PSU DISINVESTMENT – 2010

4th JANUARY, 2010

PSU Disinvestment inevitable…

On account of global recessionary trends, India witnessed slowdown in its economy which resulted in all time high 16 – year high fiscal deficit of 6.8% which by any standard is unsustainable. The government in order to overcome economic slowdown and ensure that the economic growth process is not derailed growth during it introduced three stimulus packages which resulted in fiscal deficit of 6.8% of GDP.

Economy has started improving on account of government's stimulus package. We expect, stimulus package would be withdrawn in a phased manner in tune with the gradual improvement of Indian economy.

It is encouraging to note that the government made its intentions clear to roll back the fiscal deficit to 5.5% from 6.8% of GDP in FY 11 and further down to 4% in FY 12. However government needs revenues to overcome these fiscal slippages and increasing the rates of indirect and direct taxes prematurely would defeat the very purpose of stimulus package. Government was left with the onerous task of maintaining a delicate balance between maintaining the growth momentum and ensuring rigorous fiscal discipline to bridge the fiscal deficit at acceptable levels within the shortest possible time span. Under the circumstances divestment of PSU's was the only panacea to the abovementioned dilemma.

The Cabinet Committee on Economic Affairs decided that the government will lower its stake in all listed public sector enterprises (PSEs) to atleast 90%. Government has already initiated this process by divesting 5% stake in companies like NHPC, Oil India which fetched ~Rs.42,600 mn. There are ~13 companies in which government stake is in excess of 90%. Disinvestment in these companies could fetch ~Rs. 280,000 mn which are as follows.

Listed PSUs	Govt. stake (%)	Stake that has to be divested (%)	Funds that would be raised (Rs. in mn)
Hindustan Copper	99.59	9.59	20,680
MMTC	99.33	9.33	140,520
HMT	98.88	8.88	3,900
NMDC	98.38	8.38	102,080
FACT	98.11	8.11	620
National Fertilisers	97.64	7.64	2,060
Scooters India	95.38	5.38	40
Andrew Yule & Co	94.42	4.42	650
Neyveli Lignite	93.56	3.56	7,820
ITI	92.98	2.98	330
RCF	92.5	2.5	910
STC India	91.02	1.02	190
Engineers India	90.4	0.4	268
Total			**280,068**

Source: The Economic Times-6th Nov. 2009

Government is already contemplating to bring FPO of listed PSU's like NTPC, REC in early 2010 by divesting ~10% stake in these companies. In addition to this, government is also planning to divest its stake in the unlisted PSU's which are as follows:

(Rs. in mn)

Unlisted PSUs	Total Income	Net Profit	Expected Market Cap
Coal India	425,178	52,433	786,491
Bharat Sanchar Nigam	372,193	30,094	616,898
Airports Authority of India	44,580	10,819	324,561
Hindustan Aeronautics	103,864	16,319	242,444
Rashtriya Ispat Nigam	112,275	19,427	233,129
Satluj Jal Vidyut Nigam	21,133	7,644	191,110
Nuclear Power Corporation of India*	38,576	4,214	126,417
Manganese Ore (India)*	14,095	6,638	79,655
North Eastern Electric Power Corporation	9,650	2,583	77,493
Housing and Urban Development Corporation	26,903	3,737	56,060
Total	**1,168,447**	**153,908**	**2,734,258**

Source: The Economic Times-6th Nov, 2009

Further, disinvestment by the government would lead to significant re – rating of PSU companies. Local indices and MSCI India are on free float basis, where PSUs score poorly- e.g. PSU weightage in Nifty by Market Capitalisation is ~29%while actual weightage is only 14.7% due to low free float. As a result global fund managers may have to increase their weightage in PSUs. In general, India may have a poor perception of PSU companies but these stock's have outperformed the Sensex over the last 1,3 and 10 years.

2010 can expect huge issuances from Government of India. As India is transiting from US$1 trn economy to US$ 2 trn, it has a digestable appetite to absorb these massive investments mainly due to its 38 % savings rate.

Companies in the PSU basket have huge cashable, monetizable assets like for eg. a land bank. Government is increasingly consenting to monetize these land banks.

PSU's a wealth generating story in the past…

PSUs disinvestment has created value for investors in the long run. If we recall the 1st time that PSUs got listed in 1993 – 94, it was amazing to see the bargains that one got in companies like CMC, BHEL etc.

Taking this into consideration various mutual fund houses, have launched specialty PSU funds which would tend to benefit from the disinvestment of PSUs.

For eg: Religare Mutual Fund has announced the launch of its new open – ended equity scheme – Religare PSU Equity Fund. The fund seeks to generate capital appreciation by investing in companies where the Central/State government(s) has majority shareholding or where the management control lies with the government. The fund will invest in companies having presence in core sectors and are expected to benefit from the divestment process and reforms.

On the basis of the above theme, we recommend the following stocks:

1) **RCF**
2) **NMDC**
3) **Engineers India Ltd.**
4) **Tide Water Oil**

Rashtriya Chemicals & Fertilizers Ltd. (RCF) : 04th Jan, 2010

CMP: Rs. 82.5

Financial Highlights: (Rs. mn)

Particulars	Q2FY10	Q1FY10	Q2FY09	FY09	FY08
Sales	17,919	8,430	26,142	83,659	51,402
EBIDTA	1,119	693	1,695	4,872	3,845
PAT	561	315	843	2,115	1,581
EPS (Rs.)	1.02	0.57	1.53	3.84	2.87

FV: Rs. 10

Market Capitalization (Rs.): 45,514 mn

Equity Capital: Rs 5516.9 mn

Reserves: Rs 11,213 mn

Debt: Rs 14,242 mn

Book Value (BV): Rs 30.33

P/BV: 2.44x

EPS (TTM): Rs.3.55

EPS – FY 09: Rs. 3.84

PE: 23x

Industry PE: 10.11

Promoter Holdings: 92.5% (GOI)

Outlook on Rashtriya Chemicals & Fertilizers:

1) **Disinvestment Candidate:** GOI is giving big push to its disinvestment programme and company is one of the likely candidates as GOI holds 92.5%.

2) **Land Bank:** RCF has a land bank of 800 Acres (34.85 mn sq.ft) which is valued at Rs. 174,000 mn in Sion - Chembur region in heart of Mumbai city which can unlock its value going ahead. Government is pursuing the policy to monetize the land bank.

3) **Leading producer of Fertilizer in India:** RCF is one of the leading producers of fertilizers in India. Sujala, Suphala 15:15:15, Suphala 20:20:0, Ujjwala, Microla and Biola are its major fertilizers.All the products can be used with different soil types and in various climatic conditions and have high brand equity in the fertilizer market

4) ***Management is confident to increase its sales of fertilizers from 48.33 MT in 2008-09 to 55 MT in 2009-10***.

5) **Availability of Gas eases production bottlenecks:** Production of the urea has started at the Trombay unit from Q1FY10 which had been shut down for last 4 years due to non availability of gas. This would result in higher margins in forthcoming quarters. This unit would add approx 0.33 mtpa of urea capacity.

6) **Reduction in Costs:** Co has started receiving its share of KG Basin gas from April 09 which has reduced its urea production cost to a large extent since it no longer has to depend on expensive Naptha.

7) Recently Company has been informed by UNFCCC (United Nations Framework Convention on Climate Change) that the Company's CDM (clean development mechanism) project "N20 abatment in HP Nitric Acid Plants" has been registered.

*On the basis of the above factors, we recommend **"BUY"** with a target price of*
Rs. 108/- for a 3 months horizon

NMDC LTD: 04th Jan, 2010

CMP: Rs 426.60

Financial Highlights :(Rs. mn)

Particulars	Q2FY10	Q1FY10	Q2FY09	FY09	FY08
Sales	13901	12780	16173	75,640	57,113
EBIDTA	10164	9483	12198	58,412	50,075
PAT	7708	7737	9449	43,723	32,509
EPS (Rs.)	1.94	1.95	2.38	11.03	8.19

FV: Re. 1

Market Capitalization (Rs.): 1,691,348 mn

Equity Capital: Rs 3964.7Mn

Reserves & Surplus: Rs 112404Mn

Debt: Nil

BV: Rs 29.35

P/BV: 14.53

EPS (TTM): Rs10.07

PE: 42.36

Industry PE: 29.54

Promoter Holding: 98.38% (GOI)

Outlook on NMDC Ltd:

1) **Stake Sale:** The government is planning to disinvest 8.38% stake in NMDC by March 31, 2010, as part of its divestment program. The government is hoping to raise over Rs 230 billion (US$ 4.9 billion) from the sale of a stake in iron ore miner NMDC
2) **Size Matters:** NMDC is India's largest iron ore miner co operating mines in Chhattisgarh and Karnataka.
3) **Debt Free company**
4) **Cash Rich Co:** NMDC has healthy cash & bank balance of Rs 97.39 billion as on 31st Mar, 2009
5) **100% FDI:** Current norms allow a 100% foreign direct investment in the mining business.
6) **Buzz of Foreign Partner:** State-owned NMDC may consider bringing in a foreign partner by forging joint ventures for technology and equipment for mining development.
7) **New Business Model:** Company may start work on a new model — designed to reduce raw material shortage — after a request from the Steel Ministry. The steel sector faces hurdles due to shortages of iron ore and coal.
8) **Set to break new grounds in iron ore mining:** The country's largest iron ore miner will shortly be implementing a new technology for commercial extraction of iron ore from banded hematite jasper (BHJ) and banded hematite quartzite (BHQ) rocks, which are naturally mined along with the ore during normal mining operations.
9) **Capex plans to drive Growth:** NMDC proposes to augment its production of iron ore from the present level of 30 million to 50 million tones by 2015.The estimated capital expenditure towards this is Rs. 6,070 mn. The expected date of completion is March 2010. NMDC is also planning to venture into coal mining.

*On the basis of the above factors, we recommend **"BUY"** with a target price of **Rs. 491/- for 3 months horizon***

Engineers India Ltd (EIL) : 04th Jan, 2010

CMP: Rs 1558.75

Financial Highlights :(Rs. mn)

Particulars	Q2FY10	Q1FY10	Q2FY09	FY09	FY08
Sales	4,682	3,914	3,440	15,325	7,378
EBIDTA	1,522	1,429	1,013	5,207	3,342
PAT	1,054	942	662	3,445	1,946
EPS (Rs.)	18.76	16.78	11.78	61.35	34.65

FV: Rs. 10

Market Capitalization (Rs.): 87,533 mn

Equity Capital: Rs 561.6Mn

Reserves & Surplus: Rs13191.8Mn

Debt: Nil

BV: Rs 244.91

P/BV: 6.36x

EPS (TTM): Rs 76.13

PE: 20.47

Industry PE: 25.41

Promoter Holding: 90.40% (GOI)

Outlook on Engineers India Ltd:

1) **Stake -Sale:** Government of India is planning a Follow on public offer (FPO) along with divesting 10% stake sale in EIL .In addition company will raise funds for own requirement as per reliable sources

2) **Successful Tack Record:** EIL was established in 1965 by Government for providing engineering & technical consultancy services for setting public sector refineries. The success of such large scale implementation has lead to execution of 400 major projects since its inception and catering to needs & requirements of private sector majors like (Essar Oil, Hindalco) etc.

3) **Strong Order Book:** EIL has strong order book of Rs 70,000 mn executable over a period of next 2.5 - 3 years with average margins of ~20 %. A large part of the company's order book comprises of orders from LSTK (Lump Sum Turn Key) segments. This will help the company to accelerate its revenue in the current year.

4) **Debt Free company:** EIL is a debt free company and has healthy cash and bank balance of Rs. 1,815 mn as on 31st Mar, 2009.

5) **Current Mega Projects:** EIL is undertaken 9 MMTPA grass roots Guru Gobind Singh Refinery Project of HPCL Mittal Energy. The project is making steady progress and is ahead of schedule.

   It is likely to be completed in 39 months against the schedule of 42 months. This is the biggest project being handled by EIL in petroleum refining sector, till now, both in terms of EIL fee as well as in terms of plant and machinery cost.

*On the basis of the above factors, we recommend **"BUY"** with a target price of **Rs. 1,675/- for 3 months horizon.***

Tide Water Oil : 4th January, 2010

Stock details :

BSE Code	590005
CMP – 4th January, 2010	Rs. 4,878/-
Market Capitalisation	Rs. 4,249 mn
Face Value (Rs.)	10
Book Value (Rs.)	Rs. 1,737/-
52 Wk High (BSE)	Rs. 5,600/- (14th September, 2009)
52 Wk Low (BSE)	Rs. 2,801/- (9th January, 2009)

Company Profile :

Tide Water Oil Co. (India) Ltd. is a part of the multi divisional Andrew Yule group (AYC). AYC has diverse interests in Engineering, Electrical, Tea Cultivation, Power Generation, Digital Communication Systems and Lubricants.

It has been a pioneer of Automotive and Industrial lubricants in India since 1928 and has 5 plants at Silvassa, Oragadam, Turbhe, Howrah and Faridabad.

Plant locations :

Location	Oil	Grease
Silvassa	40,000 KL	NA
Oragadam (Chennai)	16,000 KL	2,600 MT
Turbhe	14,000 KL	NA
Howrah, West Bengal	10,000 KL	1,800 MT
Faridabad (Haryana)	8,000 KL	NA

About the Business :

Engaged in the business of manufacturing engine oils for trucks, tractors, commercial vehicles, passenger cars and two/three wheelers.

It produces gear oils, transmission oils, coolants and greases for automobiles. For industrial applications, it manufactures industrial oils, greases and speciality products like metal working fluids, quenching oils and heat transfer oils.

All the products for the different segments are sold under its brand name “VEEDOL”. This is supported by an extensive network of dedicated distributors, depots and consignment depots across the country.

It has tie ups for manufacture of genuine oils with a number of renowned OEMs in the automotive and industrial equipment segment.

Company in 2007 had signed a 5 year agreement under which it sells Nippon’s Eneos brand of lubricants, a market leader in Japan, in India.

Industry overview :

The Indian lubricant industry is broadly categorized into 3 major sectors; Automotive, Industrial and Marine & Energy applications. The industry consists of a large number of players, of which four major players, (Indian Oil Corporation Limited, Bharat Petroleum Corporation Limited, Hindustan Petroleum Corporation Limited and Castrol India Limited) constitute around 70% of the market. There are several other private players including global oil-majors operating in the balance 30% of the market, leading to an extremely competitive and increasingly fragmented market scenario.

The automotive lubricant sector can be segmented as per the following vehicle categories:
(a) Trucks, Tractors and Off-Road Equipment – mainly diesel engine oils
(b) Passenger Cars - mainly gasoline engine oils
(c) Motorcycles - 2-stroke and 4-stroke oils

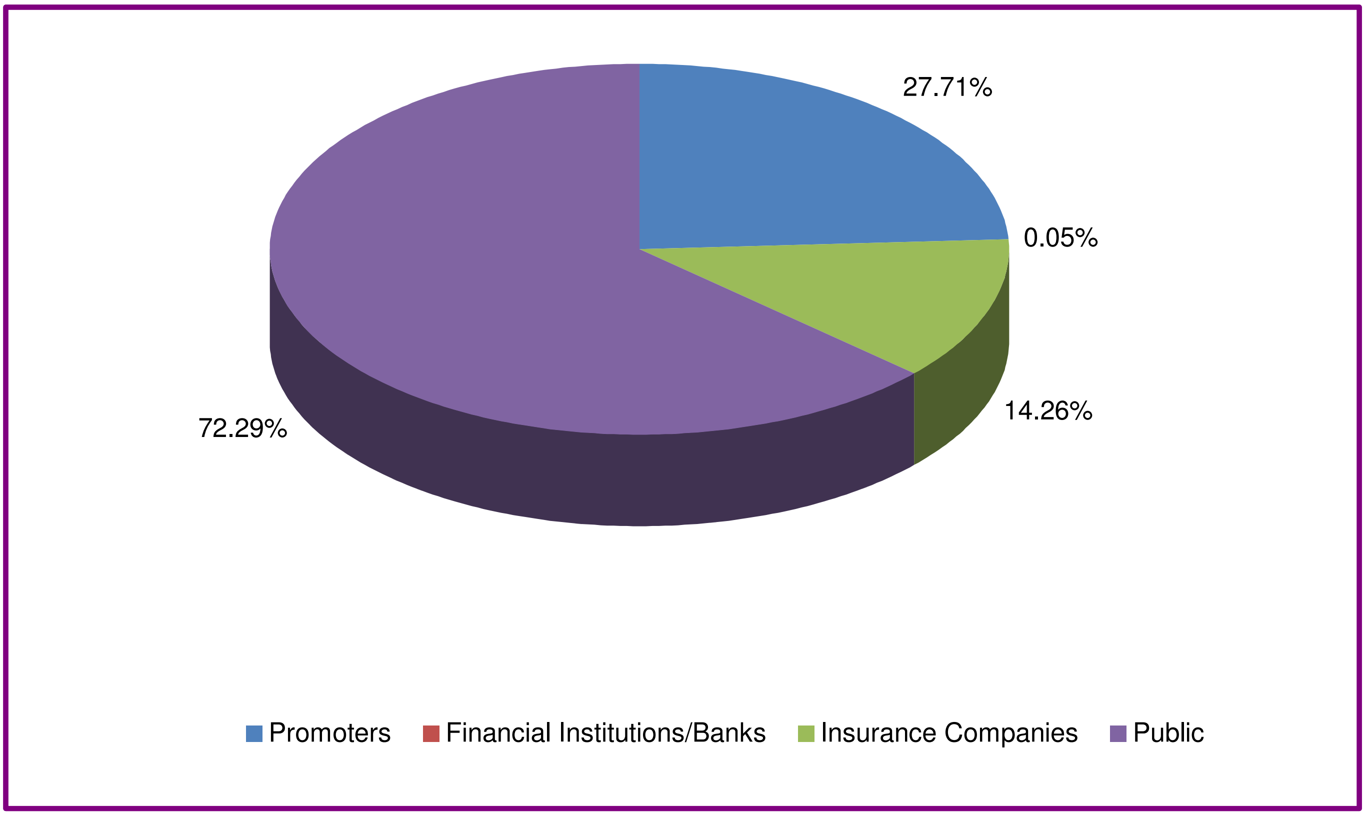
Non-Automotive sector outlook

Industrial lubricant demand is dependent on industrial production and growth trends in the economy.
The industrial production growth (April 09 – Oct 09) was 7.1% v/s 4.3% (YoY). The industrial activity is improving which would drive growth for Tide Water Oil products.

Financial highlights :

Particulars (Rs. In millions)	FY 08	FY 09	FY 10E	FY 11E
Sales	4,331	5,345	6,457	7,425
EBITDA	329	441	817	845
EBITDA Margin	7.59%	8.25%	13%	11%
Net Profit	232	276	519	534
PAT Margin	5.30%	5.09%	8%	7%
No. of Equity Shares (mn)	0.87	0.87	0.87	0.87
Diluted EPS (Rs.)	267	318	597	614
EPS growth	159%	19%	88%	3%
P/E (x)	13.8	15.3	8.17	7.94
Book Value (Rs.)	1,456	1,737	1,755	1,774

Shareholding pattern as on September 2009



Risks and concerns :

1) **Volatility in Crude oil prices:** Lubricants are highly vulnerable to volatility in crude oil prices. Rising base oil price may put pressure on margins.

2) **Price undercutting by competitors:** Price undercutting by low-cost as well as international competitors in an attempt to gain volume share. In the Industrial sector, price undercutting by small regional competitors and the tendency of PSU players to focus on volumes over margins, may put pressure on your Company's margins and market share.

3) **Dollar Appreciation to affect margins:** Any appreciation of dollar against rupee will increase the raw material costs – crude oil which would affect the margins of the company.

4) **Slowdown in Industrial Demand and decline in automobile growth:** Any slowdown in the industrial activity of Indian economy will have a significant effect on the sales which would dent the volume growth of lubricant products.

Risk Mitigation:

Any volatility in crude oil prices would be partially offset as it would be able to pass on the increased costs to its customers as it enjoys flexibility in pricing.

Financials - Income Statement – (Rs. in millions)

Particulars	FY 08	FY 09	FY 10E	FY 11E
Sales	**4,331**	**5,344**	**6,457**	**7,425**
Expenditure				
(Increase)/Decrease in inventory	273	(204)	23	(10)
Cost of Material	2,575	3,518	3,299	3,898
Operating and other expenses	1,154	1,589	2,318	2,692
EBITDA	**330**	**441**	**817**	**845**
Depreciation	26	34	45	52
EBIT	**304**	**407**	**772**	**793**
Interest	14	15	8	4
Other Income	41	65	26	20
Net Profit before tax and Extraordinary items	**331**	**457**	**790**	**809**
Extraordinary items	22	-	-	-
Less: Tax	121	182	271	275
Net Profit after tax	**232**	**275**	**519**	**534**
No. of equity shares (in mn)	**0.87**	**0.87**	**0.87**	**0.87**
EPS (Rs.)	**268**	**318**	**597**	**614**

Balance Sheet – (Rs. in millions)

Particulars	FY 08	FY 09	FY 10E	FY 11E
LIABILITIES				
Share Capital	8.7	8.7	8.7	8.7
Reserves and Surplus	1,258	1,502	1,518	1,535
Secured Loans	60	30	15	-
Total	**1,327**	**1,541**	**1,542**	**1,544**
ASSETS				
Fixed Assets	551	659	744	814
Less: Depreciation	291	322	368	420
Net Fixed Assets	**260**	**337**	**376**	**394**
CWIP	**17**	**85**	**70**	**-**
Investments	**6**	**6**	**6**	**6**
Deferred Tax Assets (Net)	**7**	**2**	**2**	**2**
Current Assets, Loans & Advances (A)	**2,166**	**2,542**	**2,612**	**2,920**
Current Liabilities and Provisions (B)	**1,129**	**1,431**	**1,524**	**1,778**
Net Current Assets: (A) – (B)	**1,037**	**1,111**	**1,088**	**1,142**
Total - ASSETS	**1,327**	**1,541**	**1,542**	**1,544**

Cash Flow Statement – (Rs. in millions)

Particulars	FY 08	FY 09	FY 10E	FY 11E
Net Profit before Tax	353	458	790	810
Operating Cash Flow before Working Capital Changes	370	464	817	845
Net Cash Flow from Operating Activities (A)	122	391	622	563
Net Cash Flow from Investing Activities (B)	(50)	(169)	(57)	62
Net Cash Flow from Financing Activities (C)	(102)	(65)	(43)	(40)
Increase/(Decrease) in cash & cash equivalents during the year	(30)	157	522	585
Cash and Cash Equivalents at the beginning of the year	187	157	314	836
Cash and Cash Equivalents at the end of the year	157	314	836	1,421

Ratio analysis :

Particulars	FY 08	FY 09	FY 10E	FY 11E
EBITDA Margin	8%	8%	13%	11%
PAT Margin	5%	5%	8%	7%
ROE (%)	18%	18%	34%	35%
ROCE (%)	15%	17%	33%	34%
Debt/Equity	0.05	0.02	0.01	-
Fixed Assets Turnover Ratio	8	8	9	9
Inventory days	68	58	41	36
Debtors days	31	27	20	18
Creditors days	19	14	16	15

Peer analysis :

Particulars	Tide Water Oil	Castrol	Gulf Oil
CMP – 4th January, 2010	4,878.15	594	102.95
Equity Capital (Rs. in mn)	8.7	1,236	148.7
FV (Rs.)	10	10	2
Market Capitalisation (Rs. in mn)	4,249	73,442	7,655
Net Sales (Rs. in mn)	5,344	22,168	9,228
Market Capitalisation/Sales	0.80x	3.31x	0.83x
EBITDA Margin	8%	19%	6%
PAT Margin	5%	12%	3%
ROE	18%	55%	7.04%
Debt/Equity	0.02	0.01	0.99
Book Value (Rs)	1,737	38.46	56
EPS (TTM)	480	28.09	7.32
PE	10.16	21.14	14.06

Investment Rationale for Tide Water Oil :

1) **Divestment by Andrew Yule (AYC):** AYC has 228,390 (26.22%) shares in Tide Water Oil. AYC is a BIFR company and as a part of restructuring package it has been directed to sell its holdings in its associate companies. In Nov 2009, there was an auction on sale of 2,420,455 shares of its associate company Dishergarh Power Supply Company Ltd. (DPSC Ltd.) at Rs. 710/- per share to Consortium of SREI Infrastructure Finance Limited and India Power Corporation Ltd. amounting to Rs. 1718.5 mn. It is learnt from sources within the company circle that procedural formalities for divestment of AYC stake sale is very much in place and it is likely to take final shape in H1 FY 10.

2) **Value unlocking on Divestment:** The Company could be a takeover target on divestment for global MNC or domestic upstream oil companies in their quest to become a fully integrated player in Oil and Gas sector.

3) **Stabilising raw materials cost:** Its main raw material constituents viz; Base Oils, Additives and Grease are all by products of crude oil. At current crude level of US$ 70 – 80 per barrel its raw material cost is ~52%. International crude prices have stabilized between US$ 70 – 80 per barrel.

4) **Planning to unlock its land holding in Mumbai and Chennai:** Company had shifted its plant facility to Oragadam in Chennai from its cramped facility at Royapuram, Chennai. It has also shifted its facility from Deonar and moved to 10 acre plot in Turbhe, Navi Mumbai. Deonar area was developed as an industrial suburb but today it is largely a residential one. Management has expressed its desire of selling its plant facility of Royapuram in Chennai and Deonar in Mumbai in the near future.

5) **No drag on cashflows:** In the immediate future, the cash flows of the company would not be affected as it is through with its capex plans.

Valuation – Tide Water Oil

At the CMP of Rs. 4,878/- the stock trades at a P/E of 15.34x its FY 09 earnings, 8.1x FY 10E earnings (EPS – Rs. 597) and 7.89x FY 11E earnings (EPS – Rs.618).

With due consideration to its attractive valuations as compared to its peers, strong market share, possible disinvestment of its parent, stable crude oil prices, steady growth outlook for lubricant industry and 18% CAGR in ROE (FY08-FY11E), we recommend a **"Buy"**.

Our rating is based on P/E 10.5x FY 11E (EPS – Rs.618/-) with a price target of Rs. 6,489/- in the near term.

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