



INDIA

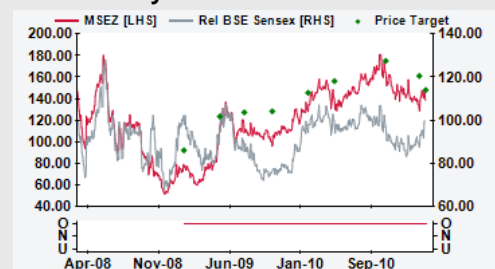
MSEZ IN Outperform
Price 28 Feb 11 Rs138.40

12-month target	Rs	148.00
Upside/Downside	%	6.9
Valuation	Rs	148.00
- Sum of Parts		
GICS sector	Transportation	
Market cap	Rsm	277,270
30-day avg turnover	US\$m	6.8
Market cap	US\$m	6,117
Number shares on issue	m	2,003

Investment fundamentals

Year end 31 Mar		2010A	2011E	2012E	2013E
Revenue	m	13,925	17,148	25,837	31,583
EBIT	m	8,019	9,788	15,308	19,321
EBIT growth	%	23.9	22.1	56.4	26.2
Adjusted profit	m	7,010	8,223	12,802	16,282
EPS adj	Rs	3.50	3.45	6.39	8.13
EPS adj growth	%	52.0	-1.5	85.3	27.2
PER adj	x	39.6	40.1	21.7	17.0
Total DPS	Rs	0.81	0.52	0.96	1.22
Total div yield	%	0.6	0.4	0.7	0.9
ROA	%	11.0	11.5	15.3	15.9
ROE	%	21.8	21.5	27.2	27.5
EV/EBITDA	x	30.7	25.1	16.5	13.3
Net debt/equity	%	65.9	46.7	39.2	20.3
P/BV	x	7.9	6.6	5.3	4.2

MSEZ IN rel BSE Sensex performance, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, February 2011 (all figures in INR unless noted)

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1 March 2011

Mundra Port & SEZ

Unexpected MAT hit

Event

- Union budget of India for FY12 has proposed to end the tax benefits available to special economic zones (SEZs). It proposes to tax developers of SEZ and units operating at SEZ at an MAT (minimum alternate tax) rate of 18.5%. The attractiveness for setting up new manufacturing units in SEZs declines.
- We view this event as negative for MSEZ. We reduce our target price from Rs161 to Rs148 to factor in a higher cash tax outgo and lower off-take of SEZ land following the new tax rules.

Impact

- Tax exemption for SEZ developers to end in FY12, to be charged MAT:** The current law (under section 80-IB) grants a tax exemption to profits earned from developing a SEZ for any ten consecutive years out of 15 years from the start of operations. The Indian budget for FY12 proposes taxing the SEZ's earnings at an MAT rate (20% effective rate). The cash tax outgo would, hence, increase to 20%. MSEZ would create a MAT tax asset for the paid tax which would be offset once the full tax rate regime kicks in future years.
- Units located in SEZ to pay MAT, business attractiveness for new units declines:** The current law grants several tax incentives to the units located in SEZ. The budget proposes removing the tax breaks and taxing the earnings at an MAT. Removal of tax benefits would make it less attractive for new units to set up base in SEZ.
 - ⇒ We have lowered our lease rental rates and land quantum assumptions by 33%. We now expect 30% of the total land parcel of 20,000 acres to be leased out over the concession period of MSEZ.

Earnings and target price revision

- We revise our target price to Rs148 from Rs161 earlier to factor in the impact of higher cash taxes and a lower valuation of SEZ.

Price catalyst

- 12-month price target: Rs148.00 based on a Sum of Parts methodology.
- Catalyst: clarity on growth opportunities in India and abroad

Action and recommendation

- Clarity needed on growth options for meaningful upside:** We believe the current stock valuation builds in near-term revenue growth due to a volume pickup over the next 2-3 years. We think clarity is needed on growth options to deploy US\$1bn of free cash flow, which MSEZ would have over the next 4-5 years, both in India and abroad, for any meaningful upside from current levels.
- Revising our target price to Rs148, maintain Outperform:** We reduce our target price by ~8% to factor in the impact of a higher tax outgo and lower valuation for SEZ following a removal of tax incentives. Our revised target price is Rs148. We believe the stock has already fallen considerably to factor in this negative news and we recommend accumulating the stock on any further fall.

Introduction of MAT – cash tax outgo to increase over FY12-14

- **No impact on reported numbers, cash tax outgo to increase:** We had built in a low tax rate of 5% over FY11-14E due to the tax exemption the company gets from the port operations under section 80-IB of Indian income tax laws. We have now increased the cash tax outgo to 20%. A reported tax outgo would continue to be low at 5% as the company would create an MAT entitlement reserve, which will be drawn upon in future years when full tax rates kick in.

Changing our lease assumptions for SEZ

- **Factoring in lower lease rentals due to decreased attractiveness of SEZ:** We have reduced our lease rental assumptions for retail and commercial leasing by 33% to Rs3.33/sq ft/yr and Rs5/sq ft/yr respectively.
- **Factoring in lower land leasing as attractiveness of setting up units in SEZ decreases:** We have reduced our land use assumption from 50% to 30% of the 20,000 acre land parcel.

Revising our earning estimates and valuation

- **Revising our target price to Rs148 from Rs161:** Our new target price factors in a reduction in NAV due to lower valuation of SEZ on account of lower offtake and reduced lease rentals.

Fig 1 Our revised target price is Rs148/share

	EV (Rs mn)	Per share (Rs)	Comment
Ports value	267,458	134	DCF
SEZ value	8,094	4	50% discount to NAV
Adani Logistics	7,500	4	At 2.5x book value
Other domestic ports	14,000	7	At 2.5x book value
TOTAL	297,051	148	

Source: Company data, Macquarie Research, February 2011

Mundra Port & Special Economic Zone (MSEZ IN, Outperform, Target Price: Rs148.00)

Quarterly Results					Profit & Loss						
	3Q/11A	4Q/11E	1Q/12E	2Q/12E		2010A	2011E	2012E	2013E		
Revenue	m	4,287	6,002	5,167	5,167	Revenue	m	13,925	17,148	25,837	31,583
Gross Profit	m	3,387	4,741	4,082	4,082	Gross Profit	m	11,054	13,547	20,411	25,266
Cost of Goods Sold	m	900	1,260	1,085	1,085	Cost of Goods Sold	m	2,871	3,601	5,426	6,317
EBITDA	m	2,967	4,154	3,603	3,603	EBITDA	m	9,701	11,870	18,015	22,340
Depreciation	m	520	729	541	541	Depreciation	m	1,681	2,082	2,707	3,019
Amortisation of Goodwill	m	0	0	0	0	Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0	Other Amortisation	m	0	0	0	0
EBIT	m	2,447	3,426	3,062	3,062	EBIT	m	8,019	9,788	15,308	19,321
Net Interest Income	m	-283	-396	-366	-366	Net Interest Income	m	-415	-1,132	-1,831	-2,181
Associates	m	0	0	0	0	Associates	m	0	0	0	0
Exceptionals	m	0	0	0	0	Exceptionals	m	0	0	0	0
Forex Gains / Losses	m	0	0	0	0	Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	0	0	0	0	Other Pre-Tax Income	m	0	0	0	0
Pre-Tax Profit	m	2,164	3,029	2,695	2,695	Pre-Tax Profit	m	7,605	8,656	13,476	17,139
Tax Expense	m	-108	-151	-135	-135	Tax Expense	m	-595	-433	-674	-857
Net Profit	m	2,056	2,878	2,560	2,560	Net Profit	m	7,010	8,223	12,802	16,282
Minority Interests	m	0	0	0	0	Minority Interests	m	0	0	0	0
Reported Earnings	m	2,056	2,878	2,560	2,560	Reported Earnings	m	7,010	8,223	12,802	16,282
Adjusted Earnings	m	2,056	2,878	2,560	2,560	Adjusted Earnings	m	7,010	8,223	12,802	16,282
EPS (rep)		1.03	1.44	1.28	1.28	EPS (rep)		3.50	2.05	6.39	8.13
EPS (adj)		1.03	1.44	1.28	1.28	EPS (adj)		3.50	3.45	6.39	8.13
EPS Growth yoy (adj)	%	17.3	17.3	678.5	55.7	EPS Growth (adj)	%	52.0	-1.5	85.3	27.2
						PE (rep)	x	39.6	67.4	21.7	17.0
						PE (adj)	x	39.6	40.1	21.7	17.0
EBITDA Margin	%	69.2	69.2	69.7	69.7	Total DPS		0.81	0.52	0.96	1.22
EBIT Margin	%	57.1	57.1	59.2	59.2	Total Div Yield	%	0.6	0.4	0.7	0.9
Earnings Split	%	25.0	35.0	20.0	20.0	Weighted Average Shares	m	2,003	4,007	2,003	2,003
Revenue Growth	%	23.1	23.1	50.7	50.7	Period End Shares	m	2,003	2,003	2,003	2,003
EBIT Growth	%	22.1	22.1	56.4	56.4						
Profit and Loss Ratios					Cashflow Analysis						
	2010A	2011E	2012E	2013E		2010A	2011E	2012E	2013E		
Revenue Growth	%	22.7	23.1	50.7	22.2	EBITDA	m	9,701	11,870	18,015	22,340
EBITDA Growth	%	23.7	22.4	51.8	24.0	Tax Paid	m	-595	-433	-674	-857
EBIT Growth	%	23.9	22.1	56.4	26.2	Chgs in Working Cap	m	-5,608	4,592	561	603
Gross Profit Margin	%	79.4	79.0	79.0	80.0	Net Interest Paid	m	-415	-1,132	-1,831	-2,181
EBITDA Margin	%	69.7	69.2	69.7	70.7	Other	m	0	0	0	0
EBIT Margin	%	57.6	57.1	59.2	61.2	Operating Cashflow	m	3,083	14,896	16,070	19,904
Net Profit Margin	%	50.3	48.0	49.6	51.6	Acquisitions	m	0	0	0	0
Payout Ratio	%	23.0	15.0	15.0	15.0	Capex	m	-11,266	-17,000	-20,000	-10,000
EV/EBITDA	x	30.7	25.1	16.5	13.3	Asset Sales	m	0	0	0	0
EV/EBIT	x	37.1	30.4	19.4	15.4	Other	m	-1,399	7,000	5,000	0
Balance Sheet Ratios					Investing Cashflow	m	-12,666	-10,000	-15,000	-10,000	
ROE	%	21.8	21.5	27.2	27.5	Dividend (Ordinary)	m	-922	-1,614	-1,614	-1,614
ROA	%	11.0	11.5	15.3	15.9	Equity Raised	m	0	0	0	0
ROIC	%	17.9	16.1	23.8	25.2	Debt Movements	m	8,442	1,558	7,000	7,000
Net Debt/Equity	%	65.9	46.7	39.2	20.3	Other	m	0	0	0	0
Interest Cover	x	19.3	8.6	8.4	8.9	Financing Cashflow	m	7,520	-56	5,386	5,386
Price/Book	x	7.9	6.6	5.3	4.2	Net Chg in Cash/Debt	m	-2,042	4,863	6,479	15,313
Book Value per Share		17.4	20.8	26.1	32.9	Free Cashflow	m	-8,183	-2,104	-3,930	9,904
					Balance Sheet						
	2010A	2011E	2012E	2013E		2010A	2011E	2012E	2013E		
Cash	m	8,587	13,660	19,579	33,748	Cash	m	8,587	13,660	19,579	33,748
Receivables	m	1,580	1,926	2,902	3,548	Receivables	m	1,580	1,926	2,902	3,548
Inventories	m	314	394	593	691	Inventories	m	314	394	593	691
Investments	m	7,210	7,210	7,210	7,210	Investments	m	7,210	7,210	7,210	7,210
Fixed Assets	m	42,099	57,018	74,311	81,292	Fixed Assets	m	42,099	57,018	74,311	81,292
Intangibles	m	0	0	0	0	Intangibles	m	0	0	0	0
Other Assets	m	20,602	9,682	5,612	6,029	Other Assets	m	20,602	9,682	5,612	6,029
Total Assets	m	80,392	89,890	110,208	132,517	Total Assets	m	80,392	89,890	110,208	132,517
Payables	m	4,164	5,262	7,928	9,691	Payables	m	4,164	5,262	7,928	9,691
Short Term Debt	m	0	0	0	0	Short Term Debt	m	0	0	0	0
Long Term Debt	m	31,572	33,130	40,130	47,130	Long Term Debt	m	31,572	33,130	40,130	47,130
Provisions	m	737	737	737	737	Provisions	m	737	737	737	737
Other Liabilities	m	9,037	9,037	9,037	9,037	Other Liabilities	m	9,037	9,037	9,037	9,037
Total Liabilities	m	45,509	48,166	57,832	66,595	Total Liabilities	m	45,509	48,166	57,832	66,595
Shareholders' Funds	m	34,882	41,724	52,376	65,922	Shareholders' Funds	m	34,882	41,724	52,376	65,922
Minority Interests	m	0	0	0	0	Minority Interests	m	0	0	0	0
Other	m	0	0	0	0	Other	m	0	0	0	0
Total S/H Equity	m	34,882	41,724	52,376	65,922	Total S/H Equity	m	34,882	41,724	52,376	65,922
Total Liab & S/H Funds	m	80,392	89,890	110,208	132,517	Total Liab & S/H Funds	m	80,392	89,890	110,208	132,517

All figures in INR unless noted.

Source: Company data, Macquarie Research, February 2011

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand

Outperform – return >3% in excess of benchmark return
Neutral – return within 3% of benchmark return
Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

Macquarie – Asia/Europe

Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie First South - South Africa

Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie - Canada

Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

Macquarie - USA

Outperform (Buy) – return >5% in excess of Russell 3000 index return
Neutral (Hold) – return within 5% of Russell 3000 index return
Underperform (Sell) – return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high-highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low-medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to Australian/NZ/Canada stocks only

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / epowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 31 December 2010

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	46.38%	62.62%	52.17%	44.99%	67.57%	50.90%	(for US coverage by MCUSA, 13.59% of stocks covered are investment banking clients)
Neutral	37.68%	18.58%	34.78%	50.61%	28.83%	35.48%	(for US coverage by MCUSA, 15.22% of stocks covered are investment banking clients)
Underperform	15.94%	18.80%	13.04%	4.40%	3.60%	13.62%	(for US coverage by MCUSA, 0.00% of stocks covered are investment banking clients)

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