Hindustan Lever

INR 249

In an unfavourable environment

REDUCE

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Losing ground to focused competition

Hindustan Lever Limited (HLL) has been consistently losing ground to its competitors. It has lost market share in toilet soaps, detergents, tea and toothpaste to Godrej, P&G, Tata Tea, and Colgate and Dabur, respectively. We believe that the competition's focus on their categories is helping them win the battle in the market place. We expect HLL to lose further market share in toilet soaps to Godrej and in toothpaste to Dabur and Colgate. In detergents and tea, HLL is expected to face stiff competition. With all its key segments under pressure, achieving considerable volume growth will be a daunting task for HLL.

Private labels likely to grab market share

The share of organised players in the USD 210 bn retailing industry is expected to increase from the current 3% to 10% by 2010E. With the unquestionable ability of players such as Reliance, Bharti, and Pantaloons to create brands, organised retailing is expected to bring in powerful private labels which could grab significant market share. According to an AC Nielsen study conducted in 2005 across 38 countries, personal care items lost 5% market share, while food and beverages lost as much as 25-50% market share to private labels. Presence of players such as Reliance in retail makes such a scenario likely in India as well.

Not just marginal margin erosion

Prices of vegetable oils, which constitute an important raw material for soaps and personal products, have increased by ~13% during January-September 2006 and we expect prices to go up a further 15%. Even after assuming a price hike of 9-12%, the operating margin of soaps and detergents, HLL's biggest segment, could decline by as much as 210bps, while that of personal products could decline by 200bps over CY05-07E. The margin contraction in soaps and detergents could come down to 80bps if linear alkyl benzene (LAB) prices soften following a decline in crude oil prices.

Valuations are stretched

Our CY07E EPS at INR 7.75 is 10% below the consensus estimates. At CMP of INR 249, HLL trades at 35.6x CY06E earnings adjusted for exceptional items and 32.1x CY07E earnings. EV/EBITDA for the stock is 30.4x and 27.5x on CY06E and CY07E, respectively. HLL is a default play on the growth in Indian consumption due to its huge size and liquidity in stock. But given the cost and competitive pressures, we believe the valuations are stretched. We initiate coverage with a **'REDUCE'** recommendation.

Reuters	:	HLL.BO
Bloomberg	:	HLVR IN

Market Data

52-week range (INR)	:	296 / 168
Share in issue (mn)	:	2,205.7
M cap (INR bn/USD mn)	:	549 / 12,203
Avg. Daily Vol. BSE/NSE ('000)	:	4,177.8

Share Holding Pattern (%)

Promoters	:	51.4
MFs, FIs & Banks	:	15.4
FIIs	:	14.0
Others	:	19.2

Financials

Year to December	CY04	CY05	CY06E	CY07E
Revenues (INR mn)	99,269	110,605	123,338	136,706
Rev. growth (%)		*11.4*	*11.5*	*10.8*
EBITDA (INR mn)	14,374	14,433	17,901	19,820
Net profit (INR mn)	11,973	14,081	18,318	17,114
Shares outstanding (mn)	2,201	2,201	2,207	2,207
EPS (INR)	5.4	6.4	8.3	7.8
EPS growth (%)		*17.6*	*29.7*	*(6.6)*
PE (x)	45.7	38.9	30.0	32.1
EV/EBITDA (x)	37.9	37.7	30.4	27.5
ROE (%)	57.2	64.0	70.7	55.2

Investment Rationale

Losing ground to focused competition

HLL has been consistently losing ground to its competitors in all the segments it operates in. It has lost market share in toilet soaps to Godrej, in detergents to P&G, in tea to Tata Tea, and in toothpaste to Colgate and Dabur. We believe that the competition's focus on their categories is helping them come up with better strategies against HLL in the market place. We expect HLL to lose further market share in toilet soaps to Godrej on account of its lower price and in toothpaste to Dabur and Colgate. In detergents and tea, P&G and Tata Tea are likely to consolidate their position after gaining significant market shares over the past couple of years. With all its key segments under pressure, achieving considerable volume growth will be a daunting task for HLL.

Table 1: Historical market shares across various categories (%)

	DQ01	DQ02	MQ06	JQ06	SQ06
Personal wash	60.2	59.8	55.8	54.6	53.8
Fabric wash	42.1	41.9	35.6	35.3	35.5
Toothpaste	36.7	33.4	30.4	30.2	30.7
Shampoo	63.8	58.0	47.7	48.0	48.9
Tea	35.0	32.0	25.6	25.5	25.8

Source: Company presentations.Note: MQ06, JQ06, and SQ06 data has been captured post the installation of new panels.

Price favours Godrej in toilet soaps

We expect Godrej to continue to grab HLL's market share in toilet soaps on the back of its ability to maintain price discounts. Godrej has been pestering HLL for quite some time now on this front. Godrej's unique proposition of offering a soap free on purchase of three soaps for INR 24, effectively selling a soap for INR 6, has been successful. Godrej's usage of cheaper raw materials helps it to operate profitably at such low price levels.

Godrej is likely to maintain its price discount compared to HLL, even in a rising prices scenario. It is important to note that HLL has not announced any price hikes in *Breeze* and *Jai*, brands priced at INR 8 per bar. We expect *Godrej No. 1* to sell at INR 6.50 post price hikes, still at ~20% discount to *Breeze* and *Jai*. We believe this will help Godrej to grab more of HLL's market share.

P&G likely to consolidate market share gains in detergents

Following the price war initiated by P&G in detergents, its market share has increased by ~400bps from 3% to 7%. We expect P&G to consolidate its position at this level for sometime. As a result, we do not expect P&G to allow HLL much room to effect price hikes in detergents. A pressure on raw materials with price increases in LAB and soda ash have led to nominal price hikes, barely enough to make up for the resulting loss in operating profits.

Tata Tea much stronger with Tetley under its belt

Over the past couple of years, Tata Tea has inched its way up in the tea segment. A focus on improving its portfolio, combined with efforts on branding are major reasons behind its success. The acquisition of Tetley has given an edge to Tata Tea's portfolio, both in terms of product and brand. We expect HLL to increase its focus on this segment, especially with the new AC Nielsen data (post the installation of new panels) representing HLL's market share to be ~25%, considerably lower than the earlier 29%. But, extracting volumes out of Tata Tea will be a tough task. We expect HLL's market share in tea to stabilize at 25% over the next one year.

Dabur Red: A major threat in toothpaste

Toothpaste has been a cause for worry for HLL over the past couple of quarters. HLL lacks a product in the discount end of the portfolio, which has led to loss of market share over the past couple of years. Till recently, Colgate's *Cibaca* was a major threat to HLL's portfolio. With growth in the popular category Colgate and Dabur have shifted their focus to their popular brands.

Colgate launched three variants under the Colgate brand last year and invested significantly in advertising and promotion. Dabur's toothpaste category has grown at ~30% over the past two quarters, resulting in its market share rising by 50bps from 7.1% in FY06 to 7.6% over April-September 2006. This has put immense pressure on HLL, resulting in its market share declining by more than 200bps over June 2005-June 2006. We expect competition to continue to hurt HLL's market share.

Table 2: Dabur—Performance in toothpaste

Brand	Growth in Q1FY07 (%)	Growth in H1FY07 (%)
Red toothpaste	34.8	26.7
Babool	51.4	51.0
Meswak	47.3	12.0
Overall toothpaste category	39.8	33.0

Source: Dabur

HLL faces severe competitive pressures in soaps, detergents, tea, and toothpastes which constitute ~60% of its total portfolio. With achieving volume growth being a daunting task, we expect HLL to grow at a slower rate compared to the market, especially in toilet soaps and toothpaste, where Godrej and Dabur are proving to be worthy competitors.

Private labels likely to grab market share

Retailing in India is expected to undergo a major change with the entry of major players such as Reliance and Bharti and scaling up of incumbent players such as Pantaloons, Trent, and Shoppers' Stop. The share of organised players in the USD 210 bn retail industry is expected to increase from the current 3% to 10% by 2010E. With the unquestionable ability of players like Reliance, Bharti, and Pantaloons to create brands, organised retailing is expected to bring in powerful private labels, which could grab a significant pie of the market going forward.

According to an AC Nielsen study on private labels of 80 categories across 38 countries, most of them from Europe, in 2005, "*retailers tend to create powerful brands that meet consumers' needs*" and hence, grab a significant pie of the market. The good news for HLL is that among all the categories, personal care items were least affected, losing only 5% to private labels. Food and beverages were the worst hit, losing as much as 25-50% market share to private labels.

Table 3: Value shares of private labels by category (%)

Category	Private label share
Tea	14.0
Coffee	13.0
Hand dish detergent	13.0
Toothbrush	9.0
Laundry detergent	8.0
Toilet soap	4.0
Shampoo	3.0
Deodorant	3.0
Toothpaste	3.0

Source: AC Nielsen

Though the impact of private labels is not expected to be significant in the near future, a scenario of private labels eating into the market share and making it tough for branded products to grow cannot be overruled. The existence of powerful players such as Reliance, Bharti, and Pantaloons makes it even more likely.

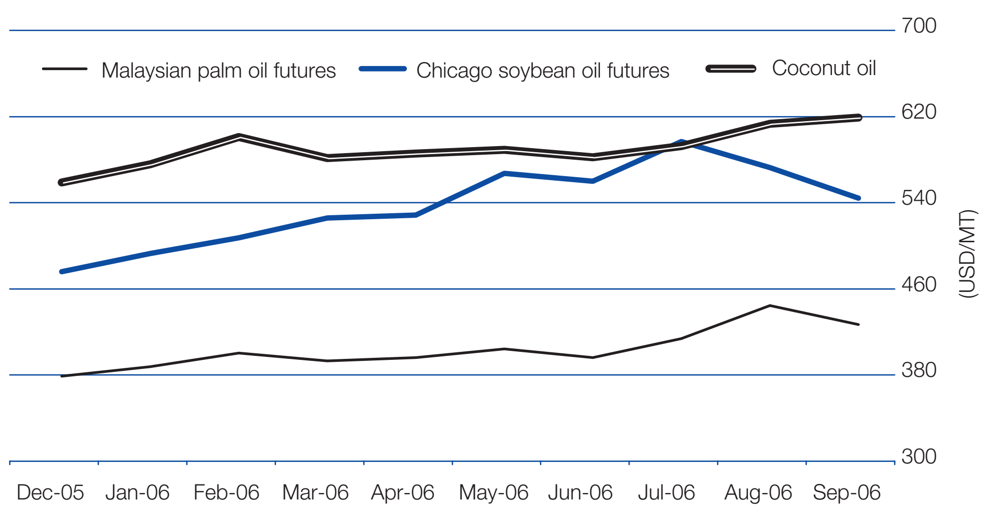
Not just marginal margin erosion

The prices of vegetable oils, which constitute an important raw material for soaps and personal products, have increased by ~13% during January-September 2006 and we expect them to go up by a further 15%. Even after assuming a price hike of 9-12%, the operating margin of soaps and detergents, HLL's biggest segment, could decline by as much as 210bps over CY05-07E. The margin contraction could decrease to 80bps if LAB prices soften following a decline in crude oil prices. Personal products, HLL's second biggest segment, is likely to follow suit with an erosion of 200bps in operating margin over CY05-07E.

Rise in vegetable oil prices: Biodiesel is the culprit

According to the IMF, palm oil prices have already gone up by ~13% this year. The rise has been significant in the previous quarter with an increase of ~8% during July-September 2006. Coconut oil and soybean oil are following a similar trend, rising by 11% and 15%, respectively, since the beginning of 2006.

Chart 1: Vegetable oil prices

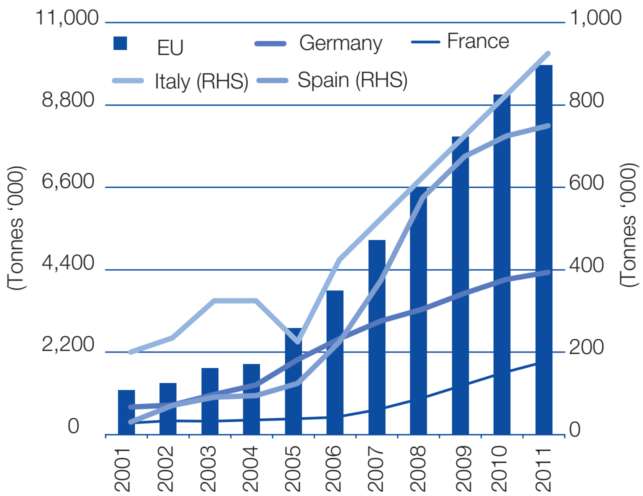


Source: IMF

The reason behind increase in vegetable oil prices is the rise in demand for biodiesel from Europe and the US, due to policies promoting its use. While the EU has ordered that biodiesel should comprise 5.75% of every tank of fuel by 2010, Germany, one of EU's member countries, is further ahead with a requirement enforcing blending of 5% biodiesel from January 1, 2007. The US has extended the biodiesel tax incentive, which was scheduled to expire in 2006 to 2010, which resulted in the National Biodiesel Board reporting a huge growth in biodiesel production to 75 mn gallons in 2005 from 30 mn gallons in 2004.

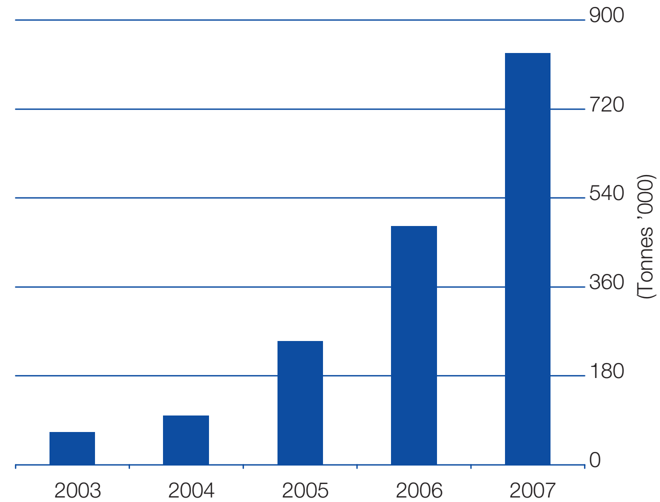
According to Frost & Sullivan, EU's biodiesel consumption is expected to more than treble over 2005-11E, from 2.9 mn tonnes to 9.9 mn tonnes. US, with its focus on ethanol, is lagging EU in biodiesel consumption, which is expected to rise from 0.25 mn tonnes in 2005 to 0.83 mn tonnes in 2007. Further, according to MPOB, Malaysia's policy of blending 5% processed palm oil or biodiesel into petroleum diesel will result in production of 70,000 tonnes of biodiesel in 2006, which will increase to 500,000 tonnes in 2007.

Chart 2: Biodiesel consumption in Europe



Source: Frost & Sullivan

Chart 3: Biodiesel consumption in the US



Source: Frost & Sullivan

The manufacturing process for biodiesel employs vegetable oil as raw material, primarily rapeseed oil, palm oil, and soybean oil. With the demand for biodiesel expected to increase, vegetable oil price rise seems to be inevitable. IOI Corp's executive chairman, Mr. Tan Sri Lee Shin Cheng, forecasted that palm oil prices will rise to as high as RM 1,900 per tonne next year, a ~23% rise from its price of ~RM 1,550 per tonne in September 2006.

Soaps will be affected the most

Coconut oil and palm oil are important raw materials for the manufacture of soaps. Fatty matter, which constitutes 60-76% of soaps by mass, is manufactured from these oils. Coconut oil is considered to have better properties, but palm oil is used as a substitute on account of being cheap. With palm and coconut oil prices on the rise, the raw material cost pressure will put significant pressures on gross margins and in turn operating margins of soap companies.

Godrej Consumer Products Ltd. (GCPL) has already announced 5-8% price hikes beginning October 2006. As per recent newspaper reports, HLL has announced 7% price hike in *Lux, Lifebuoy,* and *Pears*. Though these price hikes bring respite by mitigating the raw material price increases till date, we believe these will not be sufficient to mitigate the impact of the expected further 15% rise in raw material costs. If companies continue to hike prices they may lose out on volumes. Further, HLL runs the risk of losing volumes to Godrej as consumers are likely to downgrade in response to these price hikes.

According to our estimates, a total of 25% price hike in vegetable oil prices over CY05-07E requires a 9% hike in soap prices for HLL to be able to maintain its margin. Hence, the effected price hikes will not be sufficient for HLL to maintain its margin, assuming oils contribute c.80% of the fatty matter which constitutes 60-76% of soap depending on grade. As mentioned above, by raising prices further, HLL risks consumers downgrading to lower-end brands.

Price war and rising raw material prices hurt detergents

Margins of detergents have been under pressure over the past two years due to the combined impact of a price war initiated by P&G and rise in LAB prices, a critical raw material, on the back of rise in crude prices. According to our estimates, a rise in LAB prices from INR 60,000 per tonne to INR 70,000 per tonne during this year will dent the operating profit by ~INR 1,000 mn and a 6% price hike will be required to mitigate the impact.

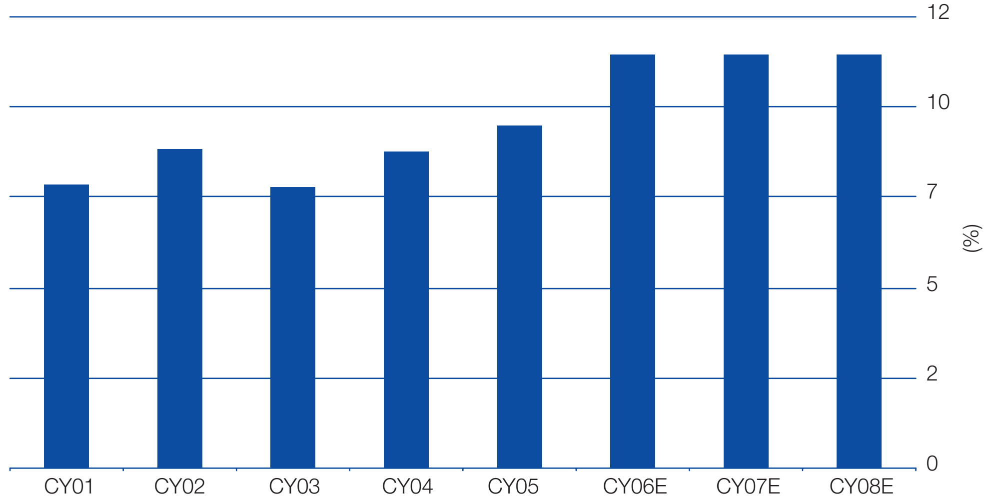
Price of soda ash, another critical raw material for detergents, has increased by ~30%. GHCL recently announced its intention to hike soda ash prices further in Q4FY07. We estimate that a 30% rise in soda ash prices over CY05-07E would require 7% hike in prices of detergents to mitigate the impact. Overall, a 12-13% price hike is required to mitigate the impact of raw material price increases.

HLL has already announced 3-5% price hikes in its major detergent brands. With the fall in crude oil prices, LAB prices are expected to soften. In such a case, a 7% price hike should be sufficient to mitigate the raw material inflation impact. Further, the war with P&G is far from over and pricing pressure is expected to continue over the medium term till P&G stabilizes its market share. The price war has helped P&G increase its market share in detergents from 3% to 7%. We expect P&G to consolidate this position over the next year before effecting significant price hikes. Hence, we expect very little room for HLL to hike prices in order to improve its margins.

Rise in advertising costs to bother margins further

Rise in advertising rates has been one of the major concerns for FMCG companies this financial year. HLL's advertising spends as a proportion of net sales has increased by ~200bps since Q4CY05, putting additional pressure on operating margin. We do not expect HLL to reduce its advertising and hence, ~2.8% hike in prices is required for HLL to protect its margins from advertising rate inflation assuming 30% channel margins.

Chart 4: Advertising as a proportion of net sales

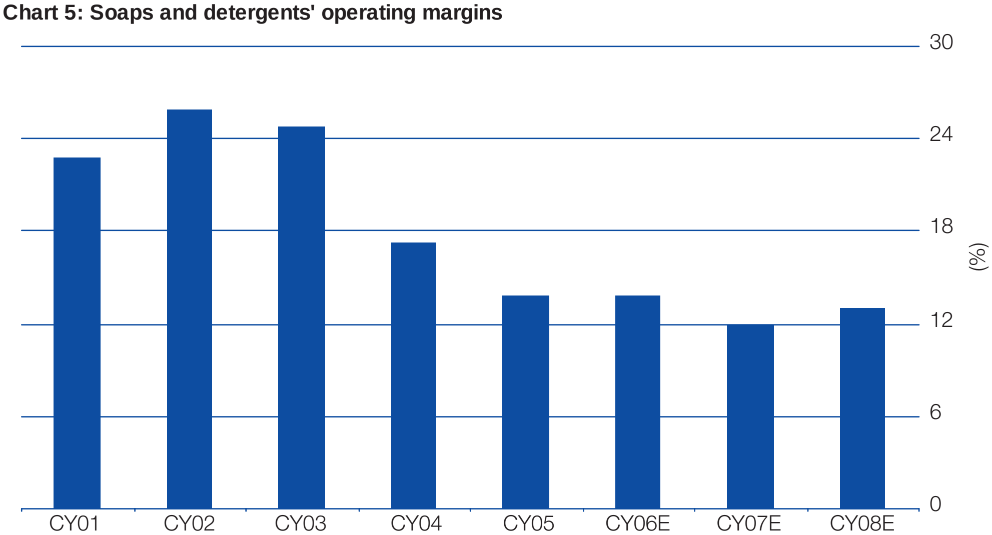


Source: Company, Edelweiss research

Soaps and detergents' margins could decline by as much as 210bps over CY05-07E

According to our estimates, soaps and detergents' margins could decline by as much as 210bps over CY05-07E even after assuming a 9% price hike in soaps and a rosy 12% price hike in detergents. If LAB prices decline following the stabilization of crude near USD 60, the decline in soaps and detergents' margins could be much lower at 80bps, with only a 9.5% price hike in detergents. We have incorporated the more conservative second case in our estimates. We forecast soaps and detergents' margins in CY06E to be 13.8%, in line with 2005, due to the more than necessary price hikes effected to compensate for future rise in raw material prices. In CY07E, we expect the operating margin to decline to 13%.

Chart 5: Soaps and detergents' operating margins

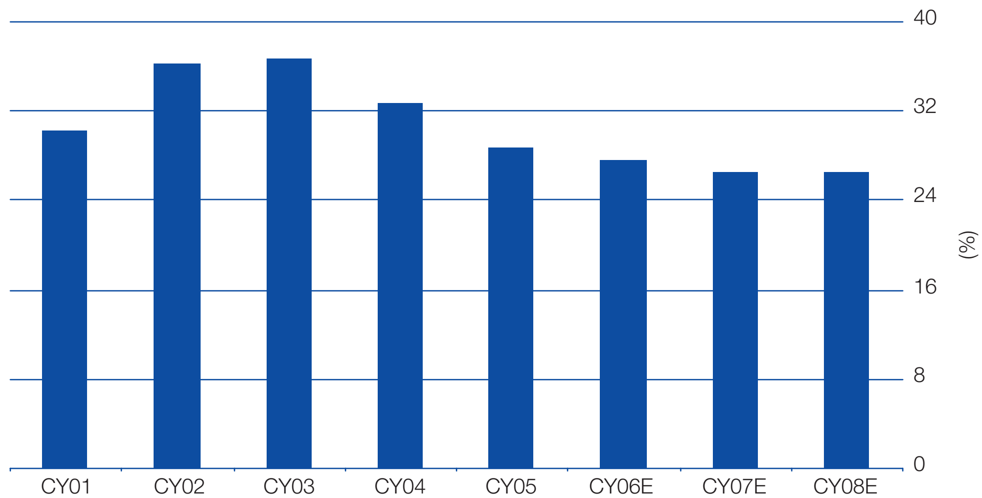


Source: Company, Edelweiss research

Personal products' margins to decline by 200bps over CY05-07E

The personal products segment, HLL's second biggest segment, is also expected to be under pressure from vegetable oil price hikes. Oleo chemicals, which are derived from vegetable oils, are critical raw materials in skin creams and cosmetics, while lauric oils (fractions of coconut oil and palm oil) are used in shampoos. An increase in vegetable oil prices is likely to result in rise in oleo chemicals and lauric oils prices. An 8-11% hike in vegetable oil prices led to a margin compression of 135bps in Q3CY07E. We conservatively estimate a further 15% hike in vegetable oil prices to cause a further 100bps contraction in margins. We expect personal products' margins to decline by 200bps from 28.6% in CY05 to 26.6% in CY07E.

Chart 6: Personal products' margins



Source: Company, Edelweiss research

Overall, we expect the company's operating margins to improve in CY06E by ~150bps to 13.3% due to greater contribution from the high margin personal products segment. In CY07E, the operating margin is expected to remain flat as the upside offered by the greater share of personal products will be negated by the decline in margins due to rise in raw material and advertising rates.

Risks and Concerns

National launch of water purifier or entry into the food segment

HLL launched *PureIt*, a water purifier, in Chennai a couple of years back. The company may launch this product at the national level. Any announcement to that effect can push the stock up in the near term. Further, the company could try its hand once again at the food segment, considering its immense potential and the experience of its parent at its disposal. Any such indications from the company can be a positive trigger for the stock.

Further fall in crude prices

If crude falls further below USD 60 per bbl, biodiesel may prove to be an uneconomical alternative, resulting in a decline in private sector interest. This could lead to lower demand for vegetable oils, which in turn could result in rationalization of their prices to historical levels.

Cost cutting initiatives

The company may take up cost cutting initiatives to mitigate the inflationary impact of raw material and advertising prices. Given that the company has already squeezed its employee costs this year, further avenues for decreasing costs may be difficult to find. In such a case, the company may even look at reducing its advertising budget in the near future, thus reducing the pressure on the operating margin.

Significant up-trading by consumers

A significant up-trading by consumers over the next couple of years may help HLL sell more expensive products, in turn making up for the loss in margins on account of cost pressures. This could impact the operating margins positively.

Financials and Valuation

In the worst case, CY07E EPS could fall by a further 4%

If LAB prices do not soften, the operating margin of soaps and detergents could decline by as much as 210bps in CY07E, compared to CY05. If we assume a 12% margin in CY07E compared to 13.8% in CY05, CY07E EPS reduces to INR 7.47, which indicates a further 4% fall from the estimated INR 7.75 per share.

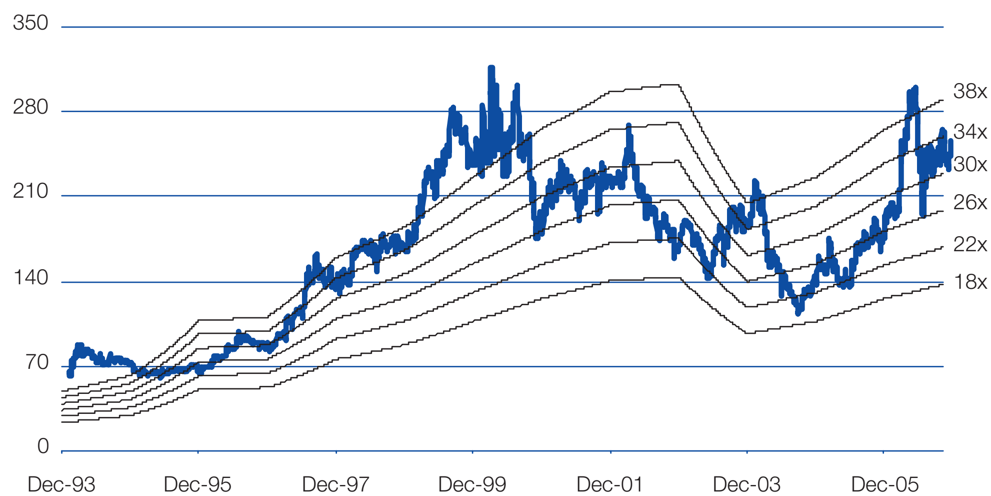
EPS will grow at a CAGR of 11% over CY05-08E

According to our estimates, HLL's EPS will grow at a CAGR of 11% over CY05-08E to INR 8.82. Adjusting for the exceptional items, EPS is estimated at INR 6.99 in CY06E and INR 7.75 in CY07E.

Valuation

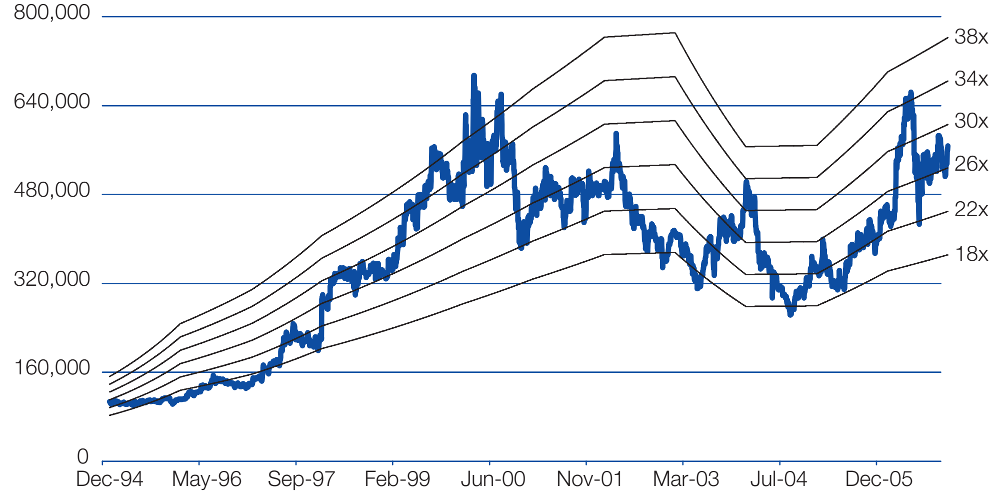
Our CY07E EPS at INR 7.75 is 10% below the consensus estimates. At CMP of INR 249, HLL trades at 35.6x CY06E earnings adjusted for exceptional items and 32.1x CY07E earnings. EV/EBITDA for the stock is 30.4x and 27.5x on CY06E and CY07E, respectively. HLL is a default play on the growth in Indian consumption due to its huge size and liquidity in stock. But given the cost and competitive pressures, we believe the valuations are stretched. We initiate coverage with a **'REDUCE'** recommendation.

Chart 7: 1-yr forward P/E band



Source: Edelweiss research

Chart 8: 1-yr forward EV/EBITDA

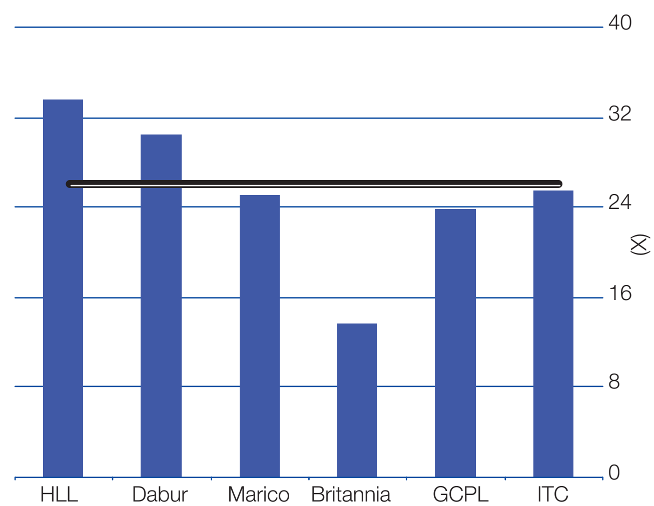


Source: Edelweiss research

Relative valuation

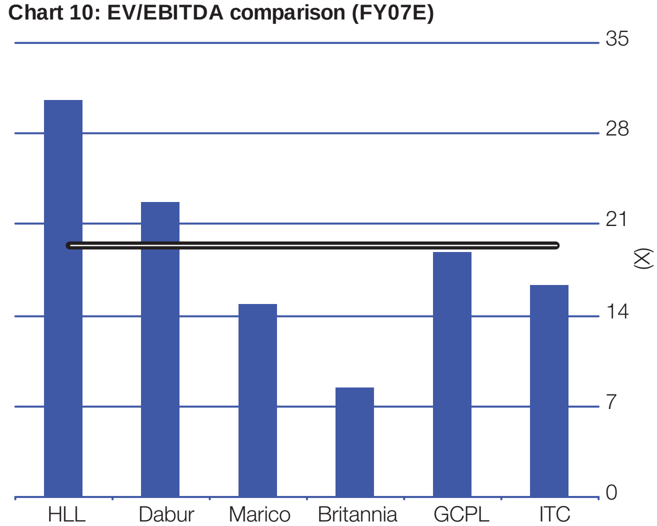
On P/E basis, HLL trades at ~30% premium to ITC, GCPL, and Marico, and ~10% premium to Dabur. On EV/EBITDA basis, due to lower taxes and HLL's ability to generate cash out of its working capital, the premium is even more significant at ~35% to Dabur and 60-100% to ITC, Marico, and GCPL.

Chart 9: P/E comparison (FY07E)



Source: Consensus, Edelweiss research

Chart 10: EV/EBITDA comparison (FY07E)



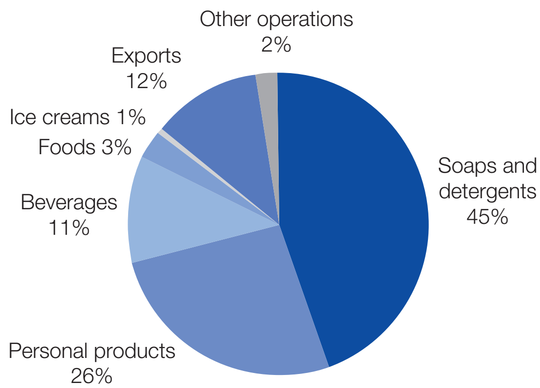
Source: Consensus, Edelweiss research

Business Overview

HLL, the largest FMCG company in India, was formed by merging three subsidiaries of Unilever in 1956. At present, Unilever Plc. holds a 51.6% stake in the company. HLL's portfolio of products covers a wide spectrum including soaps, detergents, skin creams, shampoos, toothpastes, tea, coffee, and branded *atta*. In CY05, it generated net sales of INR 123,338 mn and a profit of INR 14,081 mn.

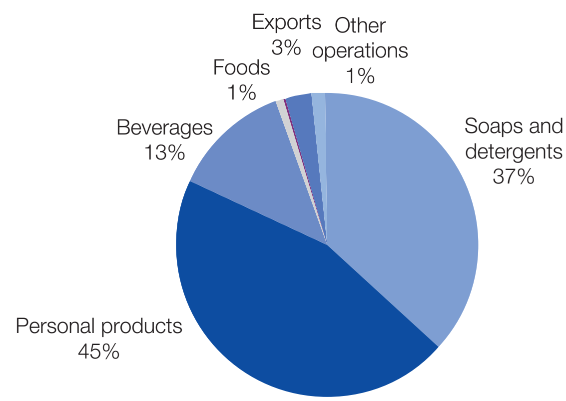
HLL's primary strengths are its powerful brands and an envious distribution network. The company operates through seven segments—soaps & detergents, personal products, beverages, foods, ice creams, exports and other operations. While soaps and detergents contribute 45% to net sales, the high margin personal products segment contributes the most to operating profit at 45%. Together personal products and soaps and detergents, which constitute the home and personal care (HPC) division contribute 71% of net sales and 82% of operating profit.

Chart 11: Split of net sales across segments



Source: Consensus

Chart 12: Split of operating profit across segments

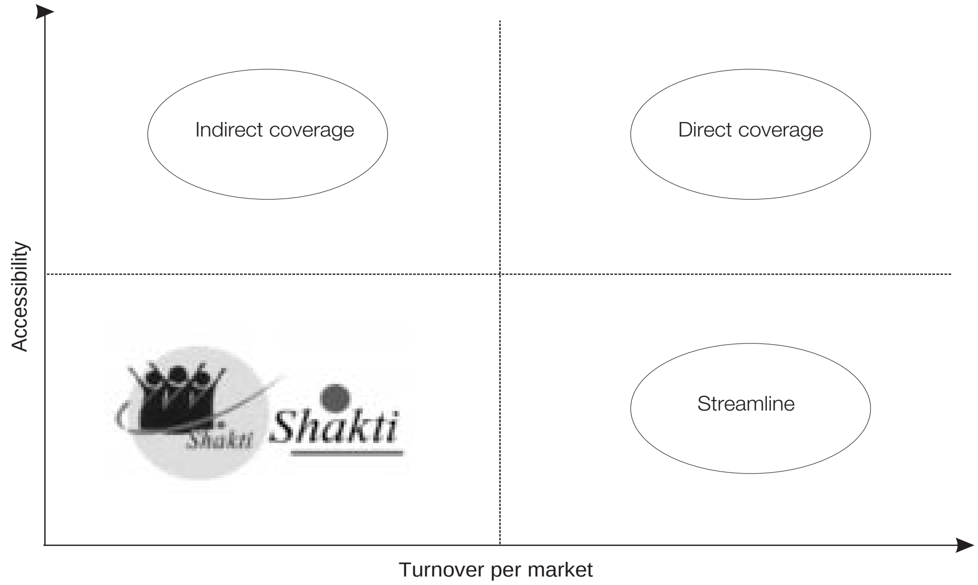


Source: Consensus

HLL is realigning its distribution network

Given that rural India accounts for 60% of consumption expenditure, HLL is keen to capture the opportunity emerging at the bottom of the pyramid and is in the process of realigning its distribution network to improve its rural reach. At present, there are 4 mn outlets in 638,000 villages reaching 775 mn people. HLL is using a four-pronged system to reach these outlets.

Fig. 1: Rural distribution



Source: Company presentation

Direct coverage is similar to the system employed in urban areas. The stock goes from factory to depots controlled by the company. From here it is fed into the trade who then take it to retailers. In indirect coverage, the stockist takes the responsibility of reaching out to outlets in various villages, whereas the streamline process involves servicing of a star seller by the distributor. Retail shops collect the products from the star seller as per requirement. To counter the problem of servicing markets with low turnover and limited accessibility, HLL has initiated *Shakti* program under which it is employing rural women to distribute its products, thus creating a win-win situation.

Shakti: Strengthening the channel

Shakti is an initiative to meet the needs of rural population in small villages where accessibility is low. It is a self-help group of women who sell HLL's products. It creates a win-win situation with HLL getting the much required reach and rural women making a considerable income of INR 700 per month, which almost doubles their household income. Currently, there are about 13,000 women engaged in this initiative selling HLL's products to 70 mn consumers spread across 50,000 villages. Further, the company is extending Shakti to social initiatives such as *Shakti Vani* and *iShakti*. By 2010, HLL plans to reach 600 mn consumers in 500,000 villages.

Financial Statements

Income statement (INR mn)

Year to December	CY04	CY05	CY06E	CY07E	CY08E
Gross sales	108,884	119,755	133,541	148,015	162,588
Excise duties	(9,614)	(9,150)	(10,203)	(11,309)	(12,422)
Net sales	99,269	110,605	123,338	136,706	150,166
Materials consumed	(54,121)	(61,621)	(65,173)	(72,258)	(78,657)
Gross profit	45,149	48,984	58,165	64,448	71,509
Operating expenses	(30,775)	(34,551)	(40,264)	(44,628)	(49,022)
EBITDA	14,374	14,433	17,901	19,820	22,486
Depreciation/Amortization	(1,209)	(1,245)	(1,457)	(1,607)	(1,770)
EBIT	13,165	13,189	16,444	18,212	20,717
Other income	3,188	3,048	2,120	2,323	2,579
Net interest	(1,300)	(192)	(48)	(48)	(48)
PBT before exceptionals	15,053	16,045	18,515	20,487	23,248
Provision for taxation	(3,060)	(2,500)	(3,077)	(3,373)	(3,787)
PAT before exceptionals	11,993	13,545	15,438	17,114	19,461
Exceptionals	(19)	536	2,880	0	0
Profit after tax	11,973	14,081	18,318	17,114	19,461
Dividends	(12,462)	(12,602)	(12,602)	(12,602)	(12,602)
Dividend per share (INR)	5.7	5.7	5.7	5.7	5.7
Dividend payout ratio (%)	104.1	89.5	68.8	73.6	64.8

Common size metrics as % of net revenues

Year to December	CY04	CY05	CY06E	CY07E	CY08E
Materials consumed	54.5	55.7	52.8	52.9	52.4
Operating expenses	31.0	31.2	32.6	32.6	32.6
EBITDA margin	14.5	13.0	14.5	14.5	15.0
EBIT margin	13.3	11.9	13.3	13.3	13.8
Net profit margin	12.1	12.7	14.9	12.5	13.0

Growth metrics (%)

Year to December	CY05	CY06E	CY07E	CY08E
Net sales	11.4	11.5	10.8	9.8
EBITDA	0.4	24.0	10.7	13.5
EBIT	0.2	24.7	10.8	13.8
Net profit	17.6	30.1	(6.6)	13.7
EPS	17.6	29.7	(6.6)	13.7

Cash flow statement (INR mn)

Year to December	CY04	CY05	CY06E	CY07E	CY08E
CFO before working cap changes	15,643	15,881	18,765	20,684	23,351
Cash for working capital	(522)	5,108	(718)	461	336
Income tax	(1,644)	(1,172)	(3,077)	(3,373)	(3,787)
Exceptionals	(462)	364	2,880	0	0
Net operating cash flow	13,016	20,181	17,849	17,772	19,900
Net cash flow from investing	3,150	3,862	(1,019)	(933)	(839)
Net cash flow from financing	(17,251)	(27,483)	(12,650)	(12,650)	(12,650)
Net increase / (decrease) in cash	**(1,084)**	**(3,440)**	**4,180**	**4,188**	**6,411**

Balance sheet

(INR mn)

As at 31st December	CY04	CY05	CY06E	CY07E	CY08E
Share capital	2,201	2,201	2,201	2,201	2,201
Reserves and surplus	18,726	20,855	26,570	31,082	37,940
Shareholders funds	20,927	23,056	28,771	33,283	40,142
Short term loans	1,460	532	532	532	532
Long term loans	13,251	38	38	38	38
Funds employed	**35,638**	**23,626**	**29,341**	**33,852**	**40,711**
Net fixed assets	14,231	13,855	14,672	15,456	16,241
Capital work in progress	944	980	980	980	980
Investments	22,296	20,142	20,142	20,142	20,142
Deferred tax assets (net)	2,260	2,201	2,201	2,201	2,201
Current assets, loans and advances	33,050	27,630	32,259	38,499	46,837
Inventories	14,704	13,218	14,255	15,800	17,218
Sundry debtors	4,893	5,228	4,673	5,179	5,689
Cash and bank balance	6,980	3,550	7,730	11,918	18,329
Other current assets	528	239	207	207	207
Loans & advances	5,944	5,395	5,395	5,395	5,395
Current liabilities	(37,143)	(41,183)	(40,914)	(43,427)	(45,691)
Liabilities	(25,908)	(29,594)	(29,325)	(31,838)	(34,102)
Provisions	(11,235)	(11,589)	(11,589)	(11,589)	(11,589)
Working capital	(4,093)	(13,553)	(8,655)	(4,928)	1,146
Uses of funds	**35,638**	**23,626**	**29,341**	**33,852**	**40,711**
BV (INR)	16.2	10.7	13.3	15.3	18.4

Ratios

Year to December	CY04	CY05	CY06E	CY07E	CY08E
ROE (%)	57.2	64.0	70.7	55.2	53.0
ROCE (%)	42.3	51.4	66.2	69.8	77.2
Debtor days	16	16	13	13	13
Inventory days	99	78	80	80	80
Fixed assets t/o	7.0	8.0	8.4	8.8	9.2
Debt/Equity	0.7	0.0	0.0	0.0	0.0
Interest coverage	12.6	84.6	387.6	428.8	486.5

Valuation parameters

Year to December	CY04	CY05	CY06E	CY07E	CY08E
EPS (diluted) (INR)	5.4	6.4	8.3	7.8	8.8
Y-o-Y growth (%)		*17.6*	*29.7*	*(6.6)*	*13.7*
CEPS	6.0	7.0	9.0	8.5	9.6
P/E (*x*)	45.7	38.9	30.0	32.1	28.2
Price/BV	15.4	23.2	18.7	16.2	13.5
EV/Sales	5.5	4.9	4.4	4.0	3.6
EV/EBITDA	37.9	37.7	30.4	27.5	24.2

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Vikas Khemani - 22864206	Co-Head, Institutional Equities

INDIA RESEARCH			SECTOR
Shriram Iyer	-	2286 4256	Head – Research
Gautam Roy	-	2286 4305	Airlines, Textile
Ashutosh Goel	-	2286 4287	Automobiles, Auto Components
Vishal Goyal, CFA	-	2286 4370	Banking & Finance
Revathi Myneni	-	2286 4413	Cement
Sumeet Budhraja	-	2286 4430	FMCG
Harish Sharma	-	2286 4307	Infrastructure, Auto Components, Mid Caps
Priyanko Panja	-	2286 4300	Infrastructure, Engineering, Telecom
Hitesh Zaveri	-	2286 4424	Information Technology
Pritesh Vinay	-	2286 4429	Metals, Mining
Priyank Singhal	-	2286 4302	Media, Retail
Prakash Kapadia	-	2286 4432	Mid Caps
Niraj Mansingka	-	2286 4304	Oil & Gas, Petrochemicals
Nimish Mehta	-	2286 4295	Pharmaceuticals, Agrochemicals
Swati Khemani	-	2286 4266	Textile
Manika Premsingh	-	4019 4847	Economist
Sachin Arora	-	2286 4512	Alternative & Quantitative
Sunil Jain	-	2286 4308	Alternative & Quantitative
Yogesh Radke	-	2286 4328	Alternative & Quantitative

INSTITUTIONAL SALES		
Nischal Maheshwari	-	2286 4205
Rajesh Makharia	-	2286 4202
Shabnam Kapur	-	2286 4394
Amish Choksi	-	2286 4201
Deepak Rao	-	2286 4204
Balakumar V	-	(044) 4263 8283
Monil Bhala	-	2286 4363
Ashish Agrawal	-	2286 4301
Nikhil Garg	-	2286 4282
Neha Shahra	-	2286 4276
Priya Ramchandran	-	2286 4389
Anubhav Kanodia	-	2286 4361
Tushar Mahajan	-	2286 4439
Harsh Biyani	-	2286 4419
Nirmal Ajmera	-	2286 4258
Ankit Doshi	-	2286 4671
Ravi Pilani	-	4009 4533
Dipesh Shah	-	2286 4434

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	**Reduce**	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	**Sell**	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	**Trading Sell**	Expected to depreciate more than 10% over a 45-day period