

Gujarat Heavy Chemicals

STOCK INFO.
BSE Sensex: 11,589

BLOOMBERG
GHCL IN

7 April 2006

Buy

S&P CNX: 3,455

REUTERS CODE
GHCH.BO

Initiating Coverage

Rs173



Taking the big leap

*Is set to transform into the world's
third-largest home textiles player*

*Soda ash business witnessing positive
momentum, backed by the industry upturn*

*Estimate revenue growth at 88% CAGR and
net profit growth at 53% CAGR over CY05-08*

*Initiate coverage with Buy – our SOTP-based
target price of Rs223 implies an upside of 29%*

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Y/E DECEMBER	2005*	2006E	2007E	2008E
Sales (Rs m)	5,165	25,883	32,075	34,214
EBITDA (Rs m)	1,372	2,671	5,193	5,799
PAT (Rs m)	685	779	2,098	2,478
EPS (Rs)	7.2	6.8	18.4	21.7
EPS Growth (%)	127.0	13.8	169.1	18.1
BV/Share (Rs)	29.0	53.8	68.8	87.1
P/E (x)	24.0	25.3	9.4	8.0
P/BV (x)	6.0	3.2	2.5	2.0
EV/EBITDA (x)	19.8	11.3	5.7	4.8
EV/Sales (x)	5.3	1.2	0.9	0.8
RoE (%)	27.1	17.5	30.0	27.9
RoCE (%)	12.5	12.3	22.0	23.6

* For a nine-month period

KEY FINANCIALS

Shares Outstanding (m)	114.1
Market Cap. (Rs b)	19.8
Market Cap. (US\$ b)	0.4
Past 3 yrs Sales Growth (%)	47.1
Past 3 yrs PAT Growth (%)	63.6
Dividend Payout (%)	27.4
Dividend Yield (%)	1.2

STOCK DATA

52-Week Range (Rs)	177/43
Major Shareholders (as of December 2005)	(%)
Promoters	44.3
Domestic Institutions	5.3
FII/FDIs	4.7
Public	45.7
Average Daily Turnover	
Volume ('000 shares)	2,447.2
Value (Rs million)	214.8
1/6/12 Month Rel. Performance (%)	23/40/184
1/6/12 Month Abs. Performance (%)	31/77/261

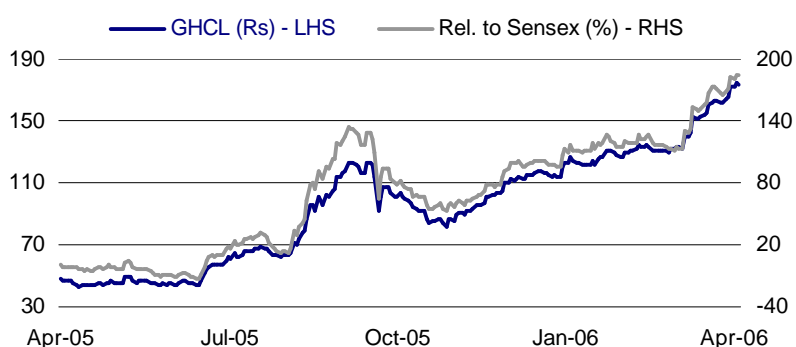
Gujarat Heavy Chemicals (GHCL) is 'taking the big leap'. It is set to transform into the third-largest home textiles player in the world. Its soda ash business is also witnessing positive momentum, backed by the industry upturn. We estimate GHCL should post revenue CAGR of 88% and post-tax profit CAGR of 53% over CY05-CY08. We initiate coverage with **Buy**.

Soda ash – on an upturn: The soda ash industry is on an upturn globally. As one of India's largest producer of high-grade soda ash, GHCL stands to benefit significantly. The company has captive raw material sources, giving it a substantial cost advantage. To make the most of the opportunity, it has already embarked on brownfield capacity expansion in India. Besides, it has recently acquired the only soda ash producer in Romania, which would allow it to gain a foothold in Europe.

Home textiles – from obscurity to global prominence: GHCL has acquired US-based Dan River, the world's third-largest home textiles company. This acquisition gives GHCL a ready market for its 36m meter home textiles processing plant, which is likely to commence commercial production in April 2006. Also, it would transform the company from a small yarn manufacturer to one of the largest home textiles players in the world.

Buy – possible upside of 29%: Post the consolidation of its overseas subsidiaries, we expect robust growth in GHCL's revenues and profits. The stock quotes at attractive valuations of 9.4x CY07E EPS and an EV of 5.7x CY07E EBITDA. We recommend **Buy**. Our SOTP-based target price of Rs223 implies an upside of 28.7%.

STOCK PERFORMANCE (1 YEAR)



Soda ash: benefiting from industry upturn

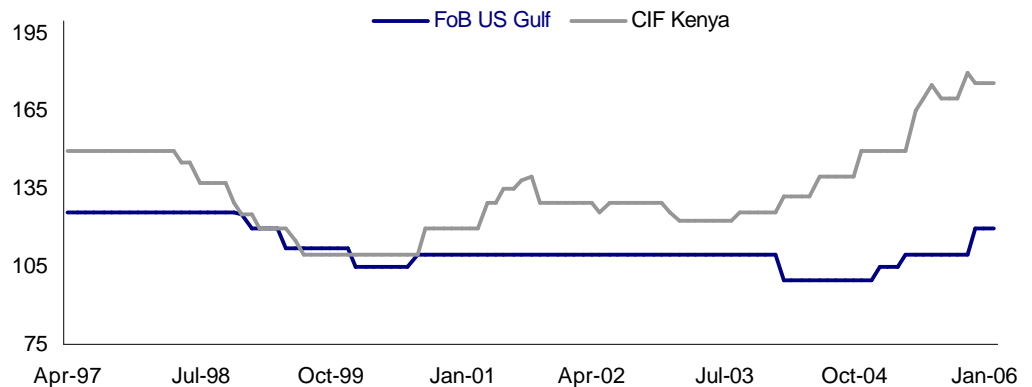
The soda ash industry is on an upturn globally. The dynamics of the domestic soda ash industry also appear attractive. As one of India’s largest producer of high-grade soda ash, GHCL stands to benefit significantly. The company has captive raw material sources, giving it a substantial cost advantage. To make the most of the opportunity it has already embarked on brownfield capacity expansion in India. Besides, it has recently acquired 65% stake in the only soda ash producer in Romania, which would allow it to gain a foothold in the growing European market.

Global soda ash industry on an upturn

Global soda ash prices have increased 33% during the last two years...

Over the last two years, global soda ash prices have increased by over 33% from US\$132/ton in February 2004 to US\$176/ton in February 2006. Global soda ash demand grew by an unprecedented 6% in CY04, compared to a 2.7% CAGR in the previous 20 years.

SODA ASH: INTERNATIONAL PRICE TREND (US\$/TON)



Source: CRIS INFAC

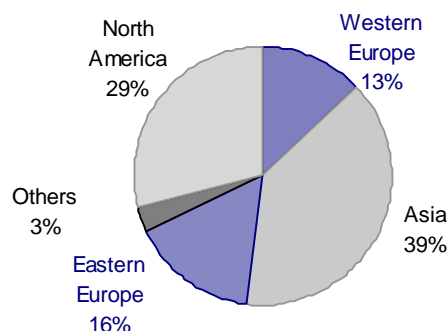
...driven by both cost push and robust demand from user industries

The key growth drivers for the global soda ash industry over the last two years have been (1) sharp increases in prices of raw materials such as coke and salt (since CY04, salt prices have increased by 150%, while coke prices have almost doubled), (2) high ocean freight rates, (3) astounding increase in demand for soda ash from China — it accounted for almost half of the global increase in soda ash volumes in CY04, (4) robust increase in demand from user industries, in particular from the glass industry (glass industry accounts for almost 55% of the global soda ash demand), (5) limited increase in supply due to low investments and high gestation period.

The size of the global soda ash industry is around 41m ton (CY04), with Asia accounting for almost 39% of the consumption. The Asian region is also the fastest growing market –

CAGR of 7% v/s a CAGR of 5% for the world. In Asia, China alone accounts for almost 80% of the capacity, and is followed by India.

SODA ASH: REGION-WISE DEMAND (CY04)



Source: Industry/ Motilal Oswal Securities

Globally, the soda ash industry is operating at very high operating rates of 90-99%. During the period CY90-04, around 18 plants closed down across the globe, resulting in supply declining by 5.2m ton. During the same time period, capacity additions were around 9m ton, with China alone accounting for 6.8m ton.

EFFECTIVE GLOBAL OPERATING RATES IN CY04 (M TON)

	NO. OF PLANTS	EFFECTIVE CAPACITY	PRODUCTION	OPERATING RATES (%)
USA	5	11.5	11.0	96
China	50	12.8	12.7	99
W. Europe	12	6.6	6.3	95
E. Europe	11	6.2	5.6	90

Source: ANSAC

GLOBAL SODA ASH CAPACITY CLOSURE & ADDITION DURING CY90-CY04 ('000 TON)

CLOSURES	YEAR	CAPACITIES	ADDITIONS	YEAR	CAPACITIES
Canada	2001	450	Uzbekistan	2004	100
Germany	1993	530	China	-	6,800
Belgium	1993	400	Pakistan	2001	40
Czech Republic	1992	150	USA	2000	1,000
Korea	2004	400	Iran	1998	80
Ukraine	1997	400	India	2000	650
USA	2004	1,000	Botswana	1991	300
France	1991	300			
Austria	2005	200			
Pakistan	2001	51			
Japan	1996-2001	780			
Bosnia	1992	225			
Albania	1993	50			
Colombia	1993	110			
Mexico	1993	150			
Total	18 plants	5,196	Total (6 plants, China excluded)		8,970

Source: ANSAC

Worldwide, announced capacity expansions over CY05-08 are 4-5m ton (China 3.4-4.4m ton and India 0.6m ton), while the world demand is likely to post 5% CAGR. We do not expect any significant change in the supply side over the next few years, as a greenfield soda ash plant takes 3-4 years to get operational. Further, there are other entry barriers such as availability of raw material.

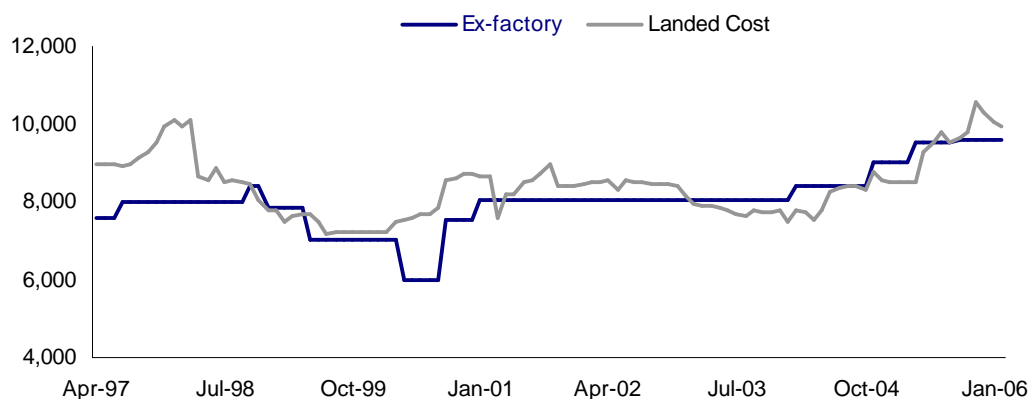
The soda ash industry has high entry barriers: (1) high capital intensity (minimum investment for economic sized plant is US\$225m), (2) project completion time of 3-4 years, (3) constraints in the form of creation of raw material resources such as salt and limestone.

Domestic soda ash prices have closely followed international prices...

Soda ash prices in India have followed the rising international prices

Soda ash prices in India have followed the rising international prices and have increased by over 28% from Rs7,778/ton in February 2004 to Rs9,972/ton in February 2006. This is despite a sharp reduction in import duty from 35% to 15% (import duty cut further to 12.5% since March 2006). Meanwhile, demand from domestic user industry has continued to remain robust.

DOMESTIC PRICE TREND (RS/TON)



Source: CRIS INFAC

... and demand is witnessing robust growth

There are no major greenfield expansions on the horizon...

The Indian soda ash industry is currently operating at 89% (FY06E) utilization rates. The industry is likely to continue to enjoy very favorable demand-supply scenario over the next few years, as there are no major greenfield expansions in the horizon. Operating rates in the domestic soda ash industry are likely to increase from 89% in FY06E to 93% in FY07E, exerting pressure on prices.

SODA ASH: DEMAND-SUPPLY SCENARIO IN INDIA ('000 TON)

	2004-05	2005-06P	2006-07P
Opening Stock	48	22	20
Production	2,320	2,416	2,510
<i>Growth in Production (%)</i>	3.7	4.1	3.9
Imports	189	240	275
Domestic Consumption	2,166	2,268	2,377
Exports	369	390	410
Closing Stock	22	20	18
<i>Growth in Consumption</i>	1.5	4.7	4.8
Capacity	2,701	2,701	2,701
<i>Operating Rate (%)</i>	86	89	93
Closing Stock to Demand Ratio (%)	1.0	0.9	0.8

Source: CRIS INFAC

...and demand from user industries continues to grow

We expect the domestic soda ash industry to grow at 6-7% over the next few years. The main industries that use soda ash in India are glass and soaps & detergents, which collectively account for almost 53% of the demand. Both these segments have been witnessing strong growth, with the glass industry growing at around 7-8% and the soaps & detergents industry growing at 6-7%. In the construction industry, the use of glass has increased in the construction of malls, corporate parks and offices. Within the glass industry, the demand for flat glass is expected to rise by 10-12% CAGR, on the back of strong growth in the automobile and construction industries.

GROWTH RATES IN THE USER INDUSTRIES (FY06)

	DEMAND (%)	3-YEAR CAGR (%) - FY06-08
Soaps & Detergents	32	6-7
Glass Industry	21	7-8
Others	47	4-5
Total	100	6-7

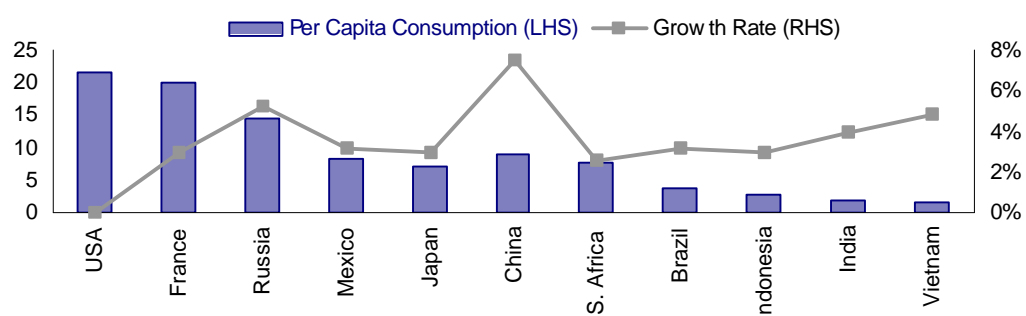
Source: Industry/ Motilal Oswal Securities

Domestic soda ash industry has potential to sustain high growth

We believe that the high growth will be sustained

The per capita consumption of soda ash is one of the lowest in India at 2kg, compared to 9kg in China and 21kg in USA. The low per capita consumption leaves plenty of scope for long-term growth in the soda ash industry.

PER CAPITA SODA ASH CONSUMPTION IN INDIA IS VERY LOW

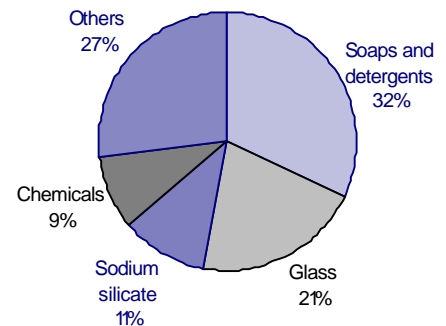
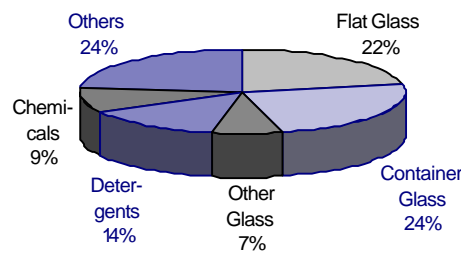


Source: Industry/ Motilal Oswal Securities

Globally glass accounts for almost 53% of the usage, while in India it currently accounts for only around 21% of the soda ash usage. India's current low per capita flat glass consumption leaves tremendous scope for accelerated growth in the future, as the economy matures and per capita glass consumption moves to global averages. The demand for flat glass is expected to rise by 10-12% CAGR, on the back of strong growth in the automobile and construction industries. In the construction industry, the use of glass has increased in the construction of malls, corporate parks and offices.

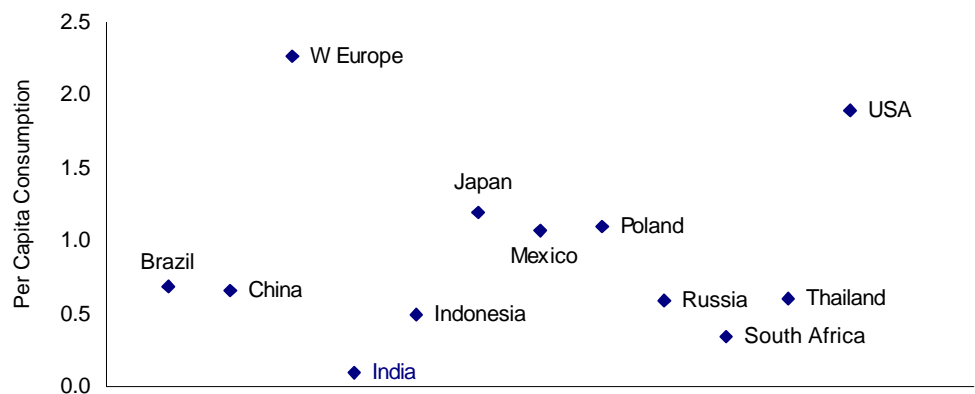
GLOBAL INDUSTRY DEMAND OF SODA ASH (CY04)

DOMESTIC INDUSTRY DEMAND OF SODA ASH (CY04)



Source: CRIS-INFAC

CURRENT LOW PER CAPITA FLAT GLASS CONSUMPTION INDICATES STRONG GROWTH AHEAD (SQ. METERS)



Source: Freedonia Group

The domestic soda ash industry is concentrated in the Saurashtra region of Gujarat on account of easy availability of salt and proximity to major consuming markets. The industry is moderately capital intensive. The minimum economic size of a soda ash plant is 1,000 ton per day, which translates into an annual capacity of 330,000 ton. The capital cost of setting up a soda ash plant of minimum economic size is Rs10b.

GHCL — one of the best proxies for India's soda ash industry

In India, the soda ash industry is fairly concentrated, with seven major players. Of these, Nirma and Birla VXL consume a large part of the soda ash produced in-house. The top two players – Tata Chemicals and GHCL – account for around 54% of the total soda ash production in India. The size of the India's soda ash industry is estimated at Rs19b.

As one of the largest producers of high-grade soda ash...

GHCL is one of the largest producers of high-grade soda ash (both dense and light varieties) in India, with a market share of about 22%. The company intends to increase its capacity from 600,000 ton per year to 1.1m ton per year by FY09 through brownfield expansion, which would increase its market share to around 33%, at current capacities.

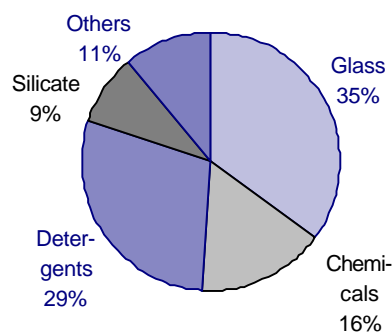
GHCL: ONE OF THE LARGEST SODA ASH PRODUCERS IN INDIA (FY05)

MANUFACTURER	LOCATION	CAPACITY ('000 TON)	% MARKET SHARE	EXPANSION PLANS ('000 TON)
Nirma/SCL*	Gujarat	1,015	38	-
Tata Chemicals	Gujarat	875	32	225
GHCL	Gujarat	600	22	500
Tuticorin Alkali	Tamil Nadu	115	4	-
DCW	Gujarat	96	4	-

* Nirma consumes most of its soda ash for detergent production

Source: AMAI

GHCL: SECTORWISE SODA ASH SALES BREAK UP (FY05)



Source: Company/Motilal Oswal Securities

...and one of the most cost-efficient producers...

Besides economies of scale, GHCL enjoys captive supplies of major raw materials including salt, limestone and coke briquettes, which gives it significant cost advantage. The company also has private mining rights for lignite, which allows it to reduce its power cost significantly. The company has been able to achieve its lowest cost status by innovative use of coke briquettes made from coke fines rather than using expensive metallurgical coke in its kilns. Also, it is the first soda ash company to obtain private mining rights for lignite, thereby substantially reducing its fuel cost. The company is aggressively working towards reducing its operating costs further to achieve overall cost of US\$100/ton, which would allow it to effectively manage a 0% import duty regime.

CAPTIVE RAW MATERIAL SOURCES GIVE GHCL SIGNIFICANT COST ADVANTAGE

RAW MATERIALS	CAPTIVE RESOURCES	% OF VARIABLE COST	ADVANTAGES
Salt	Inexhaustible 11,500 acres	19	Large crystalizers, Mech, Harvesting
Limestone	Life of more than 20 years	11	Judicious mix of purchase/captive, undesised utilization
Met Coke	Coke fines available in plenty	23	Innovatively substituted met coke for briquette coke – lower cost & captive supply
Fuel	30 years (Started in 2004)	33	First to get captive lignite mining, replacing high cost purchased lignite. Increased use of captive lignite.

Source: Company/ Motilal Oswal Securities

... GHCL stands to benefit
substantially

An international study on cost-competitiveness by British Sulphur Consultants predicts that by CY10, GHCL would emerge as one of the most cost competitive players in the world.

GHCL: ONE OF THE MOST COST COMPETITIVE MANUFACTURERS (US\$/TON)

	2005			2010		
	WYOMING (NATURAL SODA ASH)	CHINA	INDIA (GHCL)	WYOMING (NATURAL SODA ASH)	CHINA	INDIA (GHCL)
Cash Cost of Production	63.7	121.5	125.0	63.8	106	100.0
Inland Frieght to Port	50.0	5.0	9.0	55.2	5.5	10.0
Ocean Freight	60.0	40.0	35.0	40.0	26.7	23.0
Delivered Cost (US\$/TON)	173.7	166.5	169.0	159	138.2	133.0

Source: British Sulphur Consultants, CRU

Home textiles: to emerge as the third-largest player globally

GHCL has recently acquired US-based Dan River, the world's third-largest home textiles company. This acquisition gives GHCL a ready market for its 36m meter home textiles processing plant, which has started commercial production from April 2006. Also, it would transform the company from a small yarn manufacturer to one of the largest home textiles players in the world.

From a small presence in textiles...

GHCL has traditionally had only a token presence in textiles

GHCL has been a soda ash manufacturer, with a token presence in textiles. The company has two spinning units in Tamil Nadu (South India), with a total of 93,000 spindles, and a weaving capacity of 5m meters. In FY05, its textiles division posted sales of Rs850m, accounting for just about 18% of total revenues.

...to the world's third-largest home textiles company

However, it has recently acquired US-based Dan River...

Recently, GHCL has acquired US-based Dan River, the world's third-largest home textiles company. GHCL acquired the 99% stake in Dan River at a cost of US\$17.5m in equity value and an EV of US\$98.5m. Dan River has a wide distribution and sales network in USA, catering to large retailers such as JC Penney, Bed Bath and Beyond, and Wal Mart. It is also known for its brands like *Bed in a Bag*, *Marquis Home Collection*, and *Alexander Julian* in the high-end home textiles market. During CY05, Dan River recorded net sales of US\$329m, while incurring net losses of US\$53m.

DAN RIVER: CLIENT PROFILE

MARKET SEGMENTS	MAJOR CLIENTS/ BRANDS
Retailers	Walmart, JC Penney, K-Mart, Anna's Linen Inc.,
Institutional Segments	Guest Supply Inc., Best Manufacturing
Specialty Stores	Bed Bath & Beyond, Bloomingdale, Federated Stores
Juvenile Segment	Evergreen, NFL, Thomas & Friends, Robots, Pink Panther, Star Wars

Source: Company/ Motilal Oswal Securities

...making it the third-largest home textiles player, globally

Globally, 35-40% of the home textile capacity is still located in the developed countries. Going forward, majority of these production capacities are likely to migrate to low-cost developing countries. The closure of plants in the US following quota abolishment has created an additional market of an estimated US\$1.2b in the terry towels segment and US\$1.7b in the bed linen segment. Due to its strategic acquisition of Dan River, GHCL is well poised to capture this huge opportunity in the US home textiles space.

Shrinking supplier base

Large companies/capacities that have closed down/filled for chapter 11

- ✂ Pillowtex bankruptcy - US\$450m towel and US\$220m bed linen sales.
- ✂ West Point Stevens Chapter 11 – US\$455m towels and US\$580m of bed linen supply.
- ✂ Dan River - Chapter 11 (sales of US\$329m in CY05)

Other lucrative market opportunities

- ✂ Lucrative European market of US\$600m with shrinkage of supplier base
- ✂ Australian and New Zealand market of US\$50m

The company is expanding its spindle capacity from 93,000 spindles to 138,000 spindles and weaving capacity from 5m meters to 14m meters. It is also setting up a 36m meter processing unit at Vapi in Gujarat (West India), which is likely to commence production in April 2006. The Dan River acquisition has ensured a ready market for this unit.

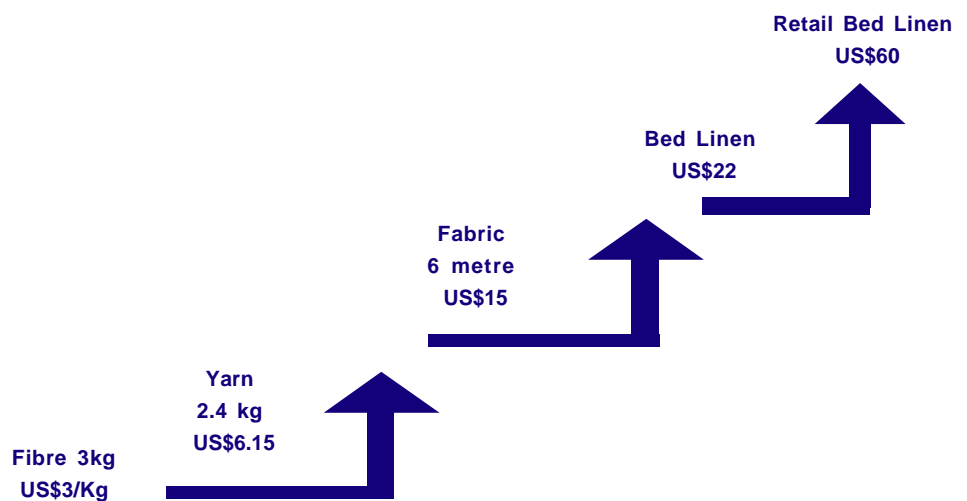
GHCL'S TEXTILE CAPACITY

SEGMENT	CURRENT CAPACITY	EXPANSION/ TIME FRAME	TOTAL CAPACITY
Spinning	93,000 spindles	35,000 by CY07	138,000 spindles
Processing	Nil	36m metres	36m metres
Weaving	5m metres	9m metres	14m metres

Source: Company/ Motilal Oswal Securities

GHCL, through its acquisition of Dan River and expansion into bed-linen, would emerge as a vertically integrated home textiles player with presence from the yarns to the retail. The exhibit below depicts the value addition possibility within the home textile value chain.

VALUE ADDITION ACROSS THE HOME TEXTILE CHAIN



Source: KSA Technopak

We expect GHCL's textile business to grow at 170% CAGR over CY05-08 to Rs22.4b. Dan River revenues should increase from Rs13.8b in CY06 to Rs16.4b in CY08. The sales from GHCL's manufacturing operations in India are likely to record a 74% CAGR (CY05-08) from Rs1.1b in CY05 to Rs5.9b in CY08.

GHCL'S TEXTILE SALES

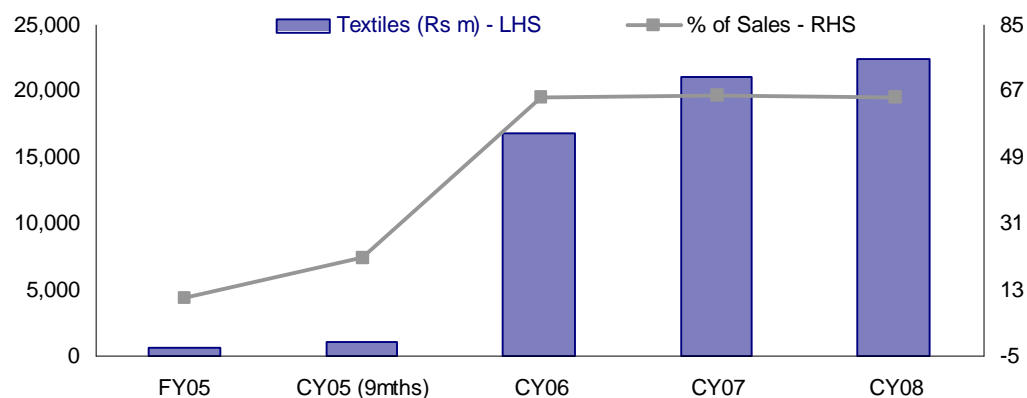
SALES-TEXTILES	CY05 *	CY06	CY07	CY08	CAGR % (3 YRS)
Spinning	1,132	851	1,175	1,459	9
Home Textiles	0	2,232	4,185	4,464	-
Dan River	0	13,795	15,700	16,454	-
Total	1,132	16,878	21,059	22,377	170

* 9 months

Source: Company/ Motilal Oswal Securities

The contribution of the textiles division to GHCL's consolidated sales is likely to increase from 18% in CY05 to around 66% of GHCL's total revenues in CY08.

INCREASING CONTRIBUTION FROM TEXTILES



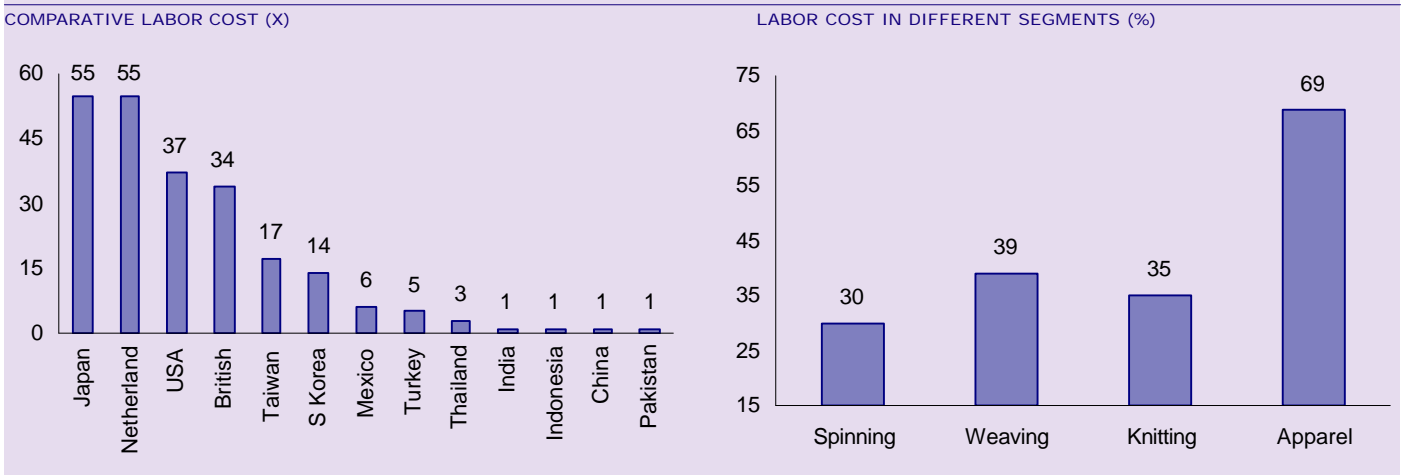
Source: Company/ Motilal Oswal Securities

Textiles industry – a perspective

The Indian textiles industry occupies a unique niche in the global market and is witnessing a fundamental shift, driven by a multitude of global and domestic factors. Indian garment manufacturers are evolving from mere converters to vendor partners of global buyers, who are aggressively consolidating their production geographically and across vendors. Large outsourcing orders from global retailers are enabling Indian companies to build capacities, lower per unit cost and become more competitive. A World Trade Organization (WTO) study suggests that post-quotas, India’s share of the US clothing market could rise to 15% by CY08 from around 3.3% in CY03, while its market share in EU is likely to expand from 6% in CY03 to 9% in CY08.

Labor force: India competitive on costs

Labor competitiveness is defined in terms of the cost per unit of output. The chart below represents the relative cost of production for different countries. As can be seen, USA’s textile labor costs are approximately 37 times higher than that of China or India. From a labor perspective, where skill sets are equivalent, the developed countries are at a competitive disadvantage.



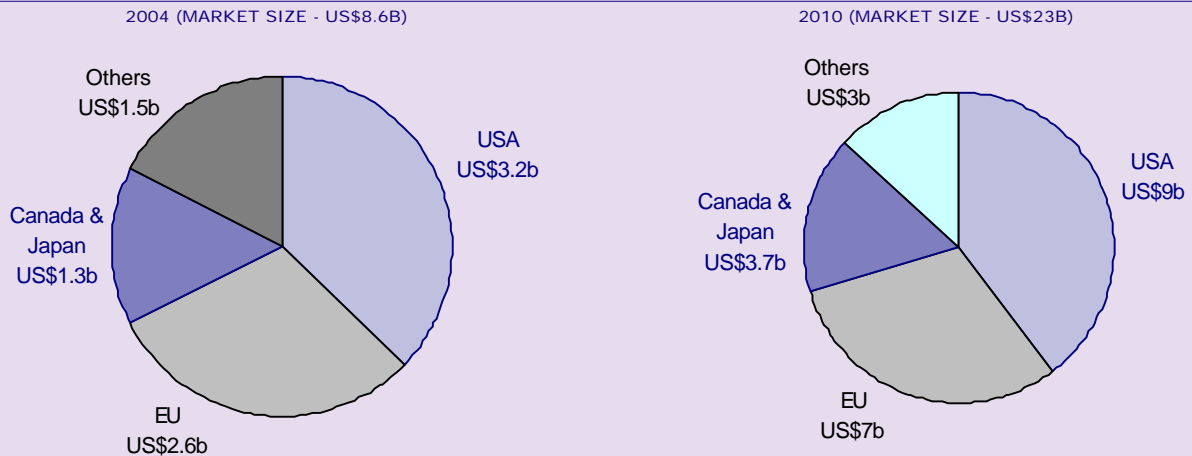
Source: Industry/Motilal Oswal Securities

Home textiles: a large opportunity

Unlike garments, where production facilities have already migrated from developed to low cost developing countries, shifting of production bases for home textiles is still to occur. Almost 40% of the global home textile capacity is still located in developed countries. Going forward, majority of these production capacities would migrate to low-cost developing countries. An estimated 120,000 ton terry towel capacity in the developed countries has been rendered unviable (West Stevens - 70,000 ton per year; Pillotex - 50,000 ton per year). We believe that this represents a huge opportunity for countries like India that have intrinsic strengths in the home textiles industry.

McKinsey estimates the global home textiles market to increase at a 18% CAGR (FY04-10) from US\$8.6b to US\$23b in CY10. GHCL, with its vertically integration and low cost manufacturing base, is well poised to capture this tremendous opportunity.

WORLD TEXTILE MARKET



INDIA HAS A STRONG PRESENCE IN THE WORLD HOME TEXTILES TRADE

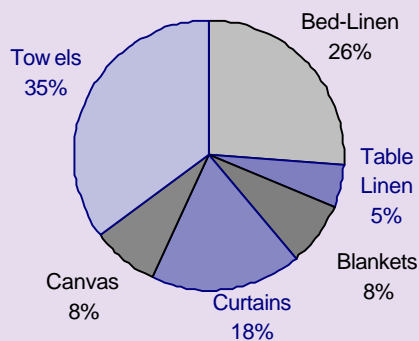
World Export and India - Cotton Textiles

1999	COTTON TEXTILE EXPORT MARKET (US\$B)	INDIA'S SHARE (%)	INDIA'S RANK
	100% = 31	14	2
Made-ups	9	17	2
Processed Fabric	13	5	10
Grey Fabric	3	11	3
Yarn	6	25	1

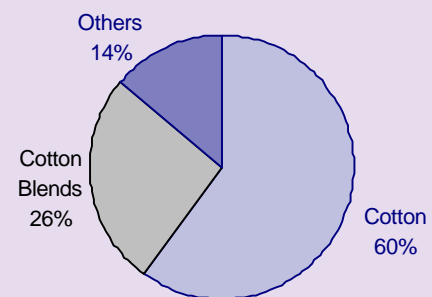
Source: Industry/ Motilal Oswal Securities

GHCL plans to target the bed-linen and curtains segment, which collectively account for 44% of the US\$8.6b global home textiles market.

SEGMENT-WISE BREAK-UP OF GLOBAL HOME TEXTILES TRADE



FIBRE-WISE BREAK-UP OF HOME TEXTILES

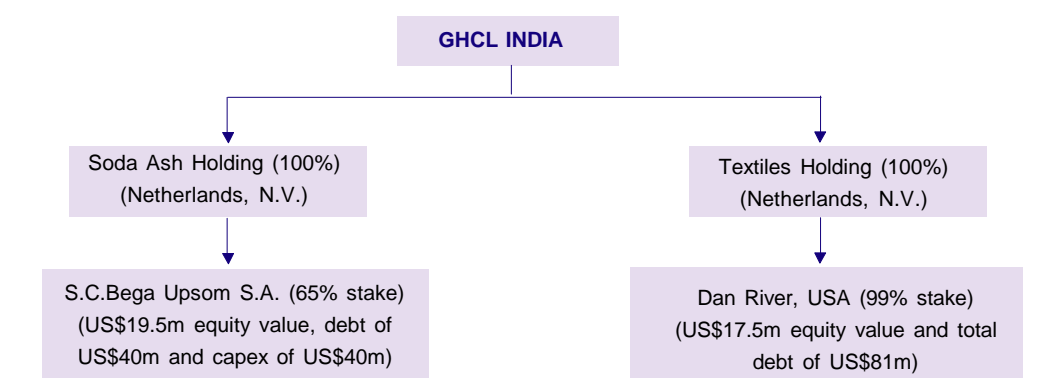


Source: Industry/ Motilal Oswal Securities

Strategic acquisitions: from local to global

GHCL has made strategic acquisitions through its overseas subsidiaries in both its core businesses – soda ash and textiles. While its acquisition of US-based Dan River would transform GHCL to one of the largest home textiles players in the world, its acquisition of SC Bega Upsom SA would make it the only soda ash producer in Romania. Although both are currently loss making, GHCL is confident of turning them around.

HOLDING PATTERN OF ACQUISITIONS BY GHCL INDIA



Source: Company/ Motilal Oswal Securities

Dan River – the world's third-largest home textiles company

GHCL has acquired 99% stake in US-based Dan River, the world's third-largest home textiles company at an equity value of US\$17.5m. While this acquisition gives GHCL a ready market and well-known brands, Dan River is currently loss making. The main reason for this is that 90% of its sales in CY05, were manufactured in the US. The cost of production in the US is very high due to high labor cost.

The table below depicts how cost of goods as a percentage of total revenues has increased from 75% in CY02 to an estimated 93% in CY05, leading to operating losses.

DAN RIVER: RISING COST OF GOODS (US\$M)

PARTICULARS	DEC-02	DEC-03	DEC-04	DEC-05E
Revenue	613	477	407	329
<i>Change (%)</i>	-2.9	-22.1	-14.8	-19.1
Cost of Goods Sold	462	426	394	306
<i>% of Revenues</i>	75.4	89.2	96.9	92.9
Gross Profit	151	52	13	23
<i>% of Revenues</i>	24.6	10.8	3.1	7.1
SG&A Expense	69	183	52	34
<i>% of Revenues</i>	11.2	38.4	12.8	10.4
Operating Income	44	-132	-39	-11
<i>Operating Margin (%)</i>	7.1	-27.6	-9.7	-3.4

Source: Company/ Motilal Oswal Securities

Cost of goods increased from 75% of revenues in CY02 to 93% in CY05

GHCL plans to turn around Dan River through its multi-pronged strategy:

- ✎ **Leverage GHCL's low cost manufacturing capabilities:** GHCL's presence in the textiles space and experience gained over the years would allow it to act as a dependable low cost supplier of high value bed-linen products to Dan River.
- ✎ **Close manufacturing facilities in the US:** GHCL has closed down all the manufacturing facilities of Dan River, including four packing and distribution centers spread over USA and Canada. This should result in substantial savings for Dan River, going forward.
- ✎ **SG&A cost rationalization:** The management believes that they can bring down Dan River's SG&A cost by almost 50% over the next couple of years by resorting to rightsizing, de-layering & restructuring, and judiciously exploiting the low labor cost in India by off shoring of functions.
- ✎ **Outsourcing of production to low cost countries:** Currently, almost 90% of Dan River's sales are being produced in developed countries, where the cost of production is 30-40% higher than low cost developing countries. GHCL plans to increase outsourcing to Asia and other low cost regions to almost 90% by CY06. This should substantially lower the cost of goods for Dan River.
- ✎ **Grow revenues aggressively by moving into new product ranges:** GHCL is hopeful of sustaining and growing current revenues through cost effective sourcing and competitive pricing. GHCL also plans to increase its product range by entering high value products.

We expect Dan River to turn around in CY07...

We expect Dan River to turn around in CY07, and post revenue CAGR of 9% over CY06-08. From a loss of Rs7m in CY06, we expect the company to post a net profit of Rs1.4b in CY08.

DAN RIVER: FORECASTS POSITIVE (RS M)

	CY06E	CY07E	CY08E
Revenue	13,795	15,700	16,454
Change (%)	-5.8	13.8	4.8
Cost of Goods (CoG)	12,140	13,188	13,739
% of Sales	88.0	84.0	83.5
SG&A	1,173	1,177	987
% of Sales	8.5	7.5	6.0
EBITDA	483	1,334	1,728
% of Sales	3.5	8.5	10.5
Interest	445	392	316
Depreciation	45	44	43
PBT	-7	898	1,369
Tax	0	0	0
PAT	-7	898	1,369
% of Sales	-0.1	5.7	8.3

Source: Company/ Motilal Oswal Securities

Increased outsourcing to results in cost of goods declining to 83.5% in CY08

SG&A cost to decline by 50% to 6% of revenues in CY08, from 12.8% in CY04

Acquisition of SC Bega Upsom SA

GHCL has acquired 65% stake in Romania's only soda ash producer, SC Bega Upsom SA at an equity value of US\$19.5m. This would enable GHCL to get a foothold in the growing European market. The company currently makes losses, but the GHCL management intends to turn it around by taking the following steps:

- ✂ Double capacity from 0.35m ton to 0.7m ton at an investment of US\$40m
- ✂ Improve efficiencies and reduce cost by around 25%
- ✂ Increase capacity for the dense variety to service East European and Middle East countries
- ✂ Improve marketing efforts

...and Bega Upsom to report a net profit of Rs564m in CY08

We believe that the company's Romanian soda ash operations would turn around in CY07, following the above initiatives. From a loss of Rs42.6m in CY06, we expect Bega Upsom to report a net profit of Rs564m in CY08.

ROMANIAN SODA ASH COMPANY: TO TURN AROUND IN CY07

ROMANIA SODA ASH COMPANY	CY06E	CY07E	CY08E
Production	507,500	626,000	700,000
Revenues	3,847	4645	5,000
EBITDA	192	929	1,000
% of Sales	5	20	20
Interest	24.9	26	120
Depreciation	210	272	316
PBT	-43	631	564
Tax	0	0	0
PAT	-42.6	631	564
% of Sales	-1	14	11

We model sharp EBITDA improvement on the back of modernization and expansion

SC Bega Upsom SA – Romania's only soda ash producer Source: Company/ Motilal Oswal Securities

Financials: expect robust growth

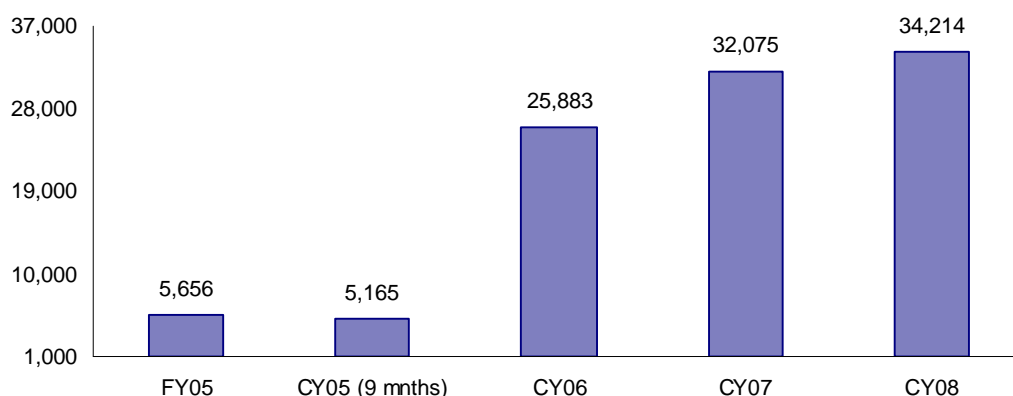
Post the consolidation of its overseas subsidiaries, we expect robust growth in GHCL's revenues and profits. We estimate revenue growth at 88% CAGR and net profit growth at 53% CAGR over CY05-08.

We expect consolidated revenues to grow at 88% CAGR over CY05-08...

Revenues to grow at 88% CAGR over CY05-CY08

GHCL is witnessing positive momentum in its core businesses of soda ash and textiles. We expect consolidated sales to register a CAGR of 88% over CY05-CY08, aided by a combination of aggressive organic and inorganic initiatives. We see GHCL emerging as a leader in both soda ash and textiles. During CY05, GHCL derived 90% of its revenues from repeat customers, its major clients include Gujarat Guardian, Asahi Glass, L&T, Phillips and HLL.

TREND IN REVENUES (RS M)



Source: Company/Motilal Oswal Securities

...driven by contribution from overseas overseas subsidiaries

We model GHCL's consolidated revenues to increase from Rs5.1b in CY05 (9 months) to around Rs34.2b in CY08. This growth would be primarily led by contribution from its overseas subsidiaries. We expect its textiles business to increase at a CAGR of 170% from Rs1.1b in CY05 (9 months) to around Rs22.4b in CY08. Its textile sales as a percentage of the total revenues would increase from around 18% in CY05 to around 66% in CY08. Revenues from Dan River would increase from Rs13.8b in CY05 (9 months) to around Rs16.5b in CY08. Its soda ash business is likely to grow at a CAGR of 50% from Rs3.4b in CY05 (9 months) to Rs11.5b in CY08. Revenues from its Romanian subsidiary, SC Bega Upsom SA, are likely to post a CAGR (CY06-08) of 14% from Rs3.8b to Rs5b in CY08.

REVENUE BREAK-UP (RS M)

	DEC'05 *	CY06	CY07	CY08
Soda Ash	3,446	4,923	6,118	6,566
Cotton Yarns	1,132	851	1,175	1,459
Salt Refined	108	156	165	175
Home Textiles		2,232	4,185	4,464
ITES	425#	-	-	-
Others	54	79	87	96
Total	5,165	8,241	11,730	12,760
Dan River	-	13,795	15,700	16,454
Romanian Sub	-	3,847	4,645	5,000
Consolidated Total	5,165	25,883	32,075	34,214

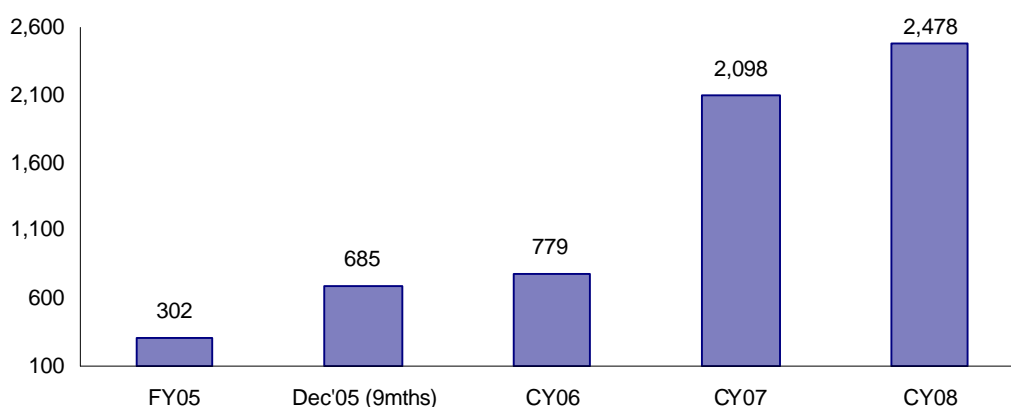
* 9 months; # The company plans to exit ITES business Source: Company/ Motilal Oswal Securities

Earnings to grow at 53% CAGR

Consolidated net profit should register a CAGR of 53% over CY05-08...

We expect GHCL's net profit to register a CAGR of 53% over CY05-08. The company would benefit from strong positive momentum in both its core businesses. GHCL's brownfield soda ash expansion would allow it to further lower its operating costs, while cheaper power in its textile operations would improve its margins in the textile business. We have assumed a strong turnaround in both its overseas acquisitions. We expect Dan River to turn around in CY07, and post revenue CAGR of 9% over CY06-08. From a loss of Rs7m in CY06, we expect the company to post a net profit of Rs1.4b in CY08. We also model GHCL's Romanian soda ash operations to turn around in CY07. From a loss of Rs42.6m in CY06, we expect Bega Upsom to report a net profit of Rs564m in CY08.

NET PROFIT (RS M)



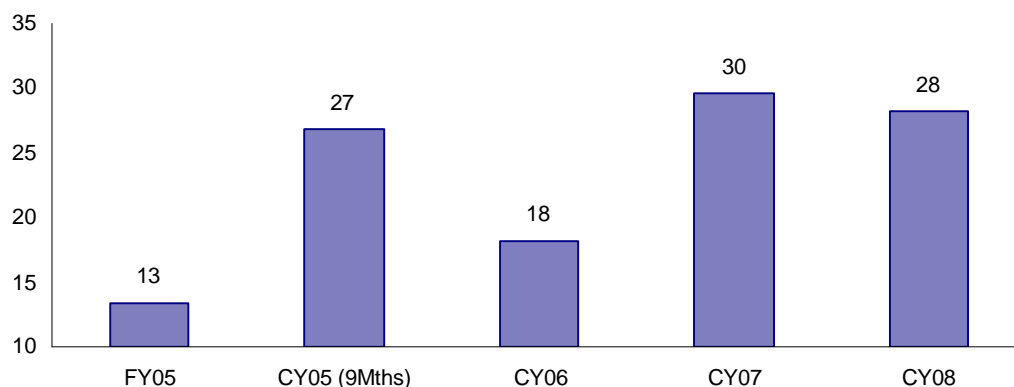
Source: Company/ Motilal Oswal Securities

RoE to expand

...and RoE should remain robust

GHCL is likely to see its RoE expand from 13% in CY05 to around 30% in CY07. This would be primarily aided by increased asset turnover ratio from 0.8x in CY05 to around 1.8x in CY08.

ROE TO INCREASE (%)



Source: Company/ Motilal Oswal Securities

Inorganic growth initiatives could surprise on the upside, over and above our estimates

Further inorganic initiatives to contribute to growth

GHCL is looking at further inorganic growth opportunities in both its soda ash and textile business. After having managed a foothold in the US market through its Dan River acquisition, it is now aggressively in the look out for further acquisitions in the US retail space. The management has conveyed that they are in advanced stage of negotiation with certain retail companies in US, which would allow them to vertically integrate from yarn to retail stage. We believe that the company would acquire entities that would complement its existing service offerings and provide access to a wider target market. However, we have not factored the same into our estimates.

Capex plans

GHCL has a Rs6.3b capex plan to organically increase its soda ash and textiles capacities. It has also acquired a 99% stake in Dan River, USA at an equity value of Rs18.5m and a 65% stake in a Romanian soda ash company at an equity value of US\$19.5m.

CAPEX PLANS

SEGMENT	EXPANSION	COST	TIME FRAME
Organic			
Spinning	35,000	Rs600m	CY07
Home Textiles	36m metres 9m metres weaving	Rs2.3b	Commercial production by April 2006
Soda Ash	200,000mtpa	Rs3.3b	CY08
	300,000mtpa	Rs4.8b	Post CY08
Inorganic			
Dan River, USA (99% stake)		US\$17.5m equity value and US\$81m debt = EV of US\$98.5m	NA
Romanian Soda Ash Plant (65% stake)		US\$19.5m equity value, debt of US\$40m, capex of US\$40m = US\$100m	Double capacity from 0.35m ton to 0.7m ton by CY06

Source: Company/ Motilal Oswal Securities

GHCL plans to finance its organic and inorganic growth plans through a combination of internal accruals, TUF loans and equity infusion. It has recently issued FCCBs of Rs3.6b to part finance its inorganic growth plans. The FCCB conversion price has, however, not been fixed and is likely to be finalized in September 2006 on the basis of two-month average stock price. We have assumed conversion at a price of Rs175/share and have assumed a dilution of 20%, which would increase equity capital from Rs950m to Rs1,141m.

MEANS OF FINANCING

PARTICULARS	AMOUNT
Borrowing	Rs4.6b
Internal Accruals	Rs1.8b
FCCB's	US\$80m or Rs3.6b

Source: Company/ Motilal Oswal Securities

Valuations: attractive; 29% upside

*Buy with a target price of
Rs223 – an upside of
nearly 29%*

GHCL is witnessing positive momentum in both its core businesses – soda ash and textiles. In the textile business, it is all set to transform from a small yarn manufacturer, into the third-largest home textiles player in the world. Its soda ash business is also witnessing positive momentum, backed by the global industry upturn. Post the consolidation of its overseas subsidiaries we expect robust growth in GHCL's revenues and profits. We expect its consolidated revenues and net profit to grow at 88% CAGR and 53% CAGR, respectively, over CY05-08. The stock quotes at attractive valuations of 9.4x CY07E EPS and an EV of 5.7x CY07E EBITDA. We recommend **Buy**. Our SOTP-based target price of Rs223 implies an upside of 28.7%.

SOTP VALUATION (CY07E)	
	(RS M)
Sales	
Soda Ash	10,928
Textiles	21,059
EBITDA	
Soda Ash	2,744
Textiles	2,490
EV/ EBITDA (x)	
Soda Ash	6.5
Textiles	7.0
EV	
Soda Ash	17,836
Textiles	17,431
Business Value	35,267
Net Debt	9,853
Equity Value	25,414
Per Share (Rs)	223
CMP (Rs)	173
Upside (%)	28.7

Valuing soda ash business at an EV of 6.5x CY07E EBITDA ...

We have valued GHCL's textile and soda ash business based on average valuations of the leaders in the respective industries. We believe GHCL has sustainable competitive advantage in the soda ash business, due to its captive raw material base and low cost structure. The benefits from the economies of scale post its brownfield expansion is likely to further increase its cost competitiveness.

There are four large soda ash manufacturers in India namely Tata Chem, GHCL, Nirma and Tuticorin Alkali. Nirma, Tata Chem and GHCL between them control almost 92% of the market. Though Nirma is the largest soda ash manufacturer in India, they consume it

internally for their soaps and detergent business. Soda ash accounts for around 24% of Tata Chem's revenues.

VALUATIONS (SODA ASH)

		GHCL *	TATA CHEM
P/E (x)	FY07E	25.3	14.3
	FY08E	9.4	12.3
EV/EBITDA (x)	FY07E	11.3	8.1
	FY08E	6.3	6.7
P/BV (x)	FY07E	3.2	2.6
	FY08E	2.5	2.3
EV/Sales (x)	FY07E	1.2	1.5
	FY08E	0.9	1.3

* GHCL's numbers are for CY07E and CY08E

Source: Motilal Oswal Securities

... and textiles business at an EV of 7x CY07E EBITDA

Post its acquisition of Dan River and completion of its greenfield bed-linen project, GHCL is all set to emerge as one of the largest home textiles players in India. We have valued GHCL's textiles business at 7x CY07E EV/EBITDA, which is based on the average of the large home textile and yarn players.

VALUATIONS (TEXTILES)

		GHCL *	TATA CHEM.	ALOK INDS	WELSPUN
P/E (x)	FY07E	25.3	14.3	8.2	16.1
	FY08E	9.4	12.3	7.3	13.1
P/BV (x)	FY07E	3.2	2.6	1.2	1.5
	FY08E	2.5	2.3	1.1	1.4
EV/Sales (x)	FY07E	1.2	1.5	1.6	2.0
	FY08E	0.9	1.3	1.6	1.7
EV/EBITDA (x)	FY07E	11.3	8.1	8.1	9.2
	FY08E	6.3	6.7	6.8	7.7

* GHCL's numbers are for CY07E and CY08E

Source: Motilal Oswal Securities

Concerns

Possible delay in turning around acquired companies: GHCL has acquired two very large companies – one in soda ash and the other in textiles. Both these companies are currently loss making, with high debt and accumulated losses. GHCL is banking on its multi-pronged strategies to quickly turn these companies around. However, failure to effectively manage the turnaround or possible delay in the turnaround process could adversely impact the company.

Import threat in the soda ash business: The import duty on soda ash has been decreased in the Union Budget 2006-07 from 15% to 12.5%. Currently, there are anti-dumping duties on soda ash imports, but this is due for review in the next few months. If these anti-dumping duties are abolished, China could emerge as a major threat, as Chinese soda ash capacity is slated to increase by 4-5m ton per year.

Risks associated with home textiles plant: GHCL's 36m meter processing unit for home textiles is slated to start commercial production in April 2006. The company has no prior experience in this segment. Hence, there could be execution risks.

GHCL — a background

Gujarat Heavy Chemicals (GHCL) was promoted in 1987 by the GIIC and the Dalmia group (through GTC Industries and Dalmia Dairy Corporation). GHCL has two core businesses – soda ash and textiles. It also has an IT services division, which focuses on voice-based business process outsourcing (BPO). This segment accounted for around 8% of the company’s revenues in FY05.

Soda ash has historically accounted for the majority of GHCL’s consolidated revenues – 74% in FY05. The company’s soda ash plant is located at Veraval, Gujarat and has a capacity of around 600,000 ton per year.

Textiles accounted for about 18% of GHCL’s consolidated revenues in FY05. It has two spinning units located in Tamil Nadu, with an installed capacity of 93,000 spindles. These units produce 100% cotton and polyester cotton yarns. The company has also set up a processing unit at Gujarat, with a capacity of 36 m meter per annum.

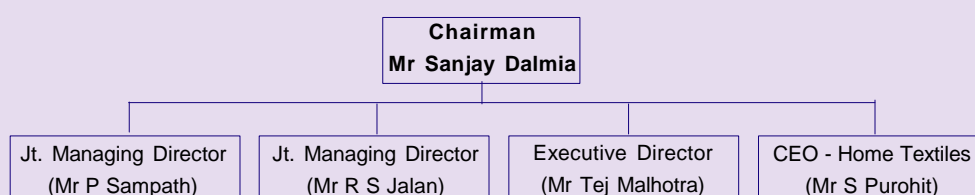
REVENUE BREAK-UP



Source: Company/Motilal Oswal Securities

Management

GHCL is part of the Dalmia group. The group has interests in diverse fields such as soda ash, textiles, cigarettes etc. The group is headed by Mr.Sanjay Dalmia and has two prominent companies under its stable namely GTC Industries and GHCL. The company boasts of a strong board with representatives from RBI, HDFC and BSE. The company has dedicated industry experts managing different segments.



Revenues to grow at 88%
CAGR over CY05-08

INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2004	2005	2005E*	CY06E	CY07E	CY08E
Net Sales	4,964	5,656	5,165	25,883	32,075	34,214
<i>Change (%)</i>	15.3	13.9	-8.7	357.6	23.9	6.7
Total Expenditure	4,223	4,683	3,792	23,211	26,881	28,415
EBITDA	741	974	1,372	2,671	5,193	5,799
<i>Change (%)</i>	-26.5	31.4	41.0	94.6	94.4	11.7
<i>% of Net Sales</i>	14.9	17.2	26.6	10.3	16.2	17.0
Depreciation	359	388	333	858	1,051	1,122
EBIT	382	586	1,039	1,813	4,142	4,677
Interest & Finance Charges	153	164	89	727	701	691
Other Income	79	87	47	65	65	65
PBT	309	509	998	1,152	3,506	4,051
Tax	104	208	304	387	1,179	1,362
<i>Effective Rate (%)</i>	33.6	41.0	30.5	33.6	33.6	33.6
PAT before MI	205	300	693	764	2,328	2,689
Minority Interest	-7	-1	8	-15	230	211
PAT after MI	212	302	685	779	2,098	2,478
<i>Change (%)</i>	-58.8	42.5	127.0	13.8	169.1	18.1
Adjusted PAT	212	302	685	779	2,098	2,478

E: MOST Estimates; * 9 months

Consolidated net profit
to register a CAGR of 53%
over CY05-08

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2004	2005	2005E*	CY06E	CY07E	CY08E
Equity Capital	951	951	951	1,141	1,141	1,141
Share Capital	951	951	951	1,141	1,141	1,141
Reserves	1,255	1,341	1,809	4,998	6,705	8,793
Net Worth	2,205	2,292	2,760	6,139	7,846	9,934
Loans	1,599	2,138	7,850	11,050	10,166	8,336
Deferred Tax Liability	697	793	810	1,003	1,239	1,512
Minority Interest	-3	-5	3	-12	218	429
Capital Employed	4,498	5,218	11,423	18,181	19,470	20,211
Gross Fixed Assets	6,792	7,479	9,929	14,179	16,679	18,679
Less: Depreciation	3,224	3,607	3,940	4,798	5,849	6,971
Net Fixed Assets	3,567	3,872	5,989	9,381	10,830	11,708
Capital WIP	18	57	57	57	57	57
Investments	10	105	4,200	4,500	4,500	4,500
Curr. Assets	2,288	2,838	2,499	9,323	10,352	11,341
Inventory	818	944	727	3,816	4,419	4,671
Sundry Debtors	588	756	637	2,978	3,691	3,937
Cash & Bank Balances	326	339	376	691	313	514
Loans & Advances & Other Current Assets	557	799	759	1,838	1,930	2,219
Current Liab. & Prov.	1,503	1,745	1,413	5,162	6,344	7,461
Sundry Creditors	602	709	497	3,918	4,556	4,781
Other Liabilities	736	817	653	849	1,274	1,911
Provisions	165	219	263	395	513	770
Net Current Assets	785	1,092	1,086	4,161	4,009	3,880
Misc Exp	118	91	91	82	74	66
Application of Funds	4,498	5,218	11,423	18,181	19,470	20,211

E: MOST Estimates; * 9 months

RATIOS

Y/E MARCH	2004	2005	2005E*	CY06E	CY07E	CY08E
Basic (Rs)						
EPS	2.2	3.2	7.2	6.8	18.4	21.7
Cash EPS	6.0	7.2	10.7	14.3	27.6	31.6
Book Value per Share	23.2	24.1	29.0	53.8	68.8	87.1
DPS	1.5	2.0	2.0	2.0	3.0	3.0
Payout (Incl. Div. Tax) %	69.5	63.3	27.4	29.9	14.7	12.7
Valuation (x)						
P/E		54.6	24.0	25.3	9.4	8.0
Cash P/E		23.9	16.2	12.1	6.3	5.5
EV/EBITDA		22.1	19.8	11.3	5.7	4.8
EV/Sales		3.8	5.3	1.2	0.9	0.8
Price to Book Value		7.2	6.0	3.2	2.5	2.0
Dividend Yield (%)		1.2	1.2	1.2	1.7	1.7
Profitability Ratios (%)						
RoE	9.6	13.4	27.1	17.5	30.0	27.9
RoCE	9.8	12.1	12.5	12.3	22.0	23.6
Turnover Ratios						
Debtors (Days)	43	49	45	42	42	42
Inventory (Days)	71	74	70	60	60	60
Creditors (Days)	145	141	125	85	85	85
Working Capital (Days)	58	70	77	59	46	41
Asset Turnover (x)	1.1	1.1	0.5	1.4	1.6	1.7
Fixed Asset Turnover (x)	0.7	0.8	0.5	1.8	1.9	1.8
Leverage Ratio						
Debt/Equity (x)	0.7	0.9	2.8	1.8	1.3	0.8

E: MOST Estimates; * 9 months

*Valuations remain
attractive at
9.4x CY07E EPS*

RoE to remain robust

CASH FLOW STATEMENT		(RS MILLION)				
Y/E MARCH	2004	2005	2005E*	CY06E	CY07E	CY08E
PBT before EO Items	230	422	950	1,087	3,441	3,986
Add: Depreciation	359	388	333	858	1,051	1,122
Interest /Div Rec	79	87	47	65	65	65
Less: Direct taxes paid	162	89	321	226	991	1,138
(Inc)/Dec in WC	533	294	-43	2,760	226	-330
CF from Operations	-27	514	1,053	-976	3,341	4,366
Minority Int. & Share of Associate Profits	-7	-1	8	-15	230	211
CF from Operations including EO Items	-21	515	1,045	-961	3,111	4,155
(Inc)/Dec in FA	-383	-652	-2,489	-4,250	-2,500	-2,000
(Pur)/Sale of Investments	210	-95	-4,095	-300	0	0
CF from Investments	-173	-747	-6,584	-4,550	-2,500	-2,000
(Inc)/Dec in Shares	0	0	0	3,328	0	0
(Inc)/Dec in Debt	410	537	5,721	3,185	-654	-1,619
Less: Dividend Paid	-143	-217	-217	-228	-342	-342
CF from Fin. Activity	336	246	5,576	5,826	-989	-1,954
Inc/Dec of Cash	142	13	37	315	-378	201
Add: Beginning Balance	184	326	339	376	691	313
Closing Balance	326	339	376	691	313	514

E: MOST Estimates; * 9 months

N O T E S



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1. Analyst ownership of the stock
2. Group/Directors ownership of the stock
3. Broking relationship with company covered

Gujarat Heavy Chemicals

No
No
No

MOST is not engaged in providing investment-banking services.

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.