

IPCL

STOCK INFO.	BLOOMBERG
BSE SENSEX: 10,007	IPCL IN
	REUTERS CODE
S&P CNX: 2,933	IPCL.BO

19 July 2006

Buy
Previous Recommendation: Buy
Rs241

Equity Shares (m)	249.1
52-Week Range (Rs)	299/178
1,6,12 Rel. Perf. (%)	-8/-12/-7
M.Cap. (Rs b)	60.1
M.Cap. (US\$ b)	1.3

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/06A	84,690	9,195	36.9	17.0	6.5	1.6	27.7	33.3	0.7	3.3
03/07E	84,838	10,613	42.6	15.4	5.7	1.3	25.4	36.0	0.5	2.3
03/08E	80,371	10,467	42.0	-1.4	5.7	1.1	20.4	28.7	0.4	1.8

- ✍ PAT at Rs2.9b, was up 29.3% YoY, in line with our forecast; EBITDA at Rs5.2b, up 22.7% YoY was also in line. Profit growth was driven by a 21.8% YoY growth in sales (14% volume growth and 8% price increase) and improvement in key product margins.
- ✍ Reported sales is higher than our forecast as part of the inventory destocking we had indicated as swing factor materialised. However, gains from higher volume could have been compromised by the timing of de-stocking (April 2006) when prices dropped. Higher staff cost due to additional charge of Rs40m too would have offset part of the gains from de-stocking.
- ✍ Key product margins improved. While PE, PP, ACN margins improved, we estimate PVC and MEG margins dropped. PE, PP, ACN and LAB margins improved on account of price increase (11.8%, 7.4% and 4.1% for PE, PP and LAB respectively), even as feedstock prices, especially propane and domestic gas prices lagged. However, a fall in PVC and MEG prices (by 5.1% and 11.5% respectively) would have set off part of the gains.
- ✍ Continued strength in product prices (on the back of rising crude prices) could drive positive earnings surprise for FY07. Possible substitution of high cost imported propane with domestic gas from PMT (Panna Mukta Tapti) in FY08 could drive earnings growth.
- ✍ Stock trades at a P/E of 5.7x FY08E and 1.8x EV/EBITDA. In comparison, Reliance's core business EV/EBITDA is 5.5x FY08E. We believe, the gap would have to narrow. We reiterate our **Buy** recommendation with a target price of Rs312/share, upside of 29.5%.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY 06				FY 07				FY 06	FY 07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Net Sales	19,830	20,450	21,430	22,980	24,150	20,845	20,200	19,642	84,690	84,837
Change (%)	9.6	12.4	11.2	-13.1	21.8	1.9	-5.7	-14.5	3.3	0.2
Change in Stocks	-280	-990	-1,030	-110	1,590	-1,000	-500	-90	-2,410	0
Raw Material Consumed	8,990	10,590	11,460	11,270	11,100	10,000	9,500	7,747	42,310	38,347
Staff Cost	910	910	900	970	1,070	1,000	1,000	1,280	3,690	4,350
Other Expenses	5,990	5,760	5,860	5,970	5,210	5,990	5,950	6,356	23,580	23,506
EBITDA	4,220	4,180	4,240	4,880	5,180	4,855	4,250	4,349	17,520	18,634
% of Net Sales	21.3	20.4	19.8	21.2	21.4	23.3	21.0	22.1	20.7	22.0
Change (%)	27.5	13.3	7.6	-7.9	22.7	16.1	0.2	-10.9	7.9	6.4
Depreciation	1,160	1,160	1,190	1,290	1,120	1,200	1,200	1,279	4,800	4,799
Interest	290	310	270	310	450	275	200	150	1,180	1,075
Other Income	400	340	360	260	600	600	600	600	1,360	2,400
PBT	3,170	3,050	3,140	3,540	4,210	3,980	3,450	3,521	12,900	15,161
Tax	920	876	860	1,050	1,300	1,194	1,015	1,039	3,706	4,548
Rate (%)	29.0	28.7	27.4	29.7	30.9	30.0	29.4	29.5	28.7	30.0
Adjusted PAT	2,250	2,174	2,280	2,490	2,910	2,786	2,435	2,481	9,194	10,612
Change (%)	82.9	57.6	20.6	-25.9	29.3	28.1	6.8	-0.3	17.0	15.4
Reported PAT	2,250	3,030	2,280	2,490	2,910	2,786	2,435	2,481	10,050	10,612

E: MOST Estimates

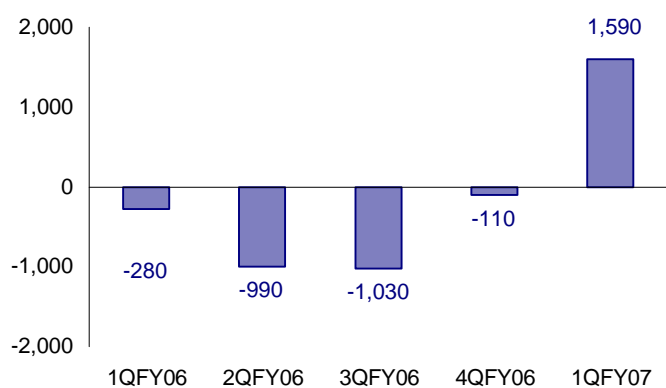
Results in line

PAT at Rs2.9b, was up 29.3% YoY, in line with our forecast; EBITDA at Rs5.2b, up 22.7% YoY was also in line. Profit growth was driven by a 21.8% YoY growth in sales (14% volume growth and 8% price increase) and improvement in key product margins. Reported sales is higher than our forecast as part of the inventory destocking we had indicated as swing factor materialised.

Volume growth driven by inventory de-stocking....

The inventory correction which was over due as indicated in our FY06 results note as well as 1QFY07 preview played out, driving 14% YoY sales volume growth, even as production volumes remained largely flat at 1.32m tons. In the coming quarters, sales volume is likely to revert back to normal levels (flat to marginal growth).

INCREASE/DECREASE INVENTORY: DE-STOCKED (RS M)



Source: Company/Motilal Oswal Securities

... but, contribution to profits minimal

While de-stocking drove sales volume growth, its contribution to profits appears limited. We believe the de-stocking was triggered by the drop in prices in the month of April 2006. This means, realizations were lower, while the weighted average inventory valuation methodology would indicate relatively higher cost of inventory, on the back of high cost of propane as well as rising naphtha prices between Jan-Mar 2006 period.

Also Rs40m higher employee cost on account of performance linked incentive payments to employees set off a major part of the inventory de-stocking profits.

Lower "other expenditure" due to lower excise duty provision

Other expenditure for the quarter was down sharply. Management indicates that it is on account of lower excise provision for excise duty on finished goods on account of de-stocking (inventory likely to have been maintained in depots and not in the factory, in which case, it would be excise paid material).

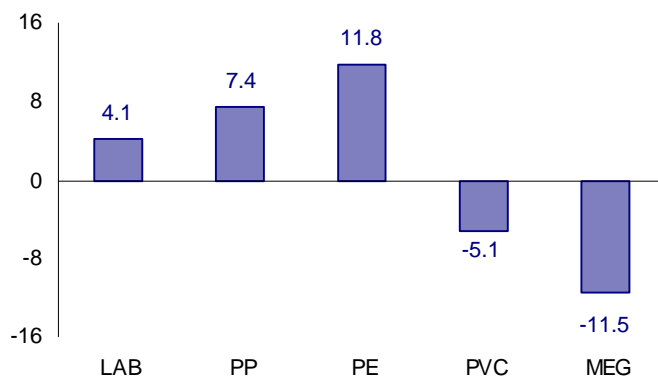
Margin expansion driven by key product prices

PE, PP, ACN, caustic and LAB margins improved on account of price increase. We estimate PE, PP and LAB prices were up 11.8%, 7.4% and 4.1% YoY respectively. However, a fall in PVC and MEG prices by 5.1% and 11.5% respectively would have set off part of the gains.

While feedstock price increase of 98%, 16% and 48% for gas, propane and c2-c3 mix was higher than product price increase, the absolute increase was still lower than product price gains, leading to margin expansion. IPCL has renewed its domestic gas contract at a higher price of US\$4.75/mmbtu compared to US\$3.86/mmbtu earlier.

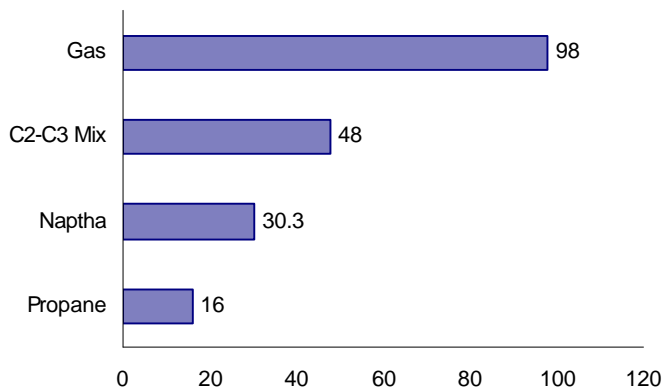
Significantly, propane prices have remained relatively subdued compared to crude as well as naphtha price increases.

SELLING PRICE: STRONG ON THE BACK OF HIGHER CRUDE PRICE (%)



Source: Company/Motilal Oswal Securities

FEEDSTOCK PRICE: STEEP INCREASE IN 1QFY07 (YOY - %)



Source: Company/Motilal Oswal Securities

Outlook: Continued product price strength could surprise positively

Product prices have further climbed over the last few weeks, with PE and PP prices hitting a historic high of US\$1250-1300/ton, driven by strong crude prices. The strong crude prices have further boosted the already significant relative advantage of gas based crackers vis-à-vis naphtha based crackers. In the case of IPCL, stable domestic gas price (contracted at US\$4.75/mmbtu for FY07) and relatively subdued propane prices could lead to sharp improvement in performance in the coming quarters, positively surprising the market.

The squeeze in margins over the last six months for naphtha based producers, further cushions gas based producers in

case of crude price weakness. Margin improvement for naphtha based producers is overdue and such an improvement could cushion any sharp decline in product prices, even if crude / naphtha fall.

Feedstock cost savings likely from PMT gas

We expect IPCL to contract additional volume of domestic gas from PMT (Panna, Mukta and Tapti). PMT is expected to increase production 5MMSCMD in FY08. This would replace high cost propane imports (currently supplementing domestic gas feed on account of short supply of domestic gas) to Gandhar. Similar substitution could also be expected at Nagothane on completion of Dahej-Uran pipeline, currently scheduled for February 2007 completion. The benefit from the substitution is expected to be between Rs3.3 - 5b per annum.

Valuation leaves room for upside

The stock trades at a P/E of 5.7x FY08E and EV/EBITDA of 1.8x FY08E compared with Reliance's core business EV/EBITDA of over 5.5x 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 Rs312/share (based on 8x FY07 estimated approximate EPS post merger) and an upside of 29.5% from current levels.

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
- ✍ Petrochemical prices are on the rise driven by strong crude prices, while gas feedstock is likely to be largely subdued.
- ✍ Advantage of gas cracker economics compared to naphtha cracker has further widened

Key investment risks

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

Recent developments

- ✍ IPCL has merged six polyester companies with itself leading to dilution of 15.7% in equity.

Valuation and view

- ✍ The stock trades at a P/E of 5.7x FY08E (standalone entity), and EV/EBITDA of 1.8x FY08E compared with Reliance's core business EV/EBITDA of 5.5x FY08E.
- ✍ 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 Rs312/share (based on 8x FY08E EPS) and an upside of 29.5%.

Sector view

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

COMPARATIVE VALUATIONS

		IPCL	RELIANCE
P/E (x)	FY07E	5.7	13.7
	FY08E	5.7	14.8
P/BV (x)	FY07E	2.3	9.2
	FY08E	1.8	9.0
EV/Sales (x)	FY07E	0.5	1.9
	FY08E	0.4	1.8
EV/EBITDA (x)	FY07E	1.3	3.8
	FY08E	1.1	3.1

SHAREHOLDING PATTERN (%)

	JUN.06	MAR.06	JUN.05
Promoters	46.0	46.0	46.0
Domestic Institutions	16.3	15.0	14.7
FII's/FDIs	14.4	13.3	14.4
Others	23.3	25.7	24.9

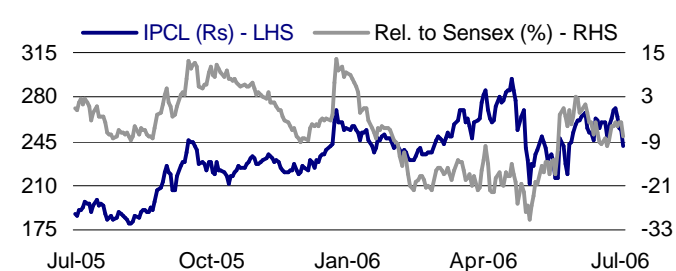
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	42.6	32.3	31.8
FY08	42.0	27.6	52.4

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
241	312	29.5	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006*	2007E	2008E
Net Sales	80,978	81,991	84,690	84,838	80,371
Change (%)	61.0	13	3.3	0.2	-5.3
Raw Materials Cons	23,967	36,839	39,121	38,347	35,404
Stores and Spares, Purchases	25,982	6,138	5,673	5,177	5,134
Sales and Distribution Exp	3,469	3,053	3,022	2,992	3,052
Employee Costs	5,338	5,224	4,701	4,350	4,698
Other Expenditure	10,865	15,153	14,652	15,337	15,969
EBITDA	10,061	15,615	17,520	18,634	16,115
% of Net Sales	12.4	19.0	20.7	22.0	20.1
Depreciation	4,716	5,057	4,800	4,799	5,121
Interest	2,992	1,620	1,180	1,075	0
Other Income	1,013	1,322	1,361	2,400	3,958
PBT	3,366	10,259	12,901	15,161	14,953
Tax	630	2,400	3,706	4,548	4,486
Rate (%)	18.7	23.4	28.7	30.0	30.0
PAT	2,736	7,859	9,195	10,613	10,467
Change (%)	4.9	187.3	17.0	15.4	-14

* FY06 PAT net of extraordinary

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
Share Capital	2,491	2,491	2,491	2,491	2,491
Reserves	20,231	26,720	34,651	43,999	53,623
Net Worth	22,721	29,211	37,141	46,490	56,114
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	12,947	15,222	17,465
Capital Employed	59,333	52,759	55,839	62,461	74,328
Gross Fixed Assets	96,469	97,858	100,241	102,531	104,826
Less: Depreciation	42,611	47,809	52,609	57,408	62,529
Net Fixed Assets	53,858	50,049	47,632	45,124	42,298
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	6,101	6,059	5,704
Debtors	4,968	7,011	7,912	7,926	7,509
Cash & Bank Balance	506	6,649	8,243	17,106	31,147
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	17,934	16,707
Provisions	2,656	3,994	2,037	2,265	2,068
Net Current Assets	3,155	468	6,054	15,184	29,877
Misc. Expenses	1	0	0	0	0
Application of Funds	59,333	52,758	55,839	62,461	74,328

E: M OSt Estimates

RATIOS					
Y/E MARCH	2004	2005	2006	2007E	2008E
Basic (Rs)					
EPS	11.0	31.6	36.9	42.6	42.0
Cash EPS	29.9	51.9	56.2	61.9	62.6
Book Value	912	117.3	149.1	186.7	225.3
Gross DPS	2.5	4.5	4.5	4.5	3.0
Payout	22.7	14.2	12.2	10.6	7.1
Valuation (x)					
P/E		7.6	6.5	5.7	5.7
Cash P/E		4.7	4.3	3.9	3.9
EV / EBITDA		4.2	3.3	2.3	1.8
EV / Sales		0.8	0.7	0.5	0.4
Price / Book Value		2.1	1.6	1.3	1.1
Dividend Yield (%)		1.9	1.9	1.9	1.2
Profitability Ratios (%)					
RoE	12.0	30.3	27.7	25.4	20.4
RoCE	11.4	26.0	33.3	36.0	28.7
Turnover Ratios					
Debtors (No. of Days)					
Fixed Asset Turnover (x)	15	16	18	19	19
Leverage Ratio					
Net Debt / Equity (x)	1.0	0.1	-0.1	-0.3	-0.5

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
OP/(Loss) before Tax	10,061	15,615	17,520	18,634	16,115
Interest Paid	-2,992	-1,620	-1,180	-1,075	0
Direct Taxes Paid	-70	-1,060	-1,771	-2,274	-2,243
(Inc)/Dec in Wkg. Capital	5,882	8,830	-3,992	-267	-653
CF from Op. Activity	12,881	21,764	10,577	15,019	13,220
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	1,361	2,400	3,958
CF from Inv. Activity	2,037	151	-934	109	1,663
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	1,593	8,864	14,040
Add: Opening Balance	211	507	6,648	8,243	17,106
Closing Balance	507	6,648	8,242	17,106	31,147



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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
4. Investment Banking relationship with company covered	No

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