

IPCL

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,450	IPCL IN
	REUTERS CODE
S&P CNX: 2,871	IPCL.BO

19 January 2006

Buy
Previous Recommendation: Buy
Rs257

Equity Shares (m)	249.1
52-Week Range (Rs)	272/156
1,6,12 Rel. Perf. (%)	14/9/0
M.Cap. (Rs b)	64.0
M.Cap. (US\$ b)	1.4

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
03/05A	81,991	7,859	31.6	187.3	8.1	2.2	30.3	26.0	0.9	4.5
03/06E*	85,113	9,075	36.4	15.5	7.1	1.7	27.4	32.9	0.7	3.6
03/07E	85,168	10,995	44.1	21.2	5.8	1.4	26.2	35.4	0.6	2.5

* FY06 PAT net of extraordinary

- IPCL reported Rs2.3b net profit, up 20.6% YoY but below expectation. Profit growth was driven by 11.2% YoY growth in sales.
- Sales grew on the back of 15.8% YoY growth in volumes; realizations fell 4.6% YoY. While LAB prices were up 15.1% YoY, PE & PP prices were down marginally. However, PVC and MEG were down sharply by 16% and 29% YoY respectively, lowering average realizations.
- However, product prices have improved, with January prices comparing favorably YoY, except for MEG and PVC. 4QFY06 volume growth versus the previous quarters too, is expected to be strong due to de-stocking, given the large inventory build-up over the last three quarters. Performance is on track; will likely better our FY06 estimates.
- The stock trades at 5.8x FY07E EPS (at a 25% discount to regional players) and EV/EBITDA of 2.5x FY07E compared with Reliance's core business EV/EBITDA of 4.7x FY07E. We believe, the gap will narrow significantly. We reiterate our **Buy** recommendation with a target price of Rs350/share (based on 8x FY07E EPS), an upside of 36.1% from current levels.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	18,100	18,190	19,270	26,430	19,830	20,450	21,430	23,403	81,990	85,113
Change (%)	33.6	35.2	-30.6	0.9	9.6	12.4	11.2	-11.5	1.2	3.8
Change in stocks	-210	-1,880	-2,270	4,330	-280	-990	-1,030	2,300	-30	0
Raw Material Consumed	8,390	9,050	10,100	9,930	8,990	10,590	11,460	8,081	37,470	39,121
Staff Cost	1,040	1,080	1,140	1,340	910	910	900	1,981	4,600	4,701
Other Expenses	5,570	6,250	6,360	5,530	5,990	5,760	5,860	6,401	23,710	24,011
EBITDA	3,310	3,690	3,940	5,300	4,220	4,180	4,240	4,639	16,240	17,279
% of Net Sales	18.3	20.3	20.4	20.1	21.3	20.4	19.8	19.8	19.8	20.3
% Change	47.8	22.2	25.1	71.5	27.5	13.3	7.6	-12.5	55.2	6.4
Depreciation	1,120	1,130	1,150	1,660	1,160	1,160	1,190	1,364	5,060	4,874
Interest	470	520	340	290	290	310	270	266	1,620	1,136
Other Income	230	330	370	-230	400	340	360	413	700	1,513
PBT	1,950	2,370	2,820	3,120	3,170	3,050	3,140	3,421	10,260	12,781
Tax	720	990	930	-240	920	876	860	1,051	2,400	3,707
Rate (%)	36.9	41.8	33.0	-7.7	29.0	28.7	27.4	30.7	23.4	29.0
Adjusted PAT	1,230	1,380	1,890	3,360	2,250	2,174	2,280	2,370	7,860	9,075
Change (%)	215.4	155.6	133.3	239.4	82.9	57.6	20.6	-29.5	187.9	15.5
Reported PAT	1,230	1,380	1,890	3,360	2,250	3,030	2,280	2,370	7,860	9,930

E: MOST Estimates

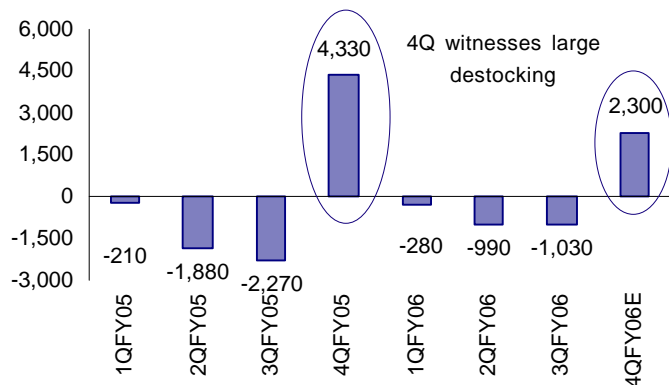
Varatharajan S (Varatharajan@MotilalOswal.com); Tel: +91 22 3982 5413

Results marginally below expectation

IPCL reported net profit of Rs2.3b, up 20.6% YoY. Growth in net profit was on account of 11.2% sales growth. Sales growth was driven primarily by 15.8% volume growth, while realizations dropped 4.6% YoY.

Lower-than-expected PAT (8% variance) was on account of lower-than-expected sales, partly on account of inventory build (though sales volume was higher YoY) and partly due to large exports of MEG, where realizations would have been lower versus domestic sales. IPCL is building inventory, like in FY05, though lower in magnitude. While we expected a drawdown of inventory in 3QFY06, weaker-than-expected polymer demand led to inventory addition. As a result, sales volume was lower than our forecast. Also, commissioning of SM Dyechem’s 80,000 tpa of MEG capacity (now owned by RIL) has led to a temporary surplus of MEG in the domestic market, leading to IPCL exporting this product.

INVENTORY CHANGES- (INCREASE)/DECREASE IN INVENTORY (RS M)



Source: Company/Motilal Oswal Securities

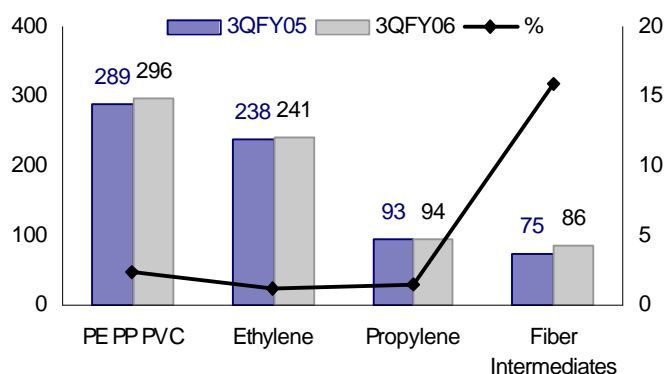
However, performance is well on track to achieve our FY06 forecasts. 4QFY06 could provide a positive surprise on the back of large de-stocking, while commissioning of RIL’s polyester capacity expansion would absorb the surplus MEG leading to possible QoQ improvement in average MEG realizations.

Sales and production volumes higher

Sales volume growth YoY (as well as QoQ) was the primary driver of sales growth. Sales volume is up 15.8% YoY (3.4% QoQ), despite inventory build. This is a function of the base effect (larger inventory build in 3QFY05) and higher production YoY. Quarterly financials indicate inventory change (addition) of Rs1b compared with Rs2.3b last year.

Fiber intermediate production is sharply higher by 15.8% YoY, while polymer production is up 2.4% YoY.

IPCL PRODUCTION VOLUMES (IN '000 TONS)



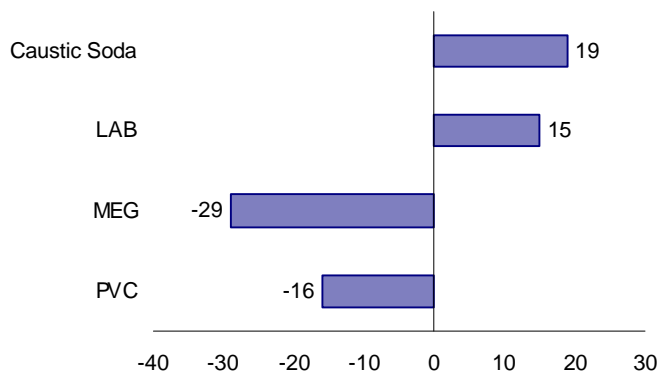
Source: Company/Motilal Oswal Securities

Sales realization was down marginally

On the price front, average realization is down 4.6% YoY. This was primarily on account of PVC and MEG, which were down sharply by 16% and 29% YoY respectively, drawing down average realizations. PE & PP prices are down marginally. However, LAB prices are up 15.1% YoY, while caustic soda is up 10%-19% YoY cushioning the decline in realizations.

However, Asian prices have been up sharply over the last few weeks, quoting well ahead of our forecast, especially PE & PP, which could contribute to a strong 4QFY06.

SELLING PRICE: YOY PERCENTAGE CHANGE IN PRICE

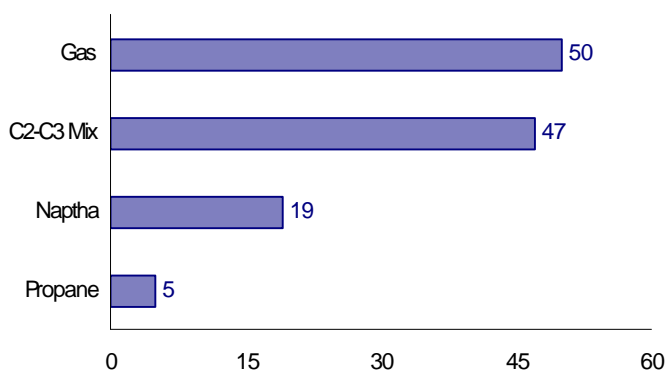


Source: Company/Motilal Oswal Securities

Feedstock cost increase squeezes margins

The EBITDA margin has dropped by 60bp YoY to 19.8% due to higher feedstock prices. Prices are up YoY, thanks to higher crude prices and deregulation of domestic gas prices. While naphtha is up 19% YoY, propane is up 5% YoY and C2C3, by 47% YoY (in line with natural gas price increase). IPCL reported an increase in natural gas price of over 50% YoY. However, procurement of a small volume from PMT (Panna, Mukta and Tapti) to replace the high-cost imported propane (with effect from mid-1QFY06) would have set off a part of the negative impact of the natural gas price increase.

FEEDSTOCK PRICE: YOY PERCENTAGE CHANGE IN PRICE



Source: Company/Motilal Oswal Securities

Feedstock cost savings in FY07

The negative impact of the recent natural gas price increase would be more than set off starting 2QFY06, when additional

gas from PMT, would eliminate the high-cost propane imports. Reliance confirmed in its recent analyst meet that additional development at PMT is on schedule for completion in June 2006.

The additional gas supply also removes a critical growth constraint. We believe, significant capacity expansion plans could be round the corner.

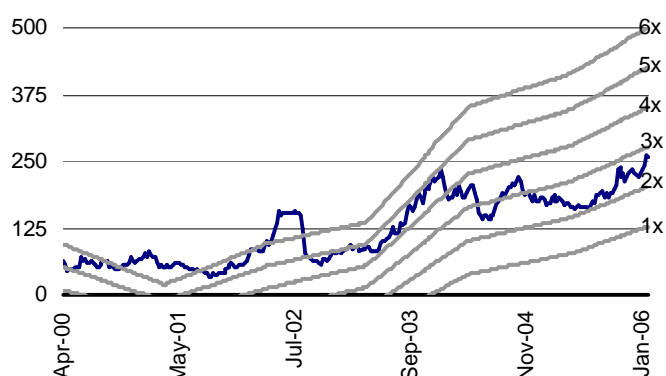
Gas cracker economics superior to naphtha

The sharp spike in crude prices and relatively stable Indian (deregulated) gas prices has led to gas cracker economics in India being superior to naphtha crackers. We believe, this advantage is not likely to disappear in the medium term, unless crude corrects sharply to levels below US\$45/bbl.

Valuation at a discount to regional and domestic peers

The stock trades at 5.8x FY07E EPS (at a discount of 25% to regional players) and EV/EBITDA of 2.5x FY07E compared with Reliance's core business EV/EBITDA of 4.7x FY07E. We believe the valuation gap should narrow significantly, given the fact that both companies are largely present in the same commodities and are under the same management. We reiterate our **Buy** recommendation with a target price of Rs350/share (based on 8x FY07E EPS) and an upside of 36% from current levels. Consensus estimates have been pessimistic and we believe, significant upgrades are likely, as confirmation of the continuing petrochemical up-cycle filters down.

ROLLING EV/EBITDA (X)



IPCL: an investment profile

Company description

IPCL is the second largest player in the petrochemicals industry in India after Reliance. It is the largest integrated PVC player, largest PE producer and second largest MEG producer. It also has the largest ethylene capacity. Low operating rates and high cost borrowings affected performance under the previous management. However, currently operating rates are considerably higher than nameplate capacity, propane imports supplement gas, and total debt as well as cost of debt has fallen significantly.

Key investment arguments

- ✍ Pure petrochemical cycle play
- ✍ While feedstock cost is set to decline, petrochemical prices are recovering
- ✍ Gas cracker economics are now superior to naphtha cracker

Key investment risks

- ✍ Weaker-than-expected global demand growth leading to a muted petrochemical cycle improvement.

Recent developments

- ✍ Domestic gas prices have been raised recently, with delivered price of gas ranging from US\$4-4.8/mmbtu
- ✍ The merger with Reliance has been put off for the next two years, thus removing a big concern that was affecting IPCL's stock performance.

Valuation and view

- ✍ The stock trades at 5.8x FY07E EPS (at a discount of 25% to regional players) and EV/EBITDA of 2.5x FY07E compared with Reliance's core business EV/EBITDA of 4.7x FY07E.
- ✍ We believe the valuation gap should narrow, given the fact that both companies are largely present in the same commodities and are under the same management.
- ✍ We reiterate our **Buy** recommendation with a target price of Rs350/share (based on 8x FY07E EPS) and an upside of 36%

Sector view

- ✍ Upcycle expected to continue over the next 18-24 months, as demand growth outpaces capacity addition.

COMPARATIVE VALUATIONS

		IPCL	RELIANCE
P/E (x)	FY06E	7.1	10.5
	FY07E	5.8	9.5
P/BV (x)	FY06E	1.7	3.4
	FY07E	1.4	2.6
EV/Sales (x)	FY06E	0.7	1.5
	FY07E	0.6	1.4
EV/EBITDA (x)	FY06E	3.6	7.8
	FY07E	2.5	6.4

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	46.0	46.0	46.0
Domestic Institutions	15.0	15.8	14.3
FII's/FDIs	13.3	11.8	14.0
Others	25.7	26.4	25.7

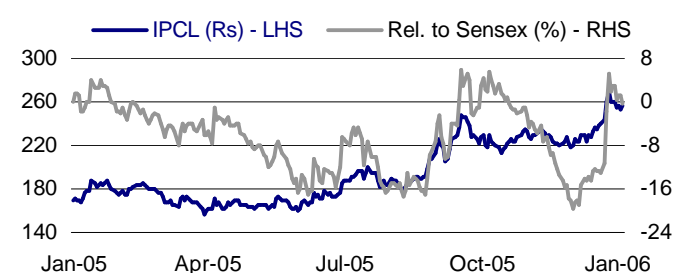
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	36.4	27.8	30.7
FY07	44.1	24.0	83.8

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
257	350	36.1	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E*	2007E	2008E
Net Sales	80,978	81,991	85,113	85,168	83,061
Change (%)	610	13	3.8	0.1	-2.5
Raw Materials Cons	23,967	36,839	39,121	37,468	36,440
Stores and Spares, Purchases	25,982	6,138	5,673	5,058	5,284
Sales and Distribution Exp	3,469	3,053	3,022	2,992	3,052
Employee Costs	5,338	5,224	4,701	5,224	5,642
Other Expenditure	10,865	15,153	15,316	15,337	15,968
EBITDA	10,061	15,615	17,279	19,089	16,676
% of Net Sales	12.4	19.0	20.3	22.4	20.1
Depreciation	4,716	5,057	4,874	4,999	5,121
Interest	2,992	1,620	1,136	288	0
Other Income	1,013	1,322	1,513	1,904	3,511
PBT	3,366	10,259	12,781	15,707	15,066
Tax	630	2,400	3,707	4,712	4,520
Rate (%)	18.7	23.4	29.0	30.0	30.0
PAT	2,736	7,859	9,075	10,995	10,546
Change (%)	4.9	187.3	15.5	21.2	-4.1

* FY06 PAT net of extraordinary

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Share Capital	2,491	2,491	2,491	2,491	2,491
Reserves	20,231	26,720	34,530	44,261	53,964
Net Worth	22,721	29,211	37,021	46,751	56,455
Long Term Loans	17,499	11,801	5,750	750	750
Short Term Loans	9,441	736	0	0	0
Deferred Tax	9,672	11,012	12,929	15,285	17,545
Capital Employed	59,333	52,759	55,700	62,787	74,750
Gross Fixed Assets	96,469	97,858	100,241	102,531	104,826
Less: Depreciation	42,611	47,809	52,683	57,682	62,803
Net Fixed Assets	53,858	50,049	47,558	44,850	42,024
Capital WIP	807	588	500	500	500
Investments	1,512	1,653	1,653	1,653	1,653
Curr. Assets, L & Adv.					
Inventory	7,731	6,231	6,169	6,019	5,885
Debtors	4,968	7,011	7,952	7,957	7,760
Cash & Bank Balance	506	6,649	8,071	17,314	31,908
Loans & Adv. and Other Assets	4,205	4,566	4,292	4,292	4,292
Current Liab. & Prov.					
Liabilities	11,598	19,995	18,456	17,524	17,194
Provisions	2,656	3,994	2,037	2,273	2,078
Net Current Assets	3,155	468	5,989	15,784	30,573
Misc. Expenses	1	0	0	0	0
Application of Funds	59,333	52,758	55,700	62,787	74,750

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
EPS	11.0	31.6	36.4	44.1	42.3
Cash EPS	29.9	51.9	56.0	64.2	62.9
Book Value	91.2	117.3	148.6	187.7	226.7
Gross DPS	2.5	4.5	4.5	4.5	3.0
Payout	22.7	14.2	12.4	10.2	7.1
Valuation (x)					
P/E		8.1	7.1	5.8	6.1
Cash P/E		5.0	4.6	4.0	4.1
EV / EBITDA		4.5	3.6	2.5	2.0
EV / Sales		0.9	0.7	0.6	0.4
Price / Book Value		2.2	1.7	1.4	1.1
Dividend Yield (%)		1.7	1.8	1.8	1.2
Profitability Ratios (%)					
RoE	12.0	30.3	27.4	26.2	20.4
RoCE	11.4	26.0	32.9	35.4	28.8
Turnover Ratios					
Debtors (No. of Days)					
Fixed Asset Turnover (x)	15	16	18	19	2.0
Leverage Ratio					
Net Debt / Equity (x)	10	0.1	-0.1	-0.3	-0.5

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
OP/(Loss) before Tax	10,061	15,615	17,279	19,089	16,676
Interest Paid	-2,992	-1,620	-1,136	-288	0
Direct Taxes Paid	-70	-1,060	-1,789	-2,356	-2,260
(Inc)/Dec in Wkg. Capital	5,882	8,830	-4,099	-551	-195
CF from Op. Activity	12,881	21,764	10,254	15,894	14,221
Others	-2,029	-254	-143	-143	-96
(Inc)/Dec in FA & CWIP	1,652	-1,029	-2,295	-2,290	-2,295
(Pur)/Sale of Investments	-627	-141	0	0	0
Inc from Invst	1,013	1,322	1,513	1,904	3,511
CF from Inv. Activity	2,037	151	-782	-387	1,216
Issue of Shares	0	0	0	0	0
Inc / (Dec) in Debt	-11,973	-14,404	-6,786	-5,000	0
Dividends Paid (incl. tax)	-621	-1,117	-1,121	-1,121	-747
CF from Fin. Activity	-12,593	-15,521	-7,907	-6,121	-747
Inc / (Dec) in Cash	295	6,141	1,422	9,243	14,594
Add: Opening Balance	211	507	6,648	8,071	17,314
Closing Balance	507	6,648	8,070	17,314	31,908



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

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	IPCL
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	Yes
3. Broking relationship with company covered	No

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