

## Gujarat Heavy Chemicals

STOCK INFO.	BLOOMBERG
BSE SENSEX: 10,227	GHCL IN
	REUTERS CODE
S&P CNX: 2,944	GHCL.BO

18 July 2006

Buy

Previous Recommendation: Buy

Rs130

Equity Shares (m)	114.1
52-Week Range (Rs)	193/56
1,6,12 Rel.Per. (%)	-27/-12/64
M.Cap (Rs. b)	14.9
M.Cap (US\$ b)	0.3

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/B V	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
12/06E	25,883	779	6.8	13.8	19.1	2.4	17.5	12.3	1.0	9.5
12/07E	32,075	2,098	18.4	169.1	7.1	1.9	30.0	22.0	0.8	4.8
12/08E	34,214	2,478	21.7	18.1	6.0	1.5	27.9	23.6	0.7	3.9

- GHCL's 2QCY06 results were better than our expectations with PAT increasing 45% YoY to Rs310m compared with our estimate of Rs240m.
- Revenues rose 19.1% YoY to Rs1.6b, driven by strong performance from the soda ash business.
- EBIT margins from soda ash increased by a robust 860bp YoY to 37%. This was primarily due to lower exports — higher domestic sales and Rs1,000/ton YoY increase in soda ash realizations.
- During the quarter, GHCL acquired 100% stake in a UK-based retail company, Rosebys for a consideration of Rs1.8b (US\$40m). It also managed to successfully turn its Romanian soda ash business EBITDA positive.
- We expect the company's consolidated revenues and net profit to grow at 88% CAGR and 53% CAGR, respectively over CY05-CY08.
- The stock is trading at attractive valuations of 7.1x CY07E EPS and 4.8x CY07E EV/EBITDA. We maintain **Buy**. Our SOTP-based target price of Rs223.

QUARTERLY PERFORMANCE									(Rs Million)
Y/E DECEMBER	CY05*			CY06#				CY05#	CY06E#
	1Q	2Q	3Q	1QA	2QA	3QE	4QE	9MTHS	
<b>Sales</b>	<b>1,391</b>	<b>1,656</b>	<b>1,692</b>	<b>2,440</b>	<b>1,657</b>	<b>1,978</b>	<b>2,166</b>	<b>4,740</b>	<b>8,241</b>
Change (%)	17.0	36.7	30.2	57.2	19.1	19.4	28.0	NA	NA
<b>EBITDA</b>	<b>432</b>	<b>451</b>	<b>469</b>	<b>491</b>	<b>638</b>	<b>543</b>	<b>544</b>	<b>1,352</b>	<b>2,216</b>
Change (%)	79.3	132.2	98.4	30.7	47.8	20.4	16.0	NA	NA
As % of Sales	31.0	27.2	27.7	20.1	38.5	27.5	25.1	28.5	27
Depreciation	98	98	101	104	138	165	191	297	598
Interest	32	35	13	20	40	69	87	80	215
Other Income	11	8	25	27	10	12	16	44	65
<b>PBT</b>	<b>313</b>	<b>326</b>	<b>381</b>	<b>394</b>	<b>470</b>	<b>322</b>	<b>281</b>	<b>1,019</b>	<b>1,467</b>
Tax	98	91	89	113	160	107	95	279	475
Effective Tax Rate (%)	31.3	28.0	23.5	28.8	34.0	33.3	33.6	27.3	32
Reported PAT	<b>215</b>	<b>234</b>	<b>291</b>	<b>281</b>	<b>310</b>	<b>215</b>	<b>187</b>	<b>740</b>	<b>992</b>
<b>Adj. PAT</b>	<b>215</b>	<b>234</b>	<b>291</b>	<b>281</b>	<b>310</b>	<b>215</b>	<b>187</b>	<b>740</b>	<b>992</b>
Change (%)	190.1	358.6	294.1	37.0	44.6	-8.4	-35.9	NA	NA

E: MOSSt Estimates; # Standalone numbers; \* Results are for nine months ended Dec'05

## Segmental results

During 2QCY06, GHCL's textiles and soda ash business registered 34% YoY and 26% YoY increase respectively. Soda ash EBIT margins improved substantially by 860bp YoY to 37%. Textile division performance was negatively impacted by start-up costs in the home textiles division; as a result, EBIT declined by almost 60% YoY to Rs12m.

### SEGMENT REVENUE (RS MILLION)

	2QFY06	1QFY05	% CH.
- Inorganic Chemicals	1346	1073	26
- Textiles	340	254	34
- Others	113	65	75
Less: Inter segment sales	-142	0	-

### Segment PBIT

- Inorganic Chemicals	501	308	63
- Textiles	12	29	-60
- Others	3	12	-70

### EBIT (%)

- Inorganic Chemicals	37	29	30
- Textiles	3	12	-70
- Others	3	18	-83

Source: Company/ Motilal Oswal Securities

## Soda ash business

Soda ash business witnessed 16% YoY volume growth and 8% YoY value growth. Exports declined by nearly 22% YoY, while domestic volumes increased by 21% YoY. Domestic soda ash margins are higher versus the exports markets due to better realizations and lower freight costs. The sharp increase in domestic soda ash was primarily due to labor problems at the Nirma plant during 2QCY06.

### BREAK-UP OF SODA ASH SALES (RS M)

SODA ASH	2QFY06	1QFY05	% CH.
Volumes	132,974	114,805	16
Domestic	122,602	101,501	21
Exports	10,372	13,304	-22
Value	1,346	1,073	26
Realizations (Rs/MT)	10,124	9,344	8

Source: Company/ Motilal Oswal Securities

## The Rosebys acquisition

During the quarter, GHCL acquired 100% stake in a UK-based retail company, Rosebys for a consideration of Rs1.8b (US\$40m). Rosebys has no debt on its books while it has

assets worth close to US\$18m. GHCL plans to fund this acquisition through the US\$80m FCCB that it had raised in FY06. Due diligence for the acquisition is likely to be completed by mid-July while the final closure is scheduled for completion by 31 July 2006.

Rosebys was established in 1925 as a market stall in Grimsby. It is currently one of UK's largest retailers of home furnishings with over 300 stores in the UK. The nearest competitor for Rosebys, besides departmental stores and superstores, is Dunelm with over 150 stores. Rosebys has strong presence in product categories such as bed linen and bedroom accessories, curtains and window dressing, bathroom textiles and accessories apart from other textile products. Rosebys' key financial data for the year ended CY2005 are:

### ROSEBYS KEY FINANCIAL DATA

PARTICULARS	US\$M
Sales	200
Gross Profits	33
GPM (%)	16.5
Operating Profit	9
OPM (%)	4.5

Source: Motilal Oswal Securities

GHCL had also recently acquired the third largest home textiles player, Dan River, USA for a consideration of US\$100m. The latest acquisition would enable GHCL to have significant presence in the two largest home textiles market of the US and EU, which collectively account for 60% of the global home textiles market. GHCL's low-cost manufacturing operations in India coupled with access to front-end retailing in the key global home textile markets of the US and EU will provide it with significant edge versus competitors.

We believe that GHCL would be able to expand EBITDA margins by shifting sourcing from UK to low-cost manufacturing countries and reduce overhead costs by shifting processes to India. However, we are awaiting more details to incorporate Rosebys financials with GHCL's consolidated financials. We believe, with this acquisition, GHCL would be able to consolidate and fully integrate its business model across the textile chain from the spinning and weaving stage to front-end retailing on a global scale.

### Textiles to grow at 170% CAGR over CY05-CY08

GHCL has recently acquired the US-based Dan River, the world's third-largest home textiles company. This acquisition gives GHCL a ready market for its 36m-meter home textiles processing plant, which began commercial production in April 2006. Further the acquisition would transform GHCL into one of the largest global home textile players. We expect GHCL's textile business to grow at 170% CAGR over CY05-CY08 to Rs22.4b. Dan River revenues should increase from Rs13.8b in CY06 to Rs16.4b in CY08.

### Further inorganic initiatives to contribute to growth

GHCL is considering further inorganic growth opportunities in both its soda ash and textile businesses. After having managed a foothold in the US market via the Dan River acquisition, it is aggressively targeting further acquisitions in the US retail space. Management has conveyed they are in an advanced stage of negotiations with certain retail companies in the US, which would allow GHCL to vertically integrate from yarn to the retail stage. We believe the company would acquire entities that would complement its existing service offerings and provide access to a wider target market. However, it is too early to factor any benefit of this event in our estimates.

### Revenues to grow at 88% CAGR over CY05-CY08

We model GHCL's consolidated revenues to increase from Rs5.1b in CY05 (9 months) to around Rs34.2b in CY08. This growth would be primarily led by contribution from its overseas subsidiaries. We expect its textiles business to increase at a CAGR of 170% from Rs1.1b in CY05 (9 months) to around Rs22.4b in CY08. Its textile sales as a percentage of the total revenues would increase from around 18% in CY05 to around 66% in CY08.

Revenues from Dan River would increase from Rs13.8b in CY05 (9 months) to around Rs16.5b in CY08. Soda ash revenues are likely to grow at a CAGR of 50% from Rs3.4b in CY05 (9 months) to Rs11.5b in CY08. Revenues from its Romanian subsidiary, SC Bega Upsom SA, are likely to post 14% CAGR (CY06-08) to Rs5b in CY08 from Rs3.8b currently.

#### REVENUE BREAK-UP (RS M)

	DEC'05 *	CY06E	CY07E	CY08E
Soda Ash	3,446	4,923	6,118	6,566
Cotton Yarns	1,132	851	1,175	1,459
Salt Refined	108	156	165	175
Home Textiles		2,232	4,185	4,464
ITES	425#		-	-
Others	54	79	87	96
<b>Total</b>	<b>5,165</b>	<b>8,241</b>	<b>11,730</b>	<b>12,760</b>
Dan River	-	13,795	15,700	16,454
Romanian Sub	-	3,847	4,645	5,000
<b>Consolidated Total</b>	<b>5,165</b>	<b>25,883</b>	<b>32,075</b>	<b>34,214</b>

Source: Company/ Motilal Oswal Securities

\* 9 months; # The company plans to exit ITES business

### Valuations and view

GHCL is witnessing positive momentum in both its core businesses – soda ash and textiles. In textiles, it is all set to transform from a small yarn manufacturer to the third largest home textiles player in the world. Its soda ash business is also witnessing positive momentum, backed by the global industry upturn. Post the consolidation of its overseas subsidiaries, we expect robust growth in revenues and profits. We expect consolidated revenues and net profit to grow at CAGR of 88% and 53% respectively, over CY05-CY08. The stock is trading at attractive valuations of 7.1x CY07E EPS and 4.8x CY07E EV/EBITDA. We maintain **Buy**. Our SOTP-based target price of Rs223.

## Gujarat Heavy Chemicals: an investment profile

### Company description

Gujarat Heavy Chemicals (GHCL) was promoted in 1987 by the GIIC and the Dalmia group (through GTC Industries and Dalmia Dairy Corporation). GHCL has two core businesses – soda ash and textiles. Historically, soda ash has accounted for a majority of GHCL's consolidated revenues – 74% in FY05.

### Key investment arguments

- ✍ The soda ash industry is on an upturn globally. GHCL thereby stands to benefit significantly.
- ✍ GHCL to transform from a small yarn manufacturer to one of the largest global home textile players.
- ✍ Its strategic acquisitions, we believe, would allow the company to achieve strong inorganic growth.

### Key investment risks

- ✍ Failure to effectively manage the turnaround of its acquisitions could have an adverse impact.
- ✍ Import duty on soda ash cut in the Union Budget 2006-2007 to 12.5% from 15%.
- ✍ GHCL has set up a 36m-meter processing unit for home textiles. However, it lacks experience in this segment.

### Recent developments

- ✍ During the quarter, it acquired 100% stake in an UK-based retail company, Rosebys for a consideration of Rs1.8b (US\$40m). It also managed to successfully turn its Romanian soda ash business EBITDA positive.

### Valuation and view

- ✍ We expect consolidated revenues and net profit to grow at 88% CAGR and 53% CAGR, respectively over CY05-CY08.
- ✍ The stock quotes at attractive valuations of 10x CY07E EPS and 6x CY07E EV/EBITDA.
- ✍ We maintain **Buy**. Our SOTP-based target price of Rs223 implies an upside of 20.5%.

### Sector view

- ✍ The Asian region is also the fastest growing market – 7% CAGR v/s 5% CAGR for the world. In Asia, India trails China, which alone accounts for nearly 80% capacity.
- ✍ Globally, the soda ash industry is operating at high rates of 90%-99%.
- ✍ McKinsey estimates the global home textiles market to increase at 18% CAGR (CY04-CY10) to US\$23b in CY10 from US\$8.6b.

#### COMPARATIVE VALUATIONS

		GHCL	TATA CHEM	ALOK INDUS
P/E (x)	FY07E	19.1	11.4	7.1
	FY08E	7.1	9.7	5.3
P/BV (x)	FY07E	2.4	2.0	4.6
	FY08E	1.9	1.8	0.8
EV/Sales (x)	FY07E	1.0	1.1	27.5
	FY08E	0.8	0.9	1.5
EV/EBITDA (x)	FY07E	9.5	6.1	0.9
	FY08E	4.7	4.7	6.2

#### SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	44.3	44.3	44.3
Domestic Institutions	10.8	5.3	10.0
FII's/FDIs	8.4	4.7	3.5
Others	36.5	45.8	42.3

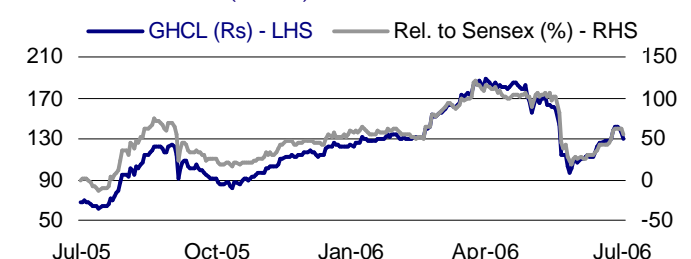
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
CY06	6.8	6.2	9.7
CY07	18.4	10.0	84.0

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
130	223	71.5	Buy

#### STOCK PERFORMANCE (1 YEAR)



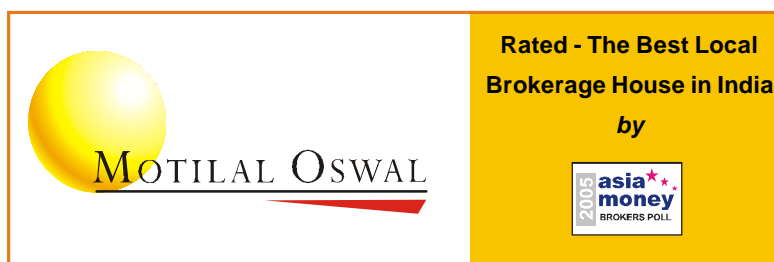
INCOME STATEMENT				
(RS MILLION)				
Y/E DECEMBER	2005E*	CY06E	CY07E	CY08E
<b>Net Sales</b>	<b>5,165</b>	<b>25,883</b>	<b>32,075</b>	<b>34,214</b>
Change (%)	-8.7	357.6	23.9	6.7
Total Expenditure	3,792	23,211	26,881	28,45
<b>EBITDA</b>	<b>1,372</b>	<b>2,671</b>	<b>5,193</b>	<b>5,799</b>
Change (%)	41.0	94.6	94.4	11.7
% of Net Sales	26.6	10.3	16.2	17.0
Depreciation	333	858	1,051	1,122
<b>EBIT</b>	<b>1,039</b>	<b>1,813</b>	<b>4,142</b>	<b>4,677</b>
	<b>20</b>	<b>7</b>	<b>13</b>	<b>14</b>
Interest & Finance Charges	89	727	701	691
Other Income	47	65	65	65
<b>PBT</b>	<b>998</b>	<b>1,152</b>	<b>3,506</b>	<b>4,051</b>
Tax	304	387	1,179	1,362
Effective Rate (%)	30.5	33.6	33.6	33.6
<b>PAT before MI</b>	<b>693</b>	<b>764</b>	<b>2,328</b>	<b>2,689</b>
Minority Interest	8	-15	230	211
<b>PAT after MI</b>	<b>685</b>	<b>779</b>	<b>2,098</b>	<b>2,478</b>
Change (%)	127.0	13.8	169.1	18.1
<b>Adjusted PAT</b>	<b>685</b>	<b>779</b>	<b>2,098</b>	<b>2,478</b>

BALANCE SHEET				
(RS MILLION)				
Y/E DECEMBER	2005E*	CY06E	CY07E	2008E
Equity Capital	951	1,141	1,141	1,141
Share Capital	951	1,141	1,141	1,141
Reserves	1,809	4,998	6,705	8,793
<b>Net Worth</b>	<b>2,760</b>	<b>6,139</b>	<b>7,846</b>	<b>9,934</b>
Loans	7,850	11,050	10,166	8,336
Deferred Tax Liability	810	1,003	1,239	1,512
Minority Interest	3	-12	218	429
<b>Capital Employed</b>	<b>11,423</b>	<b>18,181</b>	<b>19,470</b>	<b>20,211</b>
Gross Fixed Assets	9,929	14,179	16,679	18,679
Less: Depreciation	3,940	4,798	5,849	6,971
<b>Net Fixed Assets</b>	<b>5,989</b>	<b>9,381</b>	<b>10,830</b>	<b>11,708</b>
Capital WIP	57	57	57	57
Investments	4,200	4,500	4,500	4,500
<b>Curr. Assets</b>	<b>2,499</b>	<b>9,323</b>	<b>10,352</b>	<b>11,341</b>
Inventory	727	3,816	4,419	4,671
Sundry Debtors	637	2,978	3,691	3,937
Cash & Bank Balances	376	691	313	514
Loans & Advances & Other Cu	759	1,838	1,930	2,219
<b>Current Liab. &amp; Prov.</b>	<b>1,413</b>	<b>5,162</b>	<b>6,344</b>	<b>7,461</b>
Sundry Creditors	497	3,918	4,556	4,781
Other Liabilities	653	849	1,274	1,911
Provisions	263	395	513	770
<b>Net Current Assets</b>	<b>1,086</b>	<b>4,161</b>	<b>4,009</b>	<b>3,880</b>
Misc Exp	91	82	74	66
<b>Application of Funds</b>	<b>11,423</b>	<b>18,181</b>	<b>19,470</b>	<b>20,211</b>

E: M OSt Estimates

RATIOS				
Y/E DECEMBER	2005E*	CY06E	CY07E	2008E
<b>Basic (Rs)</b>				
<b>EPS</b>	<b>7.2</b>	<b>6.8</b>	<b>18.4</b>	<b>21.7</b>
Cash EPS	10.7	14.3	27.6	31.6
Book Value per Share	29.0	53.8	68.8	87.1
DPS	2.0	2.0	3.0	3.0
Payout (Incl. Div. Tax) %	27.4	29.9	14.7	12.7
<b>Valuation (x)</b>				
P/E	18.2	19.1	7.1	6.0
Cash P/E	12.2	9.1	4.7	4.1
EV/EBITDA	16.3	9.5	4.8	3.9
EV/Sales	4.3	1.0	0.8	0.7
Price to Book Value	4.5	2.4	1.9	1.5
Dividend Yield (%)	15	15	2.3	2.3
<b>Profitability Ratios (%)</b>				
RoE	27.1	17.5	30.0	27.9
RoCE	12.5	12.3	22.0	23.6
<b>Turnover Ratios</b>				
Debtors (Days)	45	42	42	42
Inventory (Days)	70	60	60	60
Creditors (Days)	125	85	85	85
Working Capital (Days)	77	59	46	41
Asset Turnover (x)	0.5	1.4	1.6	1.7
Fixed Asset Turnover (x)	0.5	1.8	1.9	1.8
<b>Leverage Ratio</b>				
Debt/Equity (x)	2.8	1.8	1.3	0.8

CASH FLOW STATEMENT				
(RS MILLION)				
Y/E DECEMBER	2005E*	CY06E	CY07E	2008E
<b>PBT before EO Items</b>	<b>950</b>	<b>1,087</b>	<b>3,441</b>	<b>3,986</b>
Add : Depreciation	333	858	1,051	1,122
Interest /Div Rec	47	65	65	65
Less: Direct Taxes Paid	321	226	991	1,138
(Inc)/Dec in WC	-43	2,760	226	-330
<b>CF from Operations</b>	<b>1,053</b>	<b>-976</b>	<b>3,341</b>	<b>4,366</b>
Minority Interest & share of as	8	-15	230	211
<b>CF from Op. incl. EO Item</b>	<b>1,045</b>	<b>-961</b>	<b>3,111</b>	<b>4,155</b>
(Inc)/dec in FA	-2,489	-4,250	-2,500	-2,000
(Pur)/Sale of Investments	-4,095	-300	0	0
<b>CF from Investments</b>	<b>-6,584</b>	<b>-4,550</b>	<b>-2,500</b>	<b>-2,000</b>
(Inc)/Dec in Shares	0	3,328	0	0
(Inc)/Dec in Debt	5,721	3,185	-654	-1,619
Less: Dividend Paid	-217	-228	-342	-342
<b>CF from Fin. Activity</b>	<b>5,576</b>	<b>5,826</b>	<b>-989</b>	<b>-1,954</b>
<b>Inc/Dec of Cash</b>	<b>37</b>	<b>315</b>	<b>-378</b>	<b>201</b>
Add: Beginning Balance	339	376	691	313
<b>Closing Balance</b>	<b>376</b>	<b>691</b>	<b>313</b>	<b>514</b>



For more copies or other information, contact  
**Institutional:** Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari  
 Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

**Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021**

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

**Disclosure of Interest Statement**

**Gujarat Heavy Chemicals**

- |   |    |
|---|----|
| 1. Analyst ownership of the stock                       | No |
| 2. Group/Directors ownership of the stock               | No |
| 3. Broking relationship with company covered            | No |
| 4. Investment Banking relationship with company covered | No |

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