

# BBY Limited

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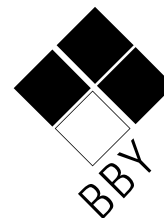
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## Sterling Biofuels International Limited

Trading at Close to Cash-Backing

# SBI

# \$0.50

# BUY

20 December 2006

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**BBY maintains its BUY recommendation on Sterling Biofuels International Limited (SBI). We have reduced our "most likely" DCF valuation to A\$1.29/s\* (prev. A\$1.73/s) as a result of a recent spike in the RBD palm olein price. Our 12 month price target is A\$0.95/s, a 26% discount to our "most likely" DCF valuation due to: i) continued uncertainty regarding the outlook for RBD palm olein prices; and ii) SBI's plant being still six months from first biodiesel production.**

▶ At current share price levels, BBY believes that SBI offers good value to investors. The stock has been oversold on concerns regarding the substantial increase in RBD palm olein prices over the past two months. Prices have risen ~30%, driven by expectations of substantial palm demand from biodiesel producers over the next few years. Biodiesel demand by 2008 is forecast to require an additional c.5.1M tonnes of palm oil as feedstock for biodiesel production. While BBY concedes that elevated RBD palm olein prices are here to stay, at A\$0.50/s, SBI is currently trading:

- on a PE FY08 of c. 2.2x; and
- at close to cash backing (the company had c.A\$30M at its last quarterly report – current market capitalisation of c.A\$33M).

▶ The company is still on track to produce biodiesel in July 2007, targeting European markets where the EU is enforcing biofuel blend levels of 5.75% by 2010. Legislative changes in the key German market mandating a compulsory 5% blend (by volume) in the new year will also underpin demand, leading to a stabilised, or even higher biodiesel price.

▶ BBY also notes that the Vance Bionenergy plant in Malaysia, which is using the Desmet technology, like SBI, is now successfully in full production.

### Impact

▶ Our long term RBD palm olein price assumption has been increased from US\$450/t to US\$500/t.

### Earnings Change

▶ FY08 NPAT reduces by A\$8.6M to A\$15.2M.

### Recommendation

Significant risks still exist in the short to medium term including: i) the successful construction of the company's biodiesel plant on time and to budget; ii) demonstrating that the plant can produce biodiesel to name-plate capacity once operational; and iii) the possibility of a further increase in the RBD palm olein price. However, BBY believes that the current share price offers an attractive entry into a biofuels company with a plant less than a year away from production. We await further news on the completion of each significant milestone of the biodiesel plant and maintain our BUY recommendation.

\* Based on a net selling biodiesel price of €580/t and a long term RBD palm olein price of US\$500/t.

### Company Data

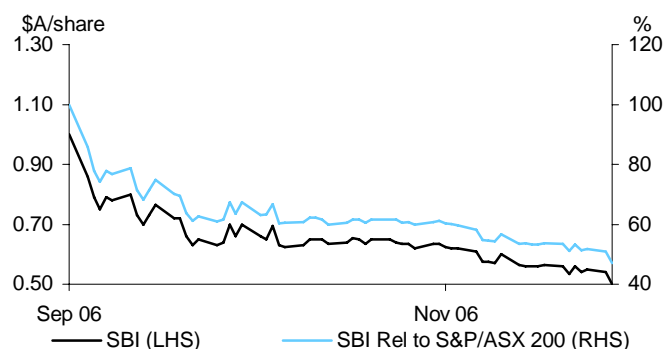
Number of shares on issue	65.0M
Market capitalisation	\$33.0M
12 month high/low	\$0.95 / \$0.49
Average monthly turnover	\$0.7M
All Ordinaries Index	5551
% All Ordinaries	n/a

### Earnings Summary

Year to June	2007F	2008F	2009F	2010F
NPAT (A\$m)	-3.8	15.2	17.9	18.8
EPS (¢/sh)	n/a	19.6	23.0	24.2
EPS growth (%)	n/a	n/a	13	0
PER (X)	n/a	2.2	1.8	1.8
Dividend (¢/sh)	0	0	0	0
Yield (%)	n/a	n/a	n/a	n/a

Figures do not include any revenue from sourcing biodiesel from other producers in Malaysia. Based on a net selling biodiesel price of €580/t and a long term RBD palm olein price of US\$500/t.

### SBI versus S&P/ASX 200 Index



Source: IRESS, BBY estimates, as at 26/10/06



## Sterling Biofuels

## Valuation data

Year ending Jun	2007	2008	2009	2010
BBY EPS Adj	n/a	0.20	0.23	0.24
P/E ratio	n/a	2.2 x	1.8 x	1.8 x
BBY EPS Adj chg %	n/a	n/a	15%	4%
Reptd EPS pre abn's	n/a	0.20	0.23	0.24
P/E ratio	n/a	2.2 x	1.80	1.80
Reptd EPS pre abns chg %	n/a	n/a	15%	4%

## Profit and loss (\$M)

Year ending Jun	2007	2008	2009	2010
Sales revenue	-	94.3	99.4	99.4
growth over pcp	n/a	n/a	5%	0%
EBITDA	(4.2)	18.8	20.5	20.5
Dep'n and amort'n	-	1.7	1.7	1.7
<b>EBIT</b>	<b>(4.2)</b>	<b>17.1</b>	<b>18.8</b>	<b>18.8</b>
growth over pcp	n/a	n/a	10%	0%
Net interest expense	-	0.40	-	-
Pre-tax profit	(3.8)	17.1	18.8	18.8
Tax	-	-	-	-
Effective tax rate	0%	0%	0%	0%
Preference dividends	-	-	-	-
Minorities	-	-	-	-
BBY adjustments	-	0.0	0.0	0.0
<b>BBY adj profit</b>	<b>(3.8)</b>	<b>17.1</b>	<b>18.8</b>	<b>18.8</b>
Reported profit (pre abn)	(3.8)	17.1	18.8	18.8
Other items (post tax)	-	(1.9)	(0.9)	-
Reported net profit	(3.8)	15.2	17.9	18.8

## Ratio analysis

Year ending Jun	2007	2008	2009	2010
EBITDA / sales	n/a	19.9%	20.6%	20.6%
<b>EBIT / sales</b>	<b>n/a</b>	<b>18.1%</b>	<b>18.9%</b>	<b>18.9%</b>
Return on assets	-0.7%	0.6%	0.5%	0.4%
<b>Return on equity</b>	<b>-13.1%</b>	<b>38.9%</b>	<b>30.4%</b>	<b>23.3%</b>
Dividend payout ratio	0%	0%	0%	0%

## Balance sheet (\$M)

Year ending Jun	2007	2008	2009	2010
Cash	4.0	13.0	26.0	41.0
Receivables	-	4.7	7.3	12.0
Inventories	-	4.0	6.0	7.8
Other	-	-	4.0	3.0
<b>Current assets</b>	<b>4.0</b>	<b>21.7</b>	<b>43.3</b>	<b>63.8</b>
Net PPE	30.0	28.3	26.6	24.9
Investments	-	-	-	-
Goodwill	-	-	-	-
Other intangibles	-	-	-	-
Other	-	-	-	-
<b>Non-current assets</b>	<b>30.0</b>	<b>28.3</b>	<b>26.6</b>	<b>24.9</b>
<b>Total assets</b>	<b>34.0</b>	<b>50.0</b>	<b>69.9</b>	<b>88.7</b>

Debt	-	-	-	-
Provisions	-	-	-	0.0
Other	5.0	6.0	8.0	8.0
<b>Total liabilities</b>	<b>5.0</b>	<b>6.0</b>	<b>8.0</b>	<b>8.0</b>
Equity / reserves	33.0	33.0	33.0	33.0
Retained profits	(4.0)	11.0	28.9	47.7
<b>Total s/h funds</b>	<b>29.0</b>	<b>44.0</b>	<b>61.9</b>	<b>80.7</b>
Minorities	-	-	-	-
<b>Total funds emp.</b>	<b>34.0</b>	<b>50.0</b>	<b>69.9</b>	<b>88.7</b>

## Cashflow (\$M)

Year ending Jun	2007	2008	2009	2010
EBITDA	(4.2)	18.8	20.5	20.5
Net interest paid	-	-	-	-
Dep'n and amort'n	-	(1.7)	(1.7)	(1.7)
Tax paid	-	-	-	-
<b>Gross cash from op'ns</b>	<b>-</b>	<b>17.1</b>	<b>18.8</b>	<b>18.8</b>
(Inc) / dec in w'k'g cap	(3.0)	(6.1)	(1.8)	(0.8)
Other	-	-	-	-
<b>Operating cashflow</b>	<b>(3.0)</b>	<b>11.0</b>	<b>17.0</b>	<b>18.0</b>
growth over pcp	n/a	n/a	55%	6%
<b>Investing cashflows</b>	<b>(21.0)</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Capital expenditure	(21.0)	0.0	0.0	0.0
Asset sales	0.0	0.0	0.0	0.0
Investments	0.0	0.0	0.0	0.0
Divestments	0.0	0.0	0.0	0.0
<b>Financing cashflows</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Equity raised	0.0	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	0.0
<b>Chg in loans</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Other non-op flows	(2.0)	(2.0)	(4.0)	(3.0)
<b>Net chg in cash</b>	<b>(26.0)</b>	<b>9.0</b>	<b>13.0</b>	<b>15.0</b>

Source: BBY



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BBY executed a mandate with SBI in August 06 and received fees for financial and advisory services. BBY was joint sponsoring broker for the issue.

Contact with SBI has been made during the preparation of this report for assistance with verification of facts.

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