

STOCK DATA

Market Capitalisation	Rs13.8bn
Book Value per share	Rs43.4
Eq Shares O/S (F.V. Rs.10)	72mn
Median Vol. (12 mths)	83,736
52 Week High / Low	304/138
BSE Scrip Code	500339
NSE Scrip Code	RAINCOM
Bloomberg Code	RCOL@IN
Reuters Code	RACL.BO

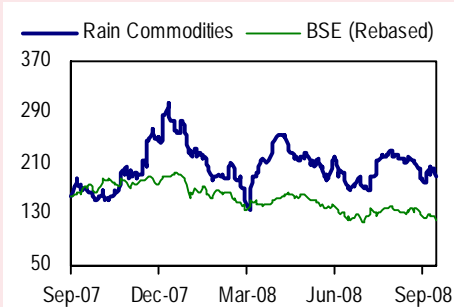
SHAREHOLDING PATTERN (%)

Qtr. Ended	Dec-07	Mar-08	Jun-08
Promoters	39.9	40.9	42.2
MFs/UTI/Fis	1.9	6.6	8.2
FII's/NRIs/OCBs	9.4	16.0	15.8
PCBs	30.6	18.5	17.5
Indian Public	18.3	18.0	16.3

STOCK PERFORMANCE (%)

	1M	3M	12M
Absolute	(11.9)	(1.9)	21.0
Relative	(2.6)	8.0	56.3

STOCK PRICE PERFORMANCE



Rain Commodities Ltd. (*Rain*), a Hyderabad-based company, is engaged in the manufacturing of calcined petroleum coke (CPC) and cement with an installed capacity of 2.5mn mtpa and 3.2mn mtpa respectively. It has emerged as the world's largest manufacturer of Calcined Petroleum Coke (CPC) with ~14% share of the global market (excl. China). CPC is consumed by primarily by the Aluminium and Titanium Dioxide industries and thus has strong demand visibility.

Rain client roster includes global majors like *Alcoa, Alcan, BHP Billiton, Dubai, Dupont, Alcasa, Norsk Hydro* etc. and domestic players like *Nalco, Vizag Steel and Kerala Minerals & Metals Ltd.*

Plans are afoot to expand its CPC capacity by 600k mtpa (400k mtpa with a 30MW power plant in India & 200k mtpa in China). Envisaged at a total outlay of ~USD150mn, these should be operational by Q2CY10.

With a 3.2mn mtpa capacity in cement, Rain is a formidable player in South India. Its latest plant of 1.5mn mtpa was operationalised in Jun'08, at a competitive cost of Rs3.3bn. This timely expansion will enable it to capitalise on the strong demand in its addressable market, which has the most stable consumption patterns in India, over the next 5-6 quarters.

At the CMP of Rs186, the stock trades at an EV/EBIDT and P/E of 4.3x and 2.8x its CY09E earnings. We expect the strong predictability of demand & margins, coupled with visibility of revenues and the operating leverage of the company's business model to enable it to capitalise on the trend of pricing advantage moving in favour of CPC manufacturers. Hence, we initiate coverage with a 'BUY' recommendation, with a price target of Rs300 on an investment horizon of 12 months.

INVESTMENT RATIONALE

- Rain's CPC business is on a strong footing as its global scale and presence afford it a discernible advantage on the raw material sourcing as well as marketing fronts, imparting stability to revenues as well as net profits.
- The timely expansion in cement should enable it to capitalise on the locational and costing advantages, in the immediate future.
- Stability in both its business line would result in high predictability of cash flows, and thus lead to a consistent de-leveraging of its balance sheet, which has the potential for a strong re-rating of the company.

KEY FINANCIALS (CONSOLIDATED)					(Rs Mn)		KEY RATIOS						
Yr Ended	Net Sales	YoY Gr (%)	Op Profits	Op Marg (%)	Net Profits	Eq Capital	Yr Ended	Dil. EPS (Rs.)	ROCE (%)	RONW (%)	P/E (x)	EV/Sales (x)	EV/EBIDT (x)
FY06	3,203	54.3	295	9.2	(767)	261	FY06	(5.4)	5.7	-	-	2.4	26.3
FY07	4,955	54.7	1,481	29.9	1,219	321	FY07	46.0	23.3	105.0	5.5	1.6	5.2
CY07(9M)	15,928	328.6	2,724	17.1	454	670	CY07(9M)	6.2	12.7	20.8	17.8	1.9	15.2
CY08E	47,758	124.9	9,405	19.7	3,739	720	CY08E	52.0	23.0	51.8	3.6	1.0	4.9
CY09E	55,176	15.5	10,197	18.5	4,841	720	CY09E	67.3	24.6	41.6	2.8	0.8	4.3

Started calcining operations in '89 with 240k mtpa capacity, along with a 49MW power plant...

Rain Calcining Ltd., promoted by Mr. Jagmohan Reddy, commenced operations in '89 with a Calcined Petroleum Coke (CPC) manufacturing plant of 240k mtpa capacity in Vishakapatnam (Vizag, A.P.), along with a 49Mw power plant. It went in for an IPO in '97 and augmented its CPC capacity by commissioning another line of 240k mtpa in '06. Through in-house expertise, it de-bottlenecked the capacity of each of its two CPC lines to 300k mtpa each, effectively taking its capacity to 600k mtpa in '08.

In '06, the promoters decided to merge operations of *Rain Calcining Ltd.*, with a group company namely *Rain Commodities Ltd.* The latter, incorporated in '74, had its IPO in '86 and operated a 1.16mn mtpa cement plant in Nalagonda, A.P, along with a 0.5 mn mtpa cement plant in the Yeraguntala cluster at Kurnool (A.P). The cement operations were housed in its 100% subsidiary, namely *Rain Industries Ltd (RIL)*.

The restructuring of business involved the following:

- 1) The cement business, housed in RIL, was transferred to Rain Commodities Ltd, w.e.f. Jul'06.
- 2) Rain Calcining Ltd. was amalgamated with *Rain Commodities Ltd (Rain)* by issuing 2 shares of Rain for every 7 shares held in *Rain Calcining Ltd.*, effective 1st April '07.
- 3) Subsequently, the CPC and power business, which came into Rain's fold, was transferred to RIL, effective 1st April '07, which in turn was renamed as *Rain CII Carbon (India) Ltd. (RCCIL)*.

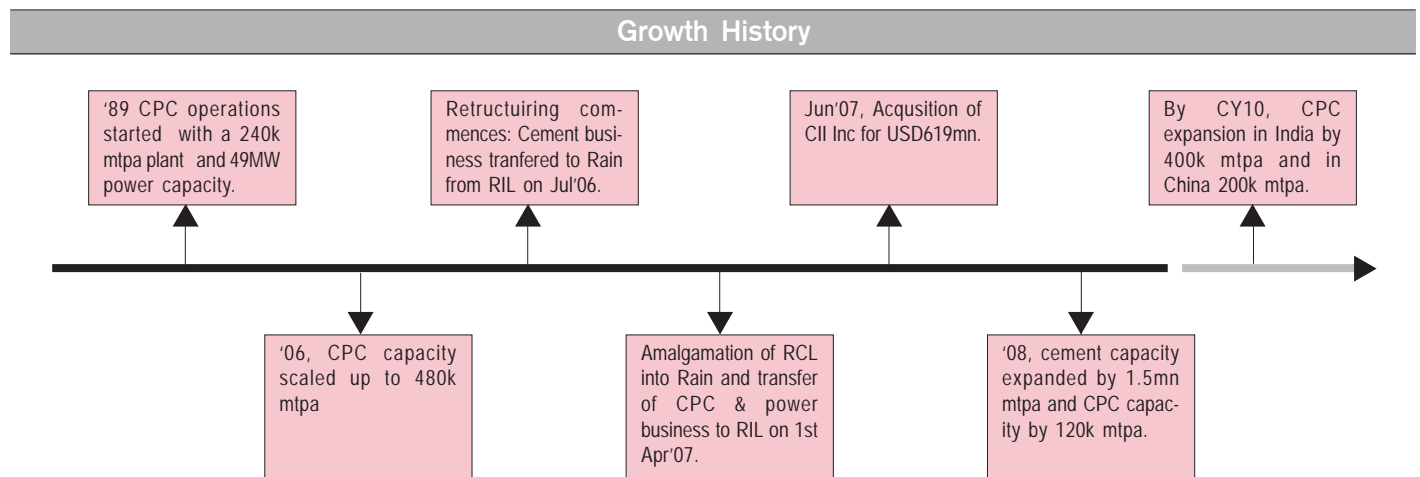
Post restructuring, there was only one listed entity viz. *Rain Commodities Ltd. (Rain)* which had an equity capital of 66.9mn shares (FV Rs10). In Nov'06, Rain's promoters subscribed to some warrants (at a premium of Rs190/warrant) and post exercise of the same, Rain's equity presently stands at 72mn shares of FV Rs10 each.

In June '08, Rain commissioned its third cement plant, with a capacity of 1.5mn mtpa at Kurnool (AP), at an outlay of Rs3.3bn.

International Acquisition: In '06-'07, Rain attempted to buy out *Great Lakes Carbon (GLC)*, a North American company, which was the largest CPC manufacturer in the world at the time. It bought ~20% stake in the company from a financial investor viz. *American Industrial Partners* for CAD11.6/share and made an attempt to buy a tranche of 73.5%, equity held by another financial investor namely *Great Lakes Carbon Income Fund*, which was a Toronto, Canada, listed fund. The transaction value would have been ~CAD767mn (~Rs25bn) at that time. However, *Oxbow Carbon and Minerals Holding Inc.*, a Florida based energy and mineral trader who was the world's largest trader in Pet coke, emerged as a counter bidder. After a bidding war, *Oxbow* successfully took over GLC at CAD14/sh. Rain exited its holdings in GLC at a profit of CAD2.4/sh.

CII acquisition boosted Rain's calcining capacity by 1.9mn mtpa...

Post this, Rain set out to acquire the next largest CPC manufacturer i.e. *CII Carbon LLC, USA (CII)* and succeeded in Jul'07. CII, with 7 plants in N. America, had a capacity of 1.9mn mtpa and the acquisition price was ~USD619mn, largely funded through debt.

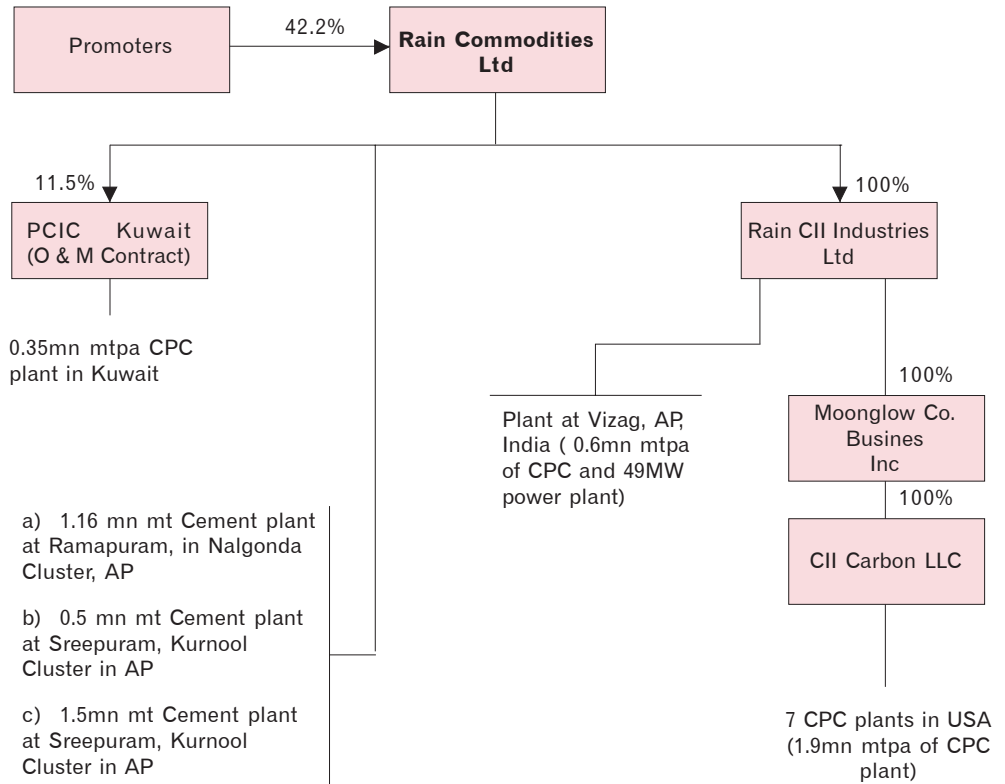


Restructuring resulted in cement operations of 3.2mn mtpa coming into Rain's portfolio...

At present, Rain owns and operates 3 cement plants with a combined capacity of 3.2mn mtpa, 8 CPC plants with a capacity of 2.5mn mtpa. Additionally, it also owns 11.5% stake (at a cost of Rs258mn) in a Kuwait based calcining company 'Petroleum Coke Industries Company' (PCIC) which is setting up a CPC plant in Kuwait, with a capacity of 350k mtpa. In addition to equity stake, Rain has an operational & maintenance (O&M) contract with the company for 5 years, for which it would be paid ~USD3.1/mt.

The structure and holdings of the company is given below.

Company Structure



Source: Company, PINC Research

CPC INDUSTRY

Calcined Petroleum Coke (CPC) is a form of electrically conductive, dense carbon (carbon content of ~99.5%) with very low specific electrical resistance. Its primary application is in *Aluminium Smelters* (as Anode), production of *Titanium Dioxide (TiO₂)*, as an electrode in *Ferro-alloy smelting*, in *Submerged Arc furnaces* etc. It also find applications in various forms in the steel industry viz. melting of steel, recarburisation, making special steels & alloys etc.

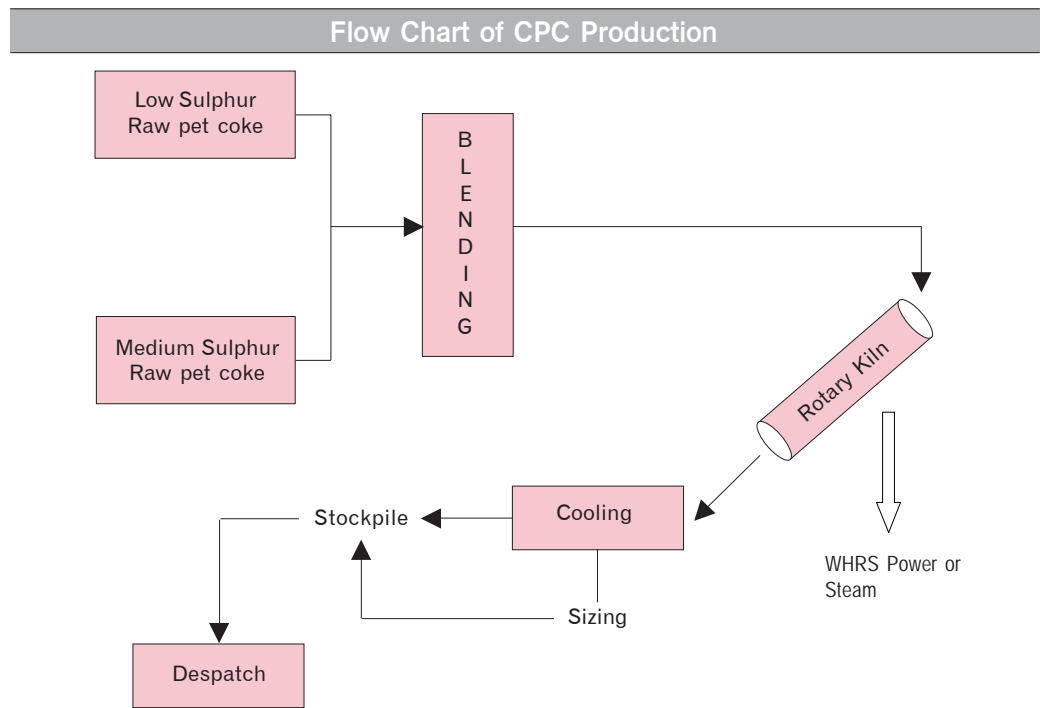
Raw coke is calcined to develop specific properties to make it suitable for industrial purposes. The calcination (of raw coke) involves controlled heating of the raw coke to a high temperature to drive out moisture, hydrocarbons and other volatile matter present in it thereby imparting density to the particles and changing its electrical properties from insulating to conducting. After calcination, raw coke becomes *Calcined Petroleum Coke (CPC)*.

Manufacturing Process: The primary raw material for manufacturing CPC is Raw Petroleum Coke (RPC) which is procured from various refineries (depending on the grade and quality) and blended to meet customer specifications viz. chemical & physical characteristics. After blending, the RPC is crushed into lumps and fed into a calcination kiln. This kiln is an oil fired rotary kiln, akin to a sponge iron/ cement kiln. It slopes downwards towards the discharge end and is usually ~10-12ft in diameter and 200-220ft in length.

The RPC in the kiln tumbles due to the rotation and moves down the kiln in a direction counter to the heat produced at the lower end (firing end) of the kiln. The temperature in the firing zone of the kiln ranges from 1,250°C - 1,350°C. During its passage down the kiln, the moisture content is driven off by hot combustion gases and the residual hydrocarbon in the RPC also evaporates and burns, thereby providing additional heat in form of flue gases (1,000-1,100° C) during the calcination process. These flue gases can be tapped in a *Waste Heat Recovery System (WHRS)* to generate steam and/or power. The RPC is retained in the kiln for ~60-70mins and is then dropped out of the firing end into a rotary cooler, placed below. Upon cooling, the resulting CPC is stacked in storage silos and in some cases, is crushed and sized (as per the customer requirement), for despatch to customers. Due care is taken to ensure that moisture is maintained within desired limits. The norm for energy consumption for manufacture of CPC is ~1MW /100k mt, and there is potential to generate ~7-8MW/100k mt of CPC, from the flue gases thus generated.

CPC is manufactured from Raw Petroleum Coke (RPC), procured from oil refineries...

WHRS technology utilised to generate power during CPC manufacturing...



Source: Company, PINC Research

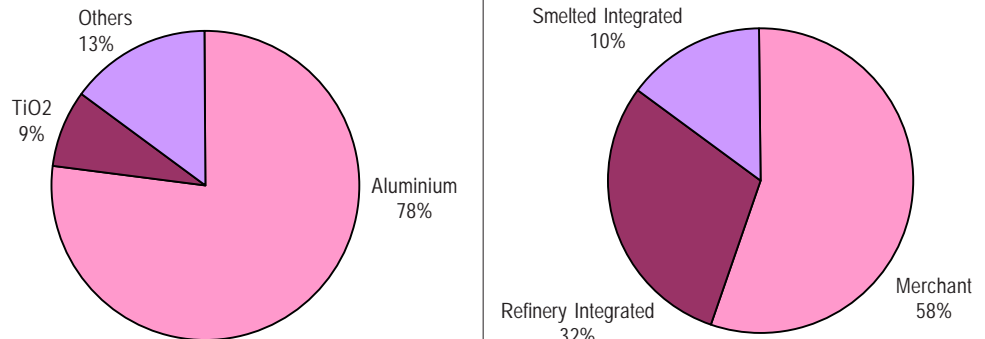
End User Industries

As mentioned earlier, CPC finds application in *Aluminium Smelters* (as an Anode), production of *Titanium Dioxide (TiO2)*, as an electrode, in *Ferro-alloy smelting*, in *Submerged Arc furnaces* etc. It also finds application in various forms in the steel industry viz. melting of steel, recarburisation, making special steels & alloys etc.

Majority of CPC consumption is for Aluminium smelting & TiO2 production...

In CY07, the aluminium industry accounted for ~78% of the total global CPC offtake, with Titanium Dioxide (TiO2) being the next largest consuming industry, (~9% of offtake). The balance consumption was spread across other diverse applications.

Global Classification of CPC Users (LHS) & Manufacturers (RHS)



Source: Company, PINC Research, Industry

As each of these industries play a significant role in the offtake of CPC, it is pertinent to delve into the dynamics of each of the same.

1. Aluminium: It is electrolytically smelted in furnaces called 'Pots' by passage of electricity, with the norm being 13.5-14KWH of power required for manufacturing 1mt of aluminium. In order to transfer this huge amount of power (low voltage but high amperage) through the raw material i.e. molten cryolite in which alumina is dissolved, an anode is inserted in the pot and the pot is itself lined with carbon. The anode is made of CPC and coal tar pitch, while the cathode consists of a thick lining of carbon/graphite. The high current flow at smelting temperature (>900°C) erodes the anodes and for each mt of aluminium produced, 0.4mt of electrodes (both cathode and anode) are consumed.

CPC is a critical input in Aluminium smelting..

Carbon anodes are usually manufactured by aluminum smelting companies via in-house operations. In this process, anode grade CPC is mixed with coal tar pitch and other binders and pressed into cubic blocks of dimension 1m3. These are then baked to form a finished, hardened carbon anode. The industry norm for raw material consumption during aluminium smelting is 0.4mt of anode grade CPC and 0.12mt of coal tar pitch. These are classified as 'Carbon consumption'.

Alternative technologies to pre-baked CPC not viable, thereby ensuring continuing demand for CPC...

A few decades ago, the carbon consumption was higher, as was the power requirement. But the global shift towards *pre-baked* technology in aluminium smelting has enabled rationalisation in power as well as CPC consumption. At present, there are no imminent technological advances which point towards a sudden reduction in CPC consumption/mt for aluminium produced, despite various attempts by the industry to experiment with inert technologies. Consequently, this affords a strong predictability in CPC demand due to the aluminium industry's capex cycle. The cost of aluminium vis-a-vis raw material and consumables is enclosed in the table overleaf:

Cost of Aluminium Production								
Particulars	Hindalco			Nalco			Balco	
	FY06	FY07	FY08	FY06	FY07	FY08	FY06	FY07
Aluminium Production (mt)	429,140	442,686	478,000	358,954	358,734	360,457	160,155	313,189
Total RM cost (Rs mn)	12,287	13,392	13,521	5,211	5,576	5,744	6,184	13,868
Cost of CPC (Rs mn)	2,325	2,619	2,777	1,767	1,746	1,938	1,126	1,824
Cost of Pitch (Rs mn)	646	1,314	930	634	1,067	758	410	1,010
Total Cost of Carbon (Rs mn)	2,971	3,932	3,707	2,401	2,813	2,696	1,536	2,834
CPC cost as (%) of total RM Cost	18.9%	19.6%	20.5%	33.9%	31.3%	33.7%	18.2%	13.2%
Pitch cost as (%) of total RM Cost	5.3%	9.8%	6.9%	12.2%	19.1%	13.2%	6.6%	7.3%
CPC cost per ton (Rs/mt)	13,899	15,305	16,502	12,551	12,315	13,745	13,770	13,476
Pitch cost per ton (Rs/mt)	14,066	28,525	22,696	17,754	29,269	21,357	15,071	26,922
Carbon cost/mt of Al produced	6,923	8,883	7,755	6,689	7,842	7,479	9,588	9,048

Source: PINC Research

As CPC gets mixed with the molten metal, its quality i.e. its physical and chemical properties, have a huge bearing on the life of the carbon anode, thereby influencing the overall cost of production, while simultaneously determining quality (on account of the amount of impurities dispersed in the finished aluminum metal). While standard anode grade CPC has a minimum level of 97% carbon purity, there would be some traces of sulphur (<2%) and other elements in the finished aluminium.

2. Titanium Dioxide (TiO₂): This industry accounts for the largest off take of CPC after Aluminium. TiO₂ is mainly used in producing white pigment because of its brightness and very high refractive index and provides good opacity to products such as paints, coatings, plastics, paper, inks, fibers, food and cosmetics. Its chemical properties are such that it does not react with other materials and is thermally stable, non-flammable and non toxic. Due to its oxidative and hydrolysis properties it is used as a potent photocatalyst. It can be manufactured using either of 2 processes viz. the sulphur route and the chloride route, with the latter being widely used at present. CPC is used as a source of energy and carbon in this process.

3. Other Industries: CPC is also utilized as a recarburiser, i.e. carbon additive/ source. It finds application in the steel and foundry industries as well as other chemical processes industries.

Demand-Supply dynamics of CPC

The global installed capacity of CPC (ex-China) was ~18mn mtpa in CY07, spread across ~70 manufacturers, with the industry's average capacity utilisation factor (CUF) at 85%. The aluminium industry accounted for ~78% of the total CPC off take, with TiO₂ being the next largest consuming industry, (~9% of off take). The balance consumption was spread across other diverse applications.

CPC can be further classified into 'Industrial grade' CPC and 'Anode grade' CPC, with the latter being consumed by the aluminium industry. The former is similar to anode grade CPC in physical characteristics, but usually has higher chemical impurities, albeit within certain set limits. As there is not much of a difference in the manufacturing process for both grades, they are collectively classified as CPC for broad industrial usage and while determining demand supply dynamics. Sometimes industrial grade CPC is processed further to meet specifications of the end users as opposed to anode grade CPC.

While CPC has world wide demand, the economics involved in calcining and its transportation dictate that production facilities be located in proximity to the RPC source i.e. petroleum refineries, or near end consumers i.e. aluminum smelters. In the earlier part of the 20th century, most of the global oil refining capacity was located in the US. Consequently, a large chunk of CPC capacity was also located there. However, the high profitability accruing from production of light distillates resulted in the steady diminution and ultimate irrelevance of RPC/CPC in a refiner's product slate. Simultaneously, aluminum smelters began to find the cost of manufacturing CPC in-house prohibitive.

CPC also used as a carburiser...

Calcining operations always located in close proximity to refineries or smelters...

This gave birth to the trend of merchant CPC manufacturing. Currently, ~58-59% of the global CPC capacity of 18mn mt consists of merchant manufacturing, 10-12% is integrated with aluminum smelters while the remaining 29-32% is refinery integrated. Today, the largest global players in the CPC space are *Rain* (2.45mn mtpa), *GLC-Oxbow* (2.4mn mtpa), *BP* (1.5mn mtpa) and *Conoco Phillips* (1.2mn mtpa).

CPC Capacity break up of western world (in '000 mt)					
Merchant Refiners		Refinery Integrated		Captive Smelters	
CII/Rain	2,475	BP	1,500	Alba	600
Oxbow	2,175	Conoco Phillips	1,225	Alcan	490
Goa Carbon	240	Petrocoque	290	Alcoa	221
Elsid	210	Chevron	250		
		OMV	250		

Source: PINC Research

Demand Scenario

Large aluminium capacities envisaged in M. East due to easy availability of gas...

Aluminium Industry: As mentioned earlier, the industry is the largest consumer of CPC. Plans are afoot to take the current global aluminum smelting capacity of ~33mn mtpa (CY08) to ~45mn mtpa by CY11, with a large chunk of the incremental capacity expected to be commissioned in the M. East and China. Some of the large capacities being set up in the M. East include 700k mtpa by *DubAl*, 700k mtpa by *EmAl*, 2 modules of 350k mtpa each by *QatAlum* etc.

In India, the installed capacity to manufacture aluminum stands at ~1.15mn mtpa and is expected to jump to ~2.1mn mtpa by FY12. Based on these numbers, we expect the aluminium industry alone to generate 0.9mn mtpa demand in India, with global demand for CPC at 16mn mtpa by CY11.

Industry sources are of the opinion that the Chinese aluminum capacity expansion will largely consume any incremental capacity that has been lined up in CPC production within the country, by local manufacturers like *XingJiang* as well as a few overseas players like *Rain*. Simultaneously, in the M. East, smelters (like *QatAlum*, *EmAl*, *Alba*, *Sohar Aluminium*, *DubAl* etc.) would be significantly under served as would others, with the exception of *Kuwait Petroleum*, since no additional CPC capacities have been lined up in the region. Thus, 11-13mn mtpa of additional aluminium capacity lined up would be served only by ~2.5-3mn mtpa of CPC.

Titanium Dioxide: Currently, TiO2 accounts for ~9% of the CPC demand i.e. 1.2-1.3mn mt. The annual global production of titanium dioxide is ~5mn mtpa and has registered a CAGR of 3.5% from CY90-01. Going forward, this trend is expected to be slightly higher at 4%, for the period CY01-10. Accordingly, CPC demand from the titanium dioxide industry is expected to top 1.5-1.52mn mtpa in CY11.

Other Industries: Other industries account for 13-14% of the demand for CPC and their consumption trend for these industries has exhibited an annual growth of 4-5% over the last 5 years. However, this segment has the potential to skew demand positively in favour of CPC manufacturers in the immediate future.

Unexpected demand for CPC as carburising agent can send demand spiralling...

This is because the largest set of users i.e. the carburising and ferro alloy industries, is witnessing high cost pressures due to the surge in pig iron (in the steel and foundry sectors) and coke (in the ferro alloys industry). With the soaring costs of coking coal (USD300/mt on long term basis and USD400/mt on spot basis) and pig iron (USD725/mt), manufacturers are currently exploring the application of CPC as a carburising agent in hitherto unused areas. Even at USD500-550/mt, CPC could emerge as a viable alternative for these industries, thus potentially skewing the existing demand curve.

Even after assuming normative growth of 4-5% in demand from this segment, global demand for CPC is expected to rise to a bare minimum of 22mn mtpa by CY11. With the current global capacity at ~18mn mtpa (CUF of 85%), the capacity addition lined up globally (excluding China) is minuscule viz. ~1.5-2mn mtpa for the same period. Thus, the demand supply equation is expected to tilt significantly in the favor of suppliers over that period.

Industry Overview

Estimated consumption of CPC					
Particulars	2008E	2009E	2010E	2011E	2012E
Domestic CPC Demand (mt)					
Indian Alum. Demand	1,260,000	1,375,000	1,780,000	2,035,000	2,335,000
CPC for Indian Alum. Demand	504,000	550,000	712,000	814,000	934,000
CPC for Others	103,229	123,875	148,650	175,407	203,472
Total CPC consm. in India (mt)	607,229	673,875	860,650	989,407	1,137,472
Global CPC Demand ('000 mt)					
Global Alum. Demand	32,045	34,681	37,137	40,356	42,528
CPC for global Alum. Demand	12,818	13,872	14,855	16,142	17,011
CPC for others	3,829	4,144	4,437	4,822	5,081
Total global consumption ('000 mt)	16,647	18,016	19,292	20,964	22,093
Global CPC Capacity ('000mt)					
CUF (%)	85%	83%	82%	81%	80%
Global CPC Production ('000mt)					
Surplus/(Deficit) ('000mt)	(72)	(918)	(1,457)	(2,334)	(2,693)

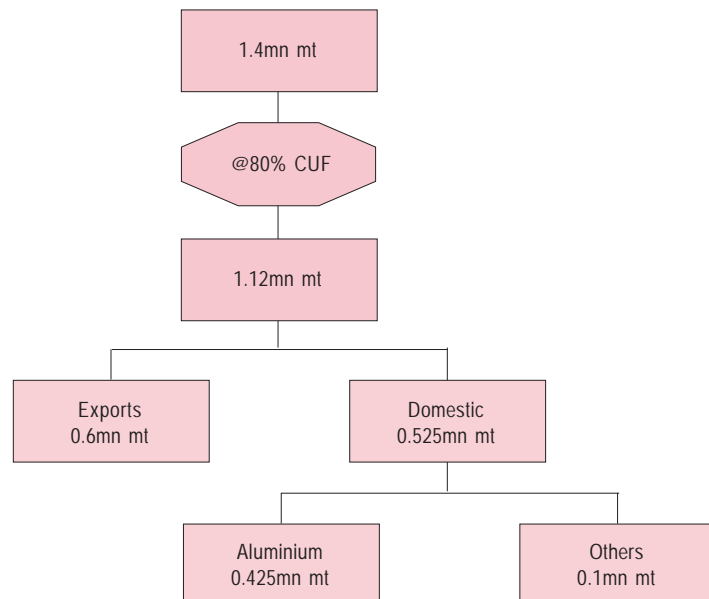
Source: PINC Research, Industry

Supply Scenario

Focus of Indian CPC players to gradually shift from exports to domestic supply...

Domestically, the installed capacity is estimated to be ~1.4mn mtpa with *Rain* (600k mtpa), *Goa Carbon* (240k mtpa), *India Carbon* (100k mtpa), *Guwahat Carbon* (100k mtpa), *IOC-Guwahati* (138k mtpa) and *Numaligarh Refineries* (60k mtpa) being the major players. The remainder of the capacity is fragmented across 9-10 players with the overall CUF estimated at ~80%. In India, aluminium accounts for ~88% of the CPC demand, which translates into an annual demand of 450-460k mt. As some players like Rain are focussed largely on exports, the average domestic:export sales ratio of the players (excluding Rain) is tilted in favor of domestic markets. However, domestic consumption is growing sharply as the substitution of CPC in carburisation is triggering off previously dormant demand. Thus, the supply from Indian players into international markets is also expected to ebb in the coming years, despite the capex being unveiled by Rain (400k mtpa greenfield project). Another factor which could accentuate the trend of slowing exports is that the minimum economic export consignment size now works out to be ~20k mt, which in turn would account for substantial amount of annual production for most CPC players, whereas the consumption trend in domestic markets is usually ~2k-4k mt consignments which would not only mitigate inventory risk, but also would ease working capital fund requirement.

Indian CPC Industry



Source: Company, PINC Research, Industry

Raw Material

The grade and quality of CPC produced are of supreme importance to aluminum smelters since any impurities in it get absorbed in aluminium during smelting. In turn, CPC quality is a function of the quality of RPC used. RPC produced by different oil refineries covers a range of physical and chemical properties, depending upon both, the types of crude oils being refined and the specific process being employed while refining.

Only select portion of global RPC is of anode grade...

Only a portion of the RPC produced by the world's oil refineries is of suitable quality for producing anode grade or industrial grade CPC, with the feedstock quality requirement for the former being more stringent than that of the latter. If the RPC produced by a refinery does not suffice the quality for calcining, it is typically sold for its fuel value at a substantially lower price as Fuel-grade Pet coke.

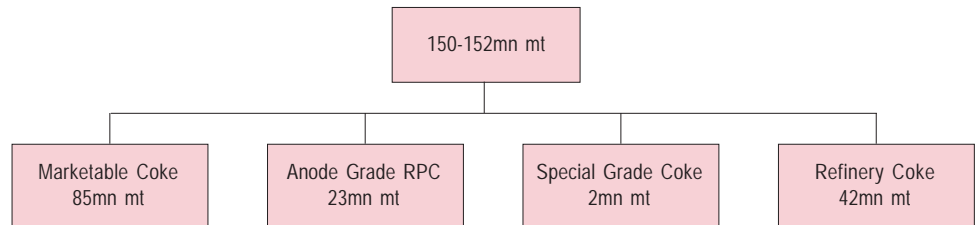
RPC is a solid, high carbon material that is a by-product of the crude oil refining process. During this process, crude oil is distilled down into its constituent products such as Naphtha, SKO, diesel fuel, jet fuel, gasoline, Diesel, Furnace Oil and Bitumen (asphalt) etc. Heavier products like Bitumen tend to settle at the bottom of the refinery column and are often referred to as 'heavy fractions' or 'bottoms'.

Complexity of refineries and differential in refining sweet & sour crude have significant bearing on RPC availability...

Usually, RPC accounts for 1-3% of the product slate (output) of a refinery, depending on the technological and operational complexity of the refinery. Earlier, most of the refineries were of low complexity and used WTI or Brent crude which is classified as 'Sweet' crude. However, the sustained upsurge in crude oil demand has necessitated setting up of refineries of high complexities which are capable of processing 'Sour' crude. Another factor influencing this has been the increasing differential between sweet crude and sour crude, which has moved around USD6.5-7.5/bbl from '01 to mid '04 and currently hovers around USD13-17/bbl. This would offer a USD2.5-3mn/day feedstock costing advantage to a standard 250kbpd refinery processing sour crude, over a WTI feedstock refinery. Thus, gross refining margins have also increased to double digits for sour crude and hence most of the newer refineries that are being set up are of high complexity and are capable of refining a wider range of sour crude. These refineries process crude with higher impurities like sulphur, phosphorous etc., which settle down in the heavier distillates like RPC, thus rendering their RPC unfit for anode grade CPC production.

In the era of high crude prices, refineries try to extract the more valuable, lighter fractions like gasoline, refineries from the heavier sediments by running them through a 'coking unit'. Post this; the almost pure carbon residue is the solid by-product, commonly referred to as 'Pet coke'. Global majors like *ExxonMobil, ConocoPhillips, Chevron, Shell, Valero, BP* etc. all produce varying quantities of Pet Coke.

Break-up of Global Pet Coke Consumption (CY07)



Source: PINC Research, Industry

Pet coke is a source of both, energy and carbon. 'Fuel grade' pet coke is usually burned to produce energy in cement plants, cogeneration plants and in other industrial applications. The most salient feature of pet coke is that it produces ~14k btu/lb on combustion vis-à-vis ~8k - 13.5k btu/lb that coal generates and has very little ash content. Thus, the cement/lime industries find pet coke as a very attractive alternative (to coal) and prefer to use the same on account of higher kiln temperatures. The sulfur dioxide generated from the coke is absorbed during the manufacturing process.

Globally, around 3 quarters of Pet Coke consumption is in energy applications, in the form of refinery fuel, for electricity generation and heating cement kilns. Demand for coke in these applications is strong and likely to increase further from current levels, albeit with significant regional variations. US is the largest producer of coke by far, accounting for 61% of the global output and 51% of the capacity. *ExxonMobil* and *ConocoPhillips* account for 17% of the total world marketable coke capacity.

At present, global refining capacity is estimated to be ~85.2mn bpd in CY07 at a CUF of 85% (*Source: IEA Estimates*), with pet coke production estimated at ~ 150mn mtpa. This includes all types of pet coke i.e catalyst coke (used in-house by refineries), needle coke (used for specialised applications like graphite electrodes etc.), green coke (used for manufacture of CPC) and marketable/ industrial coke (used as a fuel and for other industrial purposes).

As a generic term, RPC usually refers to 2 types of coke viz. green petroleum coke and industrial (fuel grade) petroleum coke. While the former is usually the output of a refinery processing sweet crude, the latter is the output from a refinery which processes sour/ heavy crude. The former is used for manufacturing industrial products which have stringent quality norms like low sulphur and phosphorous viz. anode grade CPC whereas the latter is used for firing as a fuel or as a combustion agent, largely in power plants, cement plants etc. where the impurities are processed or trapped out, after separation.

Green RPC is produced only by those refineries which use sweet crude like WTI or Brent as feed stock. However, majority of the incremental crude processing capacity that has been commissioned over the last few years has been of high complexity i.e. capable of processing 'sour' or 'heavy' crude which usually contains high sulphur etc. Thus, the supply of green coke for the CPC industry has lagged the increasing demand for industrial/anode grade CPC.

Industry estimates indicate that for CY06, global production capacity for marketable petroleum coke was 82.5mn mtpa, with US accounting for around half of that. While as much as 35mn mt of new capacity is slated to come on-stream between CY06 and CY10 and by CY12 a total of 45.2mn mtpa could be added, only a meager amount of that would be accounted for by anode grade RPC capacity.

The industry estimates that the current global supply (excluding China) of green coke to be ~23-24mn mtpa, and that would increase by a mere ~ 2-2.25mn mt in the coming 5 years.

RPC/CPC Pricing:

Till FY04, all CPC manufacturers, including Rain, used to enter into long term CIF contracts with aluminum manufacturers for off take of CPC and bought RPC on spot basis (FOB). The price of RPC was ~USD70-80/mt (depending on sulphur content), with freight charges of USD20/mt.

However, from '03 onwards, freight rates started moving up on account of an upswing in the shipping cycle. This skewed the revenue and profitability dynamics of CPC manufacturers, since RPC was produced on an FOB basis while the price of CPC was already locked in, on a CIF basis, with no recourse in passing on the costs to its consumers namely the aluminium smelters. Thus the industry experienced a tremendous squeeze on margins due to stagnant realisations and escalating costs. The situation was further aggravated in '04 when crude prices started moving northwards, resulting in a jump in RPC prices.

However, in the last 2-3 years, the industry has moved towards a variable pricing on a FOB basis, while tying down supplies on a consignment basis. CPC suppliers enter into long-term supply contracts for quantity and negotiate prices for the same on a quarterly FOB basis. This has helped mitigate margin pressures generated by escalating raw material prices and freight rates. Consequently, there is a fair degree of predictability for CPC manufacturers on the revenue front. However, the buoyancy in demand and stability in realisations has been accompanied by tight supplies on the raw material front as anode grade RPC supply has not kept pace with the rise in CPC demand,

Growth in supply of green RPC has lagged growth of refining industry due to increasing use of sour crude...

Locked in realisations of CPC, escalating prices of RPC and jump in freight rates depressed calcining margins from '03-04...

Calcining industry has since moved to variable pricing, thereby cushioning margins...

Industry Overview

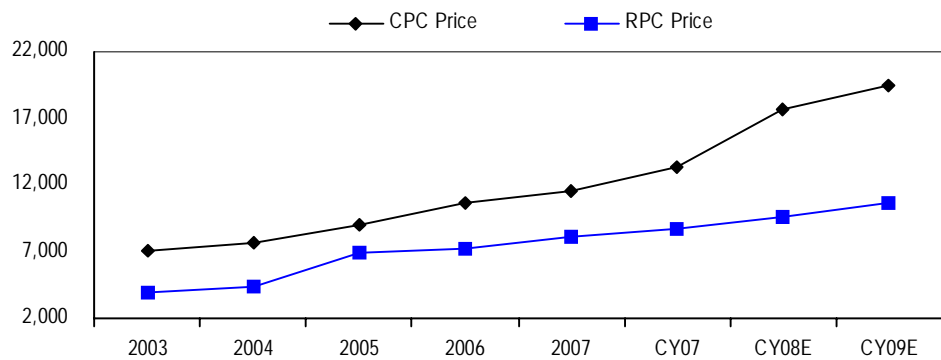
While supplies of anode grade CPC are currently capped, in the backdrop of high complexities of new refineries, a handful of industry players like Rain have modified their manufacturing activities accordingly, by blending various grades of RPC. Depending on the grade of aluminium to be produced, manufacturers blend various grades of RPC (with varying sulphur content). However, this practice is limited to the companies with extremely strong linkages with refineries and competence in adopting technology to carry out the same.

Sourcing of suitable grade of RPC is a stiff entry barrier in the calcining industry...

Some companies have taken advantage of their linkages by signing long term contracts for supplies as many of their plants are spin offs from refineries / smelters (due to the long term relationships). e.g. 4 of CII Inc's plants are spin offs from *Kaiser Aluminium* and 1 from a refinery, with 3 plants being located close to refineries.

Thus, players like Rain/CII, GLC/Oxbow are very well placed to tap the incremental demand for CPC going forward as they would have assured supplies of RPC due to the proximity of their plants to feedstock sources. *However, this assurance of feedstock supply is only on the quantity front and not price, which is fixed on a rolling quarter basis.*

Price Trend (Rs/mt)



Source: PINC Research Estimates

Background: The company commenced CPC operations in India in '89 by setting up a plant of 240k mtpa, the largest single kiln operation in Asia at that time. Over time, it set up a 49MW power plant, based on WHRS technology and ramped up calcining capacity to 480k mtpa by setting up another parallel kiln. Tweaking of these facilities led to the total capacity being enhanced to 600k mtpa in '08.

Large chunk of calcining output is consumed by international aluminium giants...

A large chunk of Rain's domestic operations consists largely of exports (~75-78% of its sales) to customers like *Alcasa, DubAl, Alba, BHP Billiton*, while its domestic clientele comprise of aluminium majors like *Nalco, Balco* and *Hindalco*.

Till recently, it relied on the global trading giant *Oxbow Inc* for sourcing RPC and to affect its CPC sales. *Oxbow* sourced ~85% of Rain's CPC, charging it a commission of USD4-4.1/mt as a sourcing fee. While tying down off take of Rain's CPC, it charged a commission of 2% of FOB realisations. Rain terminated this arrangement in CY08 and is now sourcing RPC and selling CPC on its own.

In India, Rain has a competitive advantage over its domestic peers, as its CPC plant is situated close to Vizag port. Therefore, it incurs lower costs while transporting raw materials and finished goods. Other than *Goa Carbon Ltd*, which has 2 of its plants located near ports, all other domestic players incur higher inward freight costs.

Going forward, a major chunk of expansion in the aluminium industry is being affected in *Chhattisgarh* and *Orissa*, on account of availability of key resources like bauxite. This will enable Rain to further monetise its locational advantage due to its proximity to its existing facilities to the upcoming aluminium units.

Domestic Scenario: CPC production in India is estimated to be around 1.1mn mt, of which the domestic aluminium sector consumes ~400k-425k mt. While some of the domestic aluminium players used to import some quantity of CPC, the same would be nil in the coming years. This year, the consumption from domestic aluminium industry is expected to be around 470-480k mtpa with the remaining off take (~125k-150k mtpa) being accounted for by other sectors, leaving virtually no surplus for exports from players other than Rain, which itself may have to curb its exports to cater to the domestic demand. Domestically, there are only 2 suppliers of RPC i.e. *BRL* and *IOCL* (Barauni), and their supplies are inadequate for domestic CPC production. Spot CPC prices in the domestic market have skyrocketed in the last few months and deals have been transacted at prices as high as USD700/mt.

It's CPC operations in India have a WHRS (waste heat recovery system) based power generation capacity of 49MW. While CPC manufacturing consumes only ~6MW power, the same leaves ~42-43MW as surplus for merchant sales. However, going forward, the company may consume the same in its cement division, in case the economics work in its favor and in such a case, there may not be any surplus power to be sold on a merchant basis, Q4CY08 onwards.

CII acquisition catapulted Rain onto global stage as the largest calciner...

CII Acquisition: The acquisition of 1.9mn mtpa of CPC manufacturing capacity through the purchase of *CII Inc* in '07 transformed the company into an international leader with a widespread reach. With bulk of its operations located in N.America, Rain emerged as a formidable global player with Indian operations.

CPC Plant Details of Rain Commodities

Plants	Commissioned	Rotary Kiln	Capacity (mt)	Storage capacity (mt)	Water Terminal
USA Plants					
Chalmette, Louisiana	1968	1	230,000	25,000	Chalmette Terminal
Gramercy, Louisiana	1972	1	230,000	150,000	Gramercy Terminal
Lake Charles, Louisiana	1979	2	400,000	60,000	--
Moundsville, West Virginia	1957	2	420,000	50,000	--
Norco, Louisiana	1965	1	230,000	Direct Access	Chalmette & Gramercy Terminal
Purvis, Mississippi	1959	1	70,000	--	Chalmette Terminal
Robinson, Illionis	1996	2	315,000	Direct Access	Chalmette & Gramercy Terminal
India Plant	1998	2	600,000	160,000	Vizakh Port.

Source: Company

Synergies from CII Inc. Acquisition

- 1) In addition to transforming Rain into the largest calciner in the world, the acquisition of CII also generated a lot of synergies. Previously, CII supplied to the M. East markets and Rain to South American, but now they have swapped markets due to location advantages. This will generate huge savings on freight costs and strengthen Rain's locus standee with the buyers. This exchange of markets between Rain's Indian and US operations has the potential to cut down USD20-25/mt in logistical costs, translating into savings of USD10-12mn p.a. (On shipments of ~400k mt).
- 2) In industries where pricing of finished products is highly dependent on raw material prices, control over manufacturing costs is of utmost importance. The acquisition has helped Rain and its customers in turn, to achieve the same due to the strong visibility on supplies of RPC and clarity of pricing due to CII's strong linkages with oil refineries in US and its 4 decade expertise in sourcing RPC optimally. This has also benefited Rain's Indian operations as it has secured access to GPC from Asian refineries with which CII Inc has long term supply contracts. We expect this to translate into annual savings of USD4mn, on procurement front alone.
- 3) CII has developed '*Air Lancing Technology*' for reducing fuel consumption while manufacturing CPC. Adoption of this technology by Rain's Indian operations would generate manufacturing efficiencies and result in potential savings of ~USD2.5-3mn in domestic operations.
- 4) Lastly, Rain has successfully registered with *United Nations Framework Convention on Climate Change* (UNFCCC) for carbon emission reduction at its co-gen facility. The eligibility is equivalent to the 164,677mt of CO₂ p.a. for a period of 10 years, starting from Jul'07, thereby generating ~USD3mn mt in revenues for the company.

Synergies with CII's operations to generate sizeable monetary benefits ...

Inventory/ W.Cap cycle

The sustained upsurge in CPC realisation and demand, has slowly brought in an equilibrium on the demand supply front, enabling Rain to rationalise its working capital cycle. It maintains an inventory of 45-60 days of raw material, with debtors line at similar levels. However, any sudden escalation in the unit cost of raw materials has the potential to increase the requirement for working capital funds.

Outlook

As mentioned earlier, the M.East is witnessing a large build-up in aluminium capacities due to the monetisation of the region's gas reserves. An aggressive ramp up of smelting capacities has been lined up over the next 3-4 years by regional players like *DubAl* (0.7mn mtpa), *EmAl* (0.7mn mtpa), *Qatalum* (2 X 0.35mn mtpa) & *Alba*. All these players and others, like *Alcasa* (Venezuela) (0.1mn mtpa) are Rain's existing clients. In light of the strong existing relationships with these aluminium producers, Rain should not encounter any difficulty in selling the incremental output from its proposed capacity expansion. The company has envisaged a 400k mtpa plant at Vizag with a 30MW power plant and a 200k mtpa plant in China, at an outlay of USD100mn and USD50mn respectively. These plants are expected to commence commercial production in CY10.

Incremental capacities in Aluminium smelting by Rain's existing clients generate strong visibility for future offtake...

Expansion Details					
	FY07	CY07	CY08E	CY09E	CY10E
CPC Capacity (mt)					
In India	480,000	480,000	600,000	600,000	1,000,000
In USA	-	-	1,895,000	1,895,000	1,895,000
In China	-	-	-	-	200,000
Total CPC Capacity	480,000	480,000	2,495,000	2,495,000	3,095,000
Power Capacity (MW)	49	49	49	49	79

Source: Company, PINC Research

CPC Operations

Going forward, we expect complete benefits from the CII acquisition to be visible from this year onwards. We estimate Rain to produce ~2.2mn mt of CPC in CY08 (consolidated level) with a CUF of ~94% in India and ~85% at its US facilities. We expect this utilisation rate to increase further in the immediate future and match the rising demand. In CY09E, our assumption for CPC volumes stands at 2.3mn mt, translating into a CUF of ~98% in India and ~88% in the US.

Assuming the USD:INR rate at 43, this should translate into net revenues of ~Rs40bn & Rs45bn in CY08E & CY09E respectively. On the cost front, we expect the company to maintain the industry trend of 20% Gross Contribution Margin, by maintaining tight control over manufacturing costs. After considering the rise in prices of CPC, benefits of synergy and control on other manufacturing costs, we estimate Rain's EBIDT/mt at ~Rs3.3k and ~Rs3.4k for CY08 & CY09 respectively (v/s Rs1.5k-2.5k/mt over the last 4 years).

Assuming INR trading at Rs43/USD, Rain's EBIDT/mt should settle between Rs3.3k-3.4k/mt...

Sensitivity Analysis on Net Profit (Rs mn) of CPC Operations							
			CPC Prices (Rs/mt)				
			17,200	17,500	17,800	18,100	18,400
CY08E	RPC Prices (Rs/mt)	8,950	2,948	3,528	4,108	4,687	5,267
		9,150	2,343	2,923	3,503	4,082	4,662
		9,350	1,739	2,318	2,898	3,477	4,057
		9,550	1,134	1,713	2,293	2,873	3,452
		9,750	529	1,109	2,293	2,268	2,847
CY09E	RPC Prices (Rs/mt)	10,100	18,900	19,200	19,500	19,800	20,100
		10,300	3,412	4,017	4,622	5,226	5,831
		10,500	2,789	3,394	3,998	4,603	5,208
		10,700	2,166	2,771	3,375	3,980	4,585
		10,900	1,543	2,147	2,752	3,357	3,962
			920	1,524	2,129	2,734	3,339

Risks/ Concerns

- The acquisition price of USD619mn in mid-CY07, valued *CII Inc* at a seemingly steep EV/EBIDT of ~8.5x of CY06 (CII standalone). The debt raised for this acquisition pushed the total debt on Rain's books to ~8x its EBIDT in CY07, straining its balance sheet. However, the sustained upsurge in CPC realisations, improving EBIDT/mt and benefits accruing from synergies of the acquisition have ensured that the acquisition cost now would be <3.0x of CII Inc's CY08E EBIDT and the total Debt:EBIDT ratio on Rain's consolidated balance sheet would be below 3.6x (from 5x at the time of acquisition). Going forward, in CY09, the consolidated debt/equity ratio would shrink to 2.7x, with debt being ~3.1x CY09 estimated EBIDT. Given below is the debt break up of the company.

Overhang of debt to be mitigated by healthy cash flows...

Debt Breakup (USD)			
Company	Currency	Amount (mn)	Tenor
Rain CII USA	USD	406	Payable till 2013 -2015 in tranches
Rain CII India	USD	116	Payable till 2012-2013 in tranches
Rain CII USA	USD	71	Payable post 2010
Rain Comm. (Dom Cement)	INR	4,000	

Source: Company

- While the volatile USD:INR has been a matter of concern for most of the corporates, Rain has a natural hedge, as majority of its CPC revenues (US and ~70% of domestic output) are in USD. Also, with ~USD600mn debt being in USD, the impact of gyrating USD:INR would be minimised. While there was an adverse impact of Rs419mn in Q2CY08 earnings, we believe that the same was an aberration and one off in nature.

USD denominated revenues offset threat vis-a-vis debt repayment...

Client roster of established aluminium smelters to ensure offtake of Rain's incremental CPC...

CII's experience to be leveraged while sourcing RPC...

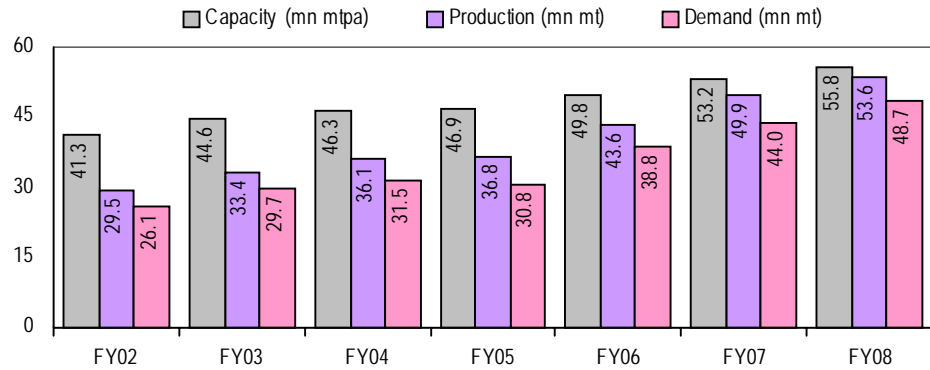
- 3) After 5 decades of operations, CII has developed very strong linkages on the raw material front in the form of long term sourcing contracts. ~50% of its raw material is sourced from majors like *Conoco Phillips, ExxonMobil, Marathoin Ashland* etc. While there exists an assurance for quantity of RPC supplied, prices of the same are fixed only a rolling quarterly basis. At present, Rain's client roster consists of marquee names like *Alcan, Alcoa, Norsk Hydro, EmAl, QatAlum* etc. Over 50% of its revenues accrue from these companies and over 90% of its CPC sales are in nature of long term contracts wherein quantity is fixed, but rates are negotiated on a periodic basis. Therefore, any sudden jump in the raw material prices might not be transferable to its clients immediately. This could impact our estimates on a quarterly basis.
- 4) CPC prices are a function of demand from the aluminium industry where large capex is outlined on the global as well as domestic level. Rain is also enhancing its capacity, in India and China over the coming 24 months to tap this demand as most of its existing clients are also in a capex mode. While we do not expect the global Aluminium capex cycle to be derailed, any unexpected delay in the same can alter the demand-supply scenario of CPC and impact our estimates.
- 5) CPC pricing is dependent on RPC pricing and availability. While the demand supply dynamics for CPC are expected to tilt decisively in favour of suppliers in the coming years, the same is true in case of RPC suppliers also. While Rain has the advantage of tapping CII's multi decade expertise and relationships in sourcing RPC, the demand supply scenario is so fine that any disruption in RPC supply due to *force majeure* causes has the potential to impact our estimates substantially.
- 6) The company has announced intentions of a 'share buy back', from Sep'09 onwards and has secured the necessary approvals for undertaking the same for a maximum 1.2mn shares at a maximum price of Rs307, at an outlay not exceeding Rs260mn. This offer has validity till Apr'09 and can alter the equity structure and cash flow of the company for CY08 and CY09 and thereby impact our estimates.

Cement Operations

Cement sold in south India under the brand name of 'Priya Cement'...

Cement operations were included in Rain's portfolio, post the scheme of arrangement in '06, as mentioned earlier. Cememnt operations commenced commercial production in Oct'86 at Nalgonda, Andhra Pradesh (A.P) with a 1.12 mn mtpa plant, and a 0.5mn tpa plant at Kurnool, AP, and was being sold under the name of 'Priya Cement'. Rain's current cement capacity stands at ~3.2mn mtpa, post the commissioning of its new 1.5mn mtpa plant at Kurnool AP.

Regional scenario - South



Source: CMA

The company has pit head limestone mines at both locations (key raw material) which are located at different clusters i.e Nalgonda and Yeraguntla with reserves sufficient to serve its plants for 70 years.

CUF and power consumption of cement business in line with industry average...

Rain has been maintaining a CUF of ~95% over the last 3 years and has a high blending ratio, (80:20 in favour of PPC) which helps control raw material costs. The strategic location of its cement plants, in proximity to limestone as well as target markets (~500km radius), has contributed in reducing the company's freight bill to its major markets. Its power consumption of 84units/mt of cement is in line with the industry average of ~85units. The company has sufficient domestic linkages to meet its coal demand for the existing plants. These factors attributed the OPM to improve from 5% in FY05 to 29% in FY08 (9 months).

Rain commenced commercial operations at its newly built 1.5mn mtpa cement plant in Jun'08. The plant, located at Sreepuram (Kurnool district, AP), was set up at an outlay of Rs3.3bn, (debt of Rs2.4bn & internal accruals Rs940mn). Rain has secured coal supply for this plant, sufficing 75% of its requirement.

In Q2CY08, RCL net revenues stood at Rs1.9bn (+45%YoY) on account of improved volumes and better price realizations. The production grew by 36% to 0.52mn mt due to robust demand and better capacity utilization (above 95%). The realisations/mt of cement rose to Rs3.7k/mt (+7%YoY).

South India - Statewise breakup (in mn tpa)

(in mtpa)	2005		2006		2007		2008	
	Cap.	Dem.	Cap.	Dem.	Cap.	Dem.	Cap.	Dem.
Andhra Pradesh	21.5	7.8	23.9	11.1	24.7	12.6	25.9	14.7
Karnataka	10.2	7.6	10.7	11.5	11.0	11.1	12.4	11.8
Kerala	0.6	6.1	0.6	9.4	0.6	7.0	0.6	7.1
Tamil Nadu	14.6	9.0	14.6	6.5	16.8	12.8	16.9	14.5
Others	0.0	0.3	0.0	0.3	0.0	0.5	0.0	0.5
Total	46.9	30.8	49.8	38.8	53.2	44.0	55.8	48.7

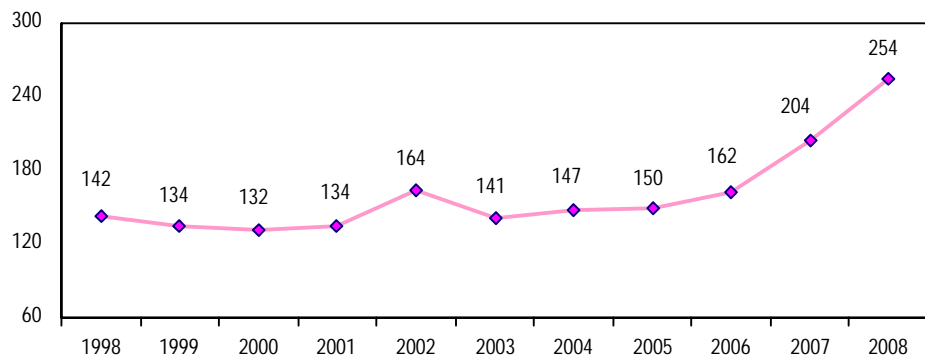
Source: CMA

Cement Operations

Spiralling coal costs dampened OPM while higher capital charges depressed net profits...

However, the company faced operating cost pressure on account of rise in key input prices. Power and fuel cost accelerated to Rs415mn (+68%YoY) due to the jump in domestic coal prices. Though it possesses sufficient coal linkages for its existing plants, the company had to purchase coal through e-auction due to shortage of domestic supply and subsequently paid higher prices for the same. Hence, OPM for the cement division fell by 480bps to 29%. Operating profits stood at Rs543mn (+24%YoY) in the quarter. Higher incidence of capital charges and taxation curtailed growth in net profits to 6% at Rs275mn.

Cement Price - South Region(Rs/50kg bag)



Source: CMA

Outlook

Due to the commoditised nature of the business, transportation costs play a key role in influencing profitability of cement manufacturers. Carting cement over long distances adds to the selling cost, resulting in lower margins. Since RCL is based in southern India, its focus is on supplying to markets in A.P., Karnataka, Kerala and Tamil Nadu.

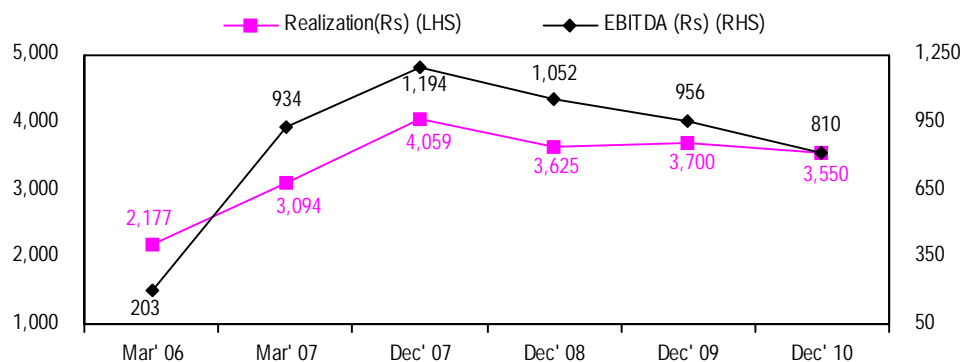
Cement demand in south India registered a CAGR of 11% from FY2002-08. The region accounted 30% of the total domestic consumption of 163mn mt in FY08, with regional cement manufacturers operating at ~96% CUF.

Demand scenario for cement in southern India remains robust...

Its home market (A.P) demand has grown at a CAGR of 23.5% (05-08). The demand was driven by infrastructure projects like Hyderabad International Airport, Gangavaram Port (near Vizag) and numerous captive ITES/IT Parks.

Going forward, we believe that demand in southern India will remain strong over the next 12-18 months, propelled by growth in housing and infrastructure projects. Most of the new capacities have been delayed by 6-8 months. Stabilization of new facilities would require another 3 months, offering a window of opportunity to the existing players. In such a scenario, RCL's timely expansion would enable it to milch the opportunity at hand, by commanding premium realisations till capacities of ~10mn mtpa are commissioned in FY10-11.

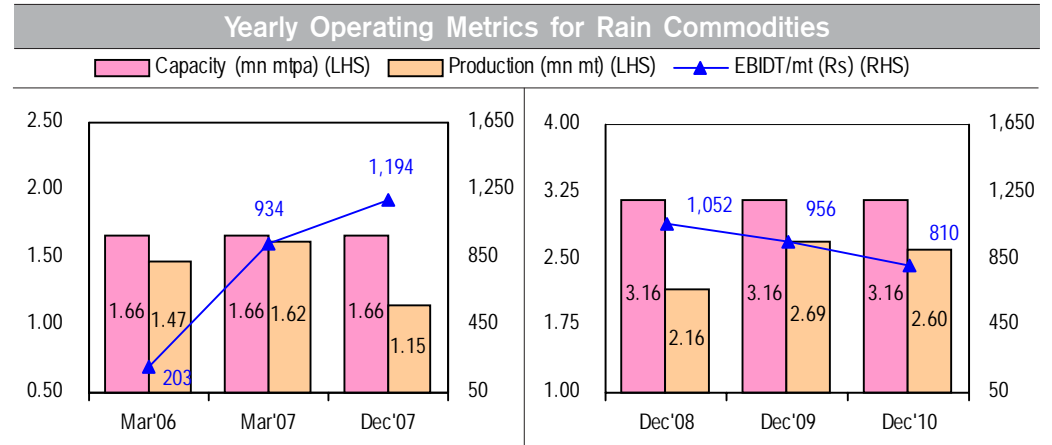
RCL's cement per ton analysis



Source: Company, PINC Research

EBIDT/mt to decline in CY09E on account of pricing and cost pressures...

On a conservative basis, we expect Rain’s cement division to register sales of Rs8bn and Rs10bn in CY08 and CY09, on back of despatches of 2.2mn mt and 2.7mn mt resp. After accounting for cost and pricing pressures, we estimate the company to clock an EBIDT/mt of Rs1,052 and Rs956 in CY08 & CY09 resp. Based on our estimates, we expect EBIDT of Rain’s cement operations at Rs2.3bn and Rs2.6bn inCY08 and CY09 respectively.



Source: Company, PINC Research

Risk & Concern

a. Slowdown in housing and infrastructure projects

90% of demand for cement is accounted for by 2 sectors, viz. housing (~60%) and infrastructure development (~30%). A huge surge in construction of residential and IT/ITES properties over the last few years is the primary reason for buoyant cement despatches and realisations in southern India. However, recent developments in the economy may result in a slowdown in construction and real estate development and in turn, dampen the demand for cement. With the imminent commissioning of 10mn mtpa of cement capacity in the next 12-18 months, a situation of excess supply could emerge, resulting in lower sales and profitability for the company.

Any untoward slowdown in infrastructure and construction could impact estimates ...

b. Shortage in availability of domestic coal

RCL has coal linkages to meet 85% of the requirement for its existing plants, with Singareni Collieries Ltd., A.P. The remaining 15% requirement is met through imports.

In the recent past, prices of imported coal have spiked by 80% to USD180/mt. The average landed cost of blended coal is ~Rs3,500/mt. Going forward, any sudden surge in coal prices would adversely impact bottomline of Rain’s cement operations.

INVESTMENT ARGUMENT

Over the past 3 years, Rain has transformed itself from a mid-sized, merchant calciners located in India, into an international calcining giant with multinational operations and global reach. The CII acquisition not only enhanced the scope and reach of operations but also catapulted it to the top spot amongst the world's calciners. It is now set to reap the benefits of operational and marketing synergies like savings on freight, centralised raw material procurement and CPC marketing. Going forward, sharing of technology across the group holds the promise of yielding tangible benefits by generating savings in operational expenditure, raw material consumption and power consumption.

On the demand front, the looming operationisation of 13mn mtpa of aluminium smelting capacity over the next 3 years, holds the possibility of a sharp and sustainable jump in CPC offtake, as also does the consumption of CPC as a carburising agent. These, coupled with the absence of incremental supply of CPC, present a lucrative opportunity to Rain.

CII's relationships and capabilities in sourcing RPC, combined with its technological capability to blend various grades of pet coke, would afford it a strong competitive advantage over peers, in terms of lower bill of material and raw material consumption. On the realisation front, its tested ties with its marquee clients would guarantee strong scope to negotiate favourable terms and maintain buoyant operating profit metrics.

Thus, we estimate Rain to effect CPC sales of ~2.1mn mt and 2.3mn mt in CY08E & CY09E resp, with gross calcining revenues at Rs39bn & Rs44bn resp. It should be able to secure gross contribution Rs4.8k/mt & Rs5k/mt in its CPC operations in CY08E & CY09E resp. We have assumed CPC realisations of Rs17.8k/mt and Rs 19.5k/mt for the above years, with the USD:INR rate at Rs43.

We expect its cement dispatches of 2.2mn mt in CY08E to accelerate to ~2.7mn mt in CY09E on account of the commissioning of Kurnool (AP) unit. Accordingly, the company should register revenues of Rs7.8bn and Rs10bn resp. We estimate the company to garner an EBIDT/mt of Rs1,052 & Rs956 in CY08E & CY09E resp.

Thus, on a consolidated basis, we estimate Rain to report sales of Rs48bn & Rs55bn in CY08E & CY09E resp, buoyed by strong offtake and improved realisations of CPC. High levels of capacity utilisation and the resultant economies of scale will enable the company to maintain OPM in the 18-20% range. While, we estimate EBIDT for CY08 and CY09 to be Rs9.4bn and Rs10.2bn, net profits should be Rs3.8bn & Rs4.8bn in CY08E & CY09E resp. At the CMP of Rs186, the stock trades at an EV/EBIDT and P/E of 4.9x and 3.6x CY08E earnings, with the same being 4.3x and 2.8x for CY09E earnings, respectively.

We believe the company is poised for a re-rating of its valuation due to the following reasons:

- *Its rugged business model and strong operating leverage would enable it to reap the benefits that would accrue from a sector which is moving towards being a 'Sellers' market'. This should propel its earnings in the next 2-3 years, thus imparting high revenue and margin visibility.*
- *Despite the current overhang of high leverage on its balance sheet, its Debt:Equity ratio, (6.5x in FY07) is expected to settle at ~2.7x by CY09E. Even after its planned capex outlay of USD150mn over the next 18-24 months for setting up new capacities in India and China, the upswing in the CPC cycle in tandem with the company's operational efficiencies should de-leverage balance sheet in quarters to come.*
- *The company has a revenue stream of ~USD45mn accruing to it from energy generated from CPC manufacturing operations (Power and process steam), The same can be enhanced in days to come and being a 'Zero Raw material Cost' , has the potential to emerge as an earning booster in coming years.*

Hence, we initiate coverage with a 'BUY', recommendation with a price target of Rs300, on an investment perspective of 12 months.

CII to be instrumental in sourcing raw material and ensuring offtake...

High revenue and margin visibility in CPC business to help de-leverage balance sheet...

We initiate coverage with a 'BUY' recommendation and price target of Rs300...

Financial Results for the quarter & half year ended Jun'30, 2008

Particulars (Rs Mn)	Quarter Ended			Six Months Ended			Year Ended (9 Months)
	30/06/08	30/06/07	Gr (%)	30/06/08	30/06/07	Gr (%)	31/12/07
Net Sales	10,810	1,301	731.2	18,879	2,724	593.1	15,928
Total Expenditure	8,052	864	831.5	14,219	1,856	666.1	13,204
(Inc)/Dec in Stock	(77)	(10)		(197)	27		(69)
Consumption of Raw Material	5,359	67	9,134.1	9,252	138	5,394.3	8,162
Purchase of Traded Goods	-	-		-	-		519
Cost of Power & Fuel	383	247	54.9	645	495	30.2	659
Staff Cost	338	32	967.5	631	72	771.3	572
SG&A Expenses	691	420	64.6	1,318	898	46.8	1,995
Other Expenditure	1,358	109	1,151.6	2,570	226	1,037.3	1,366
Operating Profit	2,758	436	532.4	4,660	868	437.0	2,724
Other Income	17	30	(42.2)	32	131	(75.9)	283
EBIDT	2,776	466	495.3	4,692	999	369.9	3,007
Interest (Net)	1,125	94	1,103.0	1,827	252	624.9	1,578
Depreciation	255	38	572.0	485	76	541.7	574
PBT	1,396	335	317.0	2,381	671	254.8	856
Provision for current tax	458	43		646	183		142
Provision for deferred tax	-	-		-	-		(65)
Provision for FBT	-	-		-	-		4
PAT before extra ordinary items	938	292	221.6	1,735	488	255.8	776
Extra ordinary items	-	(625)		(274)	(961)		316
Share of Profit/(loss) in Associate	-	-		-	-		5
Net Profits	938	917	2.3	2,008	1,449	38.6	454
Paid-up Equity Cap (FV of Rs 10 per share)	720	321		720	321		670
Reserves(excl rev res)	-	-		-	-		2,236
Basic EPS	13.0	28.5	(54.4)	27.9	45.1	(38.2)	14.1
Diluted EPS	13.0	28.5	(54.4)	27.9	45.1	(38.2)	6.2
Book Value (Rs)	-	-		-	-		43.4
OPM (%)	25.5	33.5		24.7	31.9		17.1
NPM (%)	8.7	70.5		10.6	53.2		2.9
Expenditure (% of Net Sales)							
Consumption of Raw Material	48.9	4.4		48.0	6.1		50.8
Purchase of Traded Goods	-	-		-	-		3.3
Cost of Power & Fuel	3.5	19.0		3.4	18.2		4.1
Staff Cost	3.1	2.4		3.3	2.7		3.6
SG&A Expenses	6.4	32.3		7.0	33.0		12.5
Other Expenditure	12.6	8.3		13.6	8.3		8.6

Income Statement	FY05(18M)	FY06	FY07	CY07(9M)	CY08E	CY09E
Revenues	3,113	3,203	4,955	15,928	47,758	55,176
<i>Growth (%)</i>	32.5	54.3	54.7	328.6	124.9	15.5
Total Expenditure	2,988	2,908	3,474	13,204	38,353	44,978
Operating Profit	125	295	1,481	2,724	9,405	10,197
<i>Growth (%)</i>	-	252.8	402.5	145.3	158.9	8.4
Interest & dividend income	79	186	392	283	76	74
EBIDT	205	480	1,873	3,007	9,481	10,271
(-) Interest	420	391	680	1,578	3,228	2,751
(-) Depreciation	215	146	148	574	1,361	1,361
PBT	(430)	(56)	1,044	856	4,892	6,159
(-) Tax provision (incl FBT)	(82)	69	141	80	1,148	1,313
Net Profits	(347)	(767)	1,219	454	3,739	4,841
<i>Growth (%)</i>	-	-	-	(50.3)	517.5	29.5
Fully diluted Eq. sh. O/s (mn no)	72.0	72.0	72.0	72.0	72.0	72.0
Book Value (Rs)	10.1	16.3	36.2	43.4	100.4	161.8
Basic EPS (Rs)	(15.7)	(5.4)	46.4	14.1	52.0	67.3
Diluted EPS (Rs)	(15.7)	(5.4)	46.0	6.2	52.0	67.3

Balance Sheet	FY05(18M)	FY06	FY07	CY07(9M)	CY08E	CY09E
<i>Equity Share Capital</i>	221	261	321	670	720	720
<i>Reserves & Surplus</i>	3	165	840	2,236	6,504	10,924
Net worth	224	426	1,161	2,905	7,223	11,643
Total Debt	2,320	8,057	7,565	29,982	33,482	31,982
Deferred Tax	(163)	(95)	-	1,529	1,529	1,529
Capital Employed	2,381	8,387	8,726	34,417	42,234	45,155
Fixed Assets	2,286	2,169	2,767	30,477	31,928	33,086
Net current assets	67	368	1,175	3,671	10,016	11,778
Investments	26	4,917	4,784	269	290	290
Total Assets	2,381	8,387	8,726	34,417	42,234	45,155

Cash Flow Statement	FY05(18M)	FY06	FY07	CY07(9M)	CY08E	CY09E
PBT & extraordinary items	(430)	(56)	1,044	856	4,892	6,159
Depreciation	215	146	148	574	1,361	1,361
Interest & dividend inc.	(4)	(35)	(352)	(340)	(76)	(74)
Interest paid	344	960	691	1,597	3,228	2,751
Miscellaneous expenses	107	(155)	(38)	(8)	(5)	(5)
Tax paid	-	(5)	(142)	(173)	(1,148)	(1,313)
(Inc) /Dec in working capital	(212)	(143)	57	2,202	(6,636)	(1,529)
Cash from operating activities	20	712	1,409	4,707	1,615	7,350
Net capital expenditure	(4)	(29)	(746)	(2,169)	(2,812)	(2,520)
Net investments	-	(4,958)	(0)	(19,011)	(22)	-
Interest / Dividend recd	4	35	739	86	76	74
Cash from investing activities	(0)	(4,952)	(7)	(21,094)	(2,758)	(2,446)
Issue of eq. shares	-	40	496	-	50	-
Share Premium	-	-	-	-	950	-
Change in debt	139	5,796	(432)	18,970	3,500	(1,500)
Dividend paid	-	-	-	(283)	(421)	(421)
Interest paid	(74)	(1,470)	(663)	(3,081)	(3,228)	(2,751)
Cash from financing activities	66	4,366	(598)	15,605	851	(4,672)
Inc/Dec. in cash	86	125	803	(782)	(291)	232

Key Ratios	FY05(18M)	FY06	FY07	CY07(9M)	CY08E	CY09E
OPM (%)	4.0	9.2	29.9	17.1	19.7	18.5
ROACE (%)	5.8	5.7	23.3	12.7	23.0	24.6
ROANW (%)	-	-	105.0	20.8	51.8	41.6
Sales/Total Assets (x)	0.9	0.4	0.6	0.6	1.1	1.2
Debt:Equity (x)	10.4	18.9	6.5	10.3	4.6	2.7
Current Ratio (x)	1.1	1.6	2.9	1.8	1.9	2.0
Debtors (days)	7.7	5.7	4.4	35.7	48.0	48.0
Inventory (days)	23.3	15.2	21.7	85.9	120.0	120.0
Net working capital (days)	-	-	-	42.1	73.0	73.0
Debt/EBIDT (x)	27.8	27.3	5.1	8.3	3.6	3.1
EV/Sales (x)	3.0	2.4	1.6	1.9	1.0	0.8
EV/EBIDT (x)	75.4	26.3	5.2	15.2	4.9	4.3
P/E (x)	-	-	5.5	17.8	3.6	2.8
P/BV (x)	18.4	11.4	5.1	4.3	1.9	1.2

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