

Bio Ethanol Agro Industries Limited

CRISIL IPO Grade 2/5 (Below average)

November 25, 2011

Grading summary

CRISIL has assigned a CRISIL IPO grade of '2/5' (pronounced "two on five") to the proposed IPO of Bio Ethanol Agro Industries Ltd (BEAIL). This grade indicates that the fundamentals of the IPO are below average relative to the other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals. The grade is not a recommendation to buy, sell or hold the graded instrument, its future market price or suitability for a particular investor.

The assigned grade reflects strong end-market prospects for grain-based extra neutral alcohol (ENA) producers such as BEAIL. CRISIL Research expects demand for Indian made foreign liquor (IMFL) using grain-based ENA to register a CAGR of 36% over FY10-FY15. BEAIL is one of the only three companies with grain-based ENA capacity in Andhra Pradesh (second largest grain-based IMFL consuming state) to ride the IMFL growth tide. Further, close proximity to raw materials (maize and rice growing areas) and a multi-grain production facility, which reduces the risk of raw material price fluctuation, support the grade.

The grade is constrained by the fact that BEAIL has commenced commercial operations only in June 2011; there is no historical data to gauge its business and financial stability. Also, the other promoter group companies have suffered significant networth erosion over the past three years. Further, the overall understanding of corporate governance practices in BEAIL can be improved. The grade has also considered the fact that the company will continue to face significant government regulations to operate in the alcohol industry.

As per the management, the company has commenced commercial operations in June 2011. It had a networth of Rs 205 mn as of September 2011.

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About the company

Bio Ethanol Agro Industries Ltd (BEAIL) was founded in June 2006 by Mr Venkata Meenavalli and Mr Veerabhadra Rao to produce, process, fabricate and trade in all varieties of ethanol. It has set up 30 KLPD capacity to primarily produce extra neutral alcohol (ENA) - the key raw material used for making Indian made foreign liquor (IMFL). ENA can be produced either from molasses or grains like maize, rice and sorghum; BEAIL has opted for grains.

Year	Event Details
2007	<ul style="list-style-type: none"> The Company was incorporated under the Companies Act 1956. Acquired 35 acres and 11 cents of land at Annadevarapeta (village), Tallapudi (Mandal), West Godavari District, Andhra Pradesh for setting up a plant to manufacture ENA and rectified spirit.
2009	Various licences required for production of ENA and environmental clearances acquired
2010	Awarded EPC contract to Mojj Engineering Systems Ltd for erection and commissioning; supply of plant and machinery and for civil, structural work and tank farm for Phase I.
2010	Company name changed from Bio Ethanol India Limited to Bio Ethanol Agro Industries Limited on October 22.

Source: DRHP

Issue details

No. of shares being offered	Not available at the time of grading
As per cent of post issue equity	Not available at the time of grading
Amount proposed to be raised	Fresh issue of Rs 620 mn
Objects of the issue	Building and civil works – Rs 72 mn
	Construction of raw material godown – Rs 31 mn
	Plant and machinery – Rs 314 mn
	Setting up carbon dioxide plant – Rs 60 mn
	Construction of water pipelines – Rs 34 mn
	Miscellaneous fixed assets – Rs 9 mn
	Preliminary and pre-operative expenses – Rs 11 mn
	Margin money for working capital – Rs 40 mn
	Public issue expenses – Rs 51 mn
Price band	Not available at the time of grading
Lead managers	Almondz Global Securities Limited

Source: DRHP

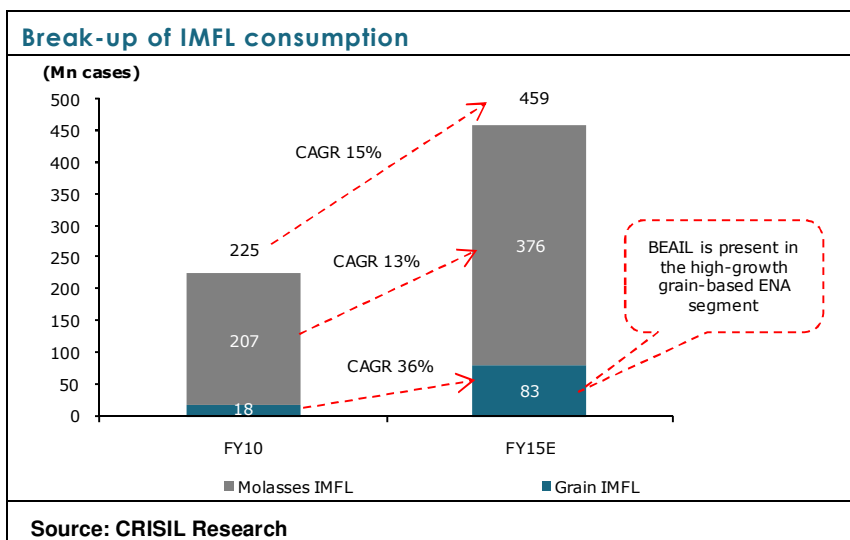
Detailed Grading Rationale

A. Business Prospect

- Healthy growth prospects for end-market – IMFL industry**

BEAIL has set up capacity to produce a key raw material – ENA – for an industry (IMFL - whisky, gin, vodka, rum and brandy) which has grown at a CAGR of ~15% over the past five years to 252 mn cases. CRISIL Research expects the IMFL market to register 12% CAGR over the next five years. Favourable demographics, higher disposable income coupled with increasing social acceptance of alcohol will largely spearhead this double-digit growth.

Consumption of grain-based IMFL to increase multi-fold: Over the next five years, CRISIL Research expects the consumption of grain-based IMFL, where BEAIL is present, to increase from ~18 mn cases in FY10 to ~83 mn cases in FY15 - CAGR of ~36%. Over the same period, consumption of molasses-based IMFL is expected to increase at a lower CAGR of ~13%, from 207 mn cases in FY10 to ~376 mn cases in FY15. The share of grain IMFL in the total IMFL pie is estimated to increase from 8% in 2009-10 to ~18% over the next five years.



Grain is largely preferred to molasses as the primary raw material for IMFL production due to the following factors:

International acceptance due to better quality and less sulphur content: Grain-based spirits are of better quality than molasses-based as the latter has greater sulphur content, which is harmful for human brain. As a result, in developed countries, grain alcohol is primarily used for potable purposes whereas molasses alcohol is largely used for industrial purposes and to manufacture gasohol (blend of ethanol and gasoline). Today, Indian players mainly use molasses, which does not meet high international standards.

Vagaries of molasses prices

Prices of molasses have been erratic in the recent past, primarily on account of fluctuations in availability of sugarcane. Distillers source molasses/ENA from sugar manufacturers. Molasses prices follow the sugar cycle, i.e. they peak during an upturn and decline during the downturn. Hence, it has become essential for distillers

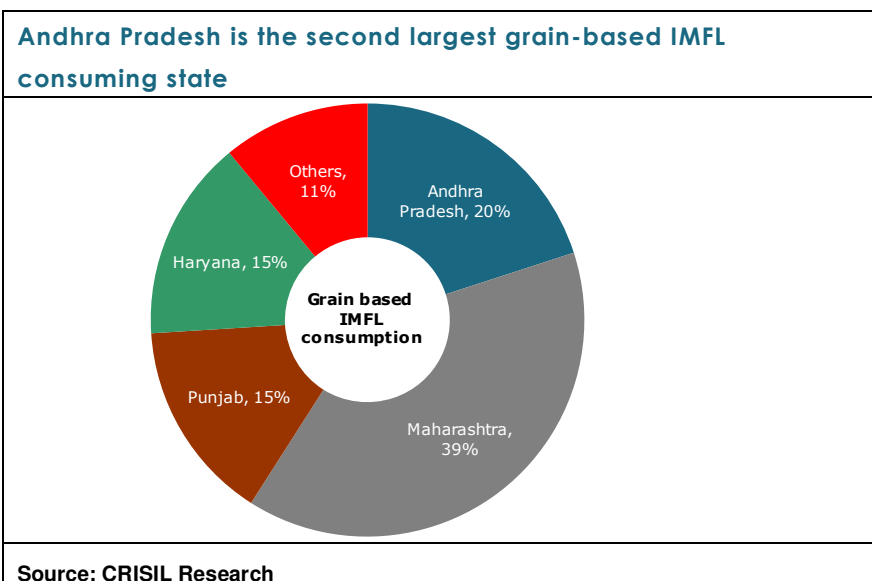
to devise an effective hedge against the unpredictable molasses prices in order to sustain their profitability.

Alternate uses for molasses

As per the 'Ethanol Program', the central government has directed oil companies to blend petrol with ethanol. Further, the price of ethanol to be paid by the oil companies was recently raised from Rs 21.5 per litre to Rs 27 per litre. Thus, selling ethanol to oil companies has become a relatively profitable proposition for the sugar companies as opposed to selling it to distillers for IMFL production. This has resulted in constrained availability of ethanol, leading distillers to resort to grain as an alternative for molasses.

- In the right place at the right time*

BEAIL is well-placed to benefit from the high growth (36% CAGR over the next five years) prospects for grain-based ENA players. The gestation period in this industry is high (three years to set up a greenfield plant) due to the high level of regulations and licences required to set up capacity and commence production. BEAIL has obtained all the necessary approvals and licences to manufacture ENA. The company is one of the three companies that have operational grain-based capacities (though not commercial) in Andhra Pradesh, the second largest grain-based IMFL consuming state. S.P.Y Agro and Sentini Bioproducts are the other two.



IMFL players are required to have manufacturing facilities in each state due to a) high excise duties in inter-state transport, b) differences in regulations across various states and c) difficulties in procuring licences for their large-scale requirements. Many players outsource or have tie-ups for procuring ENA and bottling of IMFL. They procure the ENA from the local state players like BEAIL. Being among the three players in Andhra Pradesh, a state with strong demand and limited local supply, works in favour of BEAIL.

- Locational advantage due to proximity to raw material supply*

BEAIL's plant is located near Rajahmundry, Andhra Pradesh, a major maize and rice growing area; the company uses grains (maize, rice, bajra and sorghum) and chemicals as raw materials. The plant is 8 km from river Godavari, which facilitates easy access to water, and 40 km from National Highway-9.

Further, the consumption pattern of maize - one-third human consumption and two-third poultry feed, animal feed and industrial use – allows more maize supply for the manufacture of ENA.

- *Multi-grain production facility negates volatility in raw material prices*

BEAIL is exposed to the industry-wide risk of fluctuations in grain prices. The Ministry of Agriculture announces minimum support price (MSP) for grains every year. Any increase in grain prices would have a greater impact on smaller players like BEAIL due to limited flexibility in passing on price increases.

BEAIL has hedged this risk to a certain extent by setting up a multi-grain production facility that can handle multiple types of grains like maize, rice, bajra and sorghum. It can switch between grains at any point of time according to the cost dynamics and ease of availability.

- *Lack of track record in ENA business*

BEAIL commenced operations only in June 2011; there is no historical data to gauge its business and financial stability. While promoter Mr A. Veerabhadra Rao has experience of working in the alcohol and distillery industry (diploma in fermentation and alcohol technology), Mr Venkata S. Meenavalli (the main promoter and Mr Rao's cousin) is a new entrant to the alcohol industry. For over 17 years he has been promoting and managing companies in the information technology and financial services space.

- *High level of regulations in Andhra Pradesh*

BEAIL operates in an industry which is highly regulated by respective state governments, who change policies frequently. For instance, a) the Andhra Pradesh government has banned the export of ENA from the state due to limited supply, and b) Maharashtra had stopped issuing new licences to grain-based players for setting up capacities due to shortage of grains for consumption. Any such change in legal policies could have a detrimental impact on the business, operations and financials of the company. Karnataka, Tamil Nadu and Kerala, where the company plans to expand in future, also have a high level of government regulations.

B. Financial Performance

BEAIL has commenced operations only in June 2011. Hence, financial performance of the company cannot be gauged.

Financial performance snapshot (consolidated)

Particulars	Unit	FY08	FY09	FY10	September 2010	September 2011*
Operating income	Rs mn	-	-	-	-	108
EBITDA	Rs mn	(2)	(3)	-	(4)	10
EBITDA margins	%	-	-	-	-	9.0%
Net profits	Rs mn	(2)	(5)	-	(5)	(16)
Net margins	%	-	-	-	-	(15%)
ROCE	%	(6)	(8)	-	NA	NA
ROE	%	(6)	(9)	-	NA	NA
Basic EPS*	Rs	(0.4)	(0.6)	-	(0.6)	(0.8)
No. of equity shares (FV of Rs 10)*	mn	5.6	7.6	7.6	NA	20.5
Net worth	Rs mn	50	65	84	107	205
Book value per share*	Rs	9.0	8.6	11.1	NA	NA
Current ratio	Times	35.4	11.1	0.3	NA	NA
Debt/Equity Ratio	Times	-	-	1.1	NA	NA

Source: Company, DRHP, figures have been reclassified.

C. Management Capabilities and Corporate Governance

BEAIL is one of the three companies in Andhra Pradesh with grain-based ENA capacity. BEAIL's management has been able to secure all the necessary regulatory approvals for initiating commercial production and gain a head-start over the five-six other players who are yet to set up their capacity.

- *Dependence on promoter*

Mr Meenavalli is highly experienced in IT but has no experience in either the ENA or IMFL industries. Mr Rao (co-promoter) is suitably proficient to manage the plant operations. Non-association of Mr Rao with the company (2.4% stake) could be a key risk given solo dependence on him.

- *Group companies have incurred losses in the recent past*

Northgate Technologies and its six subsidiaries have incurred losses in the past three years. The losses, according to the promoter, were due to investments in datacenters at a high cost which had to be written off during the 2009-2010 downturn. The networth of Northgate Technologies declined from Rs 2,258 mn in FY07 to 175 mn in FY10. Revenues also declined at a 37% CAGR during the same period. However, in FY11 Northgate reported revenues of 1,296 mn with a consolidated profit of Rs 10.5 mn.

Profits/(losses) of promoter group companies in the past three financial years

Particulars in Rs mn	FY08	FY09	FY10
Northgate Technologies Limited	728	(2,954)	(1,470)
Social Media India Limited	(39.7)	(49.1)	(99.4)
Globe7 Pte Limited	89.7	(2,868)	(1,635)
Globe7 HK Limited	232	(1,767)	(163)
Northgate Investments Pte. Limited	0	(2,567)	(1,801)
Green Fire Agri Commodities Limited	(0.5)	(0.6)	(0.3)
Axill Europe Limited	14	2.8	(1,343)

All the above companies except Green Fire are subsidiaries of Northgate Technologies.

- *Corporate governance practices*

Based on our conversation with the independent directors (three), we feel that they have fair understanding of the overall business of the company but understanding of corporate governance practices can be improved.

Annexure I

Business Profile

BEAIL's multi-grain distillation plant produces ENA, rectified spirit and ethanol (alternative fuel). Major by-products are distiller's dried grains with solubles (DDGS) and carbon dioxide. BEAIL has received the requisite statutory approvals and clearances pertaining to land, water, pollution and environmental clearance from the Ministry of Environment & Forests.

Products:

1) Grain-based ENA

The 96% pure grain-based ENA produced with multi-pressure distillation technology can be sold to distilleries and bottling plants for making alcoholic products (potable alcohol) and pharma grade alcohol.

2) Rectified spirits (RS)

RS can be used as an intermediate in the chemical industry. It is a base product used to produce ethanol and also to make country liquor.

3) Ethanol

Ethanol (99.99% pure) can be used as an automotive fuel by itself and can be blended with gasoline to form gasohol.

By-products

DDGS

DDGS has a reasonably high protein content, fairly low phosphorus content and low cost compared to fish meal. It can be used as a protein substitute for expensive plant protein sources and also for cattle feed/poultry feed.

Carbon dioxide

Carbon dioxide can be used in soda and soft drinks production, core hardening in foundries, MIC welding, dry ice production, preparation of artificial mineral water, effervescent lemonades and other aerated beverages. It is also used as a refrigerant in cooling, for production of refractory bricks, in pharmaceuticals, fire extinguishers, etc.

Annexure II: Profile of the Directors

Name	Designation	Age	Qualification	Experience & previous employments	Directorships / partnership in other entities
Mr. Venkata Meenavalli	Non-Executive Chairman	40	Master of Science in Computer Science from Suffield University, Certificate of proficiency in radiotelephony from Spectrum Management Agency, Australia and Certification of Novell Certified Engineer (CNE), Microsoft Certified Engineer (MCSE); and Microsoft Certified Systems Engineer + Internet (MCSE+I)	University of Sydney	Northgate Technologies Ltd, Stampede Holdings Ltd, Green Fire Agri Commodities Private Ltd, Green Fire Agro Tech Private Ltd
Mr Veerabhadra Rao	Executive Director	53	Graduation in Science from Andhra University and DIFAT (Alcohol Technology) from National Sugar Institute, Kanpur	Government Distillery, Nizam Sugars	Brilliant Securities Ltd
Mr. G. Lingamurthy	Non-Executive and Non-Independent Director	32	Post graduate in Computer Science from Institute of Advanced Studies Education University (IASE), Rajasthan	Isoftel Telecommunications Singapore, Northgate Technologies Limited	Stampede Holdings Ltd, Green Fire Agri Commodities Private Ltd, Green Fire Agro Tech Private Ltd
Mr. P. Parthasarathi	Independent Director	62	Commerce Graduate from Andhra University and CAIIB	UCO Bank, SRR Mutually Aided Co-operative Society Limited	Northgate Technologies Ltd, Social Media India Ltd, Andhra Electronics Ltd, Green Fire Agri Commodities Private Ltd
Mr. D. Prakash Rao	Independent Director	41	Master of Science in Agriculture from Andhra Pradesh Agricultural University	Shri Ramco Biotech	-
Mr. T. Naresh Kumar	Independent Director	49	Graduate in science from Osmania University and also Bachelor of Engineering in Production from Osmania University	Tool Craft Accessories, Hyderabad Connectronics Limited, Navik Systems Private Limited	Northgate Technologies Ltd, Navik Systems Private Ltd, VAR Quant Tech Securities Private Ltd, Green Fire Agri Commodities Private Ltd

Source: DRHP

Disclaimer

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