2.5 per liter. In addition, certain policy initiatives stipulate that India is permitted to engage in biofuel exports in the event that the nation is unable to use the fuel that it has produced domestically. In India, current engines are blended to the tune of 12 to 15%, with automakers attempting to work out beyond 15 to 20%.
- **E100 vehicles:** Bajaj and TVS have started work on their E100 variant two-wheeler vehicles, and three petrol pump stations are equipped with E100 ethanol dispensing stations in Pune. The price difference between a standard two-wheeler and an E100 two-wheeler will be ~15-20%.
- **Flex Fuel:** Regarding the production of flex fuel engines, the government announced a production-linked incentive scheme that went into effect in April '22. Most flex fuel engine manufacturers, such as Toyota and Suzuki, already have their flex fuel engines running in Brazil and are working on ways to provide the same in India at a reasonable price.
- **Ethanol Blending in Automobiles:** E10, E12, and E15 are well established in India; however, necessary adjustments must be made in the rubber gasket in the engine that comes into contact with the ethanol to comply with E20. There is hardly any discernible difference in the mileage up until E20. Existing fleets of vehicles can be made E20-compliant with minor modifications, and beginning the following year, E20-variant vehicles will be introduced.
- **EV:** The story of electric vehicle adoption is more likely to be played out in urban areas, whereas rural areas are more likely to adopt biofuels. Toyota has already produced a hybrid version of a flex-fuel vehicle with an EV model in Brazil; there is a good chance that this trend will catch on in large numbers in other countries as well by 2030.

Investors are advised to refer disclosures made at the end of the research report.

- **Methanol:** The fact that currently India imports methanol and that its primary application is in the chemical industry means that methanol does not pose a direct threat to the market share held by ethanol. Most methanol production facilities are found in the northeast due to the availability of coal; therefore, moving them elsewhere for unified blending would be an expensive and impractical option.

- **Cost Structure:** When compared to the cost of a 1G ethanol plant, the cost of a 2G ethanol plant is approximately ten times higher. The cost of running a 1G ethanol plant that uses sugar as its feedstock is less than running it using grain. It is necessary for a 2G ethanol plant to take one step backwards and remove lignen from cellulose and hemicellulose, which is why both capital expenditures and operating expenditures are higher in a 2G ethanol-based plant.

- **2G Ethanol Plant:** There is currently no other commercial 2G ethanol plant operating anywhere in the world except Raizen's facility which is also catering to miniscule demand. Although Clariant has begun construction on a 2G ethanol plant in Romania, the facility is still in the trial run stage. PRJ is working on three 2G ethanol plants for three OMCs; the IRR was negative when the project was launched, but it is now positive during the construction stage. The 2G ethanol plant will not only produce ethanol but will also produce other by products that are commercially viable. It is anticipated that a 2G ethanol plant for IOCL at its Panipat facility will be operational by Dec'22, and the yield that is guaranteed is 220 litres/tonne. The IRR for 2G ethanol is expected to be 15% based on the demand scenario.

- **Ethanol in Diesel, Sustainable aviation fuel (SAF):** The expected amount of ethanol that was to be blended into diesel based on a 7.7% blending rate in FY23 was 9.7 bn ltr, and it is expected that this number will rise to 14.6 bn ltr by FY30. India is to start with SAF blending and IOCL is at the forefront of launching it. By 2025, ethanol demand is expected to reach 60 bn ltrs based on a 5% SAF blending rate. ASTM (American Society for Testing and Materials) and the Indian Air Force (IAF) both approved the PRJ sample. Europe has begun mandating the use of SAF for both domestic and international flights operating in Europe; if the criteria are not met, a carbon tax will be imposed. The Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) and the International Air Transport Association (IATA) have set a target of 30–50% SAF blending by 2030. The cost of SAF will be higher than that of ATF.

- **Order book:** According to the mission statement that was established by the government for 25% blending by the year 2025, 15bn ltr of ethanol is required, of which 7.25 bn ltr has already been created, and the remaining 7.25 bn ltr needs to be created, which could either be through greenfield or brownfield expansion, and the capex requirement to be Rs200bn. The PRJ work gamut is 35–40% (Rs70–80bn) and most of these orders are anticipated to come within the next two to three years. Expansion on greenfield typically takes between 12 and 15 months, while expansion on brownfield typically takes 9 months. Enquiry basket for PRJ appears robust, suggesting a robust demand scenario.

- **Market Share:** Approximately 55–60% of the domestic market for 1G ethanol is controlled by PRJ. European countries have demonstrated a significant amount of interest in the implementation of 2G ethanol, and the policies in those nations are more favourable to the implementation of biofuels.

- **Learnings:** The offer to order timeline used to be 4-6 months in the past, and the price remained unchanged during that period. However, because of the learning post COVID, the offer to order timeline is now only 30 days, and the price will be re-negotiated if the customer does not accept the offer.
- **CBG:** CBG is only sold in the domestic market. The IRR for the CBG plant is ~between 12-14%.
- Although there was a 37% YoY increase in exports during FY22, domestic growth continued to be stronger than export growth. Additionally, ethanol accounted for approximately 70% of the total exports.
- The management has stated that margins will remain under pressure due to RM price hikes seen because of an inflationary environment until 2QFY23, and they are expecting an impact of between 200 and 250 basis points (bps) on the EBITDA margin. Input cost smoothing will be seen in 2HFY23.
- Observing promising business prospects in Europe, Latin America, the USA, and Thailand, based on a 20% ethanol blending rate, the demand scenario for ethanol in 2025 will be 1200 cr ltrs, which will increase to 1,600 cr ltrs by 2030.

Praj Matrix (R & D Centre)

- There are a total of sixteen laboratories at Praj Matrix, including those to chemical sciences, bioprocess technology, microbiology and molecular biology, process engineering and scale-up, and process engineering (including phytochemicals).
- 1000-liter fermentation scale-up facility (non GMP).
- The in-house R & D centre is certified by the Department of Scientific and Industrial Research, Government of India.
- The Maharashtra government has granted the Private Sector Biotech Park status.
- 80000 square feet of labs, pilot plants, and offices.
- So far, a total of USD 30 million has been invested.
- 76 total technologist work, of which 20 have done their PHD's and 56 have completed their master's.
- **Broad Feedstock they have in:**
  - **Sugar Feedstock** include sugarcane juice and syrup; sugar cane molasses (over 7,000 samples across the globe); sugar beet molasses.
  - **Starchy feedstock** includes corn, sorghum, millets, wheat, and barley. The database has over 2,000 samples from different countries. Sugarcane residues, corn residues, wheat straws, rice straws, cotton straws, palm residues, and grasses.
  - **Oil feedstocks** include fish oil, palm oil residues, soy, sunflower, and rice bran oil residues
- PRJ also provides with technology and builds bolt-on modules for the 2G plant which helps to valorise lignin through purification techniques through which membranes, solvents, catalysts, and enzymes are produced, which are used in marine fuel, rubber, and tyre industries.
- Yeast development expertise includes molecular typing, bio-prospecting, metabolic engineering, and yeast breeding.

- Renewable chemicals and material development are also done.
    - **Sugars –** hyaluronic acid and bio-plastics
    - **Oils –** Tocopherol, Phytosterol, and rice bran/sunflower wax
    - **Lignin -** Bio-Bitumen

FINANCIALS

Profit & Loss Statement

YE: Mar (Rs mn)	FY18	FY19	FY20	FY21	FY22
Net revenues	**9,166**	**11,410**	**11,024**	**13,047**	**23,333**
Revenue growth (%)	0	24	-3	18	79
- Op. expenses	8651	10618	10243	11923	21395
EBITDA (Excl. OI)	**515**	**792**	**781**	**1,124**	**1,938**
EBITDA margins (%)	6	7	7	9	8
- Interest expenses	11	8	31	29	25
- Depreciation	241	230	219	221	226
+ Other income	173	233	261	190	241
- Tax	135	197	124	313	518
Effective tax rate (%)	31	25	16	29	27
Reported PAT	301	591	668	751	1,410
+/- Extraordinary items	-	-	(3)	(8)	(28)
+/- Minority interest	-	-	-	-	(0)
Adjusted PAT	**396**	**681**	**705**	**811**	**1,502**
EPS (Rs/share)	2	3	4	4	8

Source: Company, Systematix Institutional Research

Balance Sheet

YE: Mar (Rs mn)	FY18	FY19	FY20	FY21	FY22
Share capital	362	365	366	366	367
Warrants	-	-	-	-	-
Reserves & Surplus	6,900	7,085	6,826	7,652	8,790
Networth	7,261	7,450	7,192	8,018	9,157
Minority interest	7	7	7	7	7
Total Debt	60	-	152	113	147
Def. tax liab. (net)	-96	-186	-266	-89	5
Capital employed	**7,232**	**7,271**	**7,085**	**8,050**	**9,316**
Net Fixed assets	3,013	2,923	2,959	2,842	2,882
Investments	2,195	2,454	1,855	3,523	4,800
Net Working capital	2,024	1,895	2,271	1,685	1,633
Cash and bank balance	803	183	493	1,325	1,551
Capital deployed	**7,232**	**7,271**	**7,085**	**8,050**	**9,316**
Net debt	-743	-183	-341	-1,211	-1,404
WC (days)	66	63	84	67	68
DE(x)	1.1	0.7	0.2	0.1	0.0

Source: Company, Systematix Institutional Research

Cash Flow

YE: Mar (Rs mn)	FY18	FY19	FY20	FY21	FY22
PBT	**530**	**879**	**831**	**1,131**	**2,049**
- Cash Tax	-127	-206	-178	-149	-450
+ Non cash items	280	205	256	109	56
Cash profit	683	878	910	1,092	1,654
- Incr/(Decr) in WC	331	-548	-763	1,159	93
Operating cash flow	**1,014**	**330**	**147**	**2,251**	**1,747**
- Capex	161	142	71	87	185
Free cash flow	**853**	**188**	**76**	**2,164**	**1,562**
- Dividend	349	463	949	4	397
+ Equity raised	89	89	26	3	26
+ Debt raised	16	-60	-0	-	-
- Investments	610	-33	-587	1,626	1,170
- Misc. items	-81	-76	-85	-16	-15
Net cash flow	**80**	**-137**	**-177**	**553**	**36**
+ Opening cash	692	772	636	459	1,039
Closing cash	772	636	459	1,011	1,075

Source: Company, Systematix Institutional Research

Ratios

YE: Mar	FY18	FY19	FY20	FY21	FY22
P/E (x)	195.2	99.4	87.9	78.2	41.7
P/BV (x)	8.1	7.9	8.2	7.3	6.4
EV/EBITDA (x)	108.3	69.9	72.4	48.1	27.1
RoE (%)	4.1	7.9	9.3	9.4	15.4
RoCE (%)	6.2	10.9	11.6	13.6	21.0
Fixed Asset turnover (x)	3.9	5.0	4.8	5.9	10.5
Dividend (%)	80	81	81	108	150
Dividend yield (%)	0.5	0.5	0.5	0.7	0.9
Dividend payout (%)	97	50	44	53	39
Debtors days	105	98	109	127	80
Creditor days	70	75	62	96	66
Inventory days	32	40	37	36	54
Revenue growth (%)	-3.3	23.6	-3.4	18.3	78.8
EBITDA growth (%)	-25	54	-1	44	72
PAT growth (%)	-25	96	13	12	88

Source: Company, Systematix Institutional Research

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