ICICI direct.com
On-line Share Trading

Initiating coverage

# Indo Rama Synthetics (INDRA)

| Current price | Target price |
|---|---|
| Rs 60 | Rs 73 |
| **Potential upside** | **Time Frame** |
| 21% | 12-15mths |

**OUTPERFORMER**

## Leveraging scale …

**Indo Rama Synthetics Ltd (IRSL), the country's largest dedicated polyester manufacturer, is well placed to capitalise on the upturn in the polyester sector due to its timely capacity expansions. Benign raw material scenario and reduction in power costs would further catalyse margins and profitability. We initiate coverage on the company with an OUTPERFORMER rating.**

- **Polyester sector headed for good times**
Polyester is becoming the preferred fibre the world over. In India, government initiatives have reduced the price differential with cotton fibres and we expect this to trigger increasing demand for polyester.

- **Timely expansion to help increase market share**
IRSL has doubled its capacity from 300,000 tpa to 600,000 tpa. The expanded capacity would enable it capture higher market share across various product categories.

- **Favourable raw material scenario**
Prices of key inputs like purified terephthalic acid (PTA) and mono ethylene glycol (MEG) have stabilized due to new capacities. This move is expected to ease the pressure on raw material costs.

- **Lower power costs to expand margin**
IRSL is merging a group company, Indo Rama Petrochemicals Ltd (IRPL), with itself. The merger will enable it to access power at substantially lower rates and reduce its power costs by Rs 26.43 crore in FY09E, thereby improving EBIDTA margins in FY09E.

### Valuation

We believe the stock is available at a very attractive FY09E market cap-to-sales ratio of 0.24x. We expect the company's net profit to grow at a CAGR of 52.3% over FY07-09E due to the ramp up in volumes and improvement in operating margins. We expect the stock to be re-rated and quote at a market cap-to-sales ratio of 0.30x to our 12-15 month target price of Rs 73, a potential upside of 21% from current levels.

**Exhibit 1: Key Financials**

| Year to March 31 | FY06 | FY07 | FY08E | FY09E |
|---|---|---|---|---|
| Net Profit (Rs crore) | 51.83 | 20.64 | 33.55 | 47.87 |
| Shares in issue (in crore) | 13.18 | 13.18 | 13.18 | 13.18 |
| EPS (Rs) | 3.93 | 1.57 | 2.54 | 3.63 |
| % Growth | -26.2 | -60.2 | 62.6 | 42.7 |
| PER (x) | 15.3 | 38.3 | 23.6 | 16.5 |
| Price / Book (x) | 2.37 | 2.40 | 2.41 | 2.32 |
| EV/EBIDTA (x) | 10.2 | 14.3 | 11.1 | 6.7 |
| RoNW (%) | 7.77 | 3.13 | 5.12 | 7.03 |
| RoCE (%) | 9.39 | 6.70 | 8.50 | 13.49 |

*Source: ICICIdirect Research*

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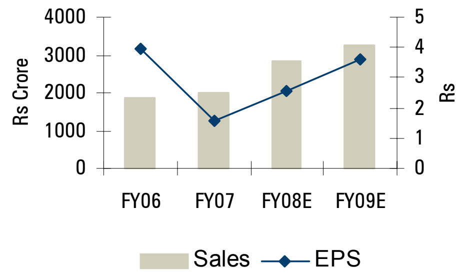
**Sales & EPS trend**



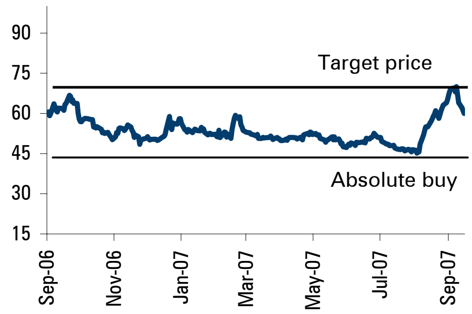

**Stock Metrics**

| | |
|---|---|
| **Promoters holding** | 57.31% |
| **Market Cap** | Rs791 crore |
| **52 Week H/L** | 71 / 44 |
| **Sensex** | 17588 |
| **Average volume** | 32,670 |

**Comparative return metrics**

| Stock return | 3 M | 6M | 12M |
|---|---|---|---|
| Reliance Industries | 41% | 79% | 107% |
| Bombay Dyeing | 14% | 39% | -8% |
| Indo Rama Synthetics | 22% | 18% | -3% |
| Century Enka | 9% | 15% | -3% |

**Price trend**



## Company Background

Indo Rama Synthetics (India) Limited (IRSL) was established in 1989. The company covers diverse fields of polyester. In 1995, the integrated polyester complex at Butibori, near Nagpur in Maharashtra in technical collaboration with Dupont of US, was set up for polymer production and partially oriented yarn (POY) and Toyobo of Japan for polyester staple fibre (PSF).

The company is today the country's largest dedicated polyester manufacturer (at a single location). Its complex at Butibori produces polyester staple fibre (PSF), polyester filament yarn (PFY), draw textured yarn (DTY) and textile grade chips. The Butibori plant produces close to 600,000 tonnes of PSF, POY, FDY, DTY and fibre grade chips.

The company's sales grew at a CAGR of only 3.6% over FY05-07, impacted by the sluggish sales trend in the industry due to low demand for polyester. The poor growth in sales was due to the following factors:

- A sharp increase in feedstock prices, which led to an increase in costs, and pushed up polyester prices making it less competitive to cotton.
- Excise exemption on cotton, which was introduced in 2004-05 Union Budget. The rates on polyester were maintained at a high level.
- Lower cotton yarn prices due to lower cotton prices on account of a bumper crop.

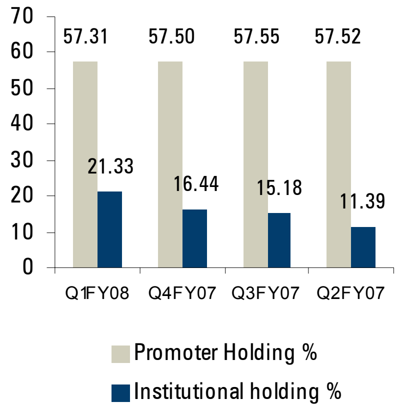
In a bid to improve the competitiveness of polyester manufacturers, the government rationalized the duty structure. Cotton prices have also hardened while raw material prices for PSF and PFY have stabilized as new capacities came on-stream. All these initiatives and developments have improved the competitiveness of polyester vis-à-vis cotton and have pushed up demand.

IRSL is among the major players in the industry and will be a key beneficiary of the upturn in the sector. Its enhanced capacities should help it increase its market share. Domestic demand for PSF and POY, which are the major revenue contributors for IRSL, is expected to grow at a CAGR of 9%.

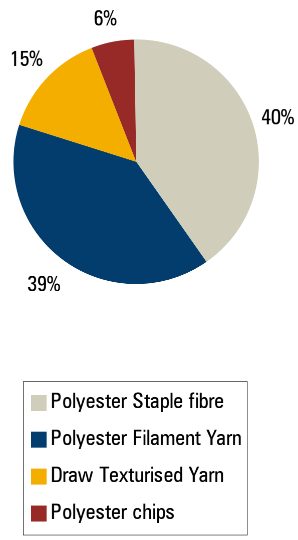
### Share holding pattern

| Share holder | % holding |
|---|---|
| Promoters | 57.31 |
| Institutional investors | 21.33 |
| Other investors | 13.88 |
| General public | 7.48 |

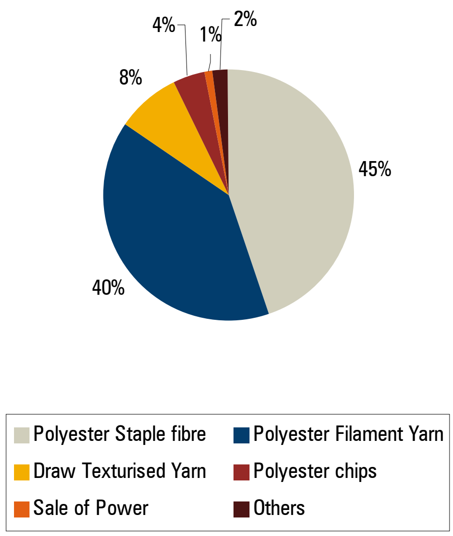
### Promoter and Institutional holding trend




### Exhibit 2: IRSL's sales mix in FY07

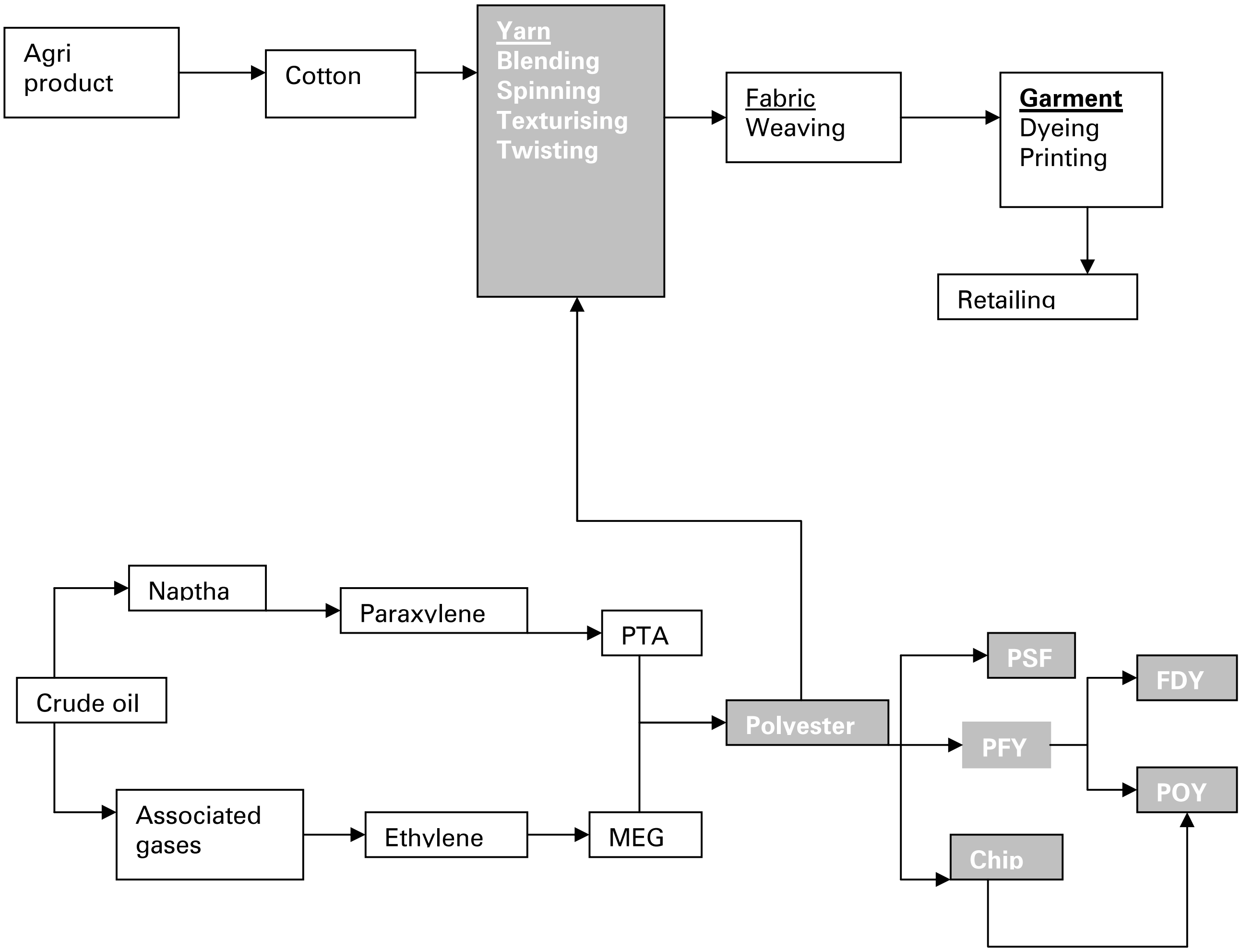



### Exhibit 3: IRSL's sales mix in FY09




*Source: Company, ICICIdirect Research*

**Exhibit 4: IRSL's presence in the textile value chain**




*Indo Rama Synthetics presence*

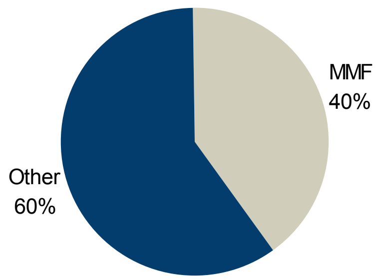
*Source: Company, ICICIDirect Research*

## INDUSTRY DYNAMICS

- **Domestic demand to follow global trend**

Globally, man-made fibres (MMF) constitute 40% of the textile market and other textiles account for the remaining 60%. In India, MMF contribution has been low and contributes only 18% of the total textile trade. The domestic market is expected to follow the international trend with MMF gaining more popularity. Until recently, the price differential between cotton and MMF was huge due to the high excise duty on the latter. The government has now rationalised the duty structure. Further, the opening up of the global textile trade after the removal of the quota system has presented the domestic MMF sector a huge growth opportunity.

**Exhibit 5: World textile trade mix**

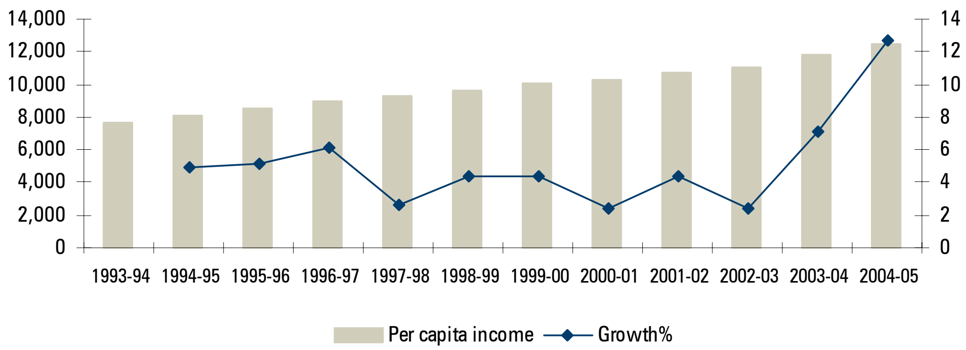



*Source: UN Stats' Comtrade Database, DGCI&S, ICICIDirect Research*

Domestic demand is expected to grow at a CAGR of 9% till 2011. After registering a meager growth of 2.5% in 2005, domestic polyester consumption increased 16%. With demand expected to pick up, major players like Reliance Industries and Indo Rama Synthetics have expanded their capacities. This has created a temporary oversupply situation in the industry. Domestic demand has remained robust and we expect it to pick up momentum.

Rising per capita income and increase in share of clothing in total expenses will drive the domestic demand for apparel fabrics. On the other hand, demand for non-apparel fabric (industrial and home textiles) will also pick up due improvement in standard of living and increased acceptability of MMF in industrial applications.

**Exhibit 6: Rising per capita income to boost apparel and non-apparel demand**




*Source: Central Statistical Organisation, ICICIDirect Research*

India has set itself an export target of US$50 billion by 2010 and a domestic market target of US$40 billion. This target can only be achieved with the rapid growth of MMF. The domestic polyester sector has the potential to more than double in the next 5 years.

**Exhibit 7: Polyester demand-supply (million tonnes)**

| | 2005 | 2006 | 2007-08E | 2010E |
|---|---|---|---|---|
| Global polyester capacity | 39.7 | 42.2 | 48.8 | 58.0 |
| Indian polyester capacity | 1.95 | 2.6 | 3.3 | 4.0 |
| Indian polyester consumption | 1.68 | 1.95 | | |
| Indian polyester consumption growth (%) | 2.50 | 16 | | |
| Polyester market size for India (Including exports) | | | | 5.0 |

*Source: Company reports, ICICIDirect Research*

With polyester demand likely to be robust and cotton supply unlikely to exceed demand, we believe that PSF and POY prices would stabilize.

- **Global polyester demand set to grow**

Cotton and polyester are substitutes for each other and their price competitiveness impacts demand. The limited availability of land to increase cotton output would result in prices firming going forward. We expect cotton prices to remain firm with an upward bias as production is expected to be less than anticipated demand.

**Exhibit 8: Cotton production (million kg)**

| Country | 1998-99 | 2005-06E | 2006-07P | 2007-08P | CAGR (%) |
|---|---|---|---|---|---|
| China | 4,501 | 5,714 | 6,730 | 6,468 | 4.1 |
| US | 3,030 | 5,201 | 4,730 | 4,407 | 4.3 |
| India | 2,805 | 4,148 | 4,590 | 4,671 | 5.8 |
| Pakistan | 1,494 | 2,089 | 2,100 | 2,192 | 4.4 |
| Uzbekistan | 1,000 | 1,210 | 1,100 | 1,153 | 1.6 |
| Others | 5,887 | 6,308 | 6,090 | 6,515 | 1.1 |
| **Total** | **18,717** | **24,670** | **25,340** | **25,406** | **3.5** |

*Source: International Cotton Advisory Committee (ICAC)*

**Exhibit 9: Cotton consumption (million kg)**

| Country | 1998-99 | 2005-06E | 2006-07P | 2007-08P | CAGR (%) |
|---|---|---|---|---|---|
| China | 4,400 | 9,617 | 10,500 | 10,920 | 10.6 |
| India | 2,781 | 3,627 | 3,920 | 4,110 | 4.4 |
| US | 2,265 | 1,282 | 1,090 | 980 | -8.9 |
| East Asia and Australia | 2,003 | 1,901 | 1,880 | 1,870 | -0.8 |
| EU, Turkey and CIS | 2,714 | 2,771 | 2,790 | 2,800 | 0.3 |
| Pakistan | 1,625 | 2,390 | 2,460 | 2,520 | 5.0 |
| Brazil | 797 | 870 | 840 | 840 | 0.6 |
| Others | 2,087 | 2,513 | 2,522 | 2,546 | 2.2 |
| **Total** | **18,672** | **24,971** | **26,002** | **26,586** | **4.0** |

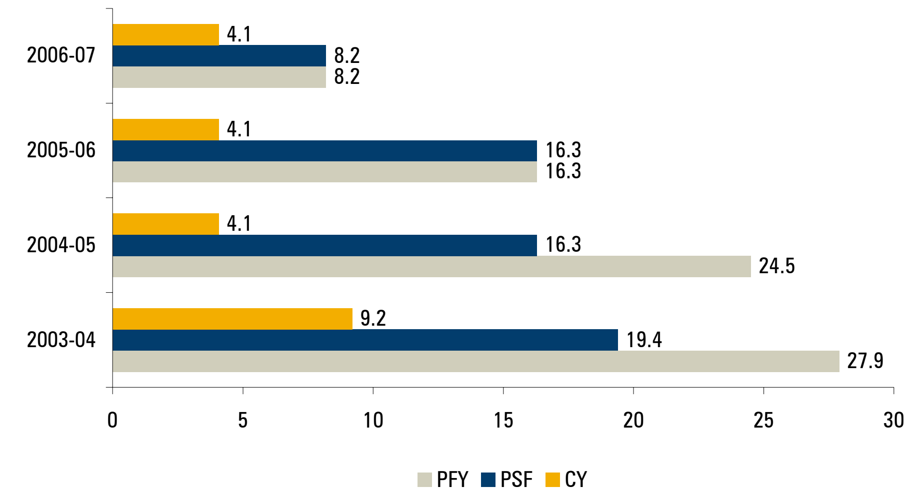
*Source: International Cotton Advisory Committee (ICAC)*

With increasing acceptance of polyester as the preferred fibre the world over due to its inherent tenacity, superior dyeing properties, and elimination of problems like shrinkage and colour fading, polyester demand is expected to grow steadily.

### Government initiatives to boost MMF sector

The government's policy initiatives like reducing import duties on synthetic raw materials such as PTA and MEG to the level of other fibre intermediates like paraxylene to 2%, and the reduction in excise duties are expected to boost the competitiveness of the MMF industry. Lately, cotton prices have also hardened. Further, prices of these raw materials have stabilised as new capacities have come on-stream.

**Exhibit 10: Drop in excise duty**




*Source: Crisil, ICICIdirect Research*

### Raw material prices have stabilized

Prices of PTA and MEG, which are the key raw materials for PSF and POY, are linked to crude prices. PTA and MEG prices had risen significantly due to hardening crude prices. The supply situation for both PTA and MEG had been tight in the past and this had kept the price at a high level.

Despite high crude prices, with new PTA and MEG capacities becoming operational and further capacities slated to become operational in next two years, the availability of key inputs will increase and result in softening of the prices of both PTA and MEG.

**Exhibit 11: Global PTA capacities**

| PTA : Global Manufacturers, 2006 (000 tonnes) | Capacity |
|---|---|
| BP | 7,200 |
| Sinopec | 3,000 |
| Formosa | 3,000 |
| Mitsubishi | 2,500 |
| Group Alfa | 2,100 |
| Reliance | 2,000 |
| Mitsui | 1,700 |
| Tuntex | 1,050 |
| KP Chem | 1,000 |
| CNPC | 1,000 |

| PTA Capacity additions (000 tonnes) | Year of Commisioning | Capacity |
|---|---|---|
| BP Zhuhai | 2007 | 900 |
| Petrocel | 2007 | 420 |
| FCFC | 2007 | 300 |
| Dalian | 2008 | 1,400 |
| Hailun | 2008 | 800 |
| MCC, India | 2008 | 800 |
| Tenglong | 2009 | 1,400 |
| Yizheng | 2009 | 1,000 |
| Shanghai | 2009 | 900 |

*Source: Crisil, ICICIdirect Research*

*PTA capacities to increase by 32% by FY09 resulting in better availability and easing of PTA prices*

**Exhibit 12: Global MEG capacities**

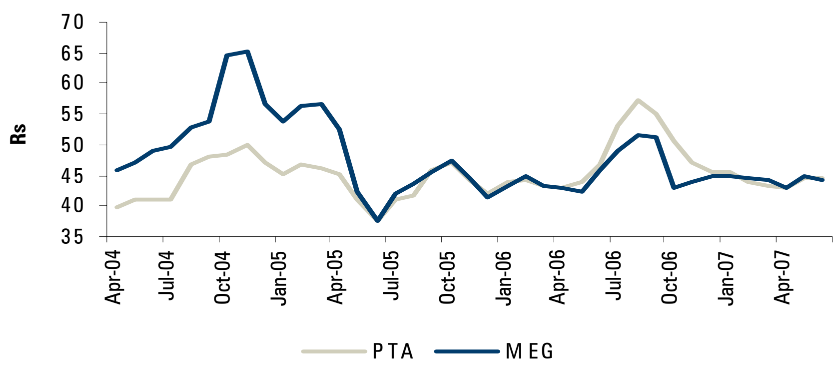
| MEG : Global Manufacturers, (000 tonnes) | Capacity |
|---|---|
| SABIC | 2,400 |
| DOW | 2,300 |
| Gformosa | 1,750 |
| Shell | 1,200 |
| Sinopec | 900 |
| Reliance | 840 |
| Jap. MEG | 840 |
| Kuwait | 750 |
| BASF | 650 |
| Ineos | 550 |

| MEG Capacity additions (000 tonnes) | Year of Commisioning | Capacity |
|---|---|---|
| Nan Ya | 2007 | 700 |
| Farsa | 2007 | 450 |
| Liaoyang | 2007 | 150 |
| Yansab | 2008 | 700 |
| SHARQ | 2008 | 700 |
| TKOC | 2008 | 600 |
| ZRCC | 2009 | 600 |
| Petroirabigh | 2009 | 500 |
| Kharg | 2009 | 500 |

*Source: Crisil, ICICIdirect Research*

*MEG capacities to increase by 40% by FY09 resulting in better availability and easing of MEG prices*

**Exhibit 13: PTA/MEG price trend**




*Source: Crisil, ICICIdirect Research*

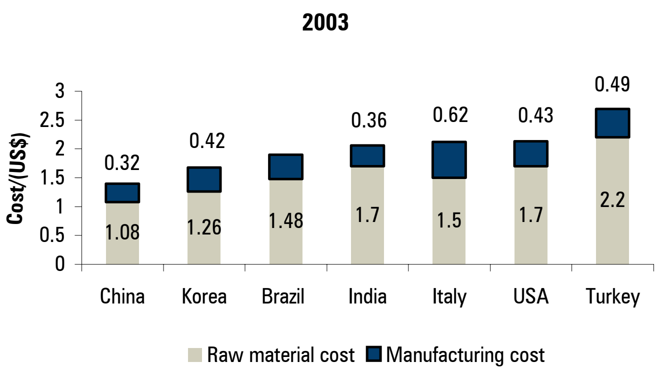
PTA prices have corrected by more than 20% from their peak, while MEG prices are down 30% from their peak. With further capacities to be added in the next two years, we expect the prices of PTA and MEG to remain soft and stabilize at current levels.

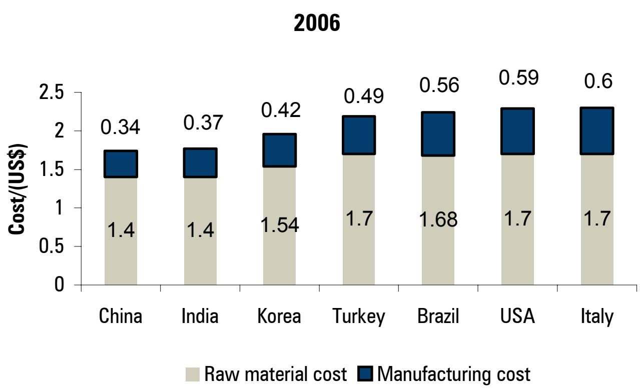
With robust demand, prices of key inputs stabilising and a favourable tax regime, the domestic polyester sector is on the verge of business cycle upturn.

- **Indian companies becoming competitive**

India is the second most cost-effective producer of POY after China and its competitiveness has improved considerably in the last 3 years. Going forward, we expect it to increase its market share of the global trade.

**Exhibit 14: Cost competitiveness of Indian companies improving**




*Source: International Textile Manufacturers Federation (ITMF), ICICIdirect Research*

## Increased penetration of high value import markets

PSF purchases by Turkey and the US, the biggest importers, grew at a CAGR of 11% and 4.8% respectively over 2001-2005. India's share in US imports of major categories of MMF products with import value of more than US$1 billion is very low.

**Exhibit 15: India's share in US MMF imports in excess of US$1 billion**

| US imports in 2005 | India's share (%) | China's share (%) |
|---|---|---|
| MMF Knit Shirts | 0.3 | 5.1 |
| MMF Trousers | 0.0 | 13.3 |
| MMF Slacks | 0.3 | 11.3 |
| MMF Body support garments | 0.0 | 28.1 |
| MMF Coats | 0.0 | 40.6 |
| Other MMF furnishing | 0.0 | 68.4 |

*Source: OTEXA,ICICIDirect Research*

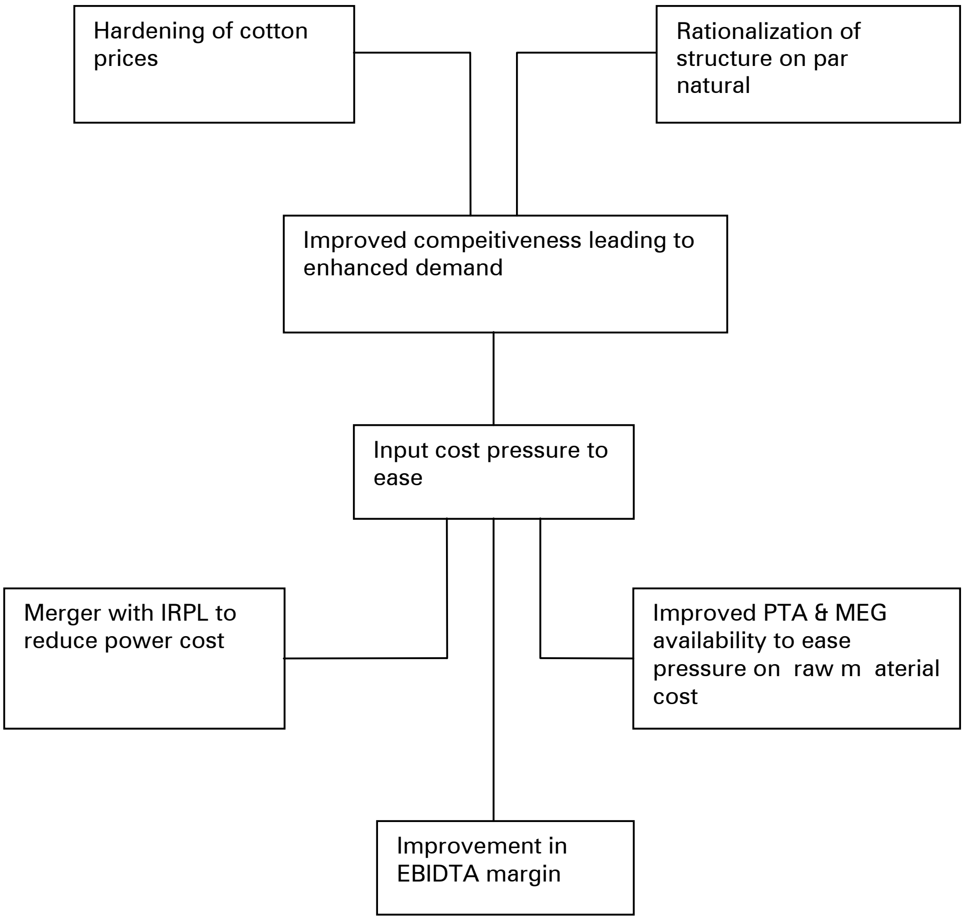
In some of high-value import categories like MMF shirts and trousers, China still faces restrictions from the US and EU. With competitive pricing and higher value additions, India can leverage this opportunity to capture higher market share at a rapid pace.

Improved competitiveness vis-à-vis other countries and better penetration of high value global markets would enable Indian MMF industry increase its share in the global textile trade pie. Even if the share of MMF items in India's exports basket increases to the global average of 40% by 2012, exports alone would be around US$20 billion.

## INVESTMENT RATIONALE

Indo Rama Synthetics Ltd (IRSL) is well-positioned to benefit from the visible upturn in the MMF sector. While its timely expansions will enable the company increase sales and also enhance its market share, benign raw materials scenario and reduction in power costs would help boost margins and profitability.

**Exhibit 16: IRSL to benefit from supportive business environment**




*Source: ICICIdirect Research*

- **Increase in capacity to capitalise on opportunity**

IRSL doubled its capacities from 800 tonnes per day (tpd) to 1,600 tpd in FY07. Its major products are polyester staple fibre (PSF) and polyester filament yarn (PFY). These products are used by manufacturers of polyester and blended garments & home textiles. Spindlage addition of 200,000 per month is taking place in the polyester industry and this is likely to push up demand for PSF and PFY. We believe that the demand for PSF and PFY will remain robust and IRSL will be able to sell its expanded capacities in the market and also enhance its market share. We expect sales to grow at a CAGR of 26.8% over FY07-09 to Rs 3,236.45 crore.

**Exhibit 17: PSF/PFY installed capacity**

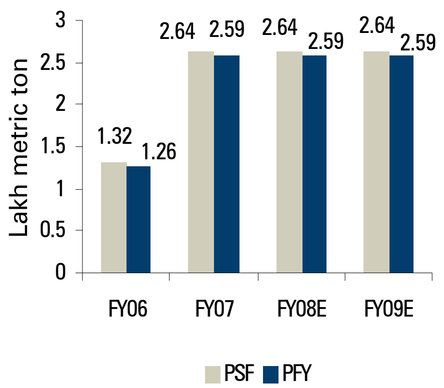
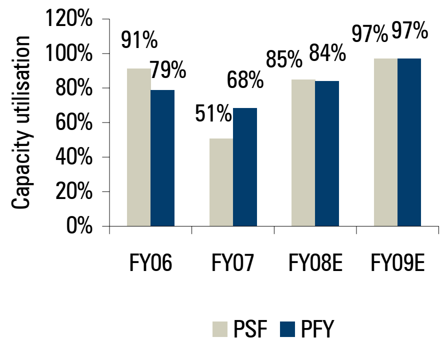


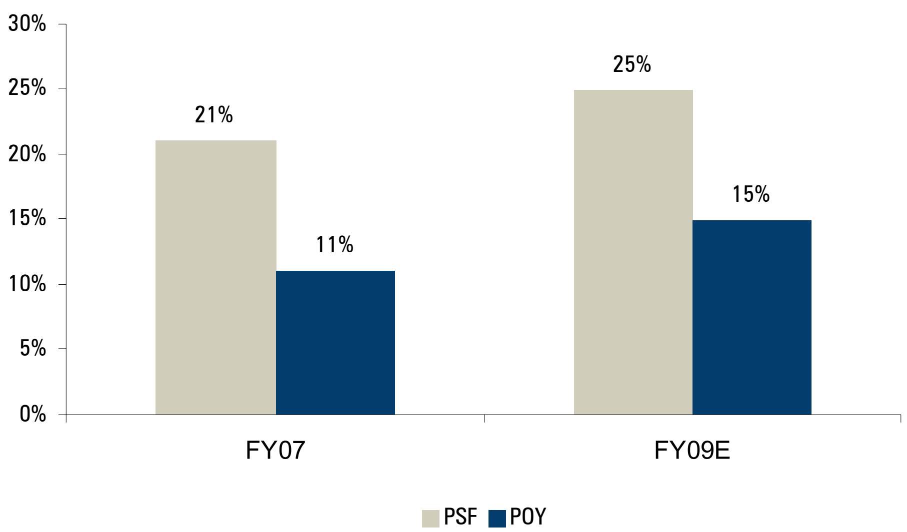

**Exhibit 18: PSF/PFY capacity utilization**




*Source: Company, ICICIdirect Research*

Currently, IRSL has a 21% market share in PSF and 11% in POY. The additional capacities would enable it increase its market share for PSF to 25% and POY to 15% by FY09.

**Exhibit 19: PSF/POY market share to increase**




*Source: Company, ICICIdirect Research*

## Merger with Indo Rama Petrochemicals Ltd to reduce power cost

IRSL is merging a group company, Indo Rama Petrochemicals Ltd (IRPL), with itself. IRPL has commissioned a 30 MW power plant comprising two coal-fired power plants of 15 MW each. The merger will enable IRSL to access power at substantially lower rates and reduce its power costs from Rs 3.90 per unit to Rs 3.10 in FY09. We expect savings to the tune of Rs 14.35 crore in FY08E and Rs 26.43 crore in FY09E.

**Exhibit 20: Savings in power cost**

| **Power & fuel consumption** | FY07 | FY08E | FY09E |
|---|---|---|---|
| Total production (crore kg) | 37.27 | 50.43 | 57.16 |
| Units consumed (crore) | 22.09 | 29.89 | 33.88 |
| Electricity consumed per kg (KWH) | 0.59 | | |
| Cost per unit (Rs) | 3.88 | 3.4 | 3.1 |
| **Power cost (Rs Crore)** | **85.73** | **101.63** | **105.03** |
| | | | |
| Fuel cost per kg (Rs) | 1.24 | 1.25 | 1.30 |
| Total fuel cost (Rs crore) | 46.22 | 63.03 | 74.30 |
| **Total Power & Fuel Cost (Rs crore)** | **131.95** | **164.67** | **179.33** |
| Reduction in cost per unit due to thermal power plant (Rs) | | 0.48 | 0.78 |
| No of units consumed (crore) | | 29.89 | 33.88 |
| **Savings on electricity cost (Rs Crore)** | | **14.35** | **26.43** |

*Source: Company, ICICIdirect Research*

## Superior technology to improve productivity at lower cost

IRSL's new continuous polymerization plants use the Zimmer technology which operates at lower temperature than other plants and results in lower polymer degradation, thus leading to higher product quality like better crimp properties and less variations of product properties making the products more customer friendly for processing by spinning mills. The new plant also enables manufacturing of specialty products thereby widening the product portfolio.

**Exhibit 21: Higher productivity, lower cost**

| **Capital cost (Rs '000 per tonne)** | |
|---|---|
| Old Plant | 60.00 |
| New Plant | 25.45 |

| **Labour productivity in terms of production in tonnes per labour** | |
|---|---|
| Old Plant | 258 |
| New Plant | 349 |

*Source: PCI, ICICIDirect Research*

## Risks & Concerns

- **Intense competition could impact sales growth and margins**

The company is operating in commodity trade and hence is subject to intense competition from other players. This can result in loss of market share and impact the margins.

- **Volatility in raw material cost**

Abnormal fluctuation in raw material costs can erode the company's price competitiveness and adversely impact its profitability.

- **Capacity expansions in polyester industry**

Huge capacity expansions by major players have resulted in a short-term demand - supply imbalance resulting in short term pressure on margins.

- **The China factor**

China's ambitious expansion plans in textiles could result in loss of exports from India, which can negatively affect the growth of domestic MMF industry. This can impact IRSL revenues and profitability

- **Appreciation of the rupee**

The company would be exporting about 15-20% of its production and would be subject to risk on account of currency exchange rate fluctuations, which could affect its realizations from exports.

- **Correction in cotton prices**

Any sharp correction in cotton prices on account of oversupply could result in reducing the competitiveness of polyester vis-à-vis cotton and weavers shifting from polyester to cotton.

- **Volatility in crude prices**

Any significant increase in the price of crude can push up the prices of feedstock and impact the margins negatively.

## FINANCIALS

- **The sales surge …strong sales growth backed by capacity expansion**

IRSL's performance during FY05-07 was impacted due to slow growth in sales. The slack growth was due to low cotton prices and low excise duty on cotton that made cotton yarn much cheaper than polyester. During the period, sales grew at a CAGR of 3.6% to Rs 2,011.68 in FY07 from Rs1,874.79 crore in FY05. Recently, the government has rationalized the duty structure for polyester by reducing excise duties. This coupled with the hardening of cotton prices has made polyester more competitive to cotton yarn.

IRSL's timely expansion of capacities will enable it to place higher volumes in the market. We expect PSF volumes to grow at a CAGR of 36.3% and POY volumes at 23.6% respectively over FY07-09E. We expect sales to grow at a CAGR of 26.8% over FY07-09E to Rs 3,236.45 crore from Rs 2,011.68 crore.

**Exhibit 22: Sales to grow at steady clip**

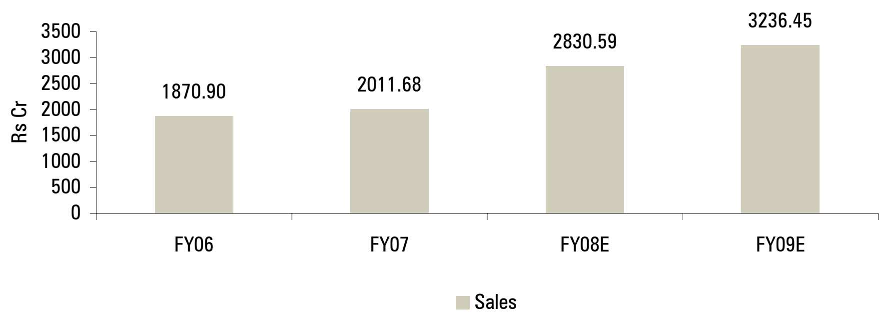



**Exhibit 23: Robust growth in PSF and PFY sales volumes**

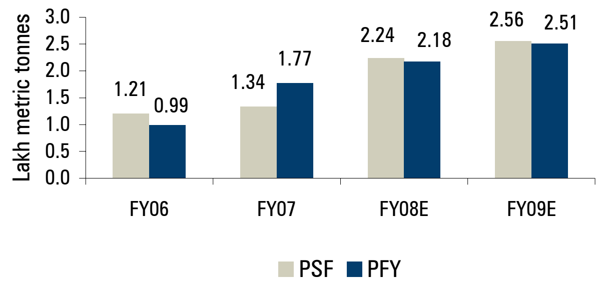
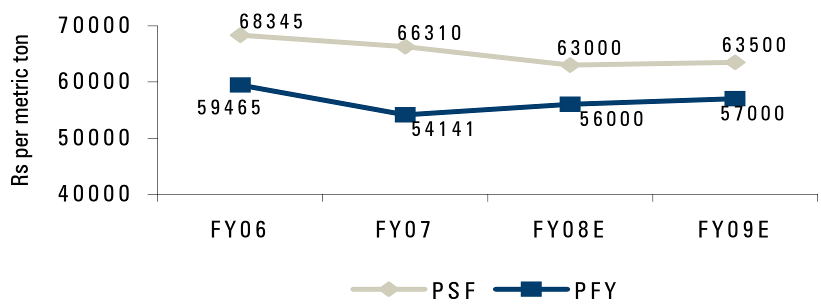



**Exhibit 24: Average realizations to remain stable**

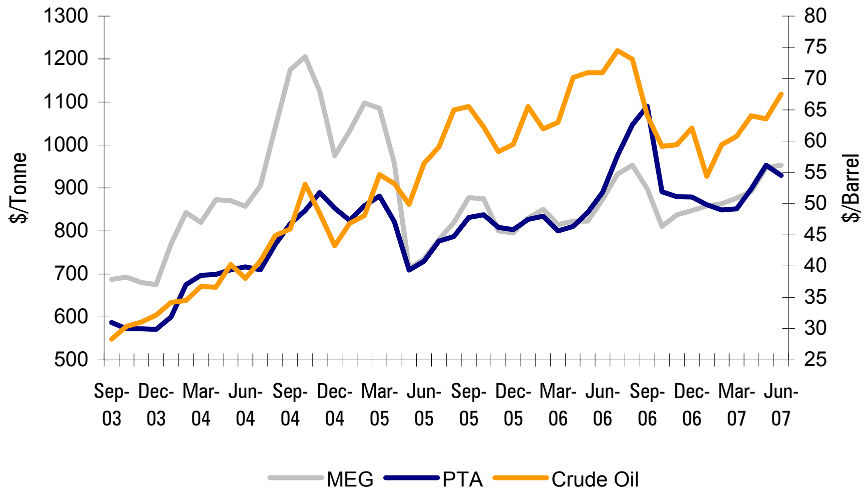



*Source: ICICIdirect Research*

- **Improving EBIDTA …operating margin to improve in FY09E**

The increased availability of key raw materials, PTA and MEG, on account of new capacities becoming operational has weakened the correlation between crude and PTA/MEG prices and we expect the prices to remain stable going forward.

**Exhibit 25: Crude and PTA/MEG price trend**




*Source: Industry, ICICIdirect Research*

*Weakening of the correlation between crude price and PTA/MEG prices due to higher availability of PTA/MEG capacities*

We expect IRSL's raw material cost to remain stable in the range of 77%-78% of sales. High power costs and rising input costs resulted in a decline in operating margin in FY06 and FY07. We expect margins to improve in FY09E, as the entire benefits of reduction in power cost would be available. OPM is expected to improve to 6.82% in FY09E from 5.96% in FY07.

**Exhibit 26: Raw material & power cost**

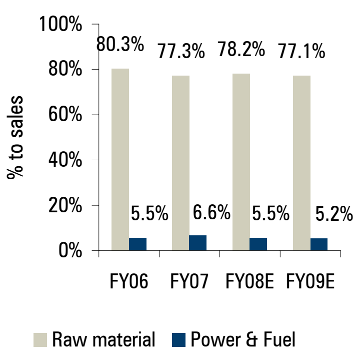
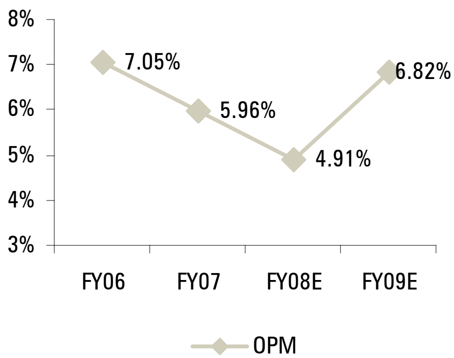


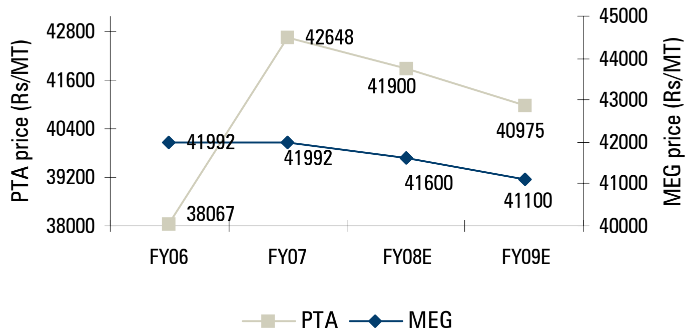

**Exhibit 27: OPM to improve**




*Source: Company, ICICIdirect Research*

*Softening prices of PTA & MEG to result in raw material cost remaining benign and coupled with reduction in power cost to result in improvement in operating margin*

**Exhibit 28: Average cost for PTA & MEG**

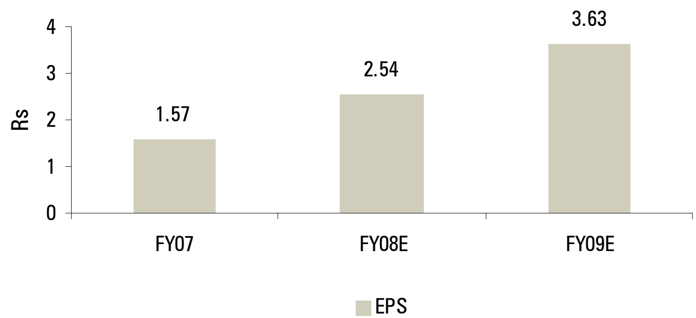



*Source: ICICIdirect Research*

## Earnings to double over FY07-09E

We expect net profit to more than double during FY07-09E to Rs 47.87 crore from Rs 20.64 crore. We expect EPS to grow at a CAGR of 52.3% to Rs3.63 over the same period.

**Exhibit 29: Robust growth in earnings**




*Source: ICICIdirect Research*

**Exhibit 30: EPS to raw material price sensitivity analysis**

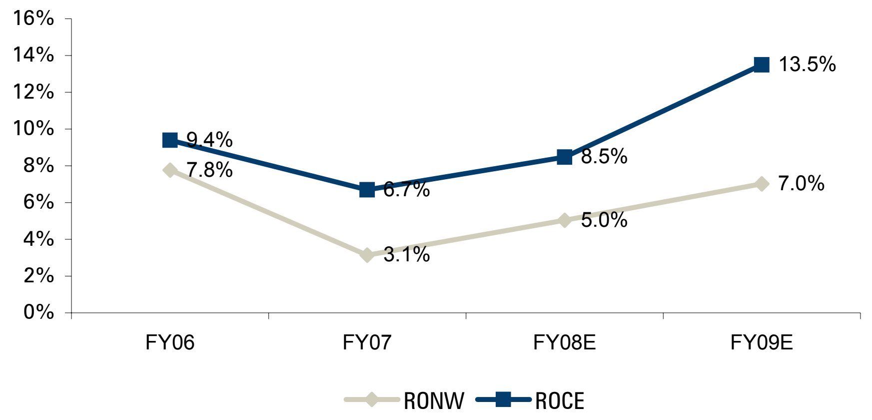
| Change in Average RM cost | FY09E EPS | EPS Variance |
|---|---|---|
| 0.25% increase in average RM cost | 3.16 | -13% |
| 0.50% increase in average RM cost | 2.68 | -26% |
| 1% increase in average RM cost | 1.74 | -52% |
| | | |
| 0.25% decrease in average RM cost | 4.1 | 13% |
| 0.50% decrease in average RM cost | 4.58 | 26% |
| 1% decrease in average RM cost | 5.52 | 52% |

*Source: ICICIdirect Research*

## Return ratios to improve

We believe the company will improve its return ratios driven by volume growth and improvement in operating margins. We expect net profit to grow at a CAGR of 52.2% over FY07-09E. Robust growth in profitability would translate into significant improvements in return ratios.

**Exhibit 31: RONW and ROCE to grow significantly**

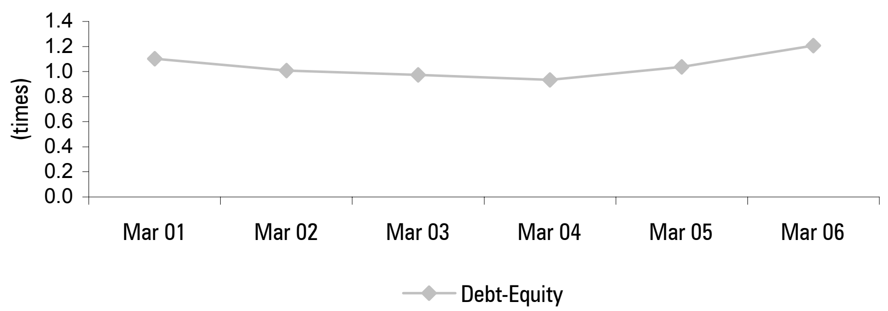



*Source: ICICIdirect Research*

## Comfortable debt-equity position

The company's debt-equity ratio is in line with major companies in the industry being leveraged at more than 1.2 owing to high component of debt. We expect the ratio to be at 1.17x for FY08E and 1.06x for FY09E.

**Exhibit 32: Polyester Industry Debt Equity ratio**




*Source: CRISIL, ICICIdirect Research*

## VALUATIONS

We expect IRSL's EPS to more than double from Rs1.57 in FY07 to Rs3.63 in FY09E, as the company places its expanded capacities in the market. As IRSL operates in a volume-driven industry, we are using market capitalization-to-sales ratio as our key valuation tool. The major domestic players in PSF/POY segments like Reliance Industries, Bombay Dyeing, and Century Enka have diverse businesses and therefore not strictly comparable. We have chosen global players operating in similar segment for comparison. The IRSL stock is available at a very attractive FY09E market capitalization to sales ratio of 0.24x. With volume ramp up and improvement in operating margins enabling net profit CAGR of 52.3% over FY07-FY09E, we expect the stock to be re-rated and quote at a market capitalization to sales multiple of 0.30x to our 12-15 month target price of Rs73 with a potential upside of 21% from current levels.

**Exhibit 33: Valuations**

| | ICI Pakistan Ltd # | Indo Rama Synthetics Ltd | Far Eastern Textile Ltd @ |
|---|---|---|---|
| Country | Pakistan | India | Taiwan |
| Currency | Rs | Rs | TWD |
| Sales (Crore) | 2393.10 | 3236.45 | 4888.90 |
| Mcap (Crore) | 2278.44 | 791.00 | 20071.95 |
| EPS | 15.43 | 3.63 | 2.65 |
| Price | 166 | 60.00 | 44.80 |
| PE (x) | 10.76 | 16.50 | 16.91 |
| Mcap / sales | **0.95** | **0.24** | **4.11** |
| P/BV | 1.86 | 2.32 | 2.13 |
| EV / sales | 0.84 | 0.53 | 6.01 |

*# December 2008, @ December 2009*

*Source: Reuters, ICICIDirect Research*

### Revenue Model

| | FY06 | FY07 | FY08E | FY09E |
|---|---|---|---|---|
| **Installed capacity (MT)** | | | | |
| PSF | 132000 | 263550 | 263550 | 263550 |
| POY | 126000 | 259000 | 259000 | 259000 |
| | | | | |
| **Capacity (MT)** | | | | |
| PSF | 91% | 51% | 85% | 97% |
| POY | 79% | 68% | 84% | 97% |
| **Production (MT)** | | | | |
| PSF | 120583 | 133714 | 224018 | 255644 |
| POY | 99449 | 177126 | 217560 | 251230 |
| **Sales (MT)** | | | | |
| PSF | 131771 | 130712 | 212817 | 242861 |
| POY | 111338 | 156224 | 206682 | 238669 |
| **Average Realization (Rs)** | | | | |
| PSF | 68345 | 66310 | 63000 | 63500 |
| POY | 59465 | 54141 | 56000 | 57000 |

### Raw Material Consumed

| | FY06 | FY07 | FY08E | FY09E |
|---|---|---|---|---|
| **Raw Material (MT)** | | | | |
| PTA | 199936 | 289399 | 287025 | 329468 |
| MEG | 77889 | 112251 | 242868 | 278780 |
| **Average cost (Rs)** | | | | |
| PTA | 38067 | 42648 | 41900 | 40972 |
| MEG | 41992 | 41992 | 41600 | 41100 |

*Source: ICICIDirect Research*

## Profit & Loss Account

| Rs Crore | FY06 | FY07 | FY08E | FY09E |
|---|---|---|---|---|
| **Net Sales** | **1870.90** | **2011.68** | **2830.59** | **3236.45** |
| % Growth | -0.21% | 7.52% | 40.71% | 14.34% |
| Raw Materials | 1501.96 | 1555.95 | 2212.97 | 2495.78 |
| Employee Expenses | 35.69 | 39.41 | 62.27 | 74.44 |
| Power & Fuel | 102.28 | 132.95 | 164.67 | 179.33 |
| Sell. & Admin. Expenses | 99.01 | 164.44 | 251.79 | 266.14 |
| **Total Exp.** | **1738.94** | **1891.75** | **2691.69** | **3015.68** |
| % Growth | 4.67% | 8.79% | 42.29% | 12.04% |
| **Operating Profit** | 131.96 | 119.94 | 138.90 | 220.77 |
| Depreciation | 98.06 | 106.81 | 149.33 | 185.30 |
| Interest expense | 29.49 | 39.63 | 69.12 | 57.60 |
| Other Income | 62.76 | 60.78 | 131.60 | 98.00 |
| **PBT** | 67.17 | 34.28 | 52.05 | 75.87 |
| Tax | 15.34 | 13.64 | 18.50 | 28.00 |
| **Net Profit** | **51.83** | **20.64** | **33.55** | **47.87** |
| Equity | 131.83 | 131.83 | 131.83 | 131.83 |
| Dividend % | 30% | 10% | 10% | 15% |
| **EPS** | **3.93** | **1.57** | **2.54** | **3.63** |

*Increased capacities resulting in CAGR of 26.8% in Sales over FY07-FY09E*

*Net profit to grow at a CAGR of 52.3% over FY07-FY09E*

## Balance Sheet

| Rs Crore | FY06 | FY07 | FY08E | FY09E |
|---|---|---|---|---|
| Share Capital | 131.83 | 131.83 | 131.83 | 131.83 |
| Reserves & Surplus. | 535.66 | 527.28 | 523.83 | 549.33 |
| Secured Loans | 560.93 | 876.89 | 705.00 | 655.00 |
| Unsecured Loans | 0.00 | 64.88 | 65.00 | 65.00 |
| Deferred Tax | 176.98 | 190.04 | 208.04 | 235.04 |
| Less: Miscellaneous Exp Not W/off | 0.00 | 0.00 | 0.00 | 0.00 |
| **Total liabilities** | **1405.41** | **1790.92** | **1633.70** | **1636.20** |
| Net Block | 1508.62 | 1748.23 | 1612.46 | 1498.66 |
| Investments | 48.98 | 37.25 | 27.00 | 60.00 |
| Inventories | 122.51 | 286.64 | 387.75 | 399.01 |
| Sundry Debtors | 67.93 | 83.37 | 155.10 | 177.34 |
| Cash & Bank | 10.16 | 17.74 | 14.33 | 33.47 |
| Loans & Adv. | 141.42 | 266.23 | 180.00 | 380.00 |
| Current Assets | 342.02 | 653.98 | 737.19 | 989.82 |
| CL & Prov. | 494.21 | 648.54 | 742.94 | 912.28 |
| Net Current Assets | -152.19 | 5.44 | -5.76 | 77.54 |
| **Total Assets** | **1405.41** | **1790.92** | **1633.70** | **1636.20** |

## Cash Flow Statement

| Rs Crore | FY06 | FY07 | FY08E | FY09E |
|---|---|---|---|---|
| **Opening Cash** | **20.29** | **10.16** | **17.74** | **14.33** |
| Profit after Tax | 51.83 | 20.64 | 33.55 | 47.87 |
| Dividend Paid | 45.10 | 15.42 | 14.89 | 22.37 |
| Depreciation | 98.06 | 106.81 | 149.33 | 185.30 |
| Cash Profit | 119.41 | 125.36 | 185.99 | 237.79 |
| **Changes In working Capital** | | | | |
| Net Increase in CL | -0.45 | 154.33 | 94.40 | 169.34 |
| Net Increase in CA | -173.21 | 304.38 | 86.61 | 233.50 |
| CF after changes in Working Capital | 289.00 | -38.56 | 171.68 | 173.63 |
| **Cash Flow from Investing Activities** | | | | |
| Purchase of FA | 289.00 | 346.42 | 13.56 | 71.50 |
| **Cash from Financing Activities** | | | | |
| Increase /(Decrease) in Loan Funds | -15.60 | 380.84 | -171.77 | -50.00 |
| **Closing Cash** | **10.16** | **17.74** | **14.33** | **33.47** |

## Ratios

| | FY06 | FY07 | FY08E | FY09E |
|---|---|---|---|---|
| EPS (Rs.) | 3.93 | 1.57 | 2.54 | 3.63 |
| Cash EPS (Rs.) | 5.69 | 4.83 | 6.94 | 8.84 |
| Book Value (Rs.) | 25.32 | 25.00 | 24.87 | 25.83 |
| Operating Margin (%) | 7.05 | 5.96 | 4.91 | **6.82** |
| Net Profit Margin (%) | 2.77 | 1.03 | 1.19 | 1.48 |
| RONW | 7.77% | 3.13% | 5.12% | 7.03% |
| ROCE | 9.39% | 6.70% | 8.50% | 13.49% |
| Debt/Equity | 0.84 | 1.43 | 1.17 | 1.06 |
| FA Turnover Ratio | 1.70 | 1.17 | 1.78 | 2.23 |
| Enterprise Value (Rs. Cr ) | 1341.75 | 1715.01 | 1546.65 | 1477.51 |
| EV/EBIDTA | 10.17 | 14.30 | 11.14 | 6.69 |
| Sales to Equity | 14.49 | 15.26 | 21.47 | 24.55 |
| Market Cap to Sales | 0.42 | 0.39 | 0.28 | 0.24 |
| Price to Book Value | 2.37 | 2.40 | 2.41 | 2.32 |

*Stabilization in raw material cost and significant reduction in power cost in FY09E to result in improvement in OPM*

## RATING RATIONALE

ICICIDirect endeavors to provide objective opinions and recommendations. ICICIdirect assigns ratings to its stocks according to their notional target price vs current market price and then categorises them as Outperformer, Performer, Hold, and Underperformer. The performance horizon is 2 years unless specified and the notional target price is defined as the analysts' valuation for a stock.

**Outperformer:** 20% or more;
**Performer:** Between 10% and 20%;
**Hold:** $\underline{+}$10% return;
**Underperformer:** -10% or more.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