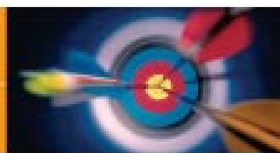
investor's eye



Index

- Stock Update >> NIIT Technologies
- Stock Update >> Orient Paper and Industries
- Stock Update >> Reliance Industries

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Aban Loyd	03-Mar-05	330	**906**	1,760
Bajaj Auto	15-Nov-05	1,873	**2,590**	3,500
BHEL	11-Nov-05	1,203	**1,799**	2,650
Esab India	21-May-04	60	**330**	575
Infosys	30-Dec-03	1,378	**2,956**	3,324

NIIT Technologies

Ugly Duckling

Stock Update

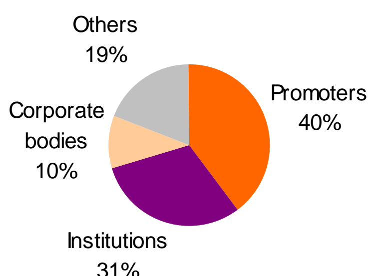
Revenues flow in steadily

Buy; CMP: Rs170

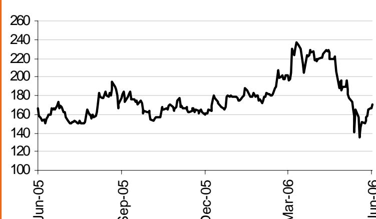
Company details

Price target:	Rs296
Market cap:	Rs657 cr
52 week high/low:	Rs242/131
NSE volume: (No of shares)	197,691
BSE code:	532541
NSE code:	NIITTECH
Sharekhan code:	NIITTECH
Free float: (No of shares)	2.3 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-12.2	-17.7	3.4	1.0
Relative to Sensex	-5.8	-10.7	-7.1	-29.2

Result highlights

- NIIT Technologies Ltd (NTL) reported a 5.6% quarter-on-quarter (q-o-q) and a 21.2% year-on-year (y-o-y) growth in its consolidated net revenues to Rs166.2 crore during the fourth quarter ended March 2006.
- The operating profit margin (OPM) improved by 60 basis points sequentially and by 200 basis points year on year (yoy) to 20% in Q4. The improvement in the OPM was largely driven by the break-even achieved in the business process management (BPM) business during Q4.
- The consolidated earnings grew 6.5% quarter on quarter (qoq) and by 13.6% yoy to Rs19.2 crore. The earnings were below our estimates of Rs20.3 crore due to higher than expected depreciation charges and a jump in the tax rate.
- On the full year basis, the consolidated revenue and earnings grew by 11.8% to Rs607.5 crore and by 13.2% to Rs66.3 crore respectively. The OPM has improved by 118 basis points to 19% in FY2006. Going forward, the company's growth is likely to accelerate on the back of the incremental revenues from the recently acquired majority stake in Room Solutions ($25 million revenues) and the benefits of the client rationalisation exercise done over the past couple of years.
- The company has announced a dividend of 60% (or Rs6 per share), which amounts to a healthy dividend yield of 3.6%.
- At the current market price the stock trades at 7.8x FY2007 and 6.2x FY2008 estimated earnings. We maintain our Buy call with a price target of Rs296.

Result table Rs (cr)

(Rs crore)	Q4FY06	Q4FY05	Q3FY06	% yoy	% qoq
Net revenue	166.2	137.1	157.4	21.2	5.6
Operating expenses	133.0	112.5	126.8	18.3	4.9
Operating profit	33.2	24.6	30.5	34.8	8.7
Other income	1.1	-0.3	0.1	-	-
Depreciation	11.0	8.7	9.3	26.9	18.3
Profit before tax	23.3	15.7	21.3	48.5	9.4
Taxation	3.6	(2.0)	3 .0	-	19.2
PAT	19.7	17.4	18.3	12.9	7.8
Minority share	0.5	0.5	0.2	-8.6	103.3
Adj. PAT	19.2	16.9	18.0	13.6	6.5
Equity capital	38.7	38.7	38.7		
EPS (Rs)	5.0	4.4	4.7		
Margins (%)					
OPM	20.0	18.0	19.4		
NPM	11.6	12.3	11.5		

Steady revenue growth

During the fourth quarter, the revenue growth was contributed by a 5.2% q-o-q growth in the software service business and a 10.5% growth in the BPM business. The growth in the software service business has been stable in the past few quarters, despite the on-going client rationalisation exercise in the non-focus industry domains.

The BPM business also appears to be back on the growth path after the conscious effort to exit some commoditised outbound call processes in the past couple of quarters. In terms of employee addition also, it added 50 employees in the BPM business as compared with the net reduction of 128 employees in the previous two quarters.

Segmental revenue growth

	Q4FY06	Q4FY05	Q3FY06	% yoy	% qoq
Software services	154.6	127.3	146.9	21.4	5.2
BPM	11.6	9.8	10.5	18.4	10.5

On the full year basis, the company reported a healthy growth of around 21.6% in the focus verticals of banking, financial services and insurance, transportation, manufacturing and retail. Consequently, the revenue contribution from the four focus verticals increased from 69% in FY2005 to 75% of the total turnover. However, the revenues from the non-focus areas declined by 9.8% due to the on-going client rationalisation and restructuring exercise, which pulled down the company's overall growth rate.

Going forward, the management expects the focus verticals to continue growing at an average rate of 22-25% in the Indian software service industry. And the revenues from the non-focus verticals are expected to grow marginally as compared with a decline in the last fiscal. Thus, the organic business is likely to show a much higher growth in FY2007. In addition to this, the incremental revenues from the recent acquisition of a 51% stake in the UK-based Room Solutions would further boost the company's overall revenue growth. We expect the revenues to grow at a compounded annual growth rate (CAGR) of 23.6% over the next two years.

Margins to remain stable

The continued improvement in the operating profit margin (OPM) is largely driven by the reduction in the losses of the BPM business. The BPM business broke even at the operating level in Q4, as compared to having negative OPMs of 30.7% and 12.4% in Q2FY2006 and Q3FY2006 respectively. On the other hand, the OPM in the software service business has remained stable in the range of 21-22%.

Going forward, the margins in the organic business are expected to improve with further improvement in the profitability of the BPM business. However, the integration of the UK-based Room Solutions (acquired in Q1FY2007) will nullify most of the margin gains in the organic business. The onsite-centric business of Room Solutions has relatively much lower OPM of 8-10%.

Earnings growth dented by higher depreciation and tax rate

The consolidated earnings grew by 6.5% qoq and by 13.6% yoy to Rs19.2 crore in Q4. The earnings growth was slightly lower than our estimates due to higher depreciation charges (as auditors advised the company to take a lower useful life in case of certain assets) that grew 18.3% qoq to Rs11 crore. The tax rate was also higher at 15.4% as compared with 14.5% in the previous quarter.

Other highlights

Healthy employee addition

The net addition of 253 employees in Q4 was the highest in the past 12 quarters. The management expects to add 700-800 employees (excluding the addition of 122 employees from the acquisition of Room Solutions) in FY2007, an increase of 20-22% to the existing employee base of 3,543 professionals.

Capex plans

NTL would invest Rs100 crore in building facilities to seat 3,000 employees at the newly built campus at Noida, near Delhi. The capital expenditure (capex) would be spread over the next 18-24 months and funded by internal accruals. The company had cash and cash equivalents of Rs157 crore as in March 2006. Though part of the free cash (around $13 million) has been utilised to acquire a majority stake in Room Solutions, the internal generation of free cash would be enough to meet its capital requirements.

Valuation

At the current price NTL trades at 7.8x FY2007 and 6.2x FY2008 estimated earnings. We maintain our Buy call with a price target of Rs296.

Key financials

Particulars	FY2005	FY2006	FY2007E	FY2008E
Net sales (Rs cr)	543.2	607.5	779.8	927.4
Net profit (Rs cr)	58.6	66.3	84.7	106.1
No of shares (cr)	3.9	3.9	3.9	3.9
EPS (Rs)	15.2	17.2	21.9	27.5
% y-o-y change	-	*13.2*	*27.8*	*25.3*
PER (x)	11.2	9.9	7.8	6.2
Price/BV (x)	2.9	2.3	1.9	1.5
EV/EBIDTA(x)	5.9	4.4	3.6	2.6
Dividend yield (%)	3.2	3.5	4.1	4.7

The author doesn't hold any investment in any of the companies mentioned in the article.

Orient Paper and Industries

Vulture's Pick

Stock Update

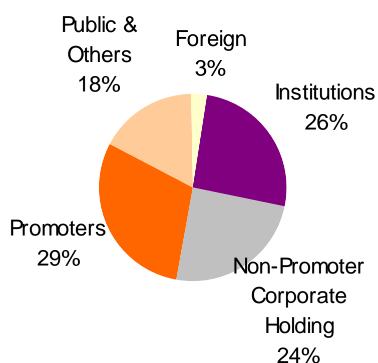
Growth to come from cement

Buy; CMP: Rs350

Company details

Price target:	Rs675
Market cap:	Rs519 cr
52 week high/low:	Rs567/118
NSE volume: (No of shares)	33,864
BSE code:	502420
NSE code:	ORIENTPPR
Sharekhan code:	ORIENTPAP
Free float: (No of shares)	1.0 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-15.4	20.2	54.4	179.1
Relative to Sensex	-9.2	30.4	38.7	95.5

We have analysed the recently released annual report of Orient Paper & Industries Ltd (OPIL) and here are the highlights of the report.

- OPIL has recorded an overall sales growth of 18.7% to Rs867 crore, driven by a 23% growth in the revenues of the cement business and a 13% growth in the paper business.
- With operating leverage coming into play (the fixed cost increased by just 2%) during the year, OPIL's operating profit jumped significantly by 86.8% to Rs117 crore.
- The cash flow from the operations doubled to Rs103.4 crore which enabled the company to repay debts worth Rs132 crore. This brought down the interest charge by Rs8 crore. The lower interest charge and stable depreciation buoyed the net earnings by 1,364% to Rs40 crore. However the reported net profit, which included extraordinary gratuity payments and expenses on account of a voluntary retirement scheme (VRS), stood at Rs21.5 crore.
- The company has been able to reduce its working capital cycle from 29 days of sales to 20 days of sales. Its return ratios have also improved commendably; eg the return on capital employed (RoCE) has improved from 10% in FY2005 to 18% in FY2006. However the debt/equity ratio still remains very high at close to 7x. With a strong earnings growth over FY2006-08, we expect the gearing to come down significantly to 2x in FY2008.
- The management sounds pretty positive on the outlook for all the three businesses, ie of paper, cement and electric fans. However, it is clear from the management discussion analysis (MDA) section of the annual report that cement will be the primary driver of the company's growth.
- The company has lined up a capital expenditure (capex) plan of Rs205 crore to expand its cement manufacturing capacity, set up of a 30MW captive power plant (CPP) and increase its paper manufacturing capacity.

In a nutshell, the key drivers of OPIL's growth are intact and hence the outlook for the company's future remains positive. All the three businesses are peaking simultaneously with the cement business driving the growth. We expect OPIL's earnings growth to gain momentum with the earnings growing at a compounded annual growth rate (CAGR) of almost 60% over FY2006-08E on the back of its proactive capacity expansion plans and timely cost control initiatives. At the current market price of Rs350, the stock is discounting the FY2007E earnings by 7x and the FY2008E earnings by 5x. Such a discount, we believe, is unwarranted considering that the various earnings growth triggers are on the verge of unfolding. Also, thanks to the cash and cash equivalents of Rs100 per share on its books (28.5% of the current market price), the stock offers a decent margin for safety. We thus expect OPIL's valuation to improve and maintain our Buy recommendation on the stock with the price target of Rs675.

Key positives

Cement remains the growth driver

The cement business contributes 48% to OPIL's revenues and 58% to its earnings before interest and tax (EBIT). The cement division operates in the markets of Maharashtra and Andhra Pradesh, ie near the Chandrapur cluster, which has traditionally been a cement surplus region due to the presence of rich limestone reserves. The excess supply situation had turned cement prices un-remunerative and resulted in the poor performance of the cement division in the past. However due to a strong growth in cement consumption and a lack of capacity addition in the last two years, the demand/supply situation has improved significantly since, turning cement prices highly remunerative. Hence the cement division showed a remarkable recovery in FY2006. It is clear from the MDA that the cement business is the focus area for the management and the driver of OPIL's growth going forward. The reasons why OPIL is focusing on the cement business are discussed below.

Healthy growth in cement prices to sustain: OPIL's cement revenues grew by 23% in FY2006, driven by a 5% growth in the volumes and a 15% growth in the realisations. The management expects the rise in the cement prices to sustain on account of the improving demand/supply scenario in its key markets and the lack of new capacity addition in the next two years.

Higher proportion of blended cement to improve margins: The blended cement sales as a percentage of the total cement sales (blending ratio) stood flat at 32% on account of the non-availability of fly ash, which is used as a blending material for cement. The company is in the process of finalising a dedicated arrangement at National Thermal Power Corporation's power plant to ensure the greater availability of fly ash. This in turn will result in higher blended cement sales and hence higher earnings before interest, depreciation, tax and amortisation (EBIDTA) margin for the cement division.

Proactive initiatives to stem rising power cost: OPIL's power and fuel cost per tonne of cement has jumped from Rs515 to Rs550. On account of the rising coal prices the company has taken three proactive steps to reduce its power cost. First, it plans to install a 30MW CPP at a cost of Rs117 crore. We expect net savings of at least Rs20 crore per annum on account of the commissioning of the CPP. Second, it has started using rice husk and saw dust as an alternative fuel to bring down the fuel cost. Third, the company is upgrading its first and second kilns which will reduce the per-tonne power consumption by the cement division. The power consumption has already reduced from 92KWH per tonne to 88.6KWH per tonne.

Expanding capacities to boost volumes: Further the company has received an in-principal approval from its shareholders to expand its cement manufacturing capacity from Rs2.4 million tonne to 3 million tonne at a cost of Rs43 crore. The expansion is likely to get completed by the end of FY2007. We believe the timely capacity expansion will maintain the volume growth. Moreover, since the expansion is being done through debottlenecking, the ROCE for the cement division will improve.

Particulars	FY2006	FY2005
Cement volumes (lakh tonne)	22.2	21.1
Cement realisation (Rs per tonne)	2188	1918
Blended cement sales (lakh tonne)	710000	675000
Blending ratio (%)	32.0	32.0
Capacity utilisation (%)	89.0	84.0

The management's optimism for the cement division can be summed up in their own words as mentioned in the annual report: "*We have every reason to feel fairly optimistic about continuous improvement in the outlook for our cement business.*"

Paper showing signs of recovery

The paper business contributes 30% to OPIL's revenue and 22% to its EBIT. The paper industry was paralysed not so long ago by excess supply due to the substantial capacity added on account of waste paper based plant. Consequently, paper prices remained stagnant for the last two years. This coupled with the rising prices of the key raw materials like wood pulp and bamboo adversely affected the performance of OPIL's paper division. Going forward, the management is cautiously optimistic about the prospects of the paper division because of the following reasons.

Structural changes improve scenario: The structural changes taking place in the paper industry are gradually improving the scenario for the paper business. First, the government's thrust on education and literacy through its programmes like "Sarva Shiksha Abhiyan" is likely to boost the consumption of paper and help absorb the excess capacities. Further, the reduction in the excise duty from 16% to 12% and the implementation of the value-added tax are likely to result in the rationalisation of the tax structure, thereby providing a level playing field to the players in the organised and unorganised sectors. The paper prices rose by 5% in FY2006 after a lag of two years.

OPIL doing better than the industry: OPIL's paper volumes grew by a healthy 7.2% compared to the industry growth rate of 6%. The paper realisation also rose by 5% in FY2006, leading to a 13% growth in the revenue of the division during the year.

100% utilisation of Amlai plant—expanding capacity by 20%: With its Brajrajnagar plant remaining closed since 1999, the company utilised almost the entire capacity of the Amlai plant. OPIL is the market leader in the tissue paper segment, which has been recording a double-digit growth. The growth in the tissue paper segment is expected to continue on account of the changing lifestyles. In order to cater to the growth opportunities, OPIL is expanding its capacity by 20,000MT per year or approximately 20%. This coupled with the healthy growth in the paper realisation shall maintain the growth momentum in the paper division and help OPIL to further consolidate its position as the market leader in the tissue paper segment.

Divestment of Brajrajnagar plant on the verge of completion: OPIL's Brajrajnagar plant in Orissa has remained closed since 1999. The plant workforce, which stood at 4,500 in 1998, has now been reduced to less than 400. This division recorded a loss of Rs12.83 crore in FY2005 at the profit before interest and tax level. The company is planning to divest this plant and the move should have a positive impact on its bottom line (Rs8.30 per share). OPIL is also writing off the expenses of Rs4.5 crore incurred annually on account of a VRS related to the Brajrajnagar plant. We expect the entire amount to be written off by the end of FY2008.

Fan business good export potential

The business of fans contributes 21% to the revenues and 13% to the EBIT of OPIL. The size of the Indian fan industry is estimated at 2.2 crore fan units valued at Rs1,400 crore. Out of this, the organised sector accounts for Rs1,100 crore and OPIL is the market leader in this segment with a 20% share. This is a fiercely competitive industry where gaining and maintaining market share are the key to success. Further, with the chances of product differentiation being slim, the selling prices have been virtually stagnant and hence the margins have been under pressure. However there exists a big export opportunity and hence the management is positive about exploiting the same.

OPIL way ahead of the industry: During FY2006 OPIL sold 26.77 lakh fan units, recording a huge 19% growth as compared with the 8% growth in the industry. The growth was driven by a 36% growth in the exports on account of the increased supply to big international retailers like Wal-Mart. However due to intense competition from the Chinese manufacturers, the export revenues grew at a slower rate of 26% (against a 36% volume growth). Overall, the fan business registered a growth of 17% to Rs210 crore.

The key growth ingredients for the fan division are in place. For example, the company has been very swift in introducing new models, reasonable and effective with regard to ad spend (5% of fan revenue) and aggressive in tapping the export market. The management expects the division to grow steadily going forward.

Improving financial health

With the stellar performance of the cement division and the turn-around of the paper division, the cash flow from the company's operations has doubled to Rs103.4 crore. This has enabled the company to repay debts worth Rs132 crore which has in turn brought down the interest charge by Rs8 crore. The lower interest charge and stable depreciation have boosted OPIL's net earnings by 1,364% to Rs40 crore. However the reported net profit, which included extraordinary gratuity payments and VRS expenses, stood at Rs21.5 crore in FY2006.

Further, the company has been able to reduce its working capital cycle from 29 days of sales to 20 days of sales. The improvement in the return ratios is also commendable with the RoCE improving from 10% in FY2005 to 18% in FY2006. However the debt/equity ratio still remains very high at close to 7x. The strong earnings growth over FY2006-08, we believe, would bring down the gearing significantly to 2x in FY2008.

Key ratios

Particulars	FY2004	FY2005	FY2006
OPM (%)	9.6	8.6	12.4
EBIDTA (%)	11.9	11.0	14.1
PAT (%)	-1.2	0.4	4.6
RoCE (%)	8.5	9.9	18.4
RoNW (%)	-20.1	6.7	97.2
Debt equity (X)	9.7	9.1	6.6

Key concerns

- The Jalgaon cement plant, which was exempt from paying sales tax, lost the tax benefit from January 2006. However the rise in the cement prices in that region would more than offset the loss of the sales tax benefit.
- The recent ban on the overloading of trucks by the Supreme Court has resulted in higher inbound and outbound logistic costs for OPIL. This has caused its freight cost to go up from 11.5% to 13.2% as a

percentage of sales. The same is likely to go up further as the ban was imposed in January 2006. This being an external factor, the management does not have any control over the cost.

- Coal India has announced a 20% cut in the allocation of coal against established linkage. Hence the shortage in the coal supply will have to be met by purchasing coal at auctions at a higher cost. This is likely to affect the margins of the paper division. However the management is contemplating setting up a CPP to stem the rising power and fuel costs.

In a nut shell

The drivers of OPIL's growth are intact and hence the outlook for the company's future remains positive. All the three businesses are peaking simultaneously with the cement business driving the growth. We expect OPIL's earnings growth to gain momentum with the earnings growing at a CAGR of almost 60% over FY2006-08E on the back of its proactive capacity expansion plans and timely cost control initiatives.

Valuation remain extremely attractive—maintain Buy recommendation

At the current market price of Rs350, the stock is discounting the FY2007E earnings by 7x and the FY2008E earnings by 5x. Such a discount, we believe, is unwarranted considering that the various earnings growth triggers are on the verge of unfolding. Also, thanks to the cash and cash equivalents of Rs100 per share on its books (28.5% of the current market price), the stock offers a decent margin for safety. We thus expect OPIL's valuation to improve and maintain our Buy recommendation on the stock with the price target of Rs675.

Earnings table

Year ended Mar 31	FY04	FY05	FY06	FY07E	FY08E
Net profit (Rs cr)	-7.7	2.7	39.9	74.5	100.0
% y-o-y growth	-	*-135.6*	*1364.1*	*86.5*	*34.2*
Shares in issue (cr)	1.5	1.5	1.5	1.5	1.5
EPS (Rs)	-5.2	1.8	26.9	50.2	67.4
% y-o-y growth	-	*-135.6*	*1364.1*	*86.5*	*34.2*
PER (x)	-67.8	190.4	13.0	7.0	5.2
P/BV (Rs)	157.4	85.9	27.1	6.0	2.9
EV/EBIDTA (x)	16.3	15.7	8.7	6.3	4.3
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
RoCE (%)	8.5	9.9	18.4	24.1	26.1
RoNW (%)	-20.1	6.7	97.2	66.5	47.8

The author doesn't hold any investment in any of the companies mentioned in the article.

Reliance Industries

Evergreen

Stock Update

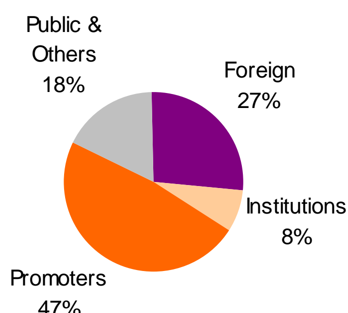
Moving to higher growth path

Buy; CMP: Rs982

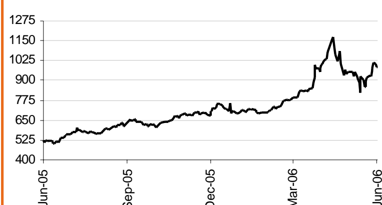
Company details

Price target:	Under review
Market cap:	Rs137,210 cr
52 week high/low:	Rs1,184/495
NSE volume: (No of shares)	70.5 lakh
BSE code:	500325
NSE code:	RELIANCE
Sharekhan code:	RIL
Free float: (No of shares)	72.6 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.6	26.8	54.9	96.9
Relative to Sensex	11.2	37.5	39.2	37.9

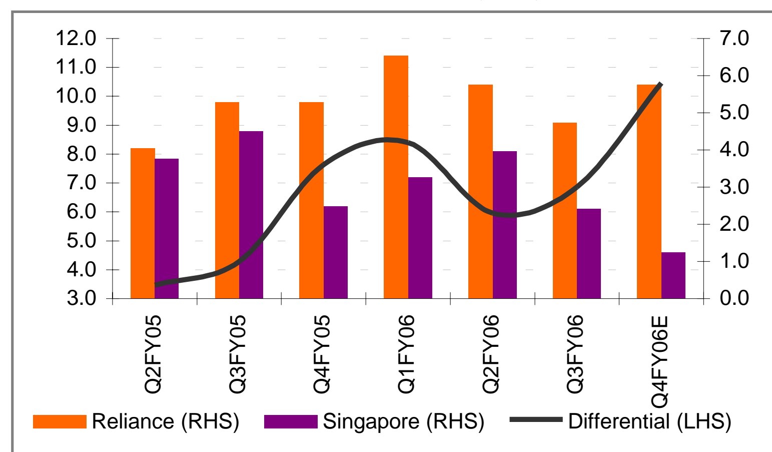
We attended the annual general meeting (AGM) of Reliance Industries Ltd (RIL) recently. We present the key takeaways from the meeting below.

FY2006—a year of splendid performance

RIL's performance in FY2006 was exceptionally good. It reported a 23% year-on-year (y-o-y) growth in its revenues and an 11.65% y-o-y growth in its operating profit during the year. The good results were achieved on the back of the strong performance of its key businesses of refining and marketing (R&M) and petrochemicals.

The R&M business enjoyed the benefit of a planned shut-down of refineries across the globe. As a result the gross refining margins (GRMs) of the R&M business remained strong throughout the year. Further, RIL continued to enjoy a substantial premium to the regional Singapore GRMs due to its rich product mix and ability to process both heavy and sour crude. However, the profitability of this business was affected by the discounts offered to the public sector oil marketing companies and under-recoveries suffered by RIL's own retailing network.

RIL GRMs and premium over Singapore GRM ($/bbl)



Source: Company, Sharekhan research

The petrochemical business enjoyed an extended upsurge in the prices due to a delay in the capacity in the Middle-East region. For FY2006, the revenues grew by 2.6% year on year (yoy) due to lower production. However, the profit before interest and tax (PBIT) grew by a strong 25.2% yoy as the PBIT margin expanded by 260 basis points on the back of strong prices.

On the exploration and production (E&P) business front, the production of crude oil from the Panna-Mukta fields improved by 19% yoy in FY2006. The gas production from the Panna-Mukta fields improved by 8.3% yoy while that from the Tapti field improved by 8.5% yoy. RIL holds 30% equity in these fields.

Retail business to be one of major growth areas

Organised retail is the new growth theme at RIL. Through Reliance Retail Ltd (RRL),

its 100% subsidiary (not considering stock options), RIL has embarked upon a Rs25,000-crore expansion plan in the organised retail space. The venture entails an equity investment of Rs10,000 crore by RIL in RRL; the balance would be in the form of equity.

RRL plans to expand its reach to 1,500 cities in India and enter several verticals like:

- Food and grocery
- Fast moving consumer goods
- Apparels and footwears
- Consumer durables
- Lifestyle products and services
- Farm implements and inputs
- Distribution of travel services
- Entertainment and leisure
- Educational products
- Health products

The company's focus will be on food, grocery and farm inputs, and it plans the back-to-back integration of these verticals by establishing a direct procurement system and food processing zones. However, the retail venture will also take care of the growing aspiration of the average Indian by selling world-class brands in all the verticals.

E&P—another growth area

RIL had identified E&P as one of its core growth areas in the late nineties and its progress in these areas has been commendable. During the year RIL won another five blocks in the fifth round of National Exploration Licencing Policy. Now RIL is the largest exploration acreage holder among the private sector companies in India with 34 domestic exploration blocks. This is in addition to its interest in one exploration block each in Yemen and Oman. The company also has five coal bed methane blocks.

It announced gas reserves of 2.2 trillion cubic feet (tcf; with a possible upside to 8.2tcf) at the NEC-25 block and of about 3.65tcf for coal bed methane (CBM) at Sohagpur east and west blocks. In the AGM, the company announced crude oil discovery in two blocks, one in the MA1 well in the deep water D6 block in the Krishna-Godavari (KG) basin and another in two wells in the KG-III-6 shallow water block. The potential of these discoveries is currently under valuation.

During the year, RIL also obtained most of the necessary approvals required to lay the 1,400-kilometre-long pipeline (with a diameter of 48 inches) connecting the eastern coast of India with its western coast. The investment has been undertaken to take full advantage of one the biggest gas finds by not only RIL but also India in the KGD6 block, which is estimated to have 14tcf of gas reserves. All the major contracts for the pipeline have been awarded and the pipeline is likely to commence operations in H2FY2009; the commercial production of gas from the said location would also commence at the same time.

R&M business

During the year under review, RIL started the construction of one the biggest greenfield refinery projects in the world. The refinery will be owned by RIL's 75% subsidiary, Reliance Petroleum Ltd (RPL). It will have a capacity to refine 580,000 barrels of crude per day. RIL has also placed a 5% stake in the refinery with the second largest energy company in the USA, Chevron Corporation, which has the right to increase its stake to 29% going forward. We expect RPL to derive tremendous synergies from its association with Chevron Corporation as the American company will help it to source the crude for the refinery as well as market its products abroad.

The refinery, which will come up in a special economic zone (SEZ) at Jamnagar in Gujarat, will have a nelson complexity index of 14.0, which means it will have the best capabilities to process heavy and sour crude in the whole of Asia. We expect the refinery to enjoy robust GRMs once its starts commercial operations in January 2009, as we expect the refining cycle to remain strong over the next four to five years. Its ability to process heavy and sour crude will help the refinery to enjoy GRMs higher than the Singapore GRMs.

Petrochemicals

RIL has undertaken a major expansion plan in its petrochemical business, as shown below.

Product	Capacity (tonne per annum)	Commencement
Polyester staple fibre	320,000	Q1FY2007
Polyester filament yarn	230,000	Q1FY2007
Butadiene	140,000	Q1FY2007
Paraxylene	10,000	Q1FY2007
Purified teraphtalic acid	630,000	Q2FY2007

In the polyester business, the focus will move beyond the appeal grade polyester. The company will now focus on providing solutions to the packaging, paper and construction industries. It will develop a whole range of technical and performance polyester fibres.

For the same, RIL plans to exploit the knowledge base of Trevira, a leading producer of branded polyester fibres in Europe that it acquired in June 2004. Trevira is a highly specialised manufacturer of polyester products. It has several valuable patents and technologies as well as a strong research and development (R&D) set-up with substantial accumulated research knowledge. Trevira is the market leader in Europe in high-value applications of polyester, especially in automotive and home textile industries.

In the petrochemical business, polypropylene (PP) will be the next thrust area. We expect the propylene-based derivatives to enjoy better cracker margins compared with the ethylene-based derivatives due to the shortage of the feedstock. The supply of propane, the feedstock for propylene, is expected to remain tight. We believe that RIL is best placed to take advantage of this imbalance, as it will have a ready access to propane, which will be a by-product at its two refineries in Jamnagar. The company has already expanded its PP capacity by 280,000 tonne per annum and will add another 900,000-tonne-per-annum capacity at its new greenfield refinery at Jamnagar SEZ.

Valuation and view

We believe that RIL is stepping into another growth phase from hereon. The first growth phase that spanned FY2002-06 saw RIL's revenues grow at a compounded annual growth rate (CAGR) of 18.4% and its profitability grow at a CAGR of 32.4%. With major capex plans lined up in the most lucrative sectors of the recent times, viz organised retail, E&P, refining and petrochemicals, we believe that RIL is all set to enter the second phase of robust growth.

At the current market price of Rs982, the stock is trading at 14.1x its FY2008E earnings per share. The valuation is attractive looking at the strong growth prospects of the company. We are in the process of revising our numbers and price target for the company and maintain our Buy recommendation on the stock.

Earnings table Rs (cr)

Year ended March 31	2005	2006	2007E	2008E
Net revenues	66,051.0	81,211.0	85,859.1	86,153.6
% y-o-y chg	*27.5*	*15.3*	*5.7*	*0.3*
Net profit	7,572.0	9,069.0	9,834.8	9,734.8
Shares in issue (cr)	139.6	139.6	139.6	139.6
EPS (Rs)	54.2	65.0	70.4	69.7
% y-o-y chg	*42.9*	*19.8*	*8.4*	*-1.0*
PER (x)	18.1	15.1	13.9	14.1
Book value (Rs)	295.0	351.5	413.4	474.6
P/BV (x)	3.3	2.8	2.4	2.1
RoNW (%)	19.9	20.1	18.4	15.7

The author doesn't hold any investment in any of the companies mentioned in the article.

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Genus Overseas Electronics
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