Equity Research
March 31, 2008
BSE Sensex: 15644

INDIA

Mundra Port & Special Economic Zone — BUY

Smooth sailing — Rs580

Infrastructure

Reason for report: Initiating coverage

Mundra Port & Special Economic Zone (MPSEZ) is the largest non-major port in India and also the only notified port-based SEZ with plans of developing ~32,000 acres land. Benefitting from an excellent location, MPSEZ is set to exploit the growing demand for cargo traffic that is hampered by capacity bottlenecks at other major ports. We value MPSEZ at Rs835/share with further upside potential from the success of its SEZ. Initiate coverage with BUY rating.

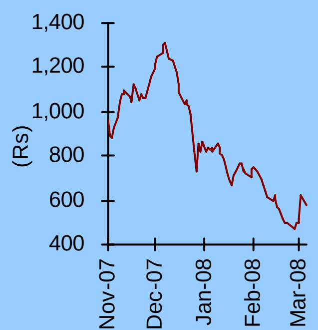
- **Valuations.** We have valued MPSEZ based on sum-of-the-parts (SOTP) methodology at Rs835/share, which implies 44% upside to the current market price. We have used free cashflow-to-equity method (cost of equity: port & CT2 12%, SEZ 14%) to value individual assets, except strategic investments in Dahej and logistics subsidiaries (that have been valued at 2x P/BV). Additional upside exists if MPSEZ is allowed to claim Sec 80IAB benefits on the entire operations, including port.
- **Major ports lack capacity to exploit strong demand for port traffic.** We estimate port traffic to reach 1,244mnte by FY12E, at 14% CAGR as against FY08E traffic of 682mnte. However, planned capacity addition by the Government of India is for a 1,009mnte traffic, of which major ports are expected to handle just ~702mnte. Hence, we believe non-major ports such as Mundra Port are set to gain.
- **MPSEZ, the ideal choice among non-major ports.** Key advantages for Mundra port include: i) MPSEZ is among the deepest draft along the West coast that implies lower cost for shipping lines, ii) ideal location regarding key global shipping routes and iii) shorter and congestion free rail connectivity to the key Northern market.
- **Mundra port and CT2, core value drivers.** We expect core port to deliver 35% EPS CAGR over FY08-15E, while CT2 is also set to contribute meaningfully by FY10E. The growth momentum is expected to be led by assured contracts for coal and POL/crude, while container traffic is also set to surge given the port's connectivity on a potentially double-stack container route. With significant surplus capacity, potential upside exists from new refining capacity plans in the North and West; also power plants with 6,000MW+ capacity have been planned in the western grid.
- **SEZ – Huge landbank; seeking demand triggers.** MPSEZ is developing a 'one-of-its-kind' port-based SEZ on ~32,000acres, of which ~50% is already under possession. We believe the port acts as a strong anchor for industrial development at the SEZ though deal with other anchor clients will lend significant upside. We value the SEZ at Rs291/share (post 15% discount) that implies Rs3.7mn/acre value.

Shareholding pattern

	Dec '07
Promoters	81.3
Institutional investors	7.7
MFs and UTI	1.7
Insurance Cos.	0.3
FIIs	3.8
Others	11.0

Source: www.bseindia.com

Price chart



Market Cap	Rs232.4bn/US$5.8bn
Reuters/Bloomberg	MPSE.BO/MSEZ IN
Shares Outstanding (mn)	400.7
52-week Range (Rs)	1324/440
Free Float (%)	18.7
FII (%)	3.8
Daily Volume (US$/'000)	15,330
Absolute Return 3m (%)	(55.3)
Absolute Return 12m (%)	NA
Sensex Return 3m (%)	(22.9)
Sensex Return 12m (%)	25.6

Year to March	FY07	FY08E	FY09E	FY10E
Revenue (Rs mn)	5,797	6,753	7,280	9,746
Net Income (Rs mn)	1,890	1,709	1,915	2,507
EPS (Rs)	5.2	4.3	4.8	6.3
% Chg YoY	51.3	(18.6)	12.0	30.9
P/E (x)	110.6	136.0	121.4	92.7
CEPS (Rs)	7.5	6.8	8.3	9.9
EV/E (x)	74.5	58.5	57.0	44.7
Dividend Yield (%)	0.2	0.3	0.3	0.3
RoCE (%)	14.0	7.3	5.6	6.0
RoE (%)	28.0	9.9	6.9	8.3

Amar Kedia
amar_kedia@isecltd.com
+91 22 6637 7271

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Valuation – 44% upside to current market price

We have valued MPSEZ on a sum of the parts methodology. Core business assets such as Mundra Port, CT2 and SEZ are valued using DCF (FCFE), while strategic investments into other assets such as Dahej Port and logistics subsidiaries – Adani Logistics and Inland Conware are valued at a conservative P/BV multiple of 2x.

We have further applied a 15% discount on the SEZ value to reflect MPSEZ's limited experience in SEZ development and monetisation. We have used a 12% discount rate for the core port, SEZ cash flows have been discounted at 14% for their higher risk.

Further, since a bulk of the projects entails substantial upfront capex deployment while returns are spread through a long horizon (30-50 years), we believe MPSEZ's current financials are not an accurate representation of the company's true potential.

Table 1: Valuation summary

Project	Value (Rs mn)	Value / share (Rs)	Discount rate / Multiple
Ports			
Mundra Port	131,083	327	12%
Container Terminal 2	78,124	195	12%
Dahej Port	5,094	13	2x P/B
Total Port Value	**214,301**		
SEZ	136,859	**342**	**14%**
Less: 15% discount	20,529	51	
Net SEZ value	**116,330**	**291**	
Logistics			
Adani Logistics	980	2	2x P/B
Inland Container	3,127	8	2x P/B
Total logistics assets value	**4,107**	**10**	
Total Value	**334,738**	**835**	

Source: Company data, I-Sec Research

Potential upsides to base case valuation

Table 2: Potential upsides to base-case valuation

Ports

- Current valuation assumes no wharfage fee post FY31; however, extension of concession on similar terms could lead to upsides
- Contribution in port traffic from SEZ could take off significantly depending on the success of the SEZ and could provide substantial upside

SEZ

- Early finalisation of anchor clients that could set the pace for the SEZ project will lead to substantial rise in realisation of the balance land and hence significant upside potential
- As visibility on land deals emerge, SEZ valuation would provide upsides

Other

- With substantial cash balance estimated post initial capex phase, MPSEZ will likely venture into businesses such as development of the SEZ on its own, shipyard / ship-breaking, logistics park, shipping etc. that could provide higher return than the currently built-in interest income and hence upsides to our valuation
- Tax benefits under section 80IAB: MPSEZ believes it can claim Section 80IAB benefits for the entire operations of the company and is also preparing its accounts accordingly. However, we have considered these benefits only for the SEZ portion and assumed that rest of the operations are required to pay MAT. If the company is allowed to claim benefits, our valuation will increase by Rs35/share (Table 3).

Source: Company data, I-Sec Research

Table 3: Sensitivity to Terminal value and Tax assumption

(Rs mn)

	Projected period value	Terminal value	Total value	MPSEZ Value / share (Rs)
Mundra Port Terminal Value				
Base case – Asset value post FY51E	119,740	11,342	131,083	835
Case 1 – Terminal growth post FY31E	86,880	45,298	132,178	838
Case 2 – Terminal growth post FY51E	119,740	7,238	126,978	825
CT2 Terminal Value				
Base case – Asset value post FY51E	66,592	11,532	78,124	835
Case 1 – Terminal growth post FY31E	43,664	28,994	72,658	822
Case 2 – Terminal growth post FY51E	66,592	6,427	73,018	823
Benefits allowed under sec 80IAB				
Base case – MAT payable				835
Bull case – MAT not payable				870

Source: I-Sec Research

Global Peer comparison

Table 4: Peer valuation

	Location	Traffic (mnte)	Container TEU (000)	Mkt Cap ($USmn)	P/E (x) CY08	P/E (x) CY09
Standalone Port						
Dalian Port Company	China	200	3,146	1,590	14.6	13.7
Xiamen International Port	China		3,019	806	15.6	NA
Port of Tarangua	New Zealand	12	423	628	17.1	15.2
Thessaloniki Port Athaurity	Greece	17	350	385	18.4	NA
Novorosleseksport	Russia	NA	NA	3,852	18.5	14.2
Port Conglomerate						
Shanghai Intl Port Group	China	537	21,720	21,224	34.6	32.1
Forth Ports	UK	46	NA	1819	42.3	39.8

Source: Bloomberg, I-Sec Research

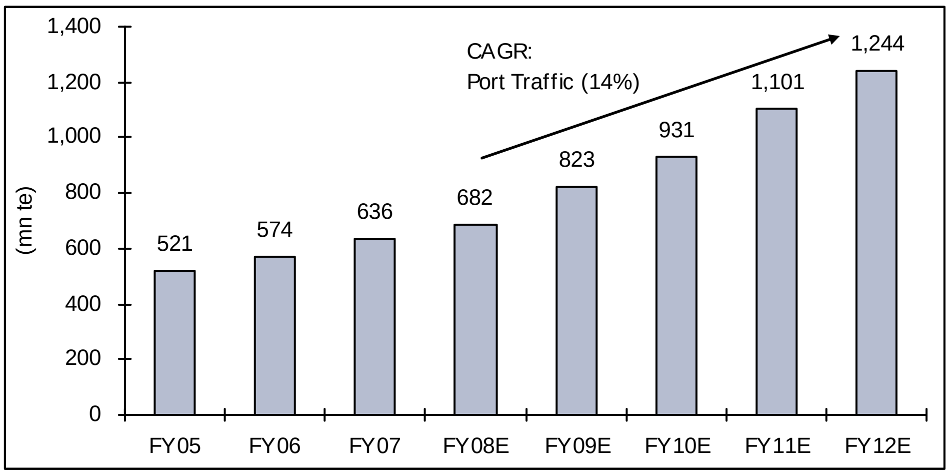
Well placed to exploit strong port traffic demand

Port traffic to reach 1,244mnte by FY12E at 14% CAGR…

We estimate, using a bottoms-up approach, India's port traffic to reach 1,244mnte by FY12E at 14% CAGR versus 682mnte traffic in FY08E. Coal, containers and POL/crude are expected to be the key contributors to this growth, which will also lead to shift in the composition of India's total traffic over the years.

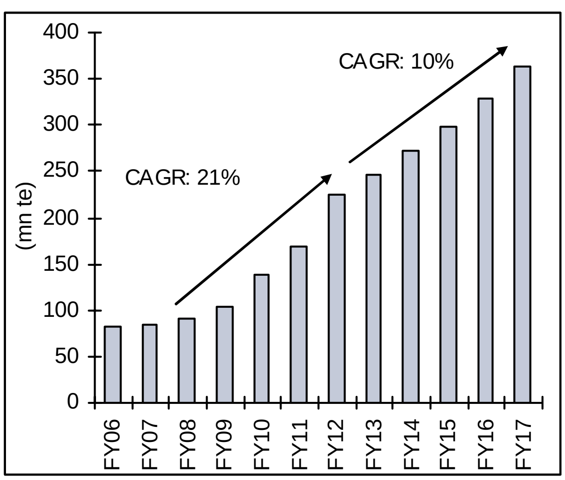
Coal, containers and POL/crude are likely to form 72% of the traffic by FY12E as compared to ~65% at present. Of these, containers and coal will likely register the sharpest growth.

Chart 1: 14% growth leading to 1,244mnte port traffic



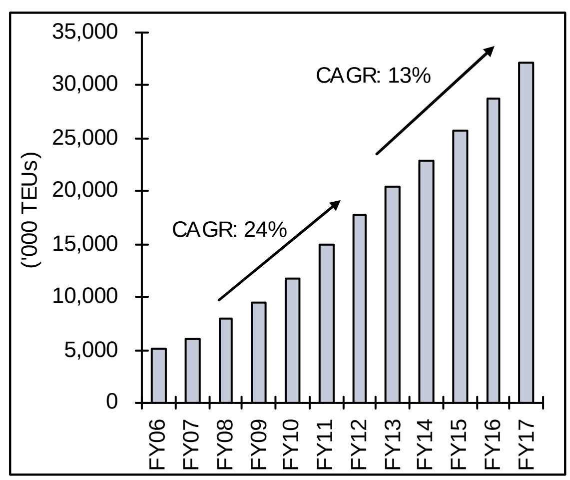
Source: Ministry of Shipping, I-Sec Research

Chart 2: Coal traffic to grow at 21% CAGR through FY12E…



Source: I-Sec Research, Ministry of Shipping

Chart 3: …while container traffic to post 24% CAGR



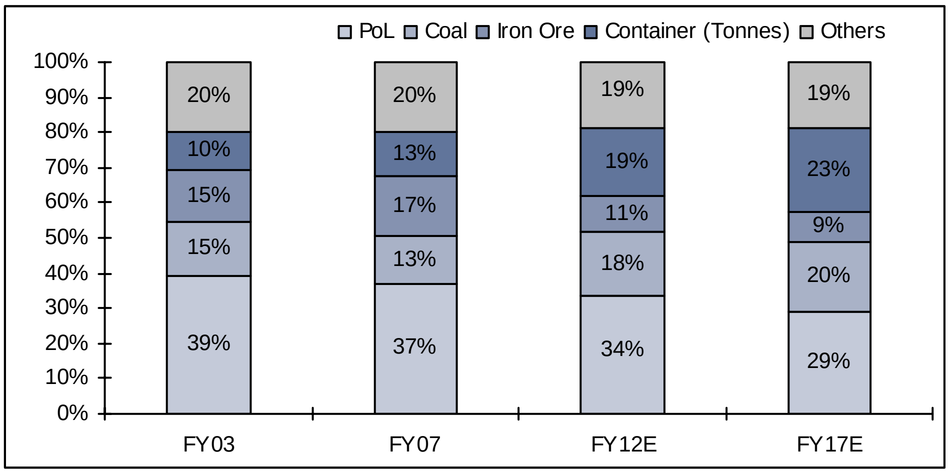
Source: I-Sec Research, Ministry of Shipping

Table 5: Key traffic growth items

(mn te)	FY07	FY12E	FY17E	CAGR (%) (FY07-12E)	CAGR (%) (FY12-17E)	Assumption
PoL	235	418	525	12	5	Refinery capacity increasing from 149MT to 239MT by '11-12, increasing crude imports
Coal	85	224	363	21	10	Coal import driven by capacity addition in power and steel
Iron Ore	110	132	159	4	4	Demand from China
Container	81	235	426	24	13	Increased containerisation and dedicated freight corridor
Container (Mn TEUs)	6.1	17.8	32.2			
Others	125	235	344	13	8	Mainly includes fertilisers and food grains
Total	**636**	**1,244**	**1,816**			

Source: I-Sec Research, Ministry of Shipping

Chart 4: Port traffic composition to undergo a shift



Source: IPA, I-Sec Research, Ministry of Shipping

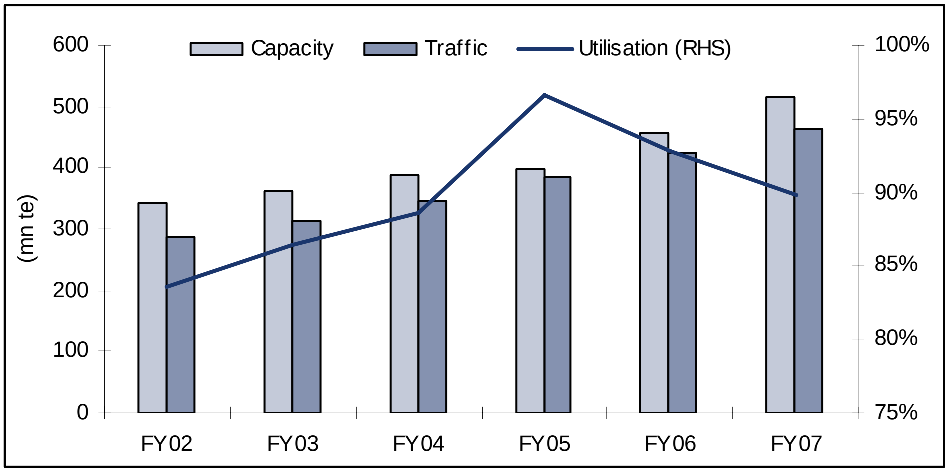
…but planned capacity for lower traffic at 1,009mnte

In FY06, the Government of India developed a financing plan for ports, which predicted traffic of 1,009mnte by FY12E at 9.9% CAGR. The GoI conceived the National Maritime Development Programme (NMDP) to invest Rs574bn for doubling the capacity of major ports to 1,002mnte by FY12E. However, significant part of the outlay allocation and key decisions regarding the actual expansion is yet to be made. We expect spill over of the targetted capacity by at least two years.

Major ports planned to manage 702mnte traffic in FY12E

As per the plan, the 12 major ports would together manage 702mnte by FY12E. In FY07, major ports managed 464mnte, operating at ~90% utilisation – far higher than the optimal 70-80%.

Chart 5: Major ports operating at unsustainable utilisation

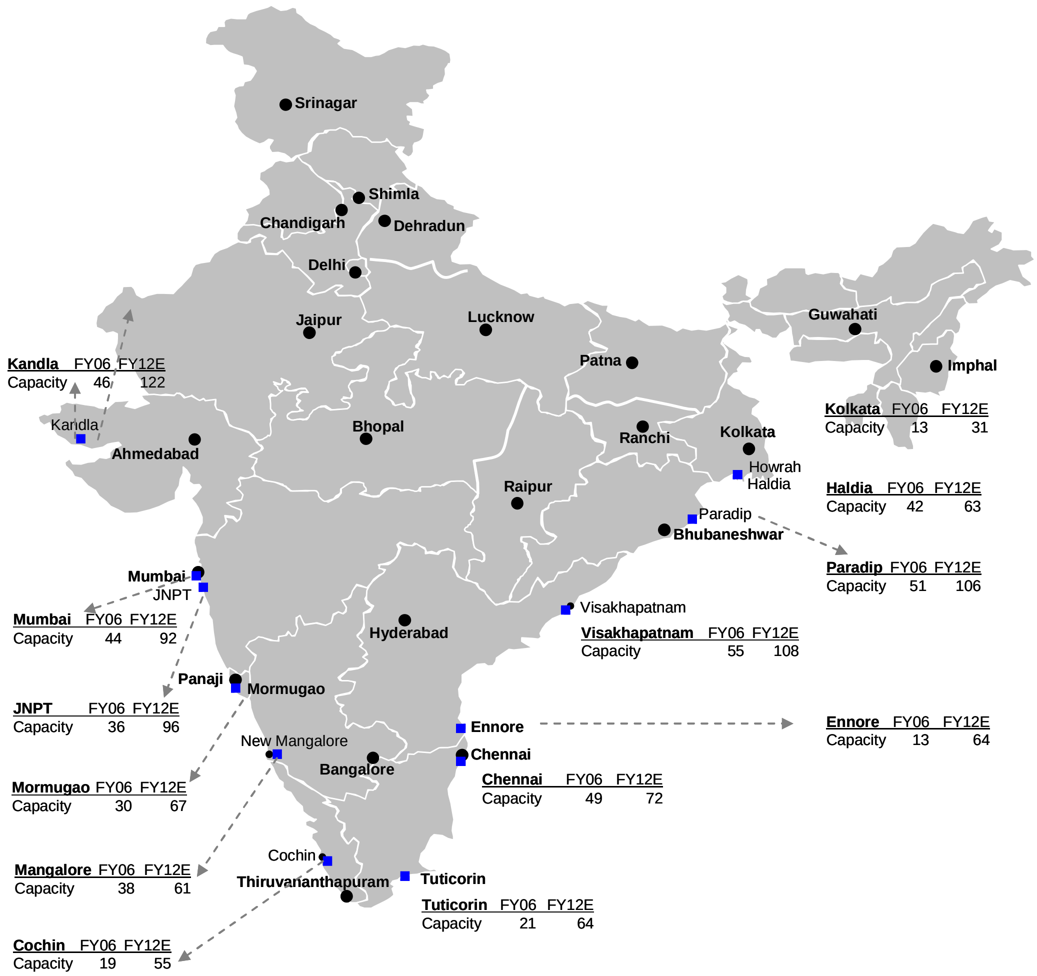


Source: Ministry of Shipping, I-Sec Research

Non-major ports expected to manage the balance 307mnte

Since major ports will manage 702mnte traffic as per the plan, minor ports are expected to share the balance 307mnte in FY12E. In FY07, minor ports handled 172mnte on a capacity of 228mnte, representing 75% utilisation. Historically, non-major ports have generally been feeder ports, playing a supporting role to the 12 major ports. However, we expect this to partially change as some of the minor ports grow faster with larger major ports already saturating in terms of capacity.

Chart 6: Planned capacity expansion at major ports under NMDP



Note: Capacity in mn te
Source: Committee on Infrastructure, Ministry of Shipping, I-Sec Research

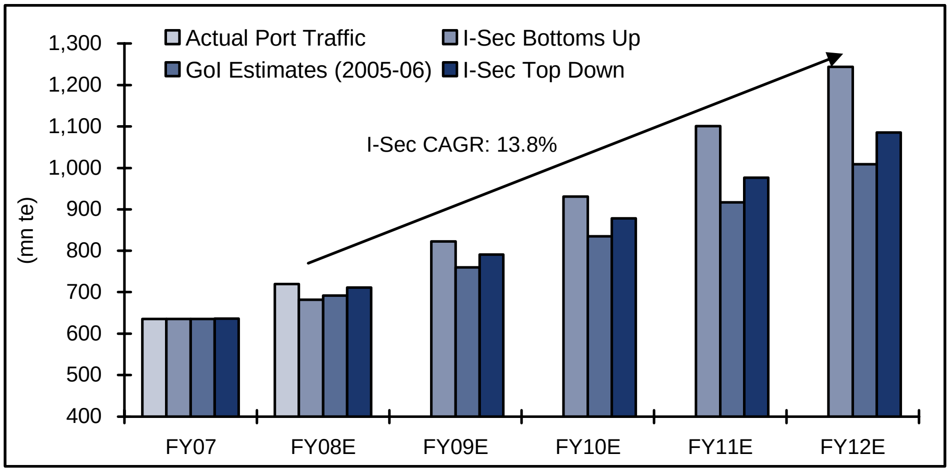
Share of non-major ports could be higher than GoI estimates

Government estimates already showing deviation

Post the finalisation of NMDP, India's port traffic has already grown higher than anticipated. This will lead to capacity shortfall even if the plans are implemented as per schedule. To illustrate:

- India's GDP and port traffic have grown at 9% per annum and 13% per annum respectively in the past two year, higher than envisaged under NMDP.
- Central Electricity Authority, the regulatory authority for the power sector, has in the XI Five Year Plan document, proposed a slew of power projects across the country with most of it being coal based. Thus, coal traffic is likely to be higher than that anticipated by the financing plan.
- Entry of private players in container railroads has opened up the possibility of improving container traffic flow into the country.

Chart 7: Actual port traffic higher than GoI estimates



Source: Committee on Infrastructure, IPA, I-Sec Research, Ministry of Shipping

I-Sec bottoms-up approach imply 542mnte traffic for minor ports

As per our bottoms-up traffic estimate, the overall cargo traffic demand could reach 1,244mnte by FY12E. Even if we assume that major ports could expand capacity (as per the proposed plans) to handle traffic of 702mnte, minor ports could still potentially handle 542mnte as compared to total traffic of 172mnte handled in FY07, implying ~26% CAGR.

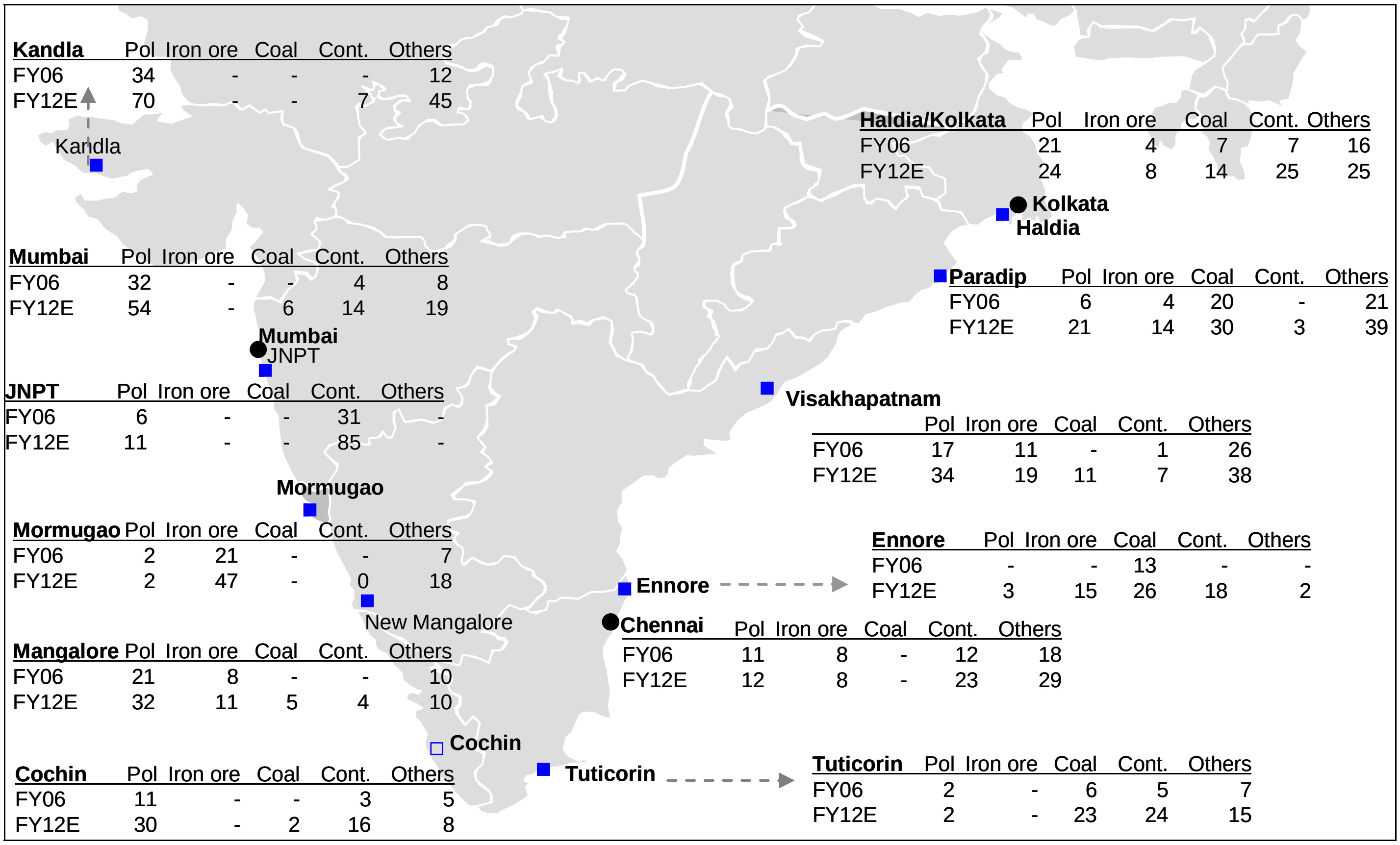
Delay in implementing NMDP

In the past 50 years, India has added 456mnte to port capacity. Thus, we believe that it will be extremely difficult to add 546mnte over FY07-12E, with one year of the plan period already being lapsed. Therefore, delays to achieving capacity target in major ports are imminent, which could signal further traffic flows to minor ports.

Commodity-wise capacity addition not in tandem with requirement

To worsen matters further, segregation of the proposed capacity addition as per commodity reveals that traffic demand for certain commodities might be much higher than the planned capacity. For example, on the back of strong pipeline of thermal power projects, we believe demand for imported coal is set to explode. However, the planned capacity addition for dedicated coal jetties along the West Coast is not sufficient to handle the expected traffic.

Chart 8: Commodity-wise expansion plan of major ports



Kandla	Pol	Iron ore	Coal	Cont.	Others
FY06	34	-	-	-	12
FY12E	70	-	-	7	45

Mumbai	Pol	Iron ore	Coal	Cont.	Others
FY06	32	-	-	4	8
FY12E	54	-	6	14	19

JNPT	Pol	Iron ore	Coal	Cont.	Others
FY06	6	-	-	31	-
FY12E	11	-	-	85	-

Mormugao	Pol	Iron ore	Coal	Cont.	Others
FY06	2	21	-	-	7
FY12E	2	47	-	0	18

Mangalore	Pol	Iron ore	Coal	Cont.	Others
FY06	21	8	-	-	10
FY12E	32	11	5	4	10

Cochin	Pol	Iron ore	Coal	Cont.	Others
FY06	11	-	-	3	5
FY12E	30	-	2	16	8

Haldia/Kolkata	Pol	Iron ore	Coal	Cont.	Others
FY06	21	4	7	7	16
FY12E	24	8	14	25	25

Paradip	Pol	Iron ore	Coal	Cont.	Others
FY06	6	4	20	-	21
FY12E	21	14	30	3	39

Visakhapatnam	Pol	Iron ore	Coal	Cont.	Others
FY06	17	11	-	1	26
FY12E	34	19	11	7	38

Ennore	Pol	Iron ore	Coal	Cont.	Others
FY06	-	-	13	-	-
FY12E	3	15	26	18	2

Chennai	Pol	Iron ore	Coal	Cont.	Others
FY06	11	8	-	12	18
FY12E	12	8	-	23	29

Tuticorin	Pol	Iron ore	Coal	Cont.	Others
FY06	2	-	6	5	7
FY12E	2	-	23	24	15

Note: Capacity in mnte
Source: Committee on Infrastructure, Ministry of Shipping, I-Sec Research

MPSEZ, the ideal choice among non-major ports

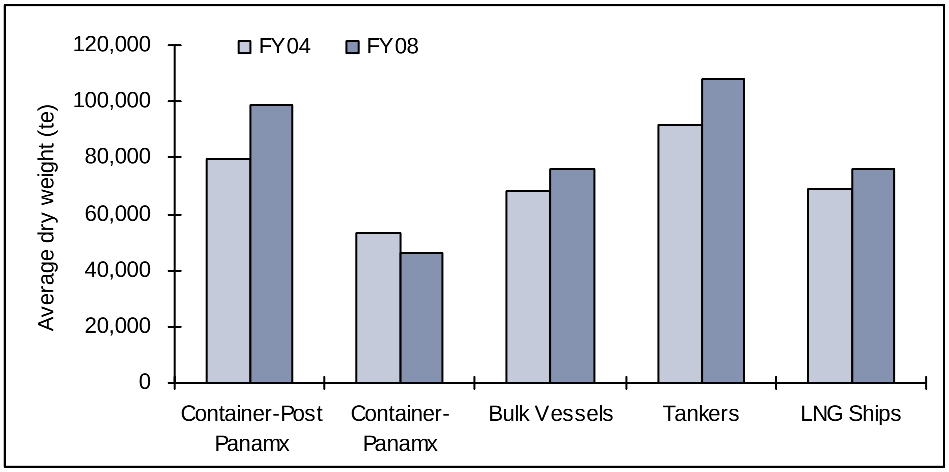
Mundra port is set to suitably exploit cargo traffic flow on the back of increasing congestion at major ports and natural advantages that it holds over other competing ports. Among key advantages that MPSEZ enjoys are deeper draft, proximity to the hinterland, better rail connectivity, surplus capacity and quicker turnaround time (that implies lower cost to shipping lines). In fact, the port has already secured several assured long-term contracts for traffic flow of coal and POL/crude.

Deeper draft at MPSEZ means lower cost for shipping lines

MPSEZ is one of the few ports with a deep draft along the west coast. With a draft varying from 15-32 metres at different points from the port, MPSEZ is able to cater to larger ships that are not serviceable at other ports. For shipping lines, this means economies of scale and hence reduced costs. Moreover, they are spared the burden of breaking journeys at transhipment points such as Colombo, Dubai or Singapore and send cargo on smaller ships to the final destination.

For instance, 120,000 dwt tanker requires a draft of 16 metres, while VLCC tankers require drafts in excess of 20 metres. In contrast, most Indian ports have draft of just 10-12 metres, which makes them inaccessible to larger ships.

Chart 9: Vessel size has increased over the past few years

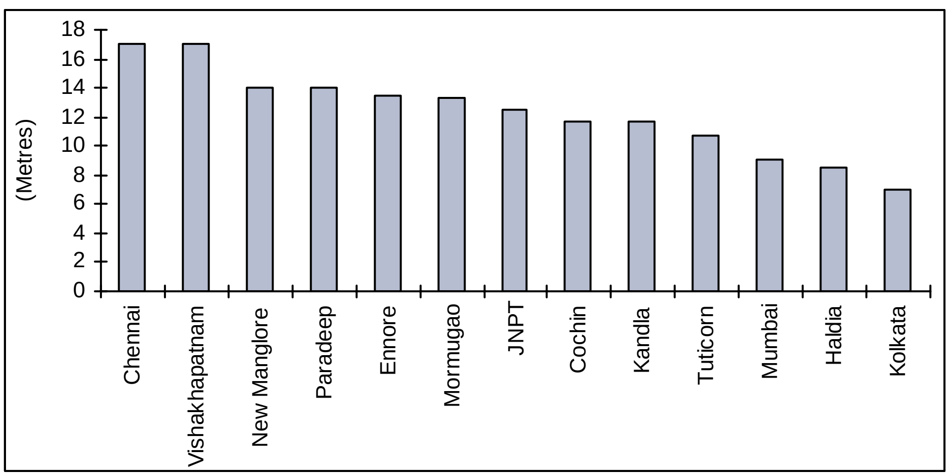


Source: I-Sec Research, Ministry of Shipping - NMDP, Clarkson's Registry

How Indian ports manage deeper draft requirements (the JNPT case)?

Interestingly, JNPT manages to service vessels with large draft requirement. While the berth – where ship docks – offers a draft of 13.5 metres, larger vessels with draft requirement of even ~12.5 metres cannot navigate all the time through the approach channel since the water depth of the main approach channel to the port is lower at ~10.9-11.1 metres. Hence, ships need to wait till the high tide to approach JNPT and dock at the berth. The port cannot service ships that require draft higher than 12.5 meters. In monsoons, this limit goes down further to 11.8 metres because of turbulent sea.

Chart 10: Very few Indian ports offer deep draft

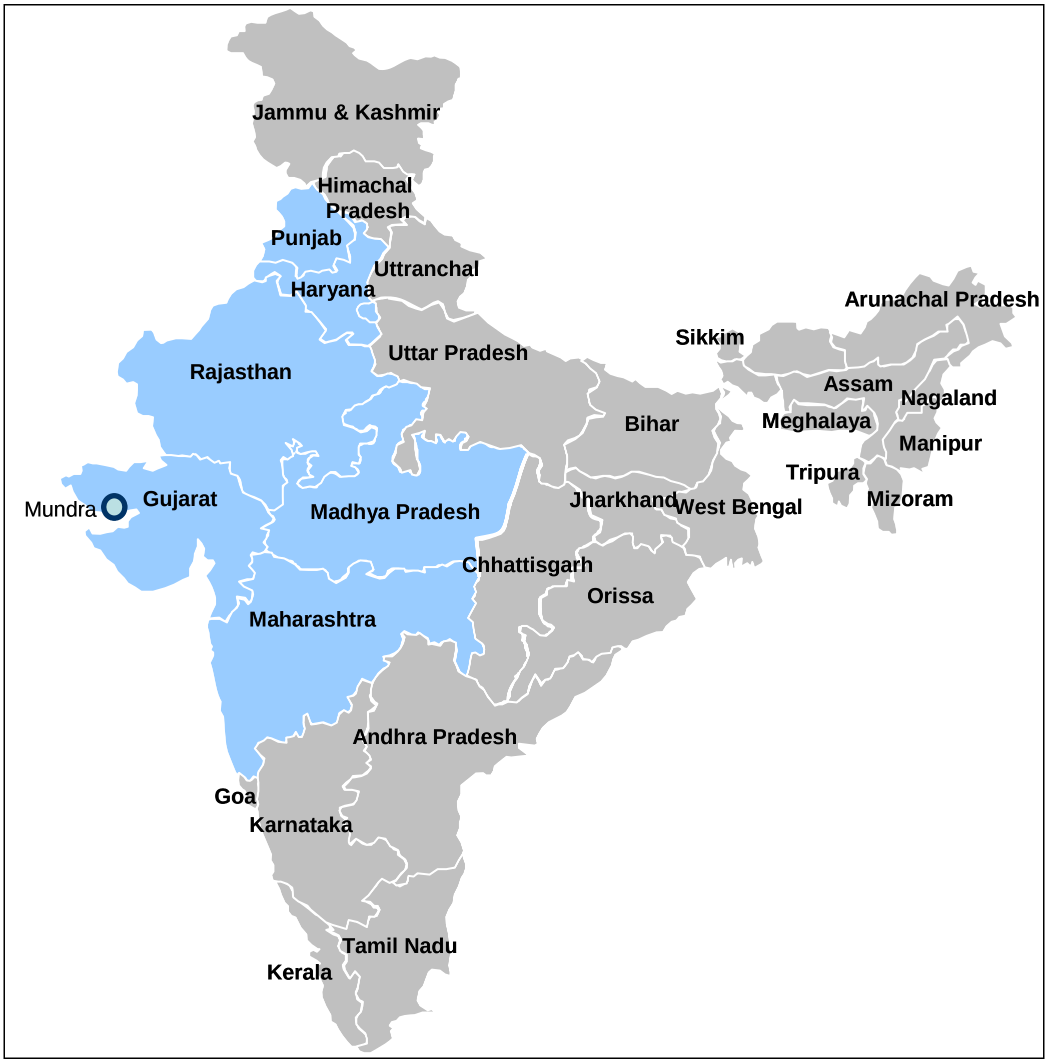


Source: I-Sec Research, Ministry of Shipping

MPSEZ's hinterland growing at a fast pace

MPSEZ's hinterland consists of among the most industrialised states in India such as Gujarat, Rajasthan, Punjab, Haryana, Delhi, parts of Uttar Pradesh (UP) and to an extent Maharashtra and Himachal Pradesh. Importantly, the GDP of this hinterland has grown at 12% over FY93-04 and accounts for nearly 70% of India's container traffic. Growth post FY04 is expected to have been higher, in line with the India GDP.

Chart 11: Mundra's hinterland includes fast-growing northern & western states



Source: I-Sec Research

Located ideally for shipping lines and rail network alike

The bulk of India's container traffic (~60%) moves between western and northern ports and MPSEZ is ideally located in this context. MPSEZ is suitably located as regards the most important shipping routes from India's trade viewpoint (Table 6). It is close to major shipping routes as regards western countries, which account for most of India's trade.

MPSEZ rail linkage with key northern ICDs is also superior over those of competing ports such as JNPT or Mumbai. For e.g. Mundra-Bhildi-Palanpur-Jaipur-Delhi line is shorter by 319kms as compared to the congested Mumbai-Vadodra-Mathura-Delhi route. Further, with the dedicated rail corridor implementation expected in phases beginning FY12-13, MPSEZ will be connected to the same through hub and spoke network. Even on the existing route, MPSEZ would be among the few ports to offer double stack container movement to key ICDs in Delhi.

Table 6: MPSEZ is ideally located vis-à-vis major shipping routes

	Location w.r.t. major shipping routes (Nautical Miles)	
	Diversion from Europe-Asia Route	Diversion from America-Far east Route
Salalah	340	~2093
Karachi	1469	1340
Mundra	**1516**	**1340**
Kandla	1566	1390
Pipavav	1616	1088
Mumbai	1656	888
JNPT	1666	898
Cochin	1849	306
Colombo	2093	0

Source: JNPT Business Plan

Chart 12: Mundra-Delhi train link shorter by 319kms versus JNPT-Ludhiana link

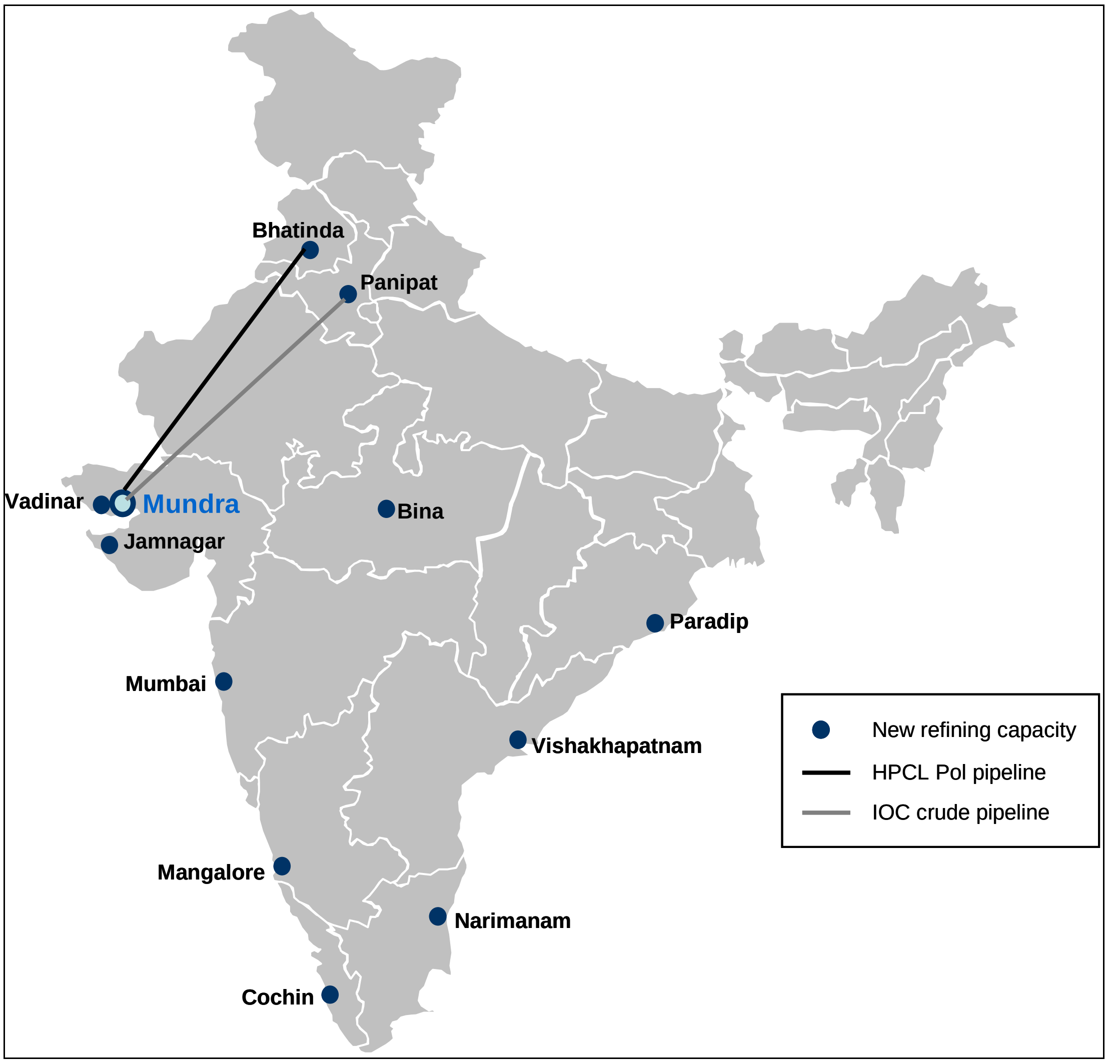
Source: Star Track terminals, I-Sec Research

Assured traffic contracts for coal and POL/crude oil

MPSEZ has already entered into long-term contracts for bulk of the projected traffic from coal and POL/crude. More than 50% of its estimated coal traffic has been tied up with two 4,000MW imported coal-based power plants coming up in Mundra (Tata Power and Adani Power). Nearly 16mtpa of POL/crude traffic has also been contracted with the likes of HPCL and IOC. MPSEZ has recently entered into an MoU with Suzuki India for setting up a dedicated car export terminal at the port with initial capacity of 250,000 cars per annum by early CY09. Gradually, the capacity is expected to increase to 400,000 cars.

Further, we believe that given the surplus capacity available at MPSEZ, strong potential upside exists for traffic movement of POL/crude emerging from new refining capacity being set up in the North and West, while coal traffic upside could emerge from over 6,000MW power plants set to come up in the western grid.

Chart 13: Assured traffic from Bhatinda and Panipat pipelines



Source: Company, I-Sec Research

Mundra port & CT2, core value drivers

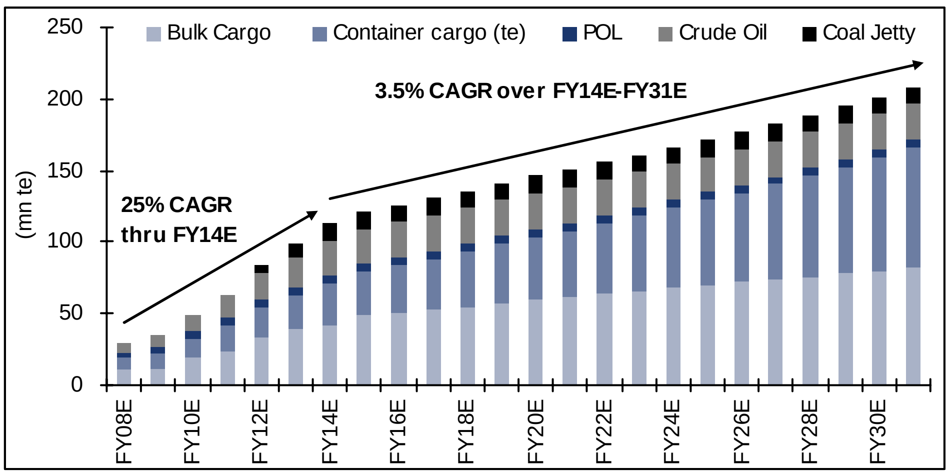
Core port to deliver 35% EPS CAGR through FY15E

On the back of 9% traffic CAGR over FY08E-31E (25% over FY08E-14E), we expect MPSEZ's core port business to register almost similar 8% revenue CAGR through the same period. This also reflects a direct play on the growth in India's economy, which is projected to grow at ~6% CAGR through the same period.

We estimate port EPS at 35% CAGR over FY08E-15E, which is higher than the projected traffic growth due to rising margins, which in turn reflects economies of scale.

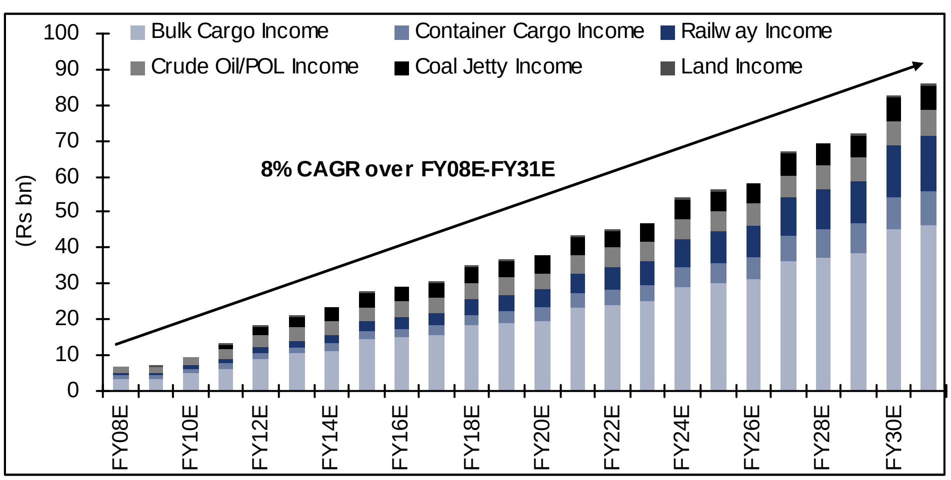
Traffic and revenue growth are primarily dominated by growth in coal and container traffic, while assured contracts for crude and POL traffic provide stability in the long term.

Chart 14: 9% traffic CAGR over FY08E-31E; steady pace of ~3.5% from FY15E



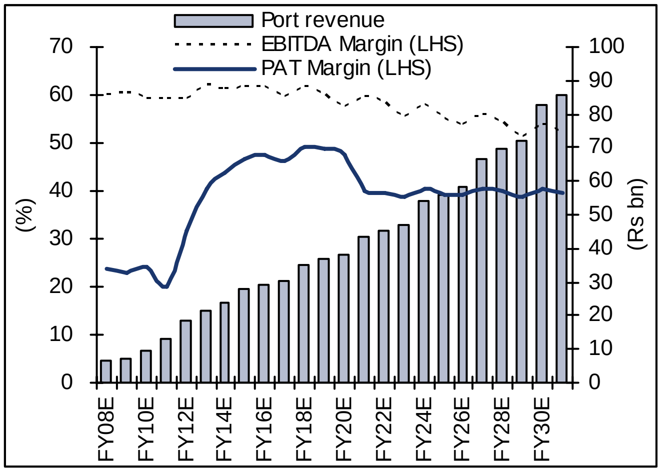
Source: I-Sec Research

Chart 15: Revenue CAGR at ~8% to follow 9% traffic CAGR



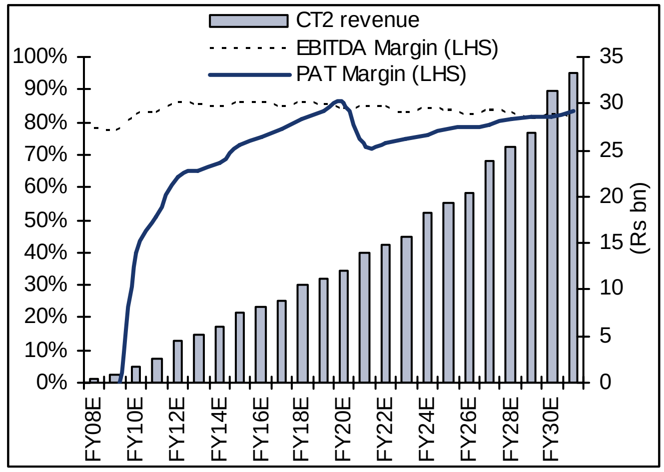
Source: I-Sec Research

Chart 16: Core port financials



Source: I-Sec Research

Chart 17: CT2 financials



Source: I-Sec Research

Container terminal 2 to add substantial value

At present, MPSEZ has 1.25mn TEU container capacity operated by MICT (DP World). However, given the significant growth in container traffic expected in the future, MPSEZ is developing another container terminal at the port with an initial capacity of 1.25mn TEU. The terminal is expected to be operational by end-FY08.

MPSEZ might consider offering partial stake in the second container terminal (CT2) to shipping lines to ensure steady volume flow. We expect CT2 and MICT to equally share the container traffic at the port going forward (this also assumes that MICT will keep adding capacity at CT1). By FY31E, we expect volume at CT2 to reach ~3.5mn TEUs.

Contribution to be robust beginning FY12E

On the back of strong traffic flow at CT2, we estimate significant contribution from CT2 to MPSEZ. By FY31E, we estimate CT2 to generate ~Rs33bn incrementally as annual revenues, which is ~38% of the standalone port revenue during the same year. EBITDA and PAT contribution is estimated to be even higher at ~60% primarily due to higher margin at CT2.

Core port valuation

Table 7: Free cashflow-to-equity based valuations

(Rs mn, year ending Mar 31)

	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
EBITDA	4,051	4,411	5,774	7,907	10,820	13,187	14,472	17,269
Other Income	415	1,144	560	317	293	451	859	1,509
Less : Tax	(431)	(882)	(1,238)	(256)	(688)	(1,132)	(1,513)	(2,065)
Project Capex	(1,922)	(12,715)	(8,727)	(1,224)	(1,245)	(1,268)	(1,290)	(4,257)
Others	(193)	(193)	(193)	(193)	(193)	(193)	(193)	(193)
WC Changes	455	(235)	(211)	(334)	(420)	(249)	(191)	(395)
Cashflow to Debt & Equity	**2,376**	**(8,470)**	**(4,034)**	**6,218**	**8,567**	**10,797**	**12,144**	**11,869**
Loan Raised / (Repaid)	5,185	4,429	141	(4,604)	(7,230)	(5,204)	(4,919)	(152)
Interest (paid)	(1,020)	(1,238)	(1,101)	(2,077)	(1,557)	(853)	(316)	(50)
Cashflows to Equity	**6,541**	**(5,279)**	**(4,994)**	**(463)**	**(219)**	**4,740**	**6,909**	**11,667**
Discounting Rate (%)	**12**							
NPV of cashflows	119,740							
Terminal value - asset	11,342							
MPSEZL Value	**131,083**							

Source: I-Sec Research

CT2 valuation

Table 8: Free cashflow-to-equity based valuations

(Rs mn, year ending Mar 31)

	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
EBITDA	331	698	1,438	2,080	3,891	4,460	5,069	6,485
Other Income	2	7	27	75	78	116	262	499
Less : Tax	(1)	(2)	(9)	(151)	(309)	(374)	(476)	(713)
Project Capex	2,948	118	120	123	3,392	1,413	1,625	997
WC Changes	-	-	-	-	-	-	-	-
Cashflow to Debt & Equity	**(2,615)**	**584**	**1,335**	**1,881**	**269**	**2,790**	**3,230**	**5,274**
Loan Raised / (Repaid)	2,948	-	(285)	(570)	(570)	(570)	(570)	(570)
Interest (paid)	264	527	520	488	435	382	329	277
Cashflows to Equity	**69**	**57**	**530**	**824**	**(736)**	**1,838**	**2,331**	**4,428**
Discounting Rate (%)	**12**							
NPV of cashflows	66,592							
Terminal value - asset	11,532							
MPSEZL Value	**78,124**							

Source: I-Sec Research

SEZ – Rich in landbank, seeking demand triggers

Planned infrastructure creation

Industrial

- Food & agro park
- Textile & apparel park
- Auto and auto components park
- Drugs and pharmaceuticals park
- Standard design factories

Commercial

- Service sector units
- Trading houses
- Offshore banking units

Global trading hub

- Warehouses
- CFS
- Cold storages

Residential

Only notified port based SEZ

MPSEZ is developing an SEZ over ~13,000 hectares (~32,000 acres) along the Mundra port. The SEZ is planned to be an industrial and logistics township and benefit from a symbiotic relationship with the port.

6,211 hectares of land has already been acquired, while the balance is in various stages of acquisition and is expected to be completed by FY09. The management expects no headwinds to the land acquisition process since most of the land is barren, waste land with no agricultural use.

Port acts as anchorage for industrial development; other anchors to boost value

Globally, successful ports have led to strong industrialisation of nearby areas, which in turn feeds further traffic into the port. Notable examples are the Port of Rotterdam, Hamburger and Shanghai. MPSEZ, too, is likely to benefit from the success of Mundra port, which in itself acts as a strong anchor for the development of industrialisation at the proposed SEZ.

Key reasons for industries to set up units at Mundra SEZ would be savings in logistics cost and time with the port being at their doorstep. With the added benefits of tax advantages, we believe demand for the SEZ should be encouraging.

However, much of the demand in the initial years is expected to be for industrial purposes and hence likely to yield low realisations. However, as the port and SEZ projects take off, demand for residential and commercial projects could also rise, leading to overall rise in realisation.

MPSEZ to act as master developer; expect role enhancement in future

Initially, MPSEZ intends to restrict its role to a master developer that will focus on designing, planning, creating social infrastructure and marketing the SEZ to industries. It has already tied up with specialised developers for provision of utility services such as telecom, water, sewerage, power etc. Development of social infrastructure and residential properties is also entrusted with Adani Enterprises, the promoter group company.

We believe that MPSEZ could venture into developing property on its own in latter years backed by surplus cash generation from the port entity so as to benefit from increasing realisations.

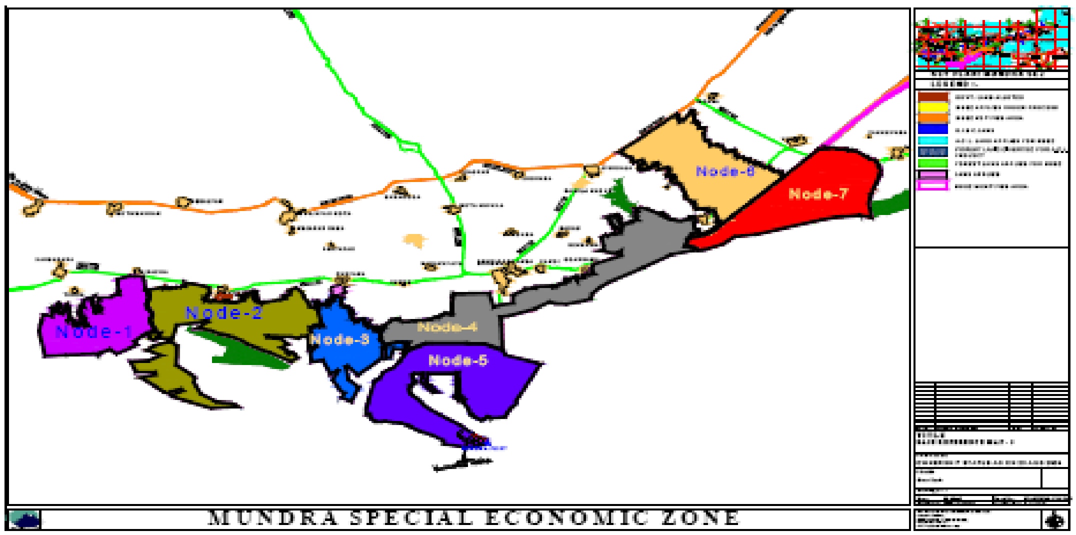
Table 9 outlines the envisaged use of land as per activity – industrial, commercial, residential etc.

Table 9: Land use plan

Activity	Area share %
Processing	**40**
Non – processing	**60**
Residential	27
Commercial	2
Public & semi-public	4
Recreational	7
Transport & Comms.	7
Other	13

Source: Company

Chart 18: Mundra SEZ project



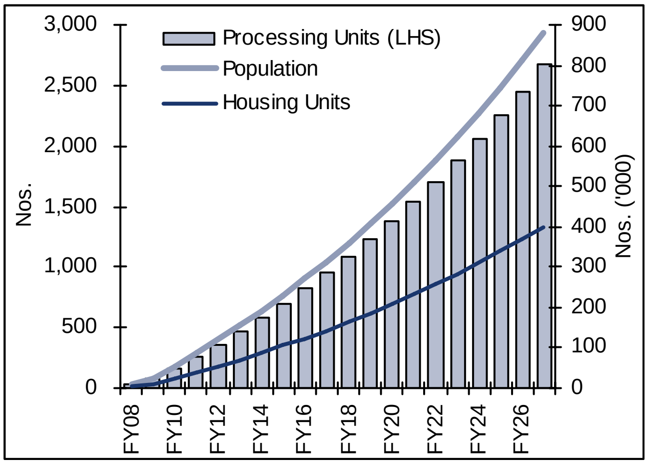
Source: Company

Table 10: Land acquisition status

Entity	Area (Hectares)	Remarks
MPSEZ	2,658	In possession
MPSEZ (MSEZ*)	2,840	In possession
MPSEZ (MSEZ*)	713	In possession
Sub-total	**6,211**	**In possession**
MPSEZ (ACL*)	1,095	Under transfer
Various Govt. land including salt fields, forests etc.	5,660	Under process
Sub-total	**6,755**	**Land under process**
Total	**12,966**	

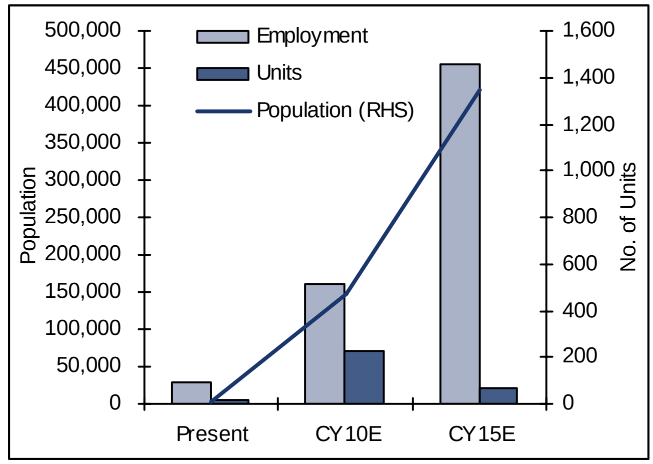
* MSEZ and ACL were merged into MPSEZ on April '06
Source: Company

Chart 19: I-Sec projected population



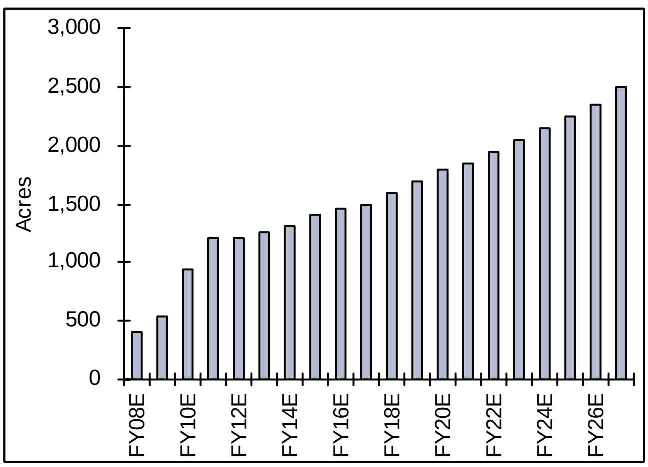
Source: I-Sec Research

Chart 20: CBRE projected population



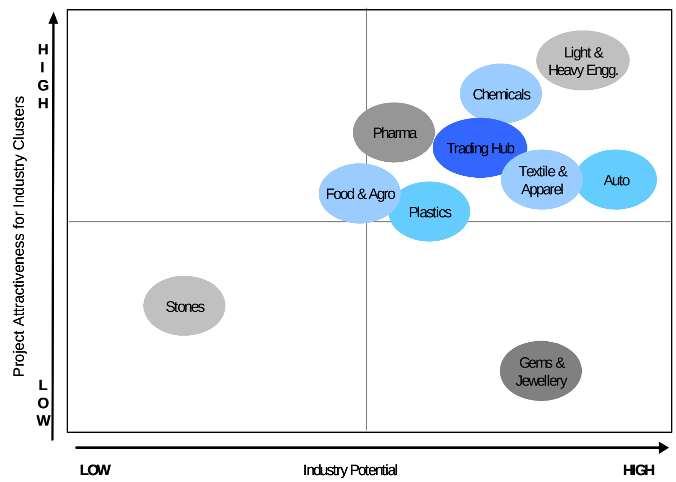
Source: CBRE

Chart 21: SEZ development expected to complete by FY27



Source: I-Sec Research

Chart 22: MPSEZ's attractiveness to various industries



Source: CBRE

Table 11: Growing trend of SEZs globally

	No of countries with investment zones	Number of investment zones	Employment (mn)
1975	25	79	1
1986	47	176	2
1997	93	845	23
2002	116	3000	43
2006	130	3500	66

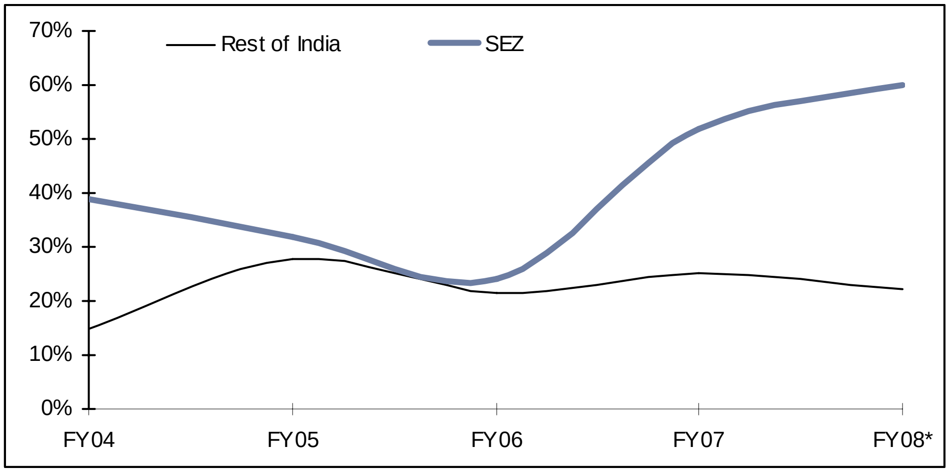
1975 and 1986 excludes China
Source: ILO, I-Sec Research

Table 12: SEZs boost employment

	Employment (Nos)		Investment (Rs mn)	
	Pre Act (Feb '06)	Post Act (Feb '06)	Pre Act (Feb '06)	Post Act (Feb '06)
Newly Notified SEZ		61,015		673,470
State govt/ Private SEZ Notified prior to SEZ Act	12,468	23,995	17,560	11,230
Central govt SEZ	121,882	61,118	26,926	19,463

Source: Ministry of Commerce, I-Sec Research

Chart 23: Exports from SEZ have outperformed other exports



Source: Ministry of Commerce, I-Sec Research

SEZ earnings and valuation

We believe that the SEZ will start material contribution only after FY10E. We base our assumption for initial lease of the land at historical deals in the area at ~Rs150/sqft (NPV of lease rentals). We believe there could be potential deviation to this especially as MPSEZ might consider bulk deal with anchor clients that would enhance the attractiveness of the overall project for future deals.

We have thus assumed slightly higher growth in realisation in the interim period. However, we have assumed that only 75% of the area will be commercially developed, while the balance would be for social infrastructure creation.

MPSEZ has also tied up with third-party vendors such as Airtel, Veolia, Apollo Hospitals, Sterling Hospitals etc for the provision of basic utility services for which MPSEZ will earn managing income either directly from the users or as royalty from the vendors.

We value the SEZ at Rs137bn. We have further applied a 15% discount on the SEZ value to reflect MPSEZ's limited experience in SEZ development and monetisation to arrive at a net value of Rs116bn that implies per acre value of Rs3.7mn.

Table 13: Key assumptions and valuations

Revenue Generating Land	%	75
Average starting lease NPV	Rs / Sqm	1,500
Cost of development	Rs / Sqm	350
Managing income	Rs / Sqm / Yr	35
Revenue escalation factor	%	8
Cost escalation factor	%	6
Cost of equity	%	14
NPV	Rs mn	116,330
NPV/acre	Rs mn	3.7

Source: I-Sec Research

Table 14: SEZ Financials

(Rs mn)

	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
Land Developed (Acres)	400	533	933	1,200	1,200	1,250	1,300	1,400
Development cost (Rs/sqm)	371	393	417	442	468	496	526	558
Area Developed %	75	75	75	75	75	75	75	75
Upfront Lease (Rs/sqm)	1,620	1,750	1,890	2,041	2,204	2,380	2,856	3,085
Mngg. Income (Rs/sqm/Yr)	38	41	44	48	51	56	67	72
Maintenance expenses %	1.00	1.25	1.33	1.40	1.49	1.58	1.67	1.77
Land Income	1,967	2,832	5,353	7,433	8,028	9,031	11,271	13,109
Mngg Income	46	116	250	443	666	930	1,379	1,795
Total Income	**2,013**	**2,948**	**5,603**	**7,876**	**8,694**	**9,961**	**12,650**	**14,904**
Expenses								
Salary & Wages	150	250	350	400	450	500	530	562
Maintenance Expenses	33	95	140	178	223	276	339	415
Total Expenses	183	345	490	578	673	776	869	977
EBITDA	**1,830**	**2,603**	**5,113**	**7,298**	**8,021**	**9,185**	**11,781**	**13,927**
PBT	1,838	2,657	5,257	7,678	8,779	10,392	13,573	16,476
PAT	**1,219**	**1,763**	**3,488**	**7,442**	**8,354**	**9,757**	**12,679**	**15,263**

Source: I-Sec Research

Table 15: SEZ valuations

(Rs mn)

	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
EBITDA	1,830	2,603	5,113	7,298	8,021	9,185	11,781	13,927
Less : Tax	(607)	(867)	(1,722)	(150)	(288)	(452)	(663)	(933)
Other Income	24	80	184	445	857	1,342	1,968	2,771
Capex	2,751	4,349	2,925	2,146	2,275	2,512	2,769	3,161
FCFE	**(1,503)**	**(2,533)**	**651**	**5,447**	**6,315**	**7,564**	**10,318**	**12,605**
Discounting Rate (%)	**14**							
NPV of cashflows	136,859							
MPSEZL Value	**136,859**							
Less: 15% discount	20,529							
Net Value	**116,330**							

Source: I-Sec Research

Strategic Investments to support core business

MPSEZ has also invested in developing a solid cargo port terminal at Dahej (74% stake) in a JV with Petronet LNG. It has also entered the container railroad business through its subsidiary Adani Logistics Limited (100%) and is also setting up a chain of ICDs at several locations across the country.

While the value of these assets on a standalone basis is insignificant, they provide support to MPSEZ's business as they enable it to capture a large share of the logistics value chain. MPSEZ can thus bundle its services under one package. We value these businesses at 2x book value.

Adani Petronet (Dahej) Port

MPSEZ (74%) has entered into a joint venture with Petronet LNG (26%) for developing a solid cargo port terminal at Dahej. The total cost of the project is expected to be Rs11.5bn and funded at a gearing of 70:30 debt:equity.

Adani Logistics

MPSEZ (50%) along with Adani Port Infrastructure (APIPL, a promoter group company) has secured a pan-India license to operate container rail through their subsidiary Adani Logistics (ALL). ALL proposes to acquire 20 rakes for the purpose while the project cost is expected at Rs3.2bn and will be funded at a gearing of 2.3:1 debt:equity.

Inland Conware

Inland Conware (ICPL) is another subsidiary of MPSEZ (50%, balance held by promoters) which is involved in the establishment of rail linked ICDs across India for EXIM and domestic services. The facilities will cater to requirements of ALL as well as third parties for a charge. The project is expected to cost Rs9.4bn and will be funded at a gearing of 2:1 debt:equity.

Valuation

Table 16 below depicts the amount invested and MPSEZ's stake in each of these subsidiaries.

Table 16: Strategic Investments Value

	Amount invested (Rs mn)	Stake held (%)	MPSEZ value (Rs mn)	MPSEZ value / share (Rs)
Dahej Port	2,547	74	5,094	13
Adani Logistics	490	50	980	2
Inland Conware	1,563	50	3,127	8
Total	**4,600**		**9,200**	**23**

Source: Company, I-Sec Research

Annexure 1: Financials (Standalone)

Table 17: Profit & Loss statement

(Rs mn, year ending March 31)

	FY07	FY08E	FY09E	FY10E
Gross Sales	**5,797**	**6,753**	**7,280**	**9,746**
Less: Excise				
Net Sales	**5,797**	**6,753**	**7,280**	**9,746**
Other Operating Income				
Total Operating Income	**5,797**	**6,753**	**7,280**	**9,746**
Less:				
Operating expenses	1,944	2,221	2,150	2,964
Personnel expenses	148	240	360	504
Administrative expenses	630	240	360	504
Total Operating Expenses	**2,721**	**2,701**	**2,870**	**3,972**
EBITDA	**3,076**	**4,051**	**4,411**	**5,774**
Depreciation	807	1,022	1,430	1,455
Other Income	164	415	1,144	560
EBIT	**2,433**	**3,444**	**4,125**	**4,880**
Less: Gross Interest	668	1,020	1,238	1,101
Recurring Pre-tax Income	**1,765**	**2,423**	**2,886**	**3,778**
Add: Extraordinary Income	(16)	77	-	-
Less: Extraordinary Expenses				
Less: Taxation	(125)	714	972	1,272
--Current Tax	59	431	882	1,238
--Deferred Tax	(183)	284	90	34
Net Income (Reported)	**1,874**	**1,786**	**1,915**	**2,507**
Recurring Net Income	**1,890**	**1,709**	**1,915**	**2,507**

Source: Company data, I-Sec Research

Table 18: Balance Sheet

(Rs mn, year ending March 31)

	FY07	FY08E	FY09E	FY10E
ASSETS				
Current Assets, Loans & Advances				
Cash & Bank balance	569	21,427	11,253	4,759
Inventory	104	88	94	126
Sundry Debtors	3,449	388	403	547
Loans and Advances	1,260	2,000	2,200	2,200
Other Current Assets	235	197	212	284
Total Current Assets	**5,618**	**24,099**	**14,163**	**7,916**
Current Liabilities & Provisions				
Current Liabilities	2012	91	93	130
Sundry Creditors				
Other Current Liabilities				
Provisions	178	178	178	178
Total Current Liabilities and Provisions	**2,189**	**269**	**271**	**308**
Net Current Assets	**3,428**	**23,831**	**13,892**	**7,608**
Investments				
Strategic & Group Investments	790	4,260	9,155	10,655
Other Marketable Investments				
Total Investments	**790**	**4,260**	**9,155**	**10,655**
Fixed Assets				
Gross Block	22331	27966	28681	29408
Less Accumulated Depreciation	2509	3531	4961	6416
Net Block	19,822	24,435	23,720	22,992
Add: Capital Work in Progress	4,179	466	12,466	20,466
Total Fixed Assets	**24,001**	**24,901**	**36,186**	**43,459**
of which intangibles				
Total Assets	**28,219**	**52,992**	**59,233**	**61,722**
LIABILITIES AND SHAREHOLDERS' EQUITY				
Borrowings				
Short Term Debt				
Secured loans	12,813	18,008	22,437	22,578
Unsecured loans	9	-	-	-
Total Borrowings	**12,822**	**18,008**	**22,437**	**22,578**
Deferred revenue	**7,415**	**7,222**	**7,030**	**6,837**
Deferred Tax Liability	**507**	**791**	**880**	**914**
Share Capital				
Paid up Equity Share Capital	3,604	4,007	4,007	4,007
No. of Shares outstanding (mn)	*360*	*401*	*401*	*401*
Face Value per share (Rs)	*10*	*10*	*10*	*10*
Preference Share Capital	28	28	28	28
Reserves & Surplus				
Share Premium	2,385	19,693	19,693	19,693
General & Other Reserve	1,457	3,243	5,158	7,665
Net Worth	**7,475**	**26,971**	**28,886**	**31,393**
Total Liabilities & Shareholders' Equity	**28,220**	**52,992**	**59,233**	**61,722**

Source: Company data, I-Sec Research

Table 19: Cashflow statement

(Rs mn, year ending March 31)

	FY07	FY08E	FY09E	FY10E
Cash Flow from Operating Activities				
Reported Net Income	1,874	1,786	1,915	2,507
Add:				
Depreciation & Amortisation	807	1,022	1,430	1,455
Amortisation of deferred revenue	2,780	(193)	(193)	(193)
Deferred Taxes	(183)	284	90	34
Less:				
Other Income	164	415	1,144	560
Net Extra-ordinary income	(16)	77	-	-
Operating Cash Flow before Working Capital change (a)	**5,130**	**2,407**	**2,098**	**3,242**
Changes in Working Capital				
(Increase) / Decrease in Inventories	(58)	17	(7)	(32)
(Increase) / Decrease in Sundry Debtors	(2,683)	3,061	(15)	(144)
(Increase) / Decrease in Operational Loans & Adv.	(513)	(740)	(200)	-
(Increase) / Decrease in Other Current Assets	(17)	38	(15)	(72)
Increase / (Decrease) in Other Current Liabilities	206	(1,921)	2	37
Working Capital Inflow / (Outflow) (b)	**(3,065)**	**455**	**(235)**	**(211)**
Net Cash flow from Operating Activities (a) + (b)	**2,065**	**2,863**	**1,863**	**3,032**
as a % of Operating Cash Flow				
Cash Flow from Capital commitments				
Purchase of Fixed Assets	(5,833)	(1,922)	(12,715)	(8,727)
Purchase of Investments	438	(3,470)	(4,895)	(1,500)
Consideration paid for acquisition of undertaking				
Cash Inflow/(outflow) from capital commitments (c)	**(5,395)**	**(5,392)**	**(17,610)**	**(10,227)**
Free Cash flow after capital commitments (a) + (b) + (c)	**(3,329)**	**(2,529)**	**(15,747)**	**(7,196)**
Cash Flow from Investing Activities				
Sale of Fixed Assets				
Sale of Investments				
Consideration received for sale of undertaking/division				
Other Income	164	415	1,144	560
Net Cash flow from Investing Activities (d)	**164**	**415**	**1,144**	**560**
Cash Flow from Financing Activities				
Issue of Share Capital during the year		17,710	-	-
Proceeds from fresh borrowings	3,204	5,185	4,429	141
Repayment of Borrowings				
Dividend paid including tax	411	914	914	914
Reserve adjustments	(821)	(914)	(914)	(914)
Net Cash flow from Financing Activities (e)	**2,794**	**22,895**	**4,429**	**141**
Net Extra-ordinary Income (f)	**(16)**	**77**	**0**	**0**
Total Increase / (Decrease) in Cash (a) + (b) + (c) + (d)+ (e) + (f)	**(387)**	**20,858**	**(10,174)**	**(6,494)**
Opening Cash and Bank balance	**957**	**569**	**21,427**	**11,253**
Closing Cash and Bank balance	**569**	**21,427**	**11,253**	**4,759**
Increase/(Decrease) in Cash and Bank balance	**(388)**	**20,858**	**(10,174)**	**(6,494)**

Source: Company data, I-Sec Research

Table 20: Key ratios

(Year ending March 31)

	FY07	FY08E	FY09E	FY10E
Per Share Data (Rs)				
Diluted Recurring Earning per share (DEPS)	5.2	4.3	4.8	6.3
Diluted Earnings per share	5.2	4.5	4.8	6.3
Recurring Cash Earnings per share (CEPS)	7.5	6.8	8.3	9.9
Free Cashflow per share (FCPS-post capex)	(10.5)	2.3	(27.1)	(14.2)
Reported Book Value (BV)	20.7	67.3	72.1	78.3
Adjusted Book Value (ABV) **	20.7	67.3	72.1	78.3
Dividend per share	1.0	2.0	2.0	2.0
Valuation Ratios (x)				
Diluted Price Earning Ratio	110.6	136.0	121.4	92.7
Price to Recurring Cash Earnings per share	77.5	85.1	69.5	58.7
Price to Book Value	28.0	8.6	8.0	7.4
Price to Adjusted Book Value	28.0	8.6	8.0	7.4
Price to Sales Ratio	36.1	34.4	31.9	23.8
EV / EBITDA	74.5	58.5	57.0	44.7
EV / Total Operating Income	39.5	35.1	34.5	26.5
EV / Operating Free Cash Flow (Pre-Capex)	111.0	82.8	135.0	85.1
EV / Net Operating Free Cash Flow (Post-Capex)	(60.8)	251.9	(23.2)	(45.3)
Dividend Yield (%)	0.2	0.3	0.3	0.3
Growth Ratios (% YoY)				
Diluted Recurring EPS Growth	51.3	(18.6)	12.0	30.9
Diluted Recurring CEPS Growth	8.9	(8.9)	22.4	18.4
Total Operating Income Growth	50.8	16.5	7.8	33.9
EBITDA Growth	45.7	31.7	8.9	30.9
Recurring Net Income Growth	202.6	(9.6)	12.0	30.9
Operating Ratios (%)				
EBITDA Margins	53.1	60.0	60.6	59.2
EBIT Margins	42.0	51.0	56.7	50.1
Recurring Pre-tax Income Margins	29.6	33.8	34.3	36.7
Recurring Net Income Margins	31.7	23.8	22.7	24.3
Personnel expenses / Revenue	2.6	3.6	4.9	5.2
Operating expenses / Revenue	33.5	32.9	29.5	30.4
Other Income / Pre-tax Income	9.3	17.1	39.6	14.8
Effective Tax Rate	(7.1)	29.5	33.7	33.7
Return / Profitability Ratios (%)				
Return on Capital Employed (RoCE)-Overall	14.0	7.3	5.6	6.0
Return on Invested Capital (RoIC)	12.9	13.7	11.1	11.0
Return on Net Worth (RoNW)	28.0	9.9	6.9	8.3
Dividend Payout Ratio	19.1	46.9	41.8	32.0
Solvency Ratios / Liquidity Ratios (%)				
Debt Equity Ratio (D/E)	2.8	1.0	1.1	1.0
Long Term Debt / Total Debt	100.0	100.0	100.0	100.0
Net Working Capital / Total Assets	10.1	4.5	4.5	4.6
Interest Coverage Ratio-based on EBIT	3.6	3.4	3.3	4.4
Debt Servicing Capacity Ratio (DSCR)	5.0	3.7	3.7	4.6
Current Ratio	2.6	89.7	52.2	25.7
Cash and cash equivalents / Total Assets	2.0	40.4	19.0	7.7
Turnover Ratios				
Inventory Turnover Ratio (x)	77.1	77.1	77.1	77.1
Assets Turover Ratio (x)	0.2	0.2	0.2	0.2
Working Capital Cycle (days)	132	737	946	403
Average Collection Period (days)	133	104	20	18
Average Payment Period (days)	0	0	0	0
Miscellaneous Ratios /Data				
Depreciation / Total Income	13.9	15.1	19.6	14.9
Depreciation / Average Gross Block	4.2	4.1	5.0	5.0
Capex / Average Gross Block	27.8	21.4	62.2	35.2
Capex / Total Sales	93.1	79.9	241.9	104.9
Dividend to cash flow	(19.9)	(31.9)	(49.0)	(30.1)

Source: Company data, I-Sec Research

Annexure 2: Company profile

Mundra Port & SEZ, is the only private port based SEZ in the country. Established as in 1998 in Kutch District, Gujarat it is now among the Top 10 largest port in the country. MPSEZ currently has a market capitalization of US$5.7bn.

The company is backed by the ~US$4.4bn Adani Group – which has presence in Trading, Mining, Real Estate, Shipping and Power. This gives MPSEZ a firm backing – which we believe is useful in port sector as it is still in a nascent stage of development. The management itself has people with experience in the parent group, but at the same time have had experience of working in the port sectors as well. The company has 5 independent directors and a Government nominee.

Chart 24: Mundra Port and SEZ location

Source: Company Website

Table 21: Management profile

Name	Designation	
Promoter		
Gautam S. Adani	Chairman & MD, CEO	Mr. Gautam Adani is the founder of Adani Group and is responsible for the group's foray into ports. He has been the Chairman and MD since 1999, the CEO since 2007
Rajesh S. Adani	Non Executive Director	Mr. Rajesh Adani has been associated with Adani Enterprises since its inception in 1988. Brother of Gautam Adani, he handles marketing and financial aspects of Adani Enterprises
Executive		
Ameet H. Desai	Director	Mr. Desai is the CFO of MPSEZ and has more than 20 years experience in corporate finance and M&A. Before MPSEZ, he has worked in Ranbaxy Laboratories and completed 4 acquisitions
Rajeev R. Sinha	Director	An IAS, Mr. Sinha has more than 31 years of experience - most of which has been in the port sector. He has been involved with Gujarat Pipavav Ports, Mumbai Port Trust and other Maharashtra ports in various capacities. He is also a fellow of the Institute of Chartered Ship Brokers, UK

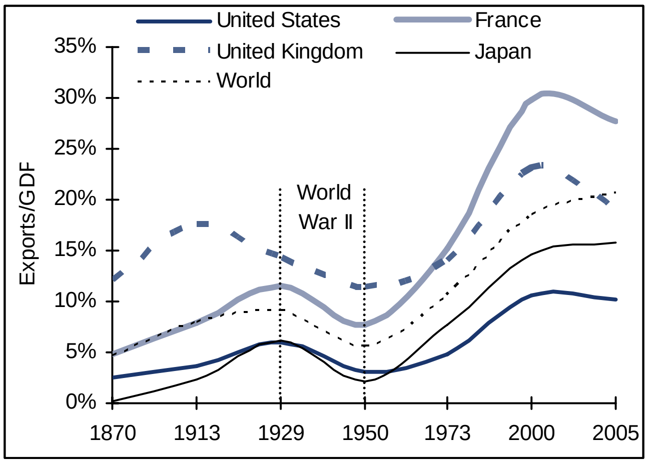
Source: Company

Annexure 3: Ports overview

World trade and port traffic have outstripped GDP growth

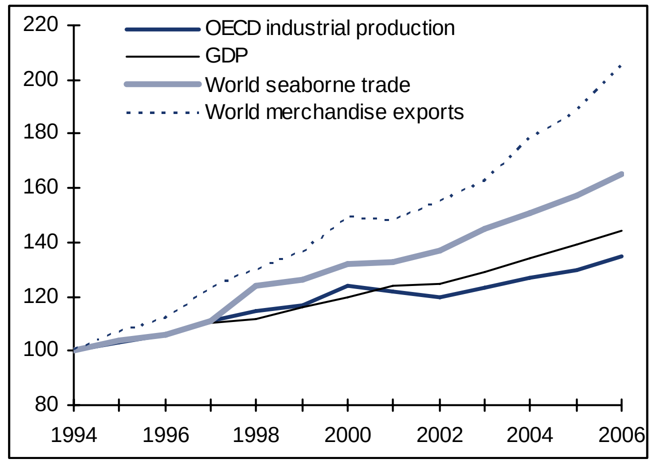
Excluding the set back during World War II, world trade has grown much faster than the GDP backed by the opening up of more economies, formation of European Union and WTO (Chart 25 & Chart 26). With most of the world trade through sea, port traffic has increased from 4bnte in 1990 to 7.4bnte in ’06.

Chart 25: Except a slump during World War II…



Source: WTO, I-Sec Research

Chart 26: …world trade has grown faster than GDP

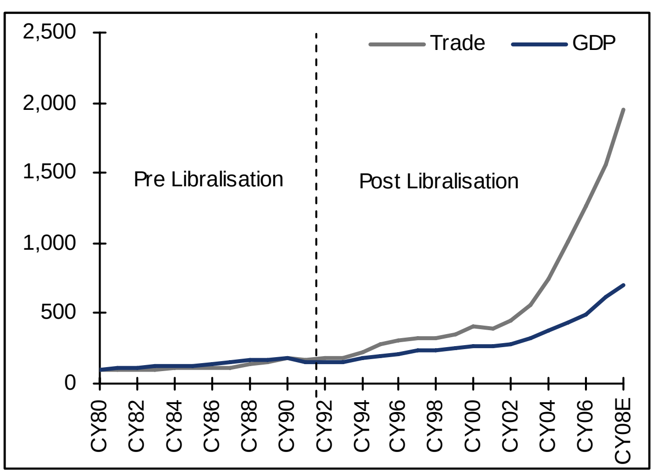


Source: WTO, I-Sec Research

Post liberalisation, port traffic in India has outperformed GDP

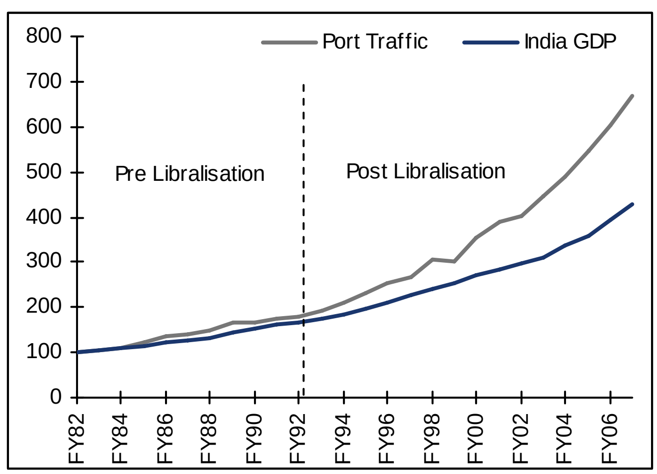
With the economy growing ~8-9% in the past four years, India’s merchandise trade has increased at nearly 27% CAGR. While the Indian trade grew in tandem with the GDP until FY92, post liberalisation the trade started growing much faster, thereby directly impacting port traffic. Port traffic growth jumped to 9.2% post FY92 as compared with just 5.3% between FY50-91 (Charts 27 and 28).

Chart 27: Trade grew faster post liberalization…



Source: I-Sec Research, IMF,WTO

Chart 28: …and so did port traffic



Source: I-Sec Research, Ministry of Shipping, RBI

Port traffic-to-GDP growth ratio has remained static in India

Growth in port traffic has steadily increased in the past five decades from 5.1% in 1950s to 9.6% post '00 versus 3.6% and 6.6% GDP growth respectively. Thus, the elasticity of traffic growth to GDP growth has remained at ~1.4x.

Table 22: Port traffic-to-GDP ratio consistent at ~1.4x

Time period	CAGR (port traffic) (%)	CAGR (GDP) (%)	Ratio (x)
The 50s	5.1	3.6	1.44
The 60s	6.3	3.9	1.61
The 70s	4.0	2.9	1.40
The 80s	7.4	5.6	1.33
The 90s	7.0	5.7	1.24
2000 to 2007	9.6	7.0	1.37
Pre Liberalisation Era	5.3	3.9	1.35
Post Liberalisation Era	9.2	6.6	1.39

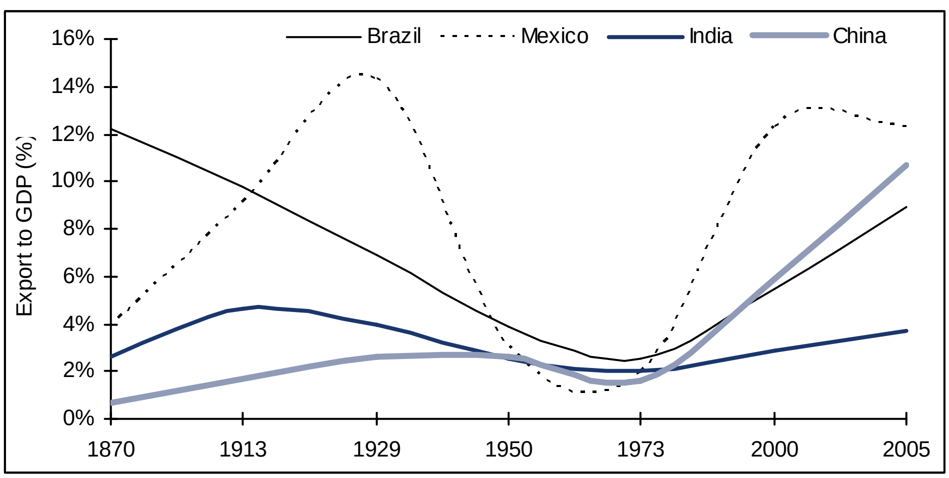
Source: I-Sec Research, Ministry of Shipping, RBI Data

Future growth in port traffic to be higher due to rising GDP

Considering the current GDP growth, its relationship with growth in port traffic and that trade itself has a strong growth potential (Chart 29), on a top-down approach, we believe port traffic will grow at 11% CAGR in XI Five Year Plan (Chart 30).

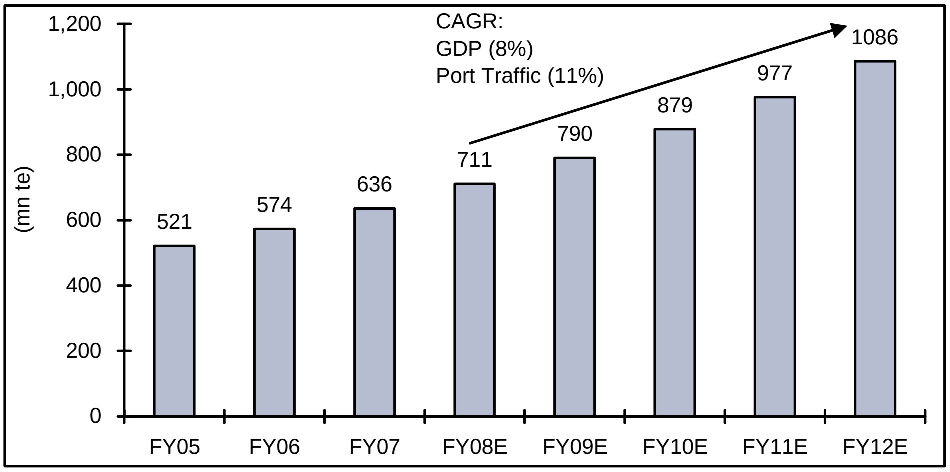
This approach assumes GDP growth of 8% in XI Five Year plan, while it does not account for the changes in structure of port traffic in the years to come, and thus we believe that our bottoms-up analysis will represent a base-case scenario for port traffic growth.

Chart 29: India's trade has strong potential to grow



Source: WTO, I-Sec Research

Chart 30: Port traffic to grow at 11% CAGR backed by 8% GDP growth



Source: Ministry of Shipping, I-Sec Research

Composition of current port traffic

Port traffic in India mainly consists of petroleum products, coal, iron ore, containers and other commodities such as fertilisers. Some of this traffic is driven by imports and some by exports.

Table 23: Composition of current port traffic

Commodity	Composition	Share of Total Traffic	Type of Traffic
PoL	Petroleum products and crude oil	37%	Export as well as imports
Coal	Thermal coal and coking coal	13%	Imports
Iron Ore		17%	Exports
Container	Different products	13%	Exports as well as imports
Others	Fertilisers, food grains, steel etc	20%	Mainly imports

Source: I-Sec Research, Ministry of Shipping, IPA

Ports not just about cargo traffic

Some of the world's biggest ports are historical landmarks and have become the economic backbone of the cities they are based in. The Port of Singapore, for example, was set up as early as the thirteenth century and has been instrumental in making Singapore one of the largest trading cities in the world. The Port of Hamburg started operations in the eleventh century and today provides jobs to 145,000 people in and around Hamburg and 220,000 people in Germany. 12% of Hamburg's GDP comes from port dependent activities. Similarly, the Port of Rotterdam – third largest port in the world – gives employment to 370,000 people.

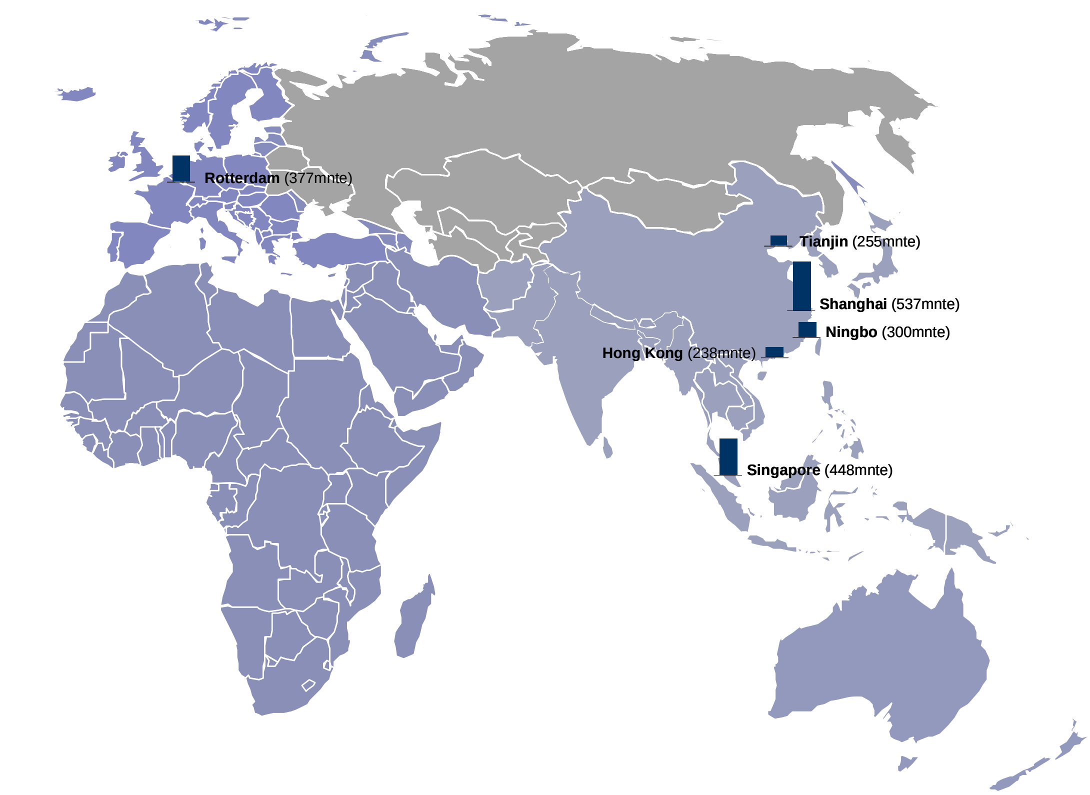
Table 24: Large ports act as economic hubs

Port	Cargo (mn te)	Employment (Nos)	Port GDP (US$bn)	City GDP (US$bn)
Rotterdam	376.7	370,000	10.0	46.1
Hamburg	134.8	220,000	12.6	100.4

Source: Port of Rotterdam, Port of Hamburg

The Port of Rotterdam provides not only cargo-related services but is also an industrial and logistics hub, giving direct employment to 70,000 people and indirect employment to 300,000 outside the port. In comparison, the 12 major Indian ports provide mainly cargo management services and thus employ 66,000 people directly. The indirect employment figures are unknown, but they are expected to be smaller as most major ports normally offer cargo-related services.

Chart 31: World's major ports



World's major ports, 2006 - 2003

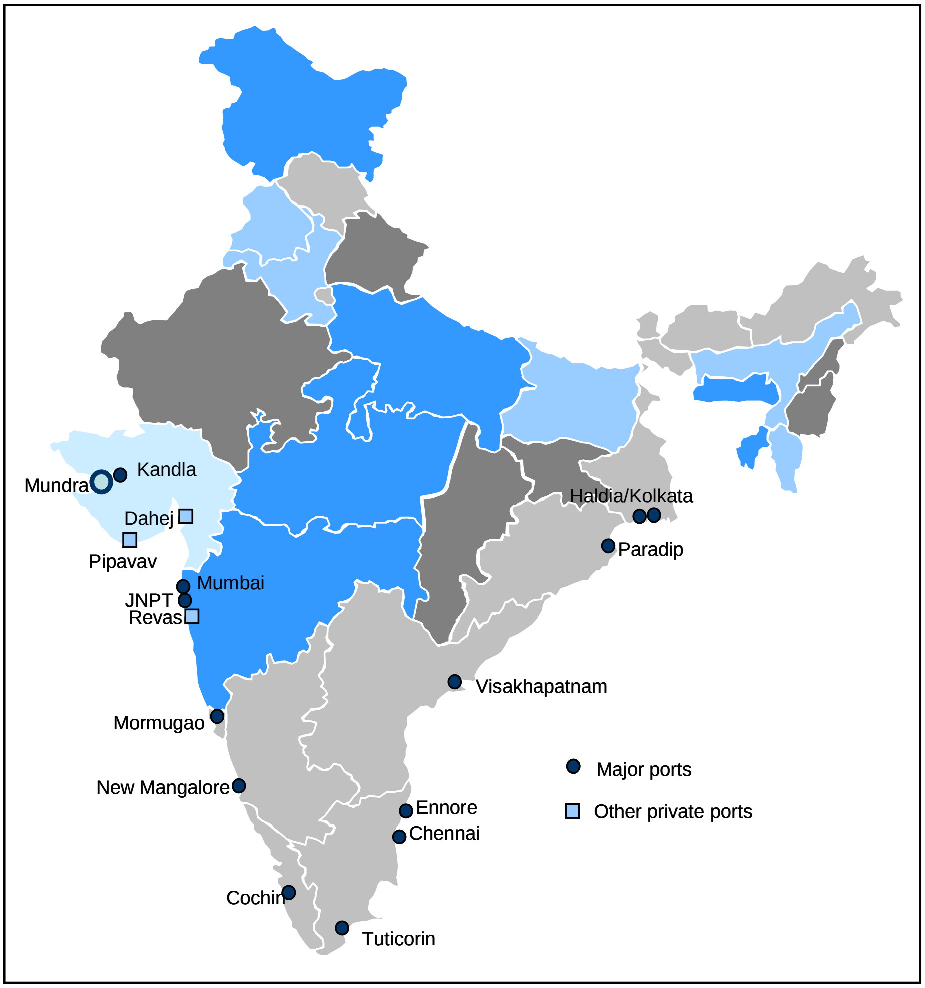
	2006	2005	2004	2003
Shanghai [1)]	537.0	443.0	379.7	315.4
Singapore	448.2	423.0	393.4	347.7
Rotterdam	**376.7**	**370.4**	**352.7**	**328.1**
Ningbo	300.0*	268.6	225.9	185.2
Guangzhou	300.0*	250.9	215.2	171.1
Tianjin	255.0*	241.4	206.2	161.8
Hong Kong [1)]	238.0*	230.1	220.9	205.8
Nagoya [2)]	206.0*	187.0	182.3	172.0
Qingdao	200.0*	186.8	162.7	140.9
Dalian	200.0*	170.0	145.2	126.0
Antwerp	167.4	160.1	152.3	142.9
Hamburg	134.8	125.7	114.4	106.3

Source: Port of Rotterdam

India's major and minor ports – An overview

More than 95% of India's trade by volume and 70% by value are carried by sea through the 12 major and 45 non-major ports. The major ports are controlled by the Central Government through port trusts, while non-major ports are managed by state governments via state maritime boards or by private companies through JVs and public-private partnerships.

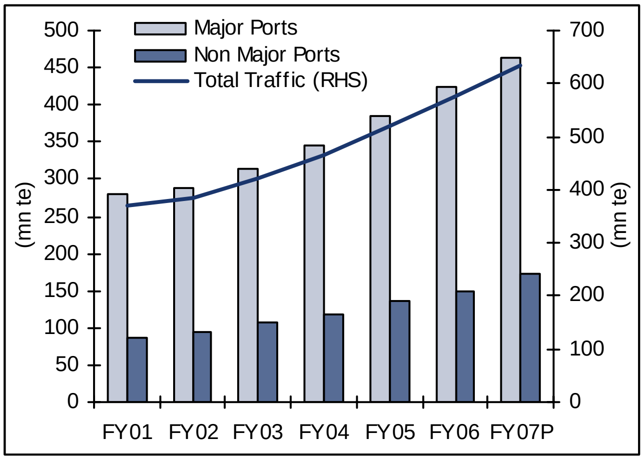
Chart 32: India's 12 major ports and three private ports



Source: I-Sec Research

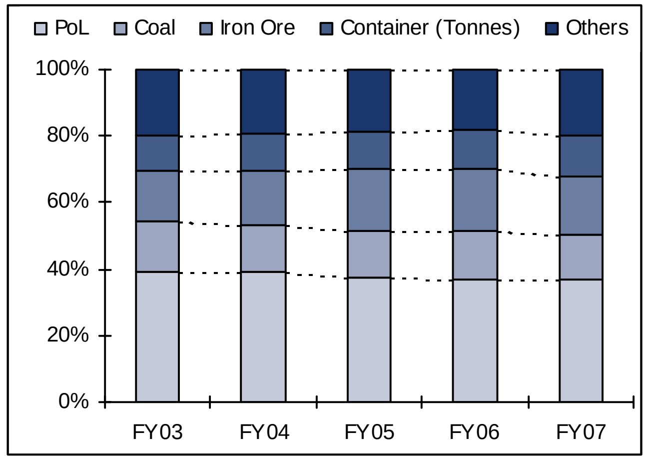
State-managed ports do not have the financial and administrative capabilities of major ports, while private ports are still at a nascent stage of development. In FY07, 73% of 636MT of India's maritime traffic was managed by these 12 ports. Most of this traffic was in the form of petroleum products (37%) followed by iron ore (17.3%) and coal (13.3%). Over the past few years, there has not been major change in this structure and, in fact, the traffic composition is similar to the global pattern, wherein petroleum products account for more than one-thirds of the total traffic (Chart 34).

Chart 33: Major ports dominate traffic share



Source: Ministry of Shipping, I-Sec Research

Chart 34: Traffic composition remained stable



Source: Ministry of Shipping, I-Sec Research, IPA

India lags behind in traffic despite an attractive coastline

The 7,000kms long Kandla-Kolkata coastline forms the backbone of Indian trade, much like the 1,000kms Hamburg-LeHarve coastline for North-West Europe. Although the coastline is longer, the 12 major ports of India have lesser traffic than 11 ports of the European coastline.

Table 25: India's coastline offers great potential

	Kandla – Kolkata range	**Hamburg – Le Harve range**
Coastline	7000 km	1000 km
Number of Major Ports	12	11
Cargo handled in 2006	420 m te	1020 m te
Hinterland Population	1100 m	200 m
Competition	Limited	Strong
Port Management	Public services ports with private terminals	Mostly landlord
Port Infrastructure	Almost at capacity	Spare capacity

Source: Port Development Plan, Port of Rotterdam

Changing role of non-major ports

In spite of adequate capacity at non-major ports and inadequate capacity at major ports, the former have always been considered as filler ports. This is because the latter enjoyed better infrastructure support in terms of rail and road connectivity.

However, various state governments are planning to invest (including PPP) Rs359bn in improving port infrastructure and augmenting capacity from 28mnte in FY07 to 573mnte by FY12E.

Table 26: Proposed development of non-major ports

(Rs mn)

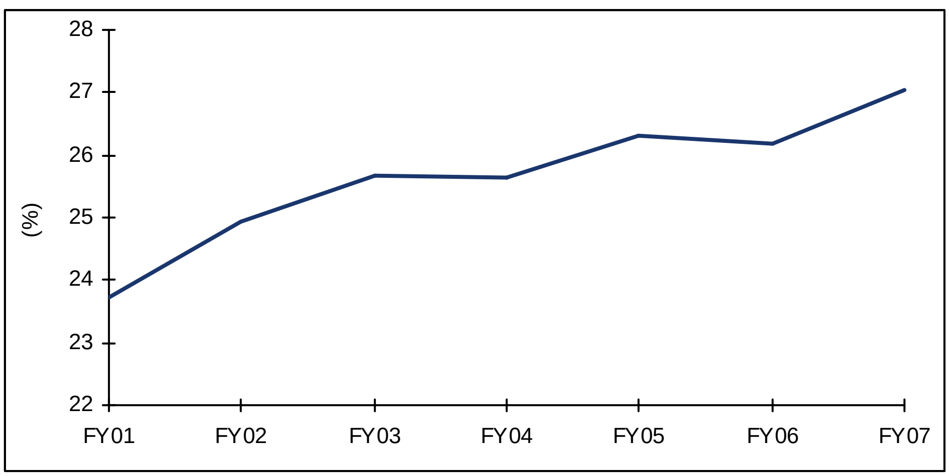
	Proposed capacity addition (mn te)	Estimated cost	State Govt.	Central Govt.	Private Sector	Others*
Andhra Pradesh	84	61,040	6,370	6,370	48,300	-
Gujarat	56	97,360	-	-	92,410	4,950
Maharashtra	85	59,930	-	-	59,930	-
Tamil Nadu	29	19,250	-	-	19,250	-
Karnataka	26	24,800	2,380	21,420	1,000	-
Orissa	13	41,000	-	-	41,000	-
Goa	4	480	50	430	-	-
Kerala	28	30,800	5,270	4,380	21,150	-
West Bengal	8	6,000	120	2,280	3,600	-
Pondicherry	12	18,670	-	-	-	18,670
Total	345	359,330	14,190	34,880	286,640	23,620

Source: Committee on Infrastructure, I-Sec Research

Importantly, of the planned 345mnte capacity addition, private players are expected add 276mnte, either in the form of greenfield projects such as Mundra Port or through development of existing state ports for example the Mumbai Port. Some of these ports are also likely to harness the experiences of global ports in developing the area along side the ports into industrial centres such as MPSEZ and Rewas Port.

Going forward, we believe minor ports will no more act as feeder ports but will actively compete with major ports for traffic flows, especially because of their ability to respond to market conditions quickly. In fact over the past few years, non-major ports' market share has increased, although they have started from a lower base.

Chart 35: Non-major ports have increased market share



Source: Ministry of Shipping, I-Sec Research

Annexure 4: Coal traffic at ports set to explode

Thermal capacity addition to drive coal demand

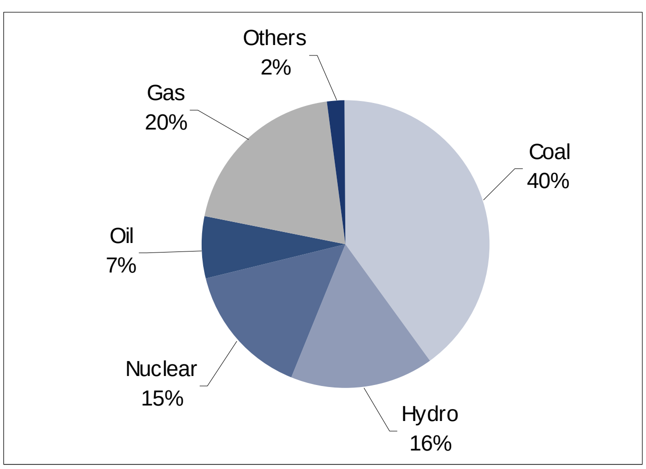
25% of world's primary energy consumption is fuelled by coal, making it one of the primary sources of energy. 66% of world steel production and 40% of world's electricity generation is dependent on coal. In some countries, this is as high as 93%. In fact, more than two-thirds of coal globally is used for power. Hence, coal trade has reached nearly 1bnte, growing at 8% per annum in the past 20 years. 60% of the trade happens in the Pacific, consisting of developing countries in Asia.

India is not different – 69% of all power plants use coal. More importantly, in India, power industry consumes 75% of all the coal used. Hence, coal demand in India is a direct function of thermal power capacity. The fact that India's power production cannot meet the current demand is well known and as the GDP increases, the power consumption is only bound to increase further leading to significant rise in coal requirement in the years to come.

Moreover, the XI Five Year Plan envisages 'Power for all by '12"' and an increase in per capita consumption to 1,000Kw-hr (from the current 600 Kw-Hr). Thus, to fulfill these objectives the XI Five Year Plan targets a capacity addition of 78,577MW through FY08-12. Sustaining GDP growth of 8-9% will require further addition of 71,000-108,000MW in the XII Plan. In other words, in the next 10 years, India will have to add at least as much capacity as it has added in the past 60 years. It is this addition, which we believe will drive coal demand in India, apart from capacity additions in steel. Specifically, 52,905MW is expected to come from coal-based power plants.

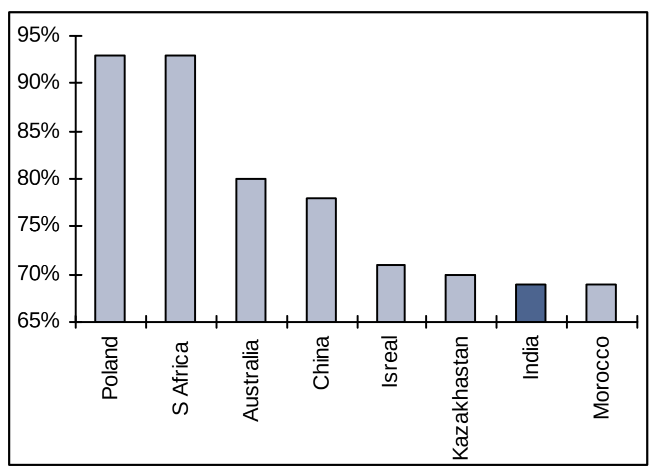
While this demand for power has led to rapid reforms in the power sector, equally strong reforms have not happened in the coal industry. Thus, while demand for coal is expected to rise at a fast pace the supply will not.

Chart 36: Share of coal based power plants is high globally…



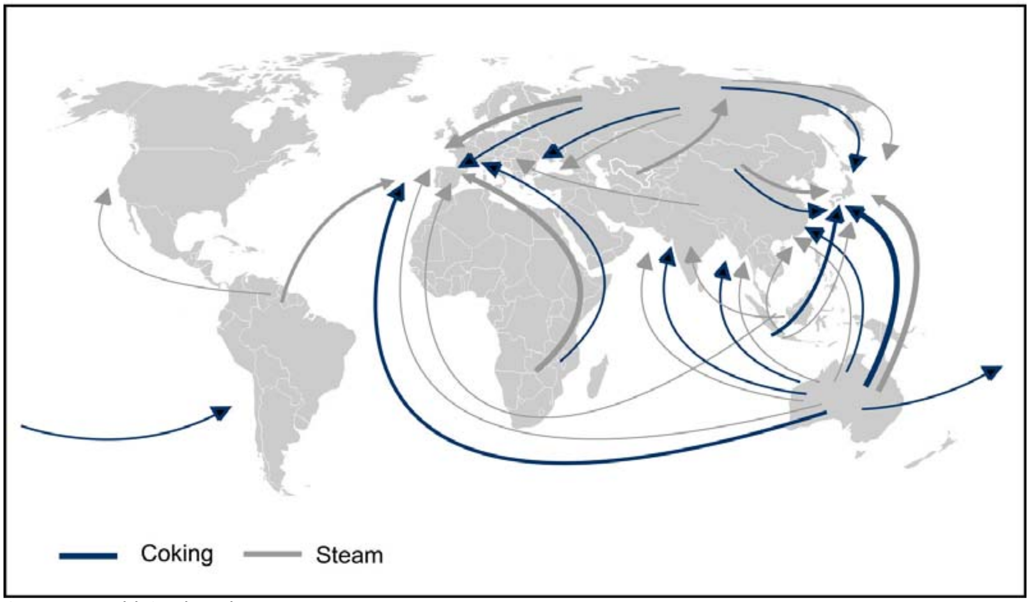
Source: I-Sec Research, World Coal Institute

Chart 37: …India is no exception



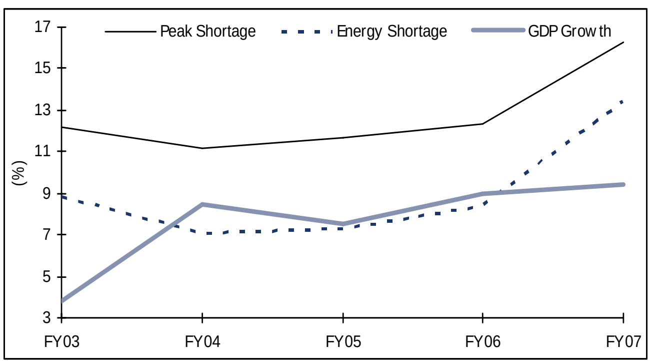
Source: I-Sec Research, World Coal Institute

Chart 38: Global coal trade flows



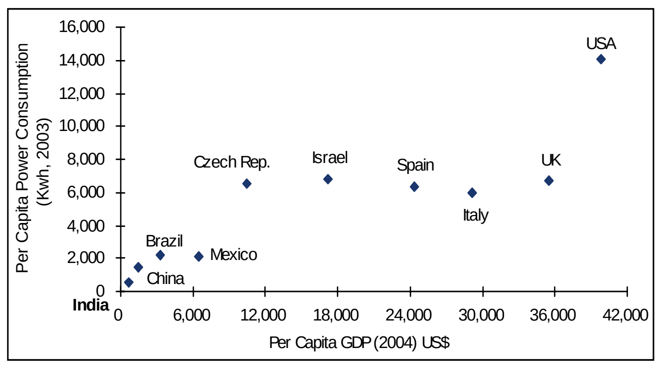
Source: World Coal Institute

Chart 39: India's power shortage is increasing



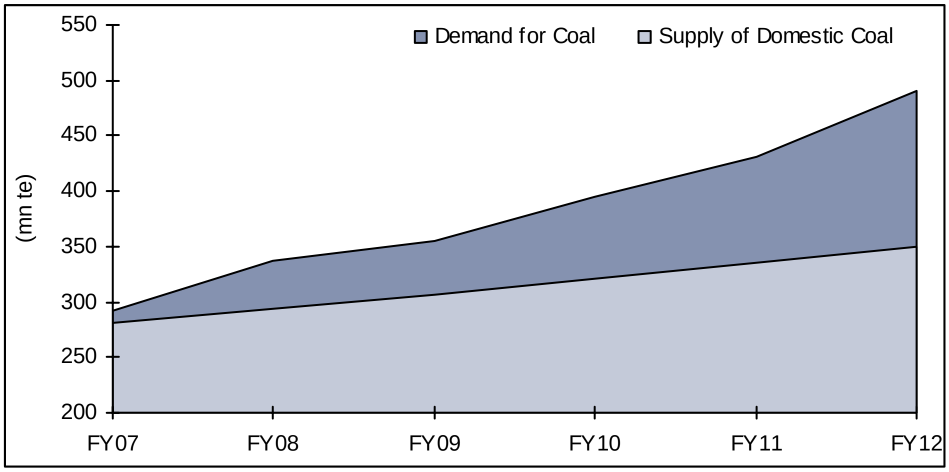
Source: Economic Survey 2006-07; Report of the Working Group on Power for 11th Plan

Chart 40: Economic growth will increase consumption further



Source: UNDP Human Development Report 2006, I-Sec Research

Chart 41: Demand-supply mismatch will require import of coal



Source: I-Sec Research, Committee on Infrastructure

China, biggest coal producer with largest reserves, but still imports coal

China produced 2.5bnte hard coal in ’06, by far the largest globally. The second largest producer, the US produced only 990mnte. China also has the largest reserves – it was the fifth largest exporter in ’06, exporting ~63mnte of hard coal.

However, surprisingly, in the same year it imported 38mnte as it was easier to import coal for coastal power plants than to transport them from the Northern regions of the country (where coal mines are based) to coastal areas in the South. Moreover, most of the coal cannot be mined because of safety reasons and many mines do not produce good quality coal. Thus, even if reserves and production in India are sufficient to meet current demand, imports may still continue and increase. Moreover, imported coal has low ash content and high calorific value, which means that many power plants will be based on imported coal because of quality. Thus, demand for imported coal will increase, which in turn will have a major impact on increasing port traffic.

Annexure 5: Container traffic too set to explode

Logistics, overall containerisation will lead to container traffic growth

Containers occupy 13% of the total traffic at ports in terms of tonnage. However, globally and in India, rising containerisation means that the growth in containerised cargo has outpaced the normal cargo traffic growth. Historically, India's foreign trade has grown 2.5x the GDP and cargo traffic through ports 0.5x the foreign trade, though containerisation at ~25% is well below the global average of 60-70%. In-built cost advantages of rail haulage over road (2-3x rail) have also helped EXIM rail container traffic's overall growth at 2-4x GDP.

Rising potential from foreign trade

Even as key containerisable cargo such as capital/project goods, machinery and others have grown at a much faster pace, overall container traffic growth has been rather low. Based on potential containerisation of individual items, we expect overall containerisation to be 50-60% for India's EXIM trade, which is almost twice the current containerisation at ~25%.

At present, overall containerisation stands at <25% as against potential of >50%

Moreover, key trade items, capital & electronic goods, textiles, metals, fertilisers, chemicals are witnessing >20% growth, promising huge potential traffic

Table 27: EXIM traffic break-up reveals potential for increasing containerisation

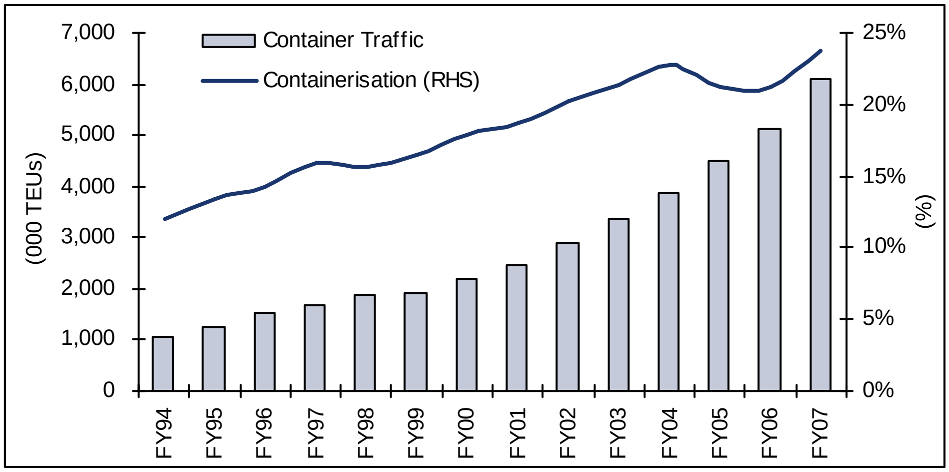
(US$ mn)

Exports ex Oil	FY04	FY05	FY06	FY07*	FY07* share (%)	CAGR FY07/04 (%)	FY07 Potential containerisation (%)
Agri & Allied Products	7,328	8,381	9,568	10,575	10.1	16.3	90
Ores & Minerals	2,369	5,079	6,189	6,501	6.2	44.1	20
Leather goods	2,163	2,422	2,626	2,899	2.8	13.5	100
Gems & Jewellery	10,573	13,762	15,547	15,038	14.4	15.8	-
Sports Goods	99	102	132	127	0.1	11.9	100
Chemicals	9,960	13,164	15,514	17,223	16.5	23.6	25
Capital Goods	12,406	17,348	21,547	28,179	27.0	35.3	100
Textiles	13,495	14,026	17,076	18,247	17.5	13.8	100
Unclassified	1,881	2,263	3,011	5,443	5.2	46.7	25
Total	**60,275**	**76,547**	**91,211**	**104,234**	**100.0**	**23.6**	**63**
Imports ex Oil							
Gems & Jewellery	7,129	9,423	9,141	7,223	6.0	3.4	-
Machinery	9,304	12,961	15,573	21,232	17.7	35.5	75
Project Goods	396	596	816	1,796	1.5	70.4	75
Other Bulk Imports	8,690	12,530	16,647	25,753	21.4	47.9	25
Others	32,062	46,164	56,276	64,225	53.4	29.8	60
Total	**57,580**	**81,673**	**98,453**	**120,228**	**100**	**31.6**	**52**

* FY07 annualised for data until February '07

Source: The Ministry of Commerce, I-Sec Research

Chart 42: Increasing containerisation with increasing container traffic

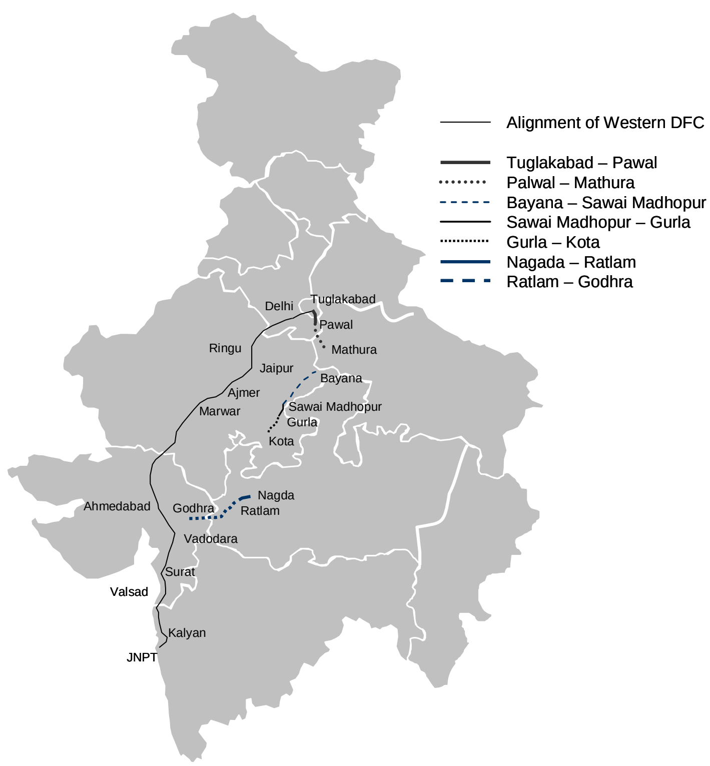


Source: I-Sec Research, IPA

EXIM rail container traffic growing at >2x GDP

Historically, India's foreign trade has grown 2.5x the GDP and cargo traffic through ports 0.5x the foreign trade. In-built cost advantages of rail haulage over road (2-3x rail) have also helped EXIM rail container traffic's overall growth of 2-4x GDP. This traffic is thus growing at 17% per annum. We believe this growth can increase to 24% per annum in the XI Five Year Plan on account of growing containerisation and increase in trade. We expect this growth to remain in the two digits – at CAGR of 13% – in the XII Five Year Plan as the dedicated freight corridor between Mumbai and Delhi is expected to become operational in '13-14.

Chart 43: Dedicated freight corridor



Source: I-Sec Research

Annexure 6: Index of Tables and Charts

Tables

Charts

ANALYST CERTIFICATION

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EQUITIES			
A Murugappan	Executive Director	+91 22 6637 7101	a_murugappan@isecltd.com
Equity Research – Telephone : +91 22 2288 2460/70 **Fax:** +91 22 2288 2448			
ANALYST	**SECTOR ALLOCATION**	**DIRECT NOS.**	**E-MAIL**
Anand Shah	Co-Head Research – FMCG	+91 22 6637 7230	anand_shah@isecltd.com
Girish Pai	Co-Head Research – Strategy	+91 22 6637 7311	girish_pai@isecltd.com
Amar Kedia	Aviation, Logistics	+91 22 6637 7271	amar_kedia@isecltd.com
Amit Mishra	Oil & Gas, Petrochemicals	+91 22 6637 7274	amit_mishra@isecltd.com
Gaurav Pathak	Real Estate	+91 22 6637 7339	gaurav_pathak@isecltd.com
Krupal Maniar, CFA	Technology	+91 22 6637 7254	krupal_maniar@isecltd.com
Novonil Guha	Cement	+91 22 6637 7385	novonil_guha@isecltd.com
Poonam Nishal	Telecom, Utilities	+91 22 6637 7443	poonam_nishal@isecltd.com
Prakash Goel	Agriculture	+91 22 6637 7373	prakash_goel@isecltd.com
Rajesh Vora	Pharmaceuticals	+91 22 6637 7508	rajesh_vora@isecltd.com
Rahul Jain	Metals	+91 22 6637 7314	rahul_jain@isecltd.com
Sanjay Singh	FMCG	+91 22 6637 7386	sanjay_singh@isecltd.com
Sandeep Shah	Technology	+91 22 6637 7114	sandeep_shah@isecltd.com
Shilpa Gupta	Automobiles, Healthcare	+91 22 6637 7134	shilpa_gupta@isecltd.com
Siddharth Teli	Banking	+91 22 6637 7298	siddharth_teli@isecltd.com
Vikash Mantri, CFA	Media	+91 22 6637 7161	vikash_mantri@isecltd.com
Gagan Dixit	Sr. Associate (Oil&Gas, Petrochemicals)	+91 22 6637 7480	gagan_dixit@isecltd.com
Nishant Bhargava	Sr Associate (Textiles)	+91 22 6637 7143	nishant_bhargava@isecltd.com
Swarit Dakalia	Sr. Associate (Construction)	+91 22 6637 7366	swarit_dakalia@isecltd.com
Sunil Teluja	Sr. Associate (Capital Goods, Engineering, Strategy)	+91 22 6637 7288	sunil_teluja@isecltd.com
Alok Kapadia	Associate (Banking)	+91 22 6637 7231	alok_kapadia@isecltd.com
Abhijit Mitra	Associate	+91 22 6637 7289	abhijit_mitra@isecltd.com
Abhishek Murarka	Associate	+91 22 6637 7351	abhishek_murarka@isecltd.com
Amit Shah	Associate	+91 22 6637 7297	amit_shah@isecltd.com
Hemant Joshi	Associate	+91 22 6637 7380	hemant_joshi@isecltd.com
Rishi Agrawal	Associate	+91 22 6637 7436	rishi_agrawal@isecltd.com
Sagar Thakkar	Associate (Technology)	+91 22 6637 7225	sagar_thakkar@isecltd.com
Sanket Maheshwari	Associate	+91 22 6637 7159	sanket_maheshwari@isecltd.com
Shaleen Silori	Associate	+91 22 6637 7188	shaleen_silori@isecltd.com
Prakriti Singh	Editor	+91 22 6637 7239	prakriti_singh@isecltd.com
Simmu Kahlon	Editor	+91 22 6637 7202	simmu_kahlon@isecltd.com
Hemant Jathar	Production	+91 22 6637 7135	hemant_jathar@isecltd.com
Ruben Fernandes	Production	+91 22 6637 7442	ruben_fernandes@isecltd.com
Equity Sales – Asia-Pacific – Telephone : +91 22 2288 2460/70 **Fax:** +91 22 2288 2341			
Rishikesh Joshi		+91 22 6637 7229	rishikesh_joshi@isecltd.com
Sachin Shahane		+91 22 6637 7223	sachin_shahane@isecltd.com
T S Baskaran		+65 6823 1556	ts_baskaran@icicisecurities.com
Vinay Patel		+91 22 6637 7275	vinay_patel@isecltd.com
Equity Sales – Europe – Telephone : +91 22 2288 2460/70 **Fax:** +91 22 2288 2341			
Darshit Shah		+91 22 6637 7152	darshit_shah@isecltd.com
Equity Sales – US – Telephone : +1 212-921-2344 / +1 212 453 670			
Melrick D'Souza		+1 646-701-4465	melrick_dsouza@icicisecurities.com
Equity Dealing – Telephone : +91 22 2281 4570 **Fax:** +91 22 2288 2341			
Kishore Chinai		+91 22 6637 7130	kishore_chinai@isecltd.com
Dharmesh Desai		+91 22 6637 7227	dharmesh_desai@isecltd.com
Ketan Shah		+91 22 6637 7121	ketan_shah@isecltd.com
Pinakin Mistry		+91 22 6637 7279	pinakin_mistry@isecltd.com
Equity Derivatives – Telephone : +91 22 2288 2460/70 **Fax:** +91 22 2288 2341			
Dr. C. K. Narayan		+91 22 6637 7365	ck_narayanan@isecltd.com
Sriram Jagdish		+91 22 6637 7455	sriram_jagdish@isecltd.com
Anant Rao		+91 22 6637 7131	anant_rao@isecltd.com
Rishad Tehrani		+91 22 6637 7193	rishad_tehrani@isecltd.com

ICICI Securities Limited
ICICI Centre, H T Parekh Marg, Churchgate, Mumbai 400 020, **Telephone:** +91 22 2288 2460/70 **Fax:** +91 22 2288 2448

ICICI Securities Inc.
Level 57, Republic Plaza, 9, Raffles Place, Singapore 048 619
Telephone: +65 6823 1556/57 **Fax:** +65 6823 1425

ICICI Securities Inc.
1 Liverpool Street, London EC2M 7QD, United Kingdom.
Tel (Board): +44 20 79562051,
Tel (Direct): +44 20 79562554 / 2555 **Fax:** +44 20 79562211

ICICI Securities Inc.
461, 5th Avenue, 16th Floor, New York, NY 10017, USA. **Telephone:** +1 212-921-2344 / +1 212 453 6704 **Fax:** +1 212-453-6710