

13th March, 2008



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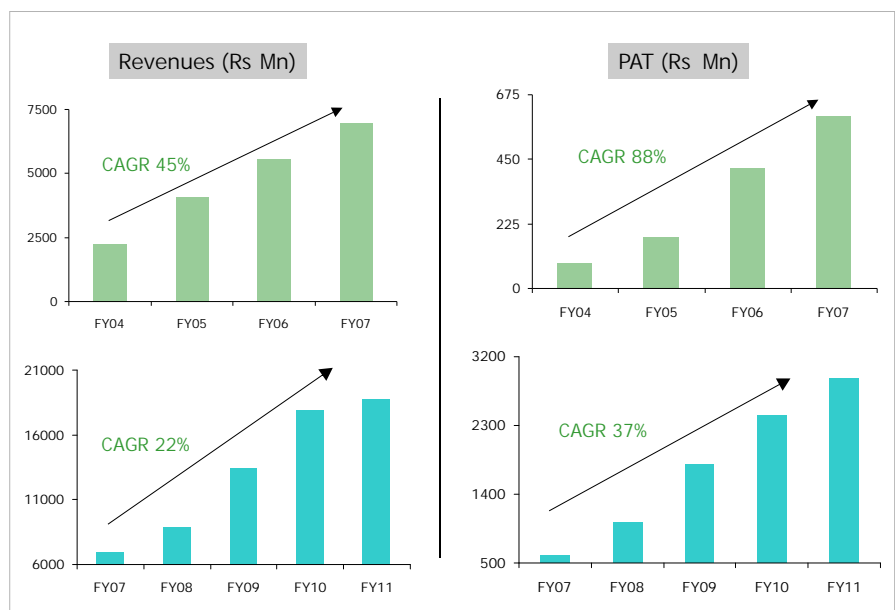
There has been a sharp spike in food grain prices worldwide in the recent times. The situation in India is not too different. The rising inflation trend over the past few weeks has brought the agriculture segment under lens. News on ban on exports for food security, the double whammy of ever-increasing Minimum Support Prices to farmers and increasing subsidy bills on welfare schemes like PDS has kept commodity specialists busy peruse the government's tightrope fiscal -political moves.

We have seen the large farmers emerge as a powerful sect of the Indian society at large. The improved affordability & increased per-capita intake is causing the demand to outpace the supply growth, which is constrained on account of limited & withering cultivable-land reserves. Reforms like the emerging organized retailing, private sector & corporate participation in the farm sector, emergence of the commodity exchanges seem to have brought about some irreversible changes in the social -map of India. Possibly, the increasing food insecurity & rising inflation are the prices we pay for the encroaching urbanization.

In Lakshmi Energy & Foods Limited, we see a unique play of the agri-boom story coupled with many unique facets, which make it stand out from its peers. A leadership positioning with scalability prospects and an entrenched surety on pricing, margins and volumes are the USPs. The impressive past performance inspires confidence in its sizeable future expansion plans. For a moment, we are surprised by the excellent margins and return ratios for this seemingly commodity player, which are comparable with some FMCG companies. We stand convinced post our research endeavours and highlight our thoughts in this report.

Past-Future Performance Snapshot

FY04 to FY07



FY07 to FY11

Lakshmi Energy & Foods Ltd. CMP - Rs. 200 BUY Target - Rs. 280

Lakshmi Energy & Foods Ltd

Buy | CMP Rs. 200
Target Rs. 280.0

Initiating Coverage

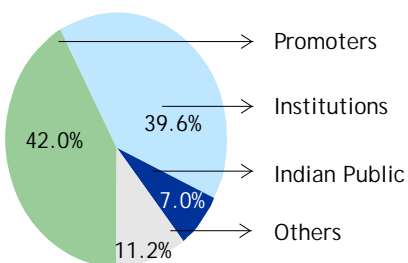
Stock Data

Bloomberg : LKEF.IN
Reuters : LAKO.BO
BSE Code : 519570
NSE Code : LAKSHMIEFL
BSE Group : B

Stock Codes

Benchmark : BSE 500
52 Week High : 295.00
52 Week Low : 146.10
Mkt Cap : Rs. 12,638.0 Mn
Face Value : Rs. 2.0

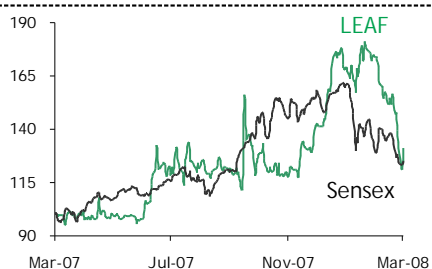
Shareholding Pattern (as on Dec '07)



Stock Returns

	1 Mth	3 Mths	6 Mths
LEAF	-24.59	-8.12	9.01
Sensex	-3.05	-20.87	3.98

Price Comparison



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Key Beneficiary of the Agricultural Boom : Rice is witnessing a demand growth of 5% against an expected production growth of just 2%. The processed food segment is experiencing a much higher demand growth on account of changing consumption pattern & its current nascent stage of growth. These mark for an extremely profitable time for the farmers & agro-processors like LEAF.

Stable Business Segments : We like LEAF's preference for a stable & higher margin business of non-basmati v/s basmati and to deal with FCI, which ensures high volumes. Post expansion, it will continue to derive ~85-90% of its earnings from the non-basmati and FCI sales would remain high at ~70%; so its still 'Advantage LEAF'.

Outstanding Track Record : Revenues grew at 41% CAGR & profits at a rocketing 164% CAGR over FY03-07 period; this growth primarily being led by increasing expansion & increasing integration.

Enterprising Expansion Plans : By mid FY10, the capacity would grow from 1 MMT to 3 MMT p.a.. Diversification into wheat and branded & packaged rice adds flavour to the growth story.

Robust Outlook : Apart from the expansion led growth (20% CAGR, FY07-11E), the return ratios remain very attractive in the range of 25-30%. The PAT margins would further benefit from increasing tax benefits upon commissioning of the power plant.

Attractive Valuations : The scrip is priced attractively at 7.1x FY09E & 5.2x FY10E earnings, given the backdrop of a shining past performance, sustained profit growth (37% CAGR, FY07-11E) and comforting return ratios. The stability in business in terms of volumes & pricing gives LEAF an edge over other listed food processing companies. We recommend BUY based on our DCF calculations with a price objective of Rs. 280 (=7.3x FY10E EPS).

Particulars	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Revenues (Rs Mn)	2,272.0	4,077.1	5,583.9	6,962.7	8,913.5	13,397.0	17,901.3	18,789.4
EBITDA (%)	6.6%	9.1%	13.4%	17.1%	21.8%	22.7%	21.8%	24.9%
PAT (Rs Mn)	89.4	180.5	420.0	603.3	1,030.3	1,791.6	2,434.7	2,914.7
EPS (Rs.)	1.8	3.5	7.7	10.6	16.3	28.4	38.5	46.1
P/E (x)	109.7	57.5	25.9	19.0	12.3	7.1	5.2	4.3
ROCE (%)	10.2%	20.5%	25.8%	22.6%	24.5%	25.8%	24.7%	23.3%
RONW (%)	11.0%	18.1%	25.7%	24.2%	23.9%	29.7%	29.1%	26.3%
Debt/Equity (x)	0.5	0.7	0.7	0.9	0.6	0.8	0.7	0.6

Lakshmi Energy & Foods Limited (LEAF) is the largest manufacturer of non-basmati rice in India. This North-India based fully integrated company has an outstanding track record with its revenues growing at 41% CAGR & profits at a rocketing 164% CAGR over FY03-07 period; this growth primarily being led by increasing expansion & increasing integration (ergo, increasing margins). Going ahead we see LEAF maintaining its accelerating pace of growth as it progresses with its ambitious expansion plans while maintaining integration. Forward integration into packaged & branded goods and investments in biomass energy add flavour to LEAF's strategy to cash in from the present & somewhat sustainable agri-boom.

Background

Founded in 1982 by its CMD Mr. Balbir Singh Uppal, LEAF is one of the leading non-basmati rice producers in the world with a current capacity of processing 1.35 Million Metric Tonnes (MMT) per annum of paddy. Post its expansion to 3 MMT p.a. LEAF would be undisputed leader in paddy production worldwide. LEAF already has the largest integrated processing plant for paddy in the world.

LEAF is located in the paddy-growing region of Punjab, situated at 45 km from Chandigarh and 50 km from Ludhiana. Punjab despite primarily a wheat consuming state, is also a key producer of rice with the highest yield per hectare, on account of its edge in terms of climate, soil quality & irrigation facilities. Lakshmi is a key supplier of rice to Food Corporation of India (FCI) for its Public Distribution System (PDS) and is located in close proximity to FCI warehouses (1 km) and railway yards.

LEAF has come a long way from rice trading & refining of raw rice to become an integrated player operating from sourcing paddy to manufacturing finished rice with solvent extraction & refinery capacities in place for its by-products.

Chronograph

Oct 2007	Entered into contract farming of wheat and seed production
Sep 2007	Diversified into wheat flour with a mill producing 100 MT/Day
June 2007	Expanded paddy processing capacity to 225 MT/day
April 2007	Established Punjab Greenfield Resources Limited, a wholly owned subsidiary, for procurement, distribution of food grains, fertilizers, seeds and farm R&D
Jan 2007	Rice Bran Oil extraction capacity increased to 300 MT from 200 MT
Dec 2006	Stock split shares with face value of Rs. 10 each into 5 equity shares of face value of Rs. 2 each
June 2006	Expanded paddy processing capacity to 65 MT/day to 105 MT/day
Aug 2000	Bonus Issue of 1:1 equity shares
April 1995	Started a 300 MT/day rice plant involving total capacity expenditure of Rs. 175 Million
Dec 1994	Initial Public Offering of Rs 10 Million at Rs. 50 per share
Aug 1994	Renamed as Lakshmi Overseas Industries Limited
Mar 1993	Revised status to a public limited company. Renamed Lakshmi Grain Processors (India) Limited
Oct 1981	Inaugurated a paddy processing plant, Lakshmi Grain Processors Private Limited, at Khamanon in Punjab with a capacity of 100 MT/day

Source : Company Presentation

In India, the key rice producing states are West Bengal, 4 South-Indian states & Punjab. East & South India are high consumption zones with little surplus for outside trade. Punjab on the other hand, despite primarily a wheat consuming state, is also a key producer of rice with the highest yield per hectare, on account of its edge in terms of climate, soil quality & irrigation facilities. Interesting point to note is that large processing mills are based only in the surplus North-Indian region. The rest of India has a far too many number of small & tiny paddy processing mills. As per one source, there are nearly 1,20,000 paddy-processing mills spread all over India. The fragmented nature of the industry can be judged from the fact that despite being the largest processor of paddy in the world, LEAF has a mere over 1% share in the Indian market.

Coming to the difference between the basmati & non-basmati segments, an interesting fact we learn from the management is that this variety of premium rice (known for its whiteness, thinness, completeness & aroma) is grown only in certain regions in Punjab, Haryana, UP & Pakistan's 'Punjab' and nowhere else in the world. These varieties generally find high demand in the international markets. Apart from the basmati variety, the other high quality rice also enjoys good export demand, particularly from the Indian migrants in the Middle-East region. India in the current year has witnessed for the first time, a deficit for rice and has banned exports of non-basmati variety as well. Sometime ago, the government had banned export of any basmati variety with a sale price lower than \$600 per tonne for exports.

A surprising observation for us has been that the basmati players have been earning lower margins, despite being into a high-end product. Reasons - First being the low volumes, which do not permit profitable exploitation of by-products and waste; Secondly, it is the branding & marketing efforts, which go into selling this product; Finally, the prices are more volatile and is exposed to the vagaries of currency & government policy fluctuations.

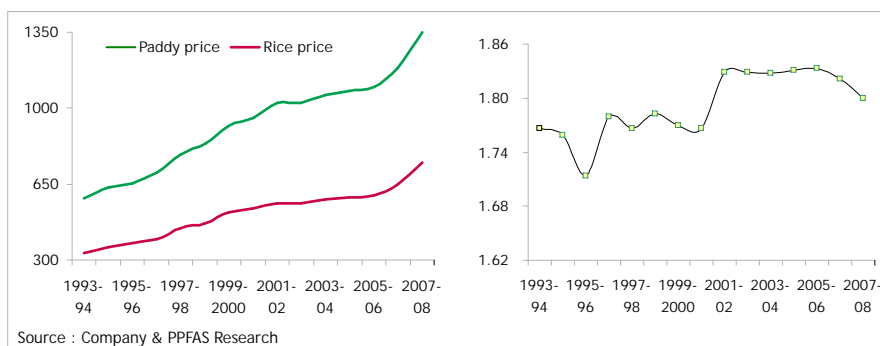
Basmati Rice	Non-Basmati Rice
Low Volume, High Price	High Volume, Low Price
Fewer by Products, down stream not possible	Down stream plants can be set up
High packaging, marketing and selling cost	Assured market from Govt agencies
Consumed by less than 2% of worldwide population	Consumed by Majority of the population
Volatility in price realisation	Steady prices and growth in realisation

Source : Company Presentation

Paddy arrival is generally in the middle of the fiscal year. LEAF competes with FCI in sourcing paddy from farmers at the mandis. The government announces a Minimum Support Price (MSP) each crop season, to ensure a reasonable price & profit to the farmers. LEAF typically manages to get a slightly better quality of the required paddy by paying a slightly higher amount by Rs. 5-10 per quintal (100 kgs) over the MSP and making the payments within 3 days as compared to FCI's practice of paying within 7 days. FCI gets its own paddy processed on contract basis from small millers plus also buys a good quantity of finished products directly from other large players.

The important issues for FCI are getting the procurement in place for PDS, reasonable prices & profits to farmers and manage overall country's food security. FCI generally buys 1/3rd of India's production of rice & wheat for subsidized distribution to the public under the PDS scheme. LEAF presently sells almost its entire production to FCI at the MSP decided for rice by the Government of India. The trend available for over the past 15 years suggest that the MSP for rice is generally 1.8 times the MSP for paddy on a per quintal basis. The MSP for the current fiscal was Rs. 675/quintal for paddy. The MSP for paddy was increased by a bonus of Rs. 100 later during October, with a corresponding increase in the rice MSP. There has been a steady increase in the MSP price over the past 15 years. MSP for paddy has risen from Rs. 330/quintal in 1993-94 to Rs. 675/quintal in 2007-08.

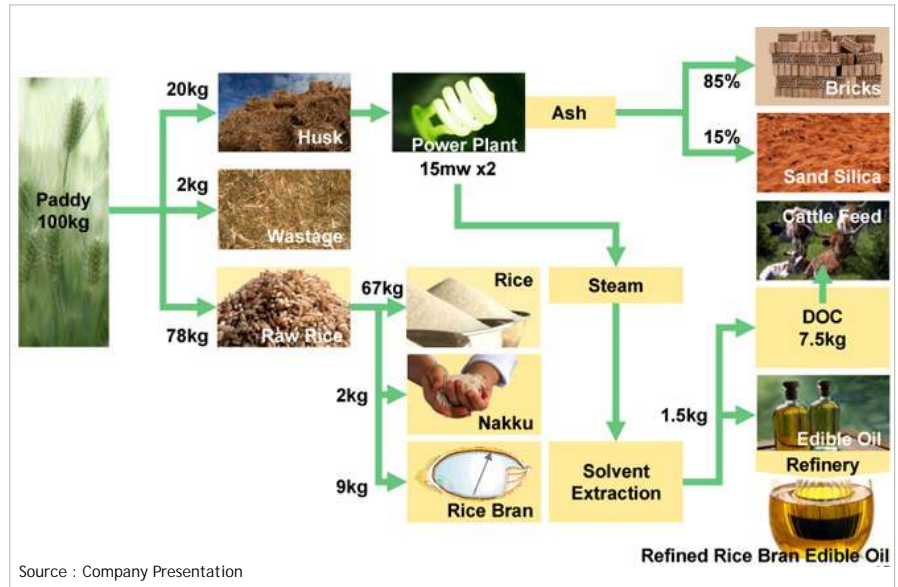
Procurement cost is incurred to the tune of 17.5% on MSP. This is on account of 4% VAT, 4% Mandi Tax, 2% Handling Cost (incl. brokerage), 4% Transport/Freight and 3.5% Agent's Commission. LEAF has been granted a waiver of 4% market fee for 10 years on paddy purchases until 2017, due to its biomass energy initiative. The net impact would be limited to 13.5-14% on MSP. The processing costs (incl. interest & depreciation) range from Rs. 35 to Rs. 50 per quintal depending on scale & efficiency.



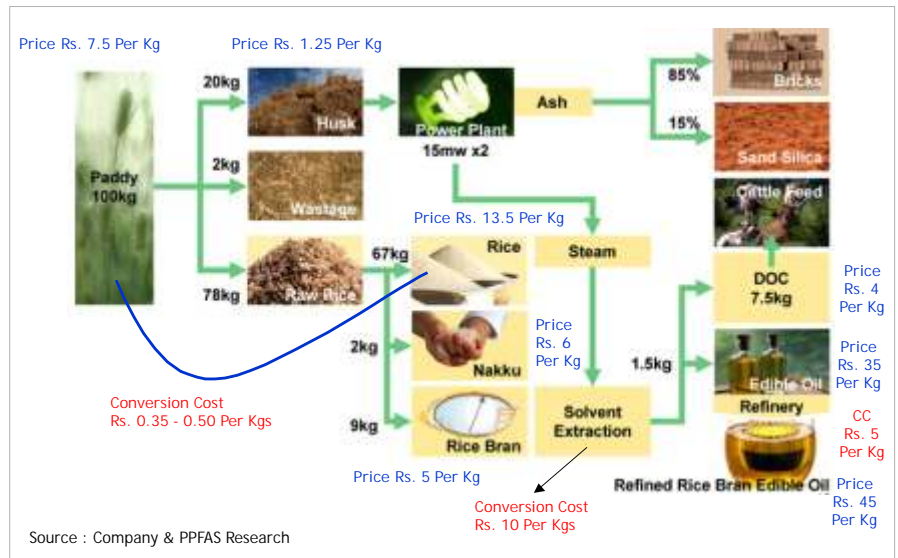
FCI as its mainstay brings in various benefits like steady & improving margins, huge volumes off-take on almost assured basis, economic viability in further processing of by-products, low/nil sales effort. This is reflected in the outstanding track record of LEAF's revenues growing at 41% CAGR & profits at a rocketing 164% CAGR over FY03-07 period.

For a commodity product with a long process chain, there are various parameters that may play crucial role at various stages. The overall profitability depends on volumes, realizations and conversion costs at various stages of functionality. The underlying graphs make this understanding easier.

Process Flow Chart



Key Prices & Conversion Costs



Solvent extraction is the most profitable activity in the above process flow. In the above graph we have shown the prices at every intermediate stage and the conversion cost at each process. The overall profitability at each stage is further elucidated in our working on [Page 12](#).

The underlying table summarizes the growth in stage-wise capacities over the years.

Installed Capacity								
TPA	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Paddy/Rice	350,000	561,000	705,000	972,000	1,350,000	1,950,000	2,850,000	2,850,000
Solvent Extraction	30,000	30,000	60,000	60,000	60,000	90,000	90,000	120,000
Oil Seed Processing	45,000	45,000	0	0	0	0	0	0
Cattle Feed	24,000	24,000	24,000	24,000	24,000	24,000	60,000	60,000
Refinery	9,000	9,000	9,000	9,000	9,000	9,000	12,000	18,000
Wheat Flour	0	0	0	0	30,000	60,000	90,000	90,000
Power (MW)	0	0	0	0	30	30	60	105

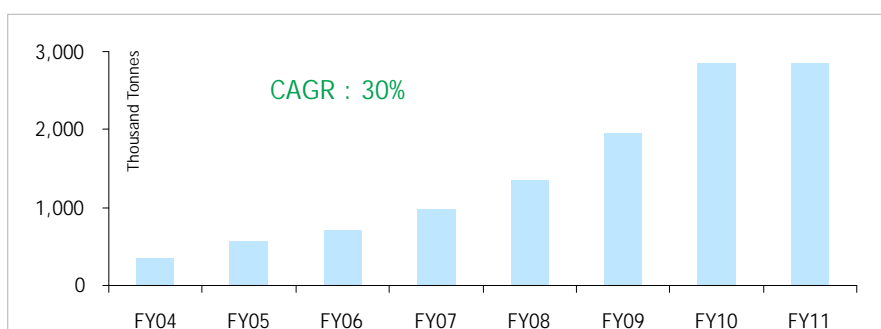
Source : Company + PPFAS Research

In FY08, LEAF has expanded its paddy processing capacity from 130 MT/hour to 225 MT/hour, i.e. an effective capacity of 1.35 Million Metric Tonnes per annum. This was undertaken at a cost of Rs. 1,250 Mn. Also, including a 30 MW biomass based power plant and modernization of its existing facilities, LEAF has incurred a total of Rs. 2,500 Mn. in the past two years. The funding was through term loans to the tune of Rs. 1,140 Mn. (Rs. 700 Mn. for expansion & Rs. 440 Mn. for power plant), 5% preferential allotment & warrants to promoters at prices ranging from Rs. 120 to Rs. 187 per share, all to be converted by April 08 and the balance by internal accruals.

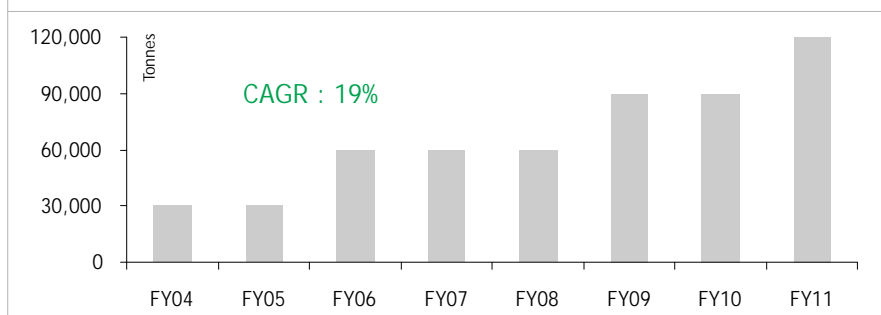
To further its growth initiatives, Lakshmi has charted a ~ Rs. 8,000 Mn. capex plan for the period FY09-12, which it plans to fund 50% through debt and balance 50% through internal accruals. The excellent overall margins and a decent asset turnover do not warrant any equity dilution. The leverage is expected to remain under control at ~ 0.5x going ahead.

Installed Capacity

Paddy Processing



Solvent Extraction



Brief description about the expansion for various segments is given below

Rice

Long grain non-basmati paddy

- FY 08 : 1.35 million MT/annum
- Mid FY 10 : 2 million MT/annum
- Mid FY 11 : 3 million MT/annum

Wheat flour

- Processing capacity of 100 MT/day.
- Additional 200 MT/day expected to be commissioned in the next nine months

Rice Bran Oil

- Processing capacity of 300 MT/day of rice bran and oil refining capacity of 30 MT/day
- Refining capacity expected to increase to 60 MT/day in 2008-09

Ancillary Products

- Cattle feed : Production capacity of 130 MT/day to be modernized and increased
- Paddy husk : Used for power generation

Biomass Power Project

- Generation of power by setting up a biomass husk and wheat straw based power plants
- First 30 MW biomass power-plant in India using husk as fuel
- Biomass power enjoys 100% tax exemption and 80% depreciation benefit in the first year
- Power to contribute over 25% to LEAF's bottom line in the longer run
- Eligibility to earn carbon credits and encash them for 10 years
- Total capacity of plant will be 105 MW in 4 years

With the above expansion in place, LEAF would have to alter its strategy of dependence on FCI sales. While the FCI sales will increase the gradual way, this multi-fold increase in capacity will have to be absorbed by outside sales. For this company plans to get into packaged sales (1kg, 2kg, 5kg, 10kg, 25 kg packs of premium non-basmati rice) to be sold mostly under 'Lakshmi Foods' brand name or maybe a private label through large format retailers. This strategy is appropriate considering the lack of sales experience of the company. The setting up of PGRL also augurs well in this regard.

Punjab Greenfield Resources Ltd (PGRL)

This wholly owned subsidiary of the Company was incorporated on 31st Jan 2007. The objective of PGRL is to procure and distribute foodgrains, pulses, vegetables, fertilizers, seeds & pesticides and undertake contract farming and farm R&D. Also we believe that PGRL will handle the branded sales of parent company. For these branded sales, the company has already appointed 18 distributors, who would be provided with advertising support by PGRL. The management anticipates as much as Rs. 2,500 Mn. sales in FY09 & Rs. 5,000 Mn. in FY10 to come from the branded segment. To push the branded sales, PGRL plans to spend upto Rs. 100 Mn. as advertising cost in FY09.

LEAF has explained in detail the functionality of PGRL in its update to BSE. The same is given below :

Corporate Announcements		
Scrip Code: 519570	Company Name: LAKSHMI OVER	October 15, 2007
News Subject:	<p>Lakshmi Overseas Industries Ltd has announce BSE that the working of Punjab Greenfield Resources Ltd (PGRL), a wholly owned subsidiary of the Company.</p> <p>PGRL is managed by professional team of officers drawn from different areas of cotton procurement, retail marketing and trade. PGRL is headed by Mr. D K Dhawan, Chief Executive Officer having three decade rich experience in Agri-business, commodity trade, import / export, distribution & logistics and has worked for 27 years in Food Corporation of India (FCI) at various senior positions. PGRL is ably guided by Mr. G S Dhiman, President (Agri-business) having experience in procurement of commodities, domestic & international trade, installing power projects and spinning mills.</p> <p>PGRL is entering into "contract farming" of wheat, seed production and extension services for the welfare of Punjab as a part of Research and Development activities.</p> <p>PGRL is in the process of procurement of cotton and is finalizing agreements with farmers to mop Best Quality Kinnows during the month.</p>	
News Body:	<p>PGRL has invited offers from the interested farmers of Punjab to undertake contract farming of wheat in 2000 acres to be grown / cultivated under the expert professional and scientific guidance of PGRL Team, Seeds, fertilizers and pesticides will be provided on subsidized basis from PGRL and advances to the farmers could be arranged through a Nationalized Bank. Low interest rates from Nationalized Bank arranged will certainly provide impetus to Punjab Farmers for adopting scientific agronomical practices to take up contract farming. Wheat produced under contract farming by PGRL will carry minimum yield guarantee and prices to be paid to farmers by PGRL under the prescribed agreement. Farmers will be paid prevailing market prices of wheat at the time of sale to PGRL.</p> <p>PGRL proposes to enter import / export of commodities in the international market in near future. PGRL is all set to jump into consumer market shortly with a dozen products of wheat and rice initially, which will further be strengthened through pulses and spices for each kitchen requirements. Infrastructure activities are also being explored with the intention to contribute further in development of Punjab State.</p>	

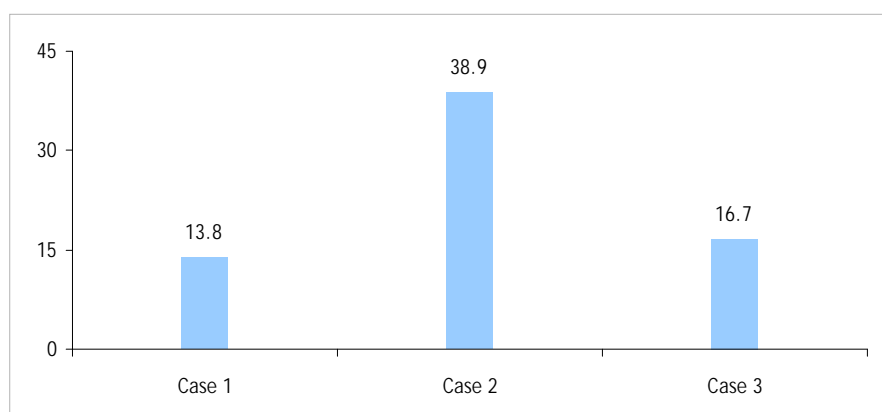
Source : BSE Website

Understanding Economics of the Value Chain

Case 1 : If Sales is made at Rice Bran Stage	
Particulars for 1 Quintal (100 kgs)	Rs.
Raw Paddy Cost	675
Procurement Cost (Incl. Taxes & Other Charges)	101
Total Material Cost	776
Processing Cost (incl. Int. & Dep.)	40
Total Cost	816
Total Realization (incl. By-Products)	909
Profit	93
Case 2 : If Rice Bran is Processed Further	
Particulars for 1 Quintal (100 kgs)	Rs.
Incremental Sales	45
Cost of Further Processing	10
Incremental Profit	35
Case 3 : If Edible Oil and DOC are Processed Further	
Particulars for 1 Quintal (100 kgs)	Rs.
Incremental Sales	24
Cost of Further Processing	5
Incremental Profit	19
Summary for Case 3	
Particulars for 1 Quintal (100 kgs)	Rs.
Total Sales	978
Total Cost	831
Total Pre-tax Profit	147

Source : PPFAS Research

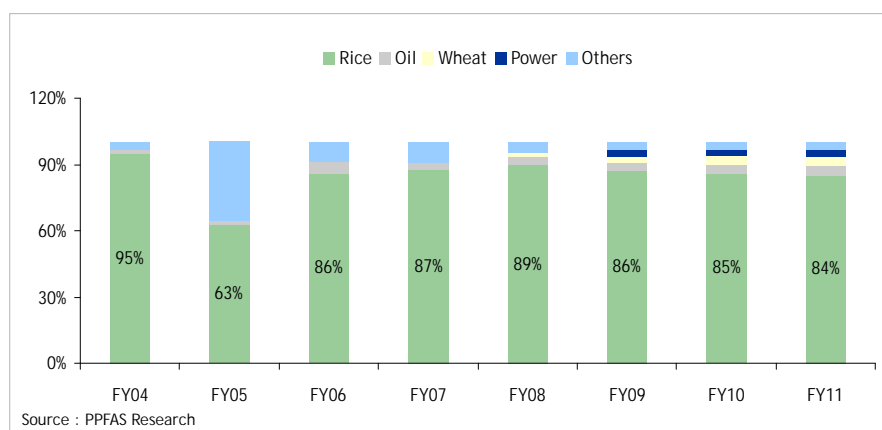
These profits would be subjected to normal taxation. However, Lakshmi would additionally benefit from the PPA for sale of power to PSEB at Rs. 3.59 per unit. Profits on this would be tax-exempt.



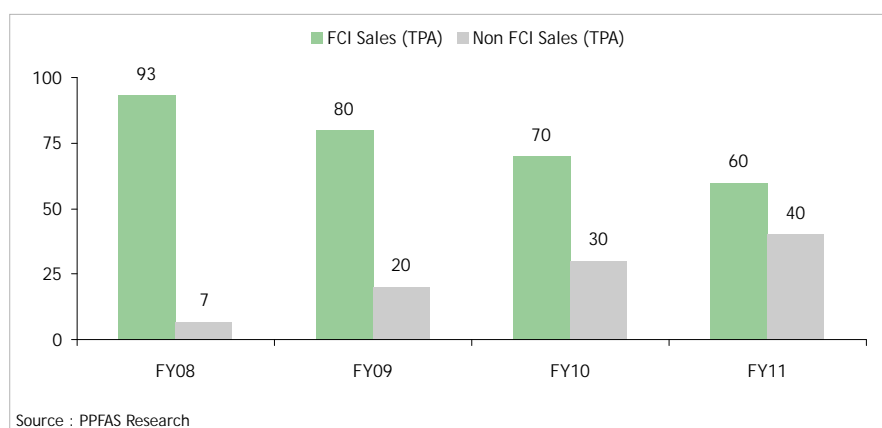
Solvent Extraction (Case 2) is the highest margin activity with 39% overall margins. Refining activity generates just under 17% margins. However, the overall margins depend on the weighted average mix, which beyond a point cannot be altered due to the integral dependence of the products on each other. The next point further elucidates this.

Changing Sales Mix

Sales Summary								
Rs. Mn.	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Rice	2,157	2,567	4,807	6,080	7,864	11,261	14,789	15,196
Incremental - Branded Sales	0	0	0	0	61	248	488	669
Nakku	1	4	68	47	122	117	171	171
Crude Rice Bran Oil	50	66	300	263	365	527	770	770
Rice Bran DOC	16	43	158	112	203	293	428	385
Others - Husk + Wastage	13	36	41	154	149	0	0	0
Wheat Flour	0	0	0	0	152	609	914	914
Refined Rice Bran Oil	0	0	0	0	0	0	0	0
Power	0	0	0	0	0	343	343	686
Others	35	1,360	209	307	0	0	0	0
Total	2,272	4,077	5,584	6,963	8,914	13,397	17,901	18,789



Despite the increasing trend in value addition of by-products, the share of rice remains steady at 85-90%. This is because any quantum of value addition to the by-product only can follow an expansion at the paddy-processing stage. Important to note in the chart is the decreasing share of 'Others', which is primarily husk & waste, makes way for contribution for high value added segments like Oil & Power. Also, the share of rice sales to Non FCI segment is increasing within the overall rice segment, contributing towards margin improvement.



Lakshmi Energy & Foods Limited (LEAF) is the largest manufacturer of non-basmati rice in India. This North-India based fully integrated company has an outstanding track record with its revenues growing at 41% CAGR & profits at a rocketing 164% CAGR over FY03-07 period; this growth primarily being led by increasing expansion & increasing integration (ergo, increasing margins). Going ahead we see LEAF maintaining its accelerating pace of growth as it progresses with its ambitious expansion plans while maintaining integration. Forward integration into packaged & branded goods and investments in biomass energy add flavour to LEAF's strategy to cash in from the present & somewhat sustainable agri-boom.

Key Beneficiary of the Agricultural Boom

The diminishing area of cultivable land and the increasing (per capita & absolute) consumption especially in a developing economy like India has brought about a mismatch in the demand-supply symmetry for consumables & farm inputs. For example, rice is witnessing a demand growth of 5% against an expected production growth of just 2%. The processed food segment is experiencing a much higher demand growth on account of changing consumption pattern & its current nascent stage of growth. These are marks of an extremely profitable time for the farmers & agro-processors like LEAF.

Some key triggers for the Indian agri-sector are listed below.

- ☑ Catalyst in form of emerging organized retailing
- ☑ Participation of private sector with initiatives like E-choupal
- ☑ Emergence of Private Sector in farm business & reformations in APMC Act
- ☑ Efficient price discovery mechanisms through large & active commodity exchanges

Stable Business Segments

What best we like about LEAF is its preference for some seemingly less appealing facets like non-basmati v/s basmati and to deal with the Government's Food Corporation of India. The non-basmati rice segment is relatively a much more stable business in terms of pricing. With almost the entire business done with FCI, offers the dual advantage of high volumes and assured prices. Even post expansion, LEAF will continue to derive most of its earnings from the non-basmati rice business and FCI sales would still be high at ~70%, thereby continuing to be a crucial support to its margins.

Outstanding Track Record	LEAF has an outstanding track with its revenues growing at 41% CAGR & profits at a rocketing 164% CAGR over FY03-07 period; this growth primarily being led by increasing expansion & integration (ergo, increasing margins). The topline grew from Rs. 2,272 Mn. in FY04 to Rs. 6,963 Mn. in FY07 and the OPMs ballooned from 3.7% to 16.8% generating over 6 fold increase in net profits from Rs. 89 Mn. to Rs. 603 Mn.
Enterprising Expansion Plans	In FY08, LEAF has expanded its paddy processing capacity from 130 MT/hour to 225 MT/hour, i.e. an effective capacity of 1.35 Million Metric Tonnes per annum. Over the next 2-3 years during FY11, this capacity would further grow to process upto 3 Million Metric Tonnes per annum. Small diversification into wheat processing and a serious foray into branded & packaged rice business add flavour to the growth story.
Robust Outlook on Growth, Margins & Returns	Apart from the expansion led growth (20% CAGR, FY07-11E), the return ratios remain very attractive in the range of 25-30%. These are driven by the healthy margins from effective use of byproducts and investments into biomass energy generation. The PAT margins would show further improvement on account of the increasing tax benefits upon stage-wise commissioning of the power plant. We have not factored in any inventory gains on account of inflation & also any possible carbon credit gains, for which the company has made an application to UNFCCC.
High Entry Barriers	There is no concerning threat of any significant competition from another large player. Setting up a large capacity, say about 1 MMT would entail a Rs 10 Bn investment and a high gestation period. Also, it would make little difference as LEAF contributes just about 1% of the Indian capacity. But most importantly, note that the entry from most players in the somewhat related Basmati segment has been non-evident in the past many years. This is because of the big difference in the way the logistics are managed for the high-volume non-basmati segment. At its current scale LEAF manages procurement from 300 mandis in Punjab involving use of nearly 1000 trucks per day and managing 2.5 crores bags of paddy. This difficulty and its inexperience in managing such stiff logistics is what has kept competition at bay.
Attractive Valuations	The scrip trades at 7.1x FY09E & 5.2x FY10E earnings. This we believe is attractive considering the shining past performance, sustained profit growth (37% CAGR, FY07-11E) and comforting return ratios. The relative stability in business in terms of volumes & pricing gives LEAF an edge over other listed food processing companies. We recommend BUY based on our DCF calculations with a price objective of Rs. 280 (40% upside), at which the scrip would trade at 7.3x FY10E EPS.

LEAF - A play on Inventory Gains ??

For LEAF, the inventory is primarily paddy. Finished rice is generally dispatched with a day or two of processing. Inventory is procured during the crop season, which last for a 3-4 months, starting from mid September. Unlike wheat, paddy can be stocked for longer durations in the open, without much storage infrastructure.

“When the price of inventory is rising over time, value of the inventory & earnings will tend to be higher in case of FIFO based inventory valuation.”

Paddy	Quantity (MT)	Increase (MT)	Price (Rs/MT)	Increase (Rs/MT)	Gains (Rs Mn)
FY03	22,186.3	-	6,050.0	-	-
FY04	41,503.1	19,316.8	6,500.0	450.0	8.7
FY05	41,709.4	206.4	6,249.9	(250.1)	(0.1)
FY06	122,397.7	80,688.3	7,250.0	1,000.1	80.7
FY07	217,894.1	95,496.4	7,915.0	665.0	63.5

The above table suggests that Inventory Gains accounted for almost 19% & 11% of LEAF's FY06 & FY07 Net Profit respectively. Whether this would continue in future depends on various parameters like price trend and sales volumes. However, considering the aggressive expansion plans in place, LEAF may have an aggressive sourcing policy in place. The general rising nature of price trend and the increased need for inventory for expanded capacity suggest, that these gains may continue over the coming few years. On the flipside, too much inventory would bring in stock valuation risks and also burden with high holding costs & blockage of capital.

- Concerns
- ☒ Inventory Gains may not be sustainable and may bring in negative surprise in terms of margin & profit expectations. For our forward calculations we have assumed flat pricing for both raw materials & finished products.

Realization per Quintal (Rs.)								
Particulars	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Rice	1,266.06	1,002.81	1,195.55	1,214.13	1,350.00	1,350.00	1,350.00	1,350.00
Paddy ^	650.00	625.00	689.69	736.92	868.90	862.50	858.75	855.00
Procurement Cost %					16.5%	15.0%	14.5%	14.0%
^ incl. of Procurement cost								
Procurement Cost % reducing on account of 4% Market Fees Waiver								

- ☒ Delays in capacities coming up and lower utilization will result into performance below expectation.
- ☒ Paddy procurement for 2.2x capacity may become a constraining factor. However, this largest player with its money power & yet, just 1% share, can throw its weight on some fragmented small millers. Nevertheless, we have assumed a very staggered & gradual improvement in utilization over the years. To be precise, we have assumed 30% utilization in FY10 & 35% in FY11 for the 250MT/hour capacity, we have assumed to be added in FY10. Also there is some potential for increasing yield-per-hectare through better farm practices.
- ☒ The margins may compress on account of future input & output prices, driven by competitive & regulatory pressures.
- ☒ Most importantly, LEAF will now have to change its strategy for increasing sales to non-FCI segment, especially packaged & branded sales. This is an untested venture for LEAF and a smooth execution on this front would be a key challenge.
- ☒ We have not factored in any trading sales & profit in PGRL (for our obvious inability to forecast quantum of any trading activity). This low margin trading activity may increase absolute profits but would lower the consolidated margins, which may impact the overall perception & the market valuation of LEAF. There is also an equal likelihood of losses from this trading activity, which would impact both absolute profits and overall margins.
- ☒ Highly fragmented nature of business may cause an unexpected influence on LEAF's performance.
- ☒ Poor dividend distribution policy relative to a FMCG play

LEAF has posted a net profit of Rs 329.6 million for the quarter ended Dec 31, 2007 as compared to Rs 282.2 million for the quarter ended Dec 31, 2006. Total Income has increased from Rs. 1820 million for the quarter ended Dec 31, 2006 to Rs. 2466.4 million for the quarter ended Dec 31, 2007. Rice and Rice Bran Oil account for 86% and 4.76 % of the sales. For the nine months ended 31st December 2007, LEAF has recorded a PAT of Rs.952.5 Mn, a growth of 36 percent over the corresponding period of the previous year. The company generated total sales of Rs.6446.9 Mn in the nine months ended 31st December 2007, a growth of 31.23% percent over the corresponding period of the previous year.

Particulars (%)	Dec-07	Dec-06	Y-Y Chng (%)	Sep-07	Q-Q Chng (%)
Rice	86.1	81.4	5.80	87.6	(1.70)
Nakku	1.1	0.1	863.60	2.4	(55.50)
Rice Bran Oil	4.8	9.5	(49.90)	5.7	(16.80)
Others	8	9	(0.11)	4.3	(1.03)

LEAF has not provided for Deferred tax in the first three quarters of the fiscal. We believe that the PAT for the March quarter would be impacted on account of provision of Deferred tax for the entire year.

Earnings Statement								
YE March (Rs. Mn.)	Q308	Q208	Q-Q(%)	Q307	Y-Y(%)	9M08	9M07	Y-Y(%)
Net Revenues	2,466.4	2,053.6	20.10%	1,820.0	35.51%	6,446.9	4,912.5	31.23%
Cost of Materials	1,866.2	1,542.6	20.98%	1,452.1	28.52%	4,885.2	3,997.1	22.22%
Gross Profit	600.2	511.0	17.45%	368.0	63.12%	1,561.7	915.4	70.61%
Staff Costs	10.3	10.0	3.20%	7.9	31.09%	28.7	19.9	44.42%
Other Expenses	43.1	49.6	-13.04%	25.5	69.31%	127.6	58.5	118.10%
Total Expenditure	53.4	59.6	-10.31%	33.3	60.28%	156.4	78.4	99.40%
Operating Profit	546.8	451.5	21.11%	334.6	63.40%	1,405.4	837.0	67.91%
OPM (%)	22.17%	21.98%	0.84%	18.39%	20.58%	21.80%	17.04%	27.94%
Other Income	2.8	1.8	53.01%	3.0	-6.98%	13.3	5.5	142.60%
EBITDA	549.6	453.3	21.24%	337.6	62.78%	1,418.6	842.5	68.39%
Depreciation	58.3	67.8	-14.06%	12.3	374.37%	156.6	34.4	355.79%
EBIT	491.3	385.5	27.45%	325.3	51.01%	1,262.0	808.1	56.17%
Interest	111.3	44.4	150.36%	11.8	845.28%	179.6	29.8	501.84%
PBT	380.0	341.0	11.44%	313.6	21.19%	1,082.4	778.3	39.08%
Tax	50.4	38.6	30.49%	31.4	60.78%	129.9	77.8	66.90%
PAT	329.6	302.4	9.00%	282.2	16.79%	952.5	700.4	35.99%
Equity Capital	120.1	120.1	0.00%	114.3	5.03%	120.1	114.3	5.03%
EPS	5.5	5.0	9.00%	4.9	11.20%	15.9	12.3	29.48%
Ratio Analysis								
Profitability								
YE March (Rs. Mn.)	Q308	Q208	Q-Q(bps)	Q307	Y-Y(bps)	9M08	9M07	Y-Y(bps)
OPM (%)	22.17%	21.98%	18.5	18.39%	378.4	21.80%	17.04%	476.1
EBITDA (%)	22.28%	22.07%	20.9	18.55%	373.2	22.00%	17.15%	485.6
EBIT (%)	19.92%	18.77%	114.9	17.88%	204.4	19.58%	16.45%	312.6
PAT (%)	13.36%	14.72%	(136.1)	15.51%	(214.2)	14.77%	14.26%	51.7
Operational Parameters								
YE March (Rs. Mn.)	Q308	Q208	Q-Q(bps)	Q307	Y-Y(bps)	9M08	9M07	Y-Y(bps)
RM Consumed	75.7%	75.1%	55.0	79.8%	(411.9)	75.8%	81.4%	(559.0)
Staff Cost	0.4%	0.5%	(6.9)	0.4%	(1.4)	0.4%	0.4%	4.1
Other Expenditure	1.7%	2.4%	(66.6)	1.4%	34.9	2.0%	1.2%	78.8
Effective Tax Rate	13.27%	11.33%	193.7	10.00%	326.7	12.00%	10.00%	200.0

Sales Analysis & Assumptions								
Particulars	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Rice								
Processing Capacity (TPA)	234,500	375,870	472,350	651,240	904,500	1,306,500	1,909,500	1,909,500
Utilization (%)	72.64%	68.11%	85.12%	76.89%	64.40%	63.85%	57.37%	58.95%
Realization per Quintal (Rs.)	1,266.06	1,002.81	1,195.55	1,214.13	1,350.00	1,350.00	1,350.00	1,350.00
Nakku								
Processing Capacity (TPA)	7,000	11,220	14,100	19,440	27,000	39,000	57,000	57,000
Utilization (%)	22.45%	8.31%	95.63%	33.59%	50.00%	50.00%	50.00%	50.00%
Realization per Quintal (Rs.)	34.66	479.55	507.41	721.32	900.00	600.00	600.00	600.00
Crude Rice Bran Oil								
Processing Capacity (TPA)	5,250	8,415	10,575	14,580	20,250	29,250	42,750	42,750
Utilization (%)	27.05%	25.28%	102.92%	50.86%	40.00%	40.00%	40.00%	40.00%
Realization per Quintal (Rs.)	3,524.59	3,113.84	2,759.68	3,544.95	4,500.00	4,500.00	4,500.00	4,500.00
Rice Bran DOC								
Processing Capacity (TPA)	26,250	42,075	52,875	72,900	101,250	146,250	213,750	213,750
Utilization (%)	21.46%	61.53%	89.81%	44.11%	50.00%	50.00%	50.00%	45.00%
Realization per Quintal (Rs.)	287.98	165.32	332.83	347.12	400.00	400.00	400.00	400.00
Others - Husk + Wastage								
Processing Capacity (TPA)	77,000	123,420	155,100	213,840	297,000	429,000	627,000	627,000
Utilization (%)	13.15%	25.54%	17.14%	33.58%	25.00%	25.00%	25.00%	25.00%
Realization per Quintal (Rs.)	132.76	115.09	155.28	214.81	200.00	200.00	200.00	200.00
Wheat Flour								
Processing Capacity (TPA)	0	0	0	0	30,000	60,000	90,000	90,000
Utilization (%)	0.00%	0.00%	0.00%	0.00%	35.00%	70.00%	70.00%	70.00%
Realization per Quintal (Rs.)	0.00	0.00	0.00	0.00	1,450.00	1,450.00	1,450.00	1,450.00
Inputs Analysis & Assumptions								
Particulars	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
RM Consumed								
Paddy (TPA)	7,335	220,350	502,800	554,300	728,973	1,045,725	1,404,675	1,424,138
Paddy (Amt Rs. Mn.)	48	1,377	3,468	4,085	6,334	9,019	12,063	12,176
Paddy Realization/ Quintal	650	625	690	737	869	863	859	855
Raw Rice (TPA)	159,997	141,143	94,699	128,681	0	0	0	0
Raw Rice (Amt)	1,539	1,133	876	1,190	0	0	0	0
Raw Rice Realzn./ Quintal	962	803	925	925	0	0	0	0
P+RR (TPA)	167,332	361,494	597,499	682,981	728,973	1,045,725	1,404,675	1,424,138
P+RR (Amt)	1,587	2,510	4,344	5,275	6,334	9,019	12,063	12,176
P+RR Realization/ Quintal	948	694	727	772	869	863	859	855
Rice Barn (TPA)	11,430	21,645	59,510	67,222	58,725	84,825	123,975	113,288
Rice Barn (Amt)	42	65	298	336	294	424	620	566
Rice Barn Realzn./Quintal	370	300	500	500	500	500	500	500
Wheat RM (TPA)	0	0	0	0	10,500	42,000	63,000	63,000
Wheat RM (Amt)	0	0	0	0	102	407	610	610
Wheat RM Realzn./Quintal	0	0	0	0	969	969	969	969

Relative Valuation

Description	P/E	EPS (TTM)	PBDIT	PAT	RONW	ROCE	CAGR (FY04-07)	
Company	(x)	(Rs.)	(%)	(%)	(%)	(%)	Revenues	PAT
Chaman Lal Setia	5.8	4.6	6.6	2.4	10.0	11.0	10.2%	16.5%
Kohinoor Foods	10.8	10.8	10.4	3.8	16.8	9.4	7.4%	15.9%
KRBL	8.3	14.4	13.3	5.4	17.9	14.0	19.2%	36.6%
LT overseas	4.3	12.5	10.8	4.3	22.8	13.5	10.8%	40.3%
REI agro	55.0	24.2	18.3	8.4	25.3	13.0	12.5%	55.0%
LEAF	11.2	18.6	17.0	12.4	34.8	31.4	32.4%	61.2%

Source : CapitaLine + PPFAS Research

There are no direct comparables as LEAF is the only pure non-basmati player listed on the bourses. The other players have diverse business dynamics; reflected in the stark difference in the operating parameters like margins, return ratios & growth.

DCF Valuation

Discounted Cashflow				
Particulars (Rs. Mn.)	FY08	FY09	FY10	FY11
Free Cashflow	(1,103.9)	(1,469.5)	(464.6)	1,565.8
Nos of Years	0.0	1.0	2.0	3.0
Free Cashflow Discounted	(1,103.9)	(1,300.4)	(363.8)	1,085.2
Discounting Rate				13.0%
Terminal Growth Rate				1.5%
Terminal Value				31,441.5
Terminal Value Discounted				21,790.5
PV - Interim Cashflows				(1,683.0)
PV - Terminal Value				21,790.5
Enterprise Value				20,107.5
Less : Debt				(2,733.4)
Add : Cash & Investments				530.6
Shareholder's Value				17,904.7
Nos of Equity Shares				63.2
Fair Value (Rs.)				283.3
Upside				41.7%

Opinion

Despite the perception of a typical commodity play, LEAF has demonstrated a sustained steady improvement in performance with its margins & return ratios comparable to a FMCG play. The scrip trades at commodity valuations of 7.1x FY09E & 5.2x FY10E earnings. This we believe is attractive considering the shining past performance, sustained profit growth (37% CAGR, FY07-11E) and comforting return ratios (25-30%). The relative stability in business in terms of volumes & pricing gives LEAF an edge over other listed food processing companies. We recommend BUY based on our DCF calculations with a price objective of Rs. 280 (40% upside), at which the scrip would trade at 7.3x FY10E EPS.

Earnings Statement								
Particulars	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Total Revenues	2,272.0	4,077.1	5,583.9	6,962.7	8,913.5	13,397.0	17,901.3	18,789.4
- Growth (%)		79.5%	37.0%	24.7%	28.0%	50.3%	33.6%	5.0%
Total Expenditure	2,187.9	3,748.1	4,841.1	5,795.5	7,000.9	10,379.4	14,020.4	14,137.4
Operating Profit	84.1	329.0	742.8	1,167.2	1,912.6	3,017.6	3,880.9	4,651.9
Other Income	66.0	42.3	7.8	21.0	29.3	26.0	16.4	18.5
EBITDA	150.1	371.3	750.6	1,188.2	1,941.9	3,043.6	3,897.3	4,670.4
Depreciation	20.3	27.2	49.2	121.9	214.0	314.0	414.0	514.0
EBIT	129.8	344.1	701.4	1,066.2	1,727.9	2,729.6	3,483.3	4,156.4
Interest	28.9	54.0	65.1	45.0	287.0	476.0	602.0	707.0
PBT	100.9	290.1	636.4	1,021.2	1,440.9	2,253.6	2,881.3	3,449.4
Tax	10.7	109.6	216.4	417.9	410.7	462.0	446.6	534.7
PAT Before EI	90.2	180.5	420.0	603.3	1,030.3	1,791.6	2,434.7	2,914.7
- Growth (%)		100.1%	132.7%	43.6%	70.8%	73.9%	35.9%	19.7%
Extra-ordinary Items	(0.8)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reported PAT	89.4	180.5	420.0	603.3	1,030.3	1,791.6	2,434.7	2,914.7
Ratio Analysis								
Particulars	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
OPM (%)	3.7%	8.1%	13.3%	16.8%	21.5%	22.5%	21.7%	24.8%
EBITDA (%)	6.6%	9.1%	13.4%	17.1%	21.8%	22.7%	21.8%	24.9%
PBIT (%)	5.7%	8.4%	12.6%	15.3%	19.4%	20.4%	19.5%	22.1%
PAT (%)	4.0%	4.4%	7.5%	8.7%	11.6%	13.4%	13.6%	15.5%
Interest Cover (x)	4.5	6.4	10.8	23.7	6.0	5.7	5.8	5.9
EPS (Rs.)	1.8	3.5	7.7	10.6	16.3	28.4	38.5	46.1
P/E (x)	109.7	57.5	25.9	19.0	12.3	7.1	5.2	4.3
P/BV (x)	12.0	10.4	6.7	4.6	2.9	2.1	1.5	1.1
BVPS (Rs.)	16.6	19.2	30.0	43.6	68.3	95.6	132.4	175.7
Market Cap (Rs. Mn.)	9,893.0	10,387.0	10,887.0	11,433.0	12,638.0	12,638.0	12,638.0	12,638.0
M Cap/Sales (x)	4.4	2.5	1.9	1.6	1.4	0.9	0.7	0.7
EV (Rs. Mn.)	10,330.3	10,995.9	11,876.4	13,068.6	14,840.8	16,832.4	17,990.6	17,293.5
EV/EBITDA (x)	68.8	29.6	15.8	11.0	7.6	5.5	4.6	3.7
EV/Sales (x)	4.5	2.7	2.1	1.9	1.7	1.3	1.0	0.9
ROCE (%)	10.2%	20.5%	25.8%	22.6%	24.5%	25.8%	24.7%	23.3%
RONW (%)	11.0%	18.1%	25.7%	24.2%	23.9%	29.7%	29.1%	26.3%
Debt/Equity Ratio (x)	0.5	0.7	0.7	0.9	0.6	0.8	0.7	0.6
Inventory T/o Days	107.9	87.1	129.6	147.0	150.0	150.0	150.0	150.0
Debtors T/o Days	14.0	10.6	1.3	2.0	10.0	15.0	20.0	25.0
Advances T/o Days	23.4	35.8	35.3	48.2	40.0	40.0	40.0	40.0
Creditors T/o Days	20.8	35.8	27.3	65.1	40.0	45.0	45.0	45.0
Working Cap T/o Days	125.8	104.1	128.8	142.1	168.5	154.6	158.2	195.8
Fixed Assets T/o (Gross)	2.8	4.5	4.3	2.8	2.1	2.1	2.2	1.8
DPS (Rs.)	0.0	0.6	0.4	0.9	1.0	1.0	1.5	2.5
Dividend Payout (%)	0.0%	16.9%	5.6%	8.5%	6.1%	3.5%	3.9%	5.4%
Dividend Yield (%)	0.0%	0.3%	0.2%	0.5%	0.5%	0.5%	0.8%	1.3%

Balance Sheet								
Particulars	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Equity Capital	98.9	103.9	108.9	114.3	126.4	126.4	126.4	126.4
Share Application Money			70.1	96.4	0.0	0.0	0.0	0.0
Reserves	722.8	894.7	1,452.5	2,283.5	4,192.5	5,912.0	8,238.6	10,973.3
Shareholders Funds	821.7	998.6	1,631.5	2,494.2	4,318.9	6,038.4	8,365.0	11,099.7
Borrowed Funds	446.4	681.9	1,082.3	2,233.4	2,733.4	4,533.4	5,733.4	6,733.4
Deferred Tax Liability			94.1	358.4	617.7	843.1	987.1	1,159.6
Total Liabilities	1,268.1	1,680.4	2,807.9	5,086.0	7,670.0	11,414.9	15,085.6	18,992.7
Fixed Assets	483.7	516.0	832.3	2,363.3	3,543.1	5,729.1	7,315.1	8,901.1
Investments	1.1	1.7	4.7	11.4	11.4	11.4	11.4	11.4
Current Assets								
Inventory	671.5	973.0	1,983.3	2,803.6	3,663.1	5,505.6	7,356.7	7,721.7
Sundry Debtors	87.1	118.5	19.9	38.8	244.2	550.6	980.9	1,286.9
Loans & Advances	145.9	399.5	539.7	919.0	976.8	1,468.2	1,961.8	2,059.1
Cash & Bank Balance	8.0	71.3	88.2	586.5	519.3	327.7	369.4	2,066.6
Current Liabilities								
Sundry Creditors	129.2	399.6	417.2	1,241.4	976.8	1,651.7	2,207.0	2,316.5
Provisions			242.9	395.2	311.0	525.9	702.7	737.6
Net Current Assets	783.4	1,162.8	1,971.0	2,711.3	4,115.5	5,674.4	7,759.1	10,080.2
Miscellaneous Expenditure	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Assets	1,268.1	1,680.4	2,807.9	5,086.0	7,670.0	11,414.9	15,085.6	18,992.7
Cash Flow								
Particulars	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Opening Cash & Bank	6.7	8.0	71.3	88.2	586.5	519.3	327.7	369.4
Profit After Tax	90.2	180.5	420.0	603.3	1,030.3	1,791.6	2,434.7	2,914.7
Invnt Income	(66.0)	(42.3)	(7.8)	(21.0)	(29.3)	(26.0)	(16.4)	(18.5)
Interest Paid	28.9	54.0	65.1	45.0	287.0	476.0	602.0	707.0
Miscellaneous Exp W/Off	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Depreciation	20.3	27.2	49.2	121.9	214.0	314.0	414.0	514.0
Deferred Taxation	2.1	2.1	69.9	264.3	259.4	225.4	144.1	172.5
Others	(43.1)	64.6	296.3	353.2	0.0	0.0	0.0	0.0
Change in Working Cap	59.8	(316.0)	(791.3)	(242.1)	(1,471.5)	(1,750.5)	(2,042.9)	(624.0)
CF - Operating Activities	93.2	(29.9)	101.3	1,124.7	289.8	1,030.5	1,535.4	3,665.8
Change in Fixed Assets	(38.1)	(95.3)	(400.9)	(1,688.2)	(1,393.8)	(2,500.0)	(2,000.0)	(2,100.0)
Change in Investments	0.0	(0.6)	(3.0)	(6.7)	0.0	0.0	0.0	0.0
Investment Income	66.0	42.3	7.8	21.0	29.3	26.0	16.4	18.5
CF - Investing Activities	27.9	(53.6)	(396.1)	(1,673.9)	(1,364.4)	(2,474.0)	(1,983.6)	(2,081.5)
Increase in Equity	15.0	0.0	0.0	0.0	866.4	0.0	0.0	0.0
Changes in Borrowings	(105.8)	235.5	400.5	1,151.1	500.0	1,800.0	1,200.0	1,000.0
Interest Paid	(28.9)	(54.0)	(65.1)	(45.0)	(287.0)	(476.0)	(602.0)	(707.0)
Dividend Paid	0.0	(34.5)	(23.7)	(58.7)	(72.0)	(72.0)	(108.1)	(180.1)
CF - Financing Activities	(119.7)	146.9	311.7	1,047.4	1,007.4	1,252.0	489.9	112.9
Net Change in Cash	1.3	63.4	16.9	498.3	(67.2)	(191.6)	41.8	1,697.1
Closing Cash & Bank Bal	8.0	71.3	88.2	586.5	519.3	327.7	369.4	2,066.6

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