

ESSEL PROPACK LIMITED (EPL)

Sensex 5298.16

CMP Rs.224.55

Initiating Coverage**BUY**

Incorporated in 1984, Essel Propack Limited (EPL) is an Essel Group company. It manufactures laminated tubes and seamless plastic tubes. It has 30% share in laminated tubes market globally. Laminated tubes find application in mainly oral care (toothpastes) cosmetics, pharmaceutical and food industry.

We initiate our coverage on EPL with a **buy** recommendation and a price target of Rs.290-300 (29-33% upside) over 12 months time period.

Summary**Investment Rationale**

We expect the revenues to grow by 15% and 13.5% for FY04 and FY05 respectively. Growth in revenues will mainly come from USA and China. Effects of full scale operations of its USA plant for the full year will be visible this year. As competition heats up between P & G and Unilever in China, EPL expects volume led growth in this region.

EPL has the opportunity to **enter new markets (both geographically and product-wise) and build new relationships by entering into joint ventures or through acquisitions. (Recently acquired Arista Tubes, U.K.)**

Potential: There is still potential left in laminated tubes market. The scope for conversion from aluminium and plastic tubes is huge. EPL plans to increase its market share from 30% to 50%. Also there are opportunities in closures business and pharmaceutical industry.

Valuation: We expect EPL's earnings to increase by 11.5% and 13.5% in FY04 and FY05, respectively. At CMP of Rs.224.55 the stock is trading at P/E of 8.9x FY04E and 7.8x FY05E. We recommend **a buy on EPL with the price target of Rs.290-300 (29-33% upside).**

Key Share Data

Company	Essel Propack Ltd.
Sector	Packaging

Bloomberg	ESEL IN
Reuters	ESEL.BO

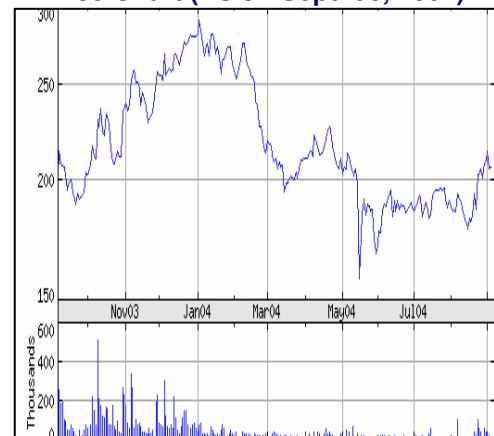
Face Value	Rs.10
52 Week H / L	Rs.497 / 157
Market Cap	Rs. 700 crores
Enterprise Value	Rs 949 crores
Free Float	62.88%
30 day avg. vol.	31091
Dividend Yield	3.56%

Valuation	FY03	FY04E	FY05E
P/E (x)	9.11	8.90	7.84
P/ BV (x)	1.00	1.01	0.92
EV/EBIDTA (x)	6.07	4.77	4.25

Summary Financials

Rs. Crores	FY03	FY04	FY05E	FY06E
Net Sales	576.9	663.0	753.0	820.0
Other Income	23.9	20.0	18.0	18.0
Total Expenditure	415.9	484.0	547.8	594.9
EBIDTA	184.9	199.0	223.2	243.1
Interest	20.4	19.0	20.0	21.0
Depreciation	62.6	69.0	77.0	83.0
PBT	101.9	111.0	126.2	139.1
Income Tax	29.9	33.3	37.9	41.7
PAT (adj.)	70.6	78.7	89.3	98.4
EPS	22.6	25.2	28.6	31.5

Source: Company, SKP Estimates *Y/E December 31st

Price Chart (As on Sept. 06, 2004)

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Background and Business Highlights

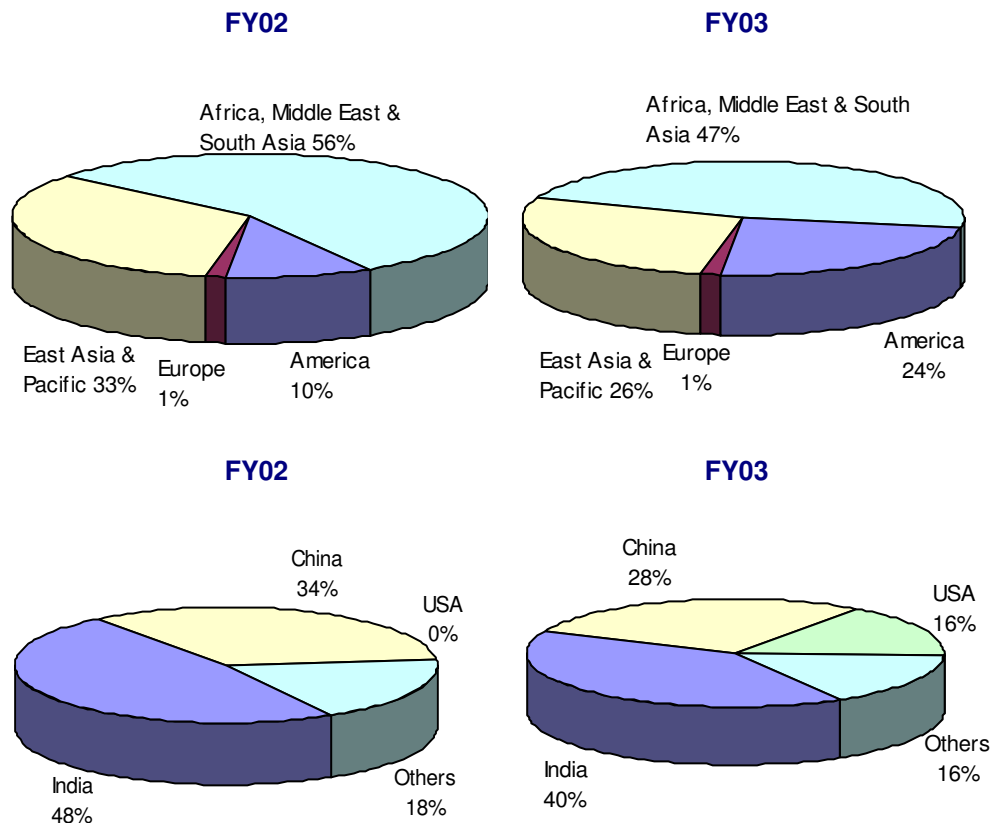
Background

- Incorporated in 1984, Essel Propack Limited (EPL) is an Essel Group company. **It manufactures laminated tubes and seamless plastic tubes. Laminated tubes find application in mainly oral care (toothpastes) cosmetics, pharmaceutical and food industry.**
- The company has strong global presence with 17 factories located worldwide.

Market Addressed	Location
America	USA, Venezuela, Columbia
Europe	Germany
East Asia and Pacific	Indonesia, Philippines, China
Africa, Middle East & South Asia	India, Nepal, Egypt

- EPL is the largest lamitube manufacturer in the world. In 2000 it acquired Switzerland's Propack AG, then the world's fourth largest lamitube company. EPL now has 30% market share of 12.8 billion tubes p.a. lamitube industry.
- EPL has preferred supplier relationship with global giants in oral care and cosmetics like P & G, Unilever and Colgate. It has long term contract with P&G to supply its tube requirements for entire North American Market. EPL expects to move with its existing companies as they build their production facilities in the prospective markets of Asia, Eastern Europe and Africa.

Business Segments Geographical revenue break-up



Financial Performance

H1FY04 results . . .

• Sales up by 22.2% during FY03, profits were up around 12% YoY. The topline growth in FY04 is the effect of the P&G USA plant being commissioned.

• Sales and PAT up by 11.9% and 9.9% for H1FY04 YoY.

Particulars (Rs. In Crores)	H1FY04	H1FY03	Var. (%)	FY03	FY02	Var. (%)
Income						
Net Sales (Incl. of taxes/duties)	297.7	266.0	11.9%	576.9	472.0	22.2%
Other Income	2.1	1.8	16.7%	7.2	6.2	16.3%
Total Income	299.8	267.8	11.9%	584.1	478.2	22.2%
(Increase)/Decrease in stock	3.4	-0.5	-	(0.7)	(0.8)	6.7%
Consumption of Raw Material	131.3	119.6	9.8%	262.0	194.0	35.0%
Staff Cost	35.2	26.9	30.9%	57.2	41.7	37.3%
Other Expenditure	41.8	38.4	8.9%	96.1	86.7	10.9%
Total Expenses	211.7	184.4	14.8%	414.6	321.6	28.9%
PBIDTA	88.1	83.4	5.6%	169.5	156.6	8.2%
Interest	2.6	2.5	4.0%	5.0	10.5	-52.2%
PBDT	85.5	80.9	5.7%	164.5	146.1	12.6%
Depreciation	32.1	32.8	-2.1%	62.6	56.1	11.6%
PBT	53.4	48.1	11.0%	101.9	90.0	13.2%
Provision for Taxation	16.9	13.6	24.3%	29.9	24.5	22.0%
PAT	36.5	34.5	5.8%	72.0	65.5	9.9%
Prior period / Extra ordinary Items	0.0	-1.3	-	(2.1)	(3.5)	39.3%
Minority Interest	0.00	0.00	-	0.6	0.9	-35.1%
PAT (Adjusted)	36.5	33.2	9.9%	70.5	63.0	11.9%
EPS (Not annualised)	11.7	10.6	9.9%	22.6	20.2	11.9%

Source: Company reports

Performance analysis by Region

Africa, Middle East and South Asia...

Rs. Crores	FY02	FY03	Change
Sales	279.28	286.68	2.6%
EBIT	60.93	65.82	8.0%

This region includes operation in India, Nepal and Egypt.

- ✓ Q4FY03 saw high volume growth.
- ✓ Company increasing reach in non-dentifrice segments
- ✓ Sales grew by only 2.6%. This figure was even lower for Indian operations at mere 0.3% growth YoY in sales in FY03.
- ✓ Technological upgradation by investing in Blown film manufacturing facilities.
- ✓ Going forward, we do not see much growth potential in this region, reason being slowdown in FMCG sector. Company will be just able to maintain its market share. We expect the revenues from this region to grow by 2-4% for next few years.

Indian Operations

Rs.Crores	FY02	FY03	Change
Sales	227.50	227.95	0.2%
PBT	66.50	63.60	-4.4%
PAT	46.34	39.84	-14.0%

East Asia and Pacific...

Rs.Crores	FY02	FY03	Change
Sales	165.91	167.73	1.1%
EBIT	32.87	30.12	-8.4%

This region includes operations in Indonesia, Philippines and China.

- ✓ Revenues registered a growth of 1.1% but EBIT declined by 8.4% due to operational inefficiencies.
- ✓ Price competition is expected in Chinese market thereby putting pressure on margin.
- ✓ FMCG sector looks very promising in this region. P&G has recently launched its flagship toothpaste brand "Crest" in China.
- ✓ Urban Chinese FMCG market is growing at 9%. Toothpastes recorded 10.2% growth in China for the year ended April 2004 as per a recent AC Nielsen survey.
- ✓ In-house laminates facility and vertical integration into Blown Film manufacturing were the technological highlights.
- ✓ Philippines will be used as an entry into ASEAN market.

Americas

Rs.Crores	FY02	FY03	Change
Sales	50.03	145.67	191.1%
EBIT	6.47	10.00	54.5%

This region includes operations in USA and Latin America.

- ✓ Huge growth in revenues was due to commencement of P&G USA operation. However higher start up costs led to lower PAT. PAT declined by 6% YoY to US \$ 1.2 mn.
- ✓ Operations in Venezuela have fairly stable revenues. It caters to Colgate's requirement.
- ✓ The Mexico operations have been incurring losses in the last two years. The company expects to turnaround them by redeployment and rationalisation of assets.

Europe

Rs.Crores	FY02	FY03	Change
Sales	7.01	9.13	30.1%
EBIT	1.06	0.85	-19.8%

This region includes operations in Germany.

- ✓ The company has plans of entering Eastern European markets along with Russia. It has recently received an order for 40-50 million tubes from Russia.
- ✓ ESEL recently acquired Arista Tubes, U.K. It is one of the leading manufacturers of plastic tubes in UK and Ireland.

Industry Overview

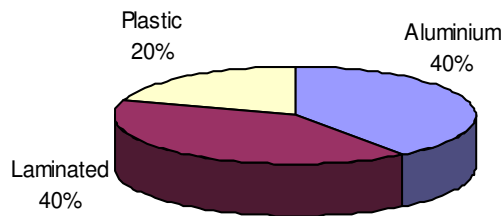
Global Packaging Industry...

The complex and dynamic packaging industry is worth an estimated \$417 billion globally (Europe \$129 billion, North America \$116 billion, Japan \$81 billion). It is a major contributory factor in the food chain, product marketing and merchandising, and logistics. The global packaging industry can be broken down by raw material type: paper and board, plastic, metal and glass. Paper, board and plastics account for approximately 70% of the packaging market.

Laminated Tubes...

Packaging Tubes is a sub-segment of the packaging industry. Global packaging tubes industry is of 32 billion tubes p.a. **Global lamitubes market is estimated at 12.8 billion tubes p.a.** EPL has 30% market share in this segment (3.85 billion tubes p.a.) and is the market leader. Its closest competitors viz. Cebal and Betts together have 22-24% market share.

Global Packaging Tubes Industry



Source: Company Reports and Industry data

Laminated tubes acquired 40% share by mainly eating into aluminium tube's share. Lamitubes have almost entirely replaced the aluminium collapsible tube

for toothpaste packaging and are now making inroads into the pharmaceutical sector.

Laminated tubes have advantage over aluminum tubes....

Main reasons for this phenomenon were as under:

- ✓ Aluminum tends to leach and it needs a lot of washing. Fluoride, for example, reacts with aluminum to form a toxic chemical. Some of the solvents used in processing aluminum can cause contamination.
- ✓ Laminated tubes offer a form of tube material with the advantages of plastic but with properties close to those of metal. Lamitubes are made by press rolling together alternative layers of polyethylene and metals.
- ✓ Laminated tubes have a good "feel" and maintain their attractiveness throughout the life of their contents. Laminated tubes are cleaner and they can be decorated more easily and attractively.

Demand Drivers

Oral care segment and conversion from aluminum to laminated tubes

- ✓ 75% of the world's laminated tubes produced are consumed in oral care industry. Oral care industry is growing at 3-4% p.a. in volume terms. This is even higher in developing and third world countries as huge market potential lies untapped there. The scope for conversion from aluminium and plastic tubes is huge. As global giants in oral care are conquering countries like China, Russia and African countries EPL will have enough scope to enhance installed capacity and capture volume driven growth.

"Pharma" factor

- ✓ Only 6-7% of the total requirement of the pharmaceutical industry is addressed by laminated tubes today. We see a clear opportunity here. Migration to laminated tubes by major pharmaceutical companies may provide opportunity.

Developing countries

- ✓ Developing countries consume only 2 tubes of toothpaste per capita as compared to 8 for developed countries. As global oral care companies strive to tap this market, EPL can expect to derive fresh demands from these countries.

Investment Positives

China factor and USA operations...

EPL has a global business and therefore has opportunity to capture the growth in emerging oral care, cosmetics and pharmaceuticals market. At the same time it can keep its revenues stable in less attractive or stagnant markets. **Growth in revenues will mainly come from USA and China.** The Danville plant in USA was fully operational since last July only. Effects of full scale operations for the full year will be visible this year. Also EPL is aiming to win more orders (other than P & G) and convert more customers to laminated tubes from metal tubes. Company aims to sell 100 million tubes to customers other than P & G.

Also, P & G has launched its flagship toothpaste brand “Crest” in China. China accounts for 28% of the EPL’s revenues. **As competition heats up between P & G and Unilever in China, EPL can expect volume led growth in this region.**

Chinese urban FMCG market grew by 9% for the year ended April 2004....

Growth in China

Category	% Growth
Toothpaste	10.2
Shampoo	3.1
Skin moisturiser	25.3

Source: AC Nielsen Survey

Volume led growth – Acquisitions to gain entry into new markets and large exclusive contracts...

As laminated tube is a low value product and competition is very intense, growth in revenues will come from increasing volume. EPL plans to unleash its spare capacity. To maintain economies of scale EPL will look for joint ventures and acquisitions route. This offers the opportunity to **enter new markets (both geographically and product-wise) and build new relationships.** Recently EPL acquired Arista Tubes, U.K. It makes plastic seamless tubes and has 30% share in U.K. and Ireland market.

Potential left in laminated tubes market...

The scope for conversion from aluminium and plastic tubes is huge. Still 40% tubes are made in aluminium. Also, only 6-7% of the total requirement of the pharmaceutical industry is addressed by laminated tubes today.

Caps and closures market...

Currently, caps and closures (for tubes as well as other packaging media) account for revenues of only Rs.6.55 crores. The company has plans of diversifying into this segment as well. **The market for closures is of US\$ 4 billion in USA alone.** EPL can leverage relationships with its major customers to provide closures alongwith tubes.

Free cash flows and dividend yield...

Company is generating good free cash flows (Rs.65 crores for FY03). We expect the company to generate good operating cash flows which will help in financing acquisitions and/or capex plans mostly from internal accruals.

Also the dividend yield on stock at CMP of Rs.207.10 is 3.56%

Investment Risks

Promoters' Loan One cause of concern is loans given to promoters. As on 31st December 2003, the loans to other related parties were Rs.31.4 crores (on 31st December 2002, Rs.24 crores). A majority of these "other related parties" are promoter companies.

Return ratios are looking poor... To achieve the target to acquire 50% market share in coming years, EPL will need to build capacities or acquire smaller companies. The company has already spent US\$ 110 millions in the last 3 years for this purpose. Before these assets sweat out return ratios look poor. EPL's RoNW is 12% and RoCE is 13% (FY03). This, we believe, is low for a global leader.

Recent Developments

Acquisition of Arista Tubes, U.K.

EPL has taken over Arista Tubes (AT) of the UK, manufacturer of plastic seamless tubes, for an undisclosed amount. The acquisition forms a part of EP's plans to expand its product line and also tap the European market, which is considered a big market for laminated tubes. EP acquired AT through its wholly-owned subsidiary, Lamitube Technologies Ltd, Mauritius. The funds for the acquisition were raised through internal accruals and borrowing. Arista Tubes has a turnover of \$20 million. It manufactures tubes used in cosmetics, personal care, toiletries and pharmaceutical segments. **It commands 30 % market share in the UK and Ireland** and has an integrated manufacturing unit at Stevenage near London.

Recommendation and Valuation

BUY

We expect EPL's earnings to increase by 11.5% and 13.5% in FY04 and FY05, respectively. Our estimates do not take into account acquisition of Arista Tubes; U.K. Growth is basically expected to come from USA and China region. Also Russia is expected to increase its contribution to revenue pie.

Valuation Summary

Valuation Method	Price Target (Rs.)
DCF	275
EV/EBIDTA (6x FY05E)	315
PER (10x FY05E)	286

Discounted cash flow based on free cash flow to firm

Assumptions

ROCE	12%
Growth Rate	8%
Free Cash to Firm	33%
Discount Rate	12.5%
Terminal Multiple	11.8

Year	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
EBIT (1-t)	31.0	34.7	37.9	40.9	44.2	47.7	51.6	55.7	60.1	65.0
FCFF	10.3	11.6	12.6	13.6	14.7	15.9	17.2	18.6	20.0	21.7

Terminal Value	763.2
Discounted Value of FCFF	90.1
Discounted Terminal Value	264.4
Total EV Per share	354.5
Less: Net Debt	79.5
Value for shareholder	275.0

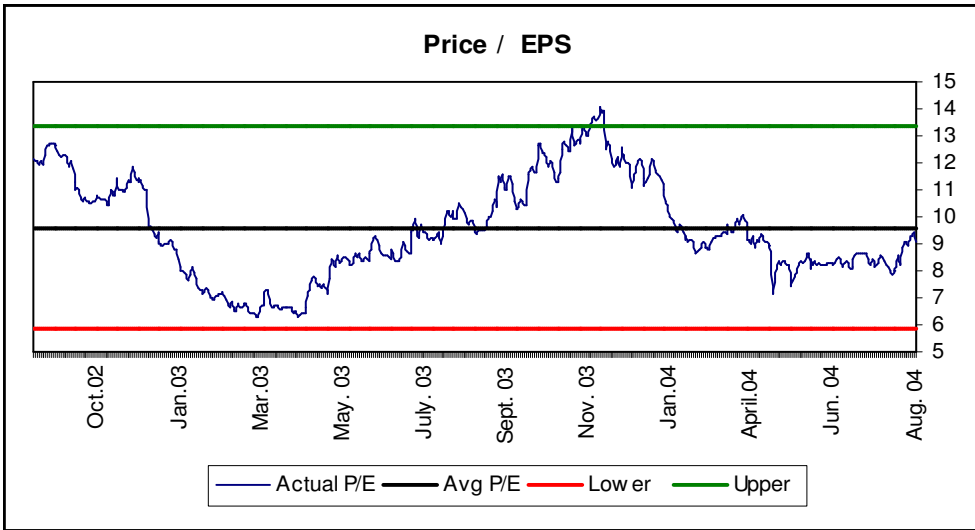
EV / EBIDTA

Particulars	Rs.
EBIDTA FY05E	205
EV (6x)	1231
Net Debt	248
Equity value	983
Equity value per share	315

If we look at the M & A data for the global packaging industry for the years 2001, 2002 and 2003 the range of EV / EBIDTA has been 5x to 7x. Applying a multiple of 6x to FY05 EBIDTA (excluding other income) gives us the price of Rs.315.

PER

Standard deviation bands of P/E ratio (+2 σ and -2 σ)



We have applied a P/E of 10x to FY05E. Currently the stock is trading at P/E of 9.1x based on FY03 earnings. Company will gain entry into newer markets, consolidate its position in the existing market, benefit from growth in Chinese market. There is also potential from pharmaceutical business and closures. Return ratios are expected to improve going forward. At CMP of Rs.207.10 the stock is trading at P/E of 8.9x FY04E and 7.8x FY05E.

We recommend a buy on PIL with the 12-month price target of Rs.290-300 (29-33% upside). This would imply a P/E of 10.20x FY05E.

Profit and Loss Account

Year Ending on 31st December

PARTICULARS (Rs. In Crores)	FY01	FY02	FY03	FY04E	FY05E	FY06E
Income						
Net Sales (Net of taxes/duties)	357.57	472.00	576.92	663.00	753.00	820.00
Other Income (Incl. share of profit from associate Co.)	3.70	21.84	23.92	20.00	18.00	18.00
Total Income	361.26	493.84	600.85	683.00	771.00	838.00
Change %	-	36.70%	21.67%	13.67%	12.88%	8.69%
Expenditure						
(Increase)/Decrease in stock in trade	(5.30)	(0.75)	(0.71)	0.00	0.00	0.00
Consumption of Raw Material	157.62	193.99	261.98	298.35	338.85	364.90
Manufacturing exp.	31.80	42.51	49.51	59.67	67.77	72.16
Personnel Cost	24.76	41.67	57.21	66.30	73.42	79.95
Administrative & other exp.	24.63	35.71	37.55	46.41	52.71	59.45
Selling and Distribution Expenses	4.94	9.71	10.40	13.26	15.06	18.45
Total Expenses	238.43	322.85	415.95	483.99	547.81	594.91
PBIDTA	122.83	170.99	184.90	199.01	223.19	243.09
Change %	-	39.21%	8.14%	7.63%	12.15%	8.91%
Interest	10.89	24.88	20.40	19.00	20.00	21.00
PBDT	111.94	146.11	164.50	180.01	203.19	222.09
Depreciation	37.39	56.10	62.57	69.00	77.00	83.00
PBT	74.55	90.01	101.93	111.01	126.19	139.09
Provision for Taxation	12.60	24.50	29.92	33.30	37.86	41.73
PAT	61.96	65.51	72.01	77.71	88.33	97.36
Prior period Adj. / Extra ordinary Items	(1.86)	(3.46)	(2.06)	0.00	0.00	0.00
Minority Interest	(0.32)	0.94	0.61	1.00	1.00	1.00
Pre Acquisition Profit	4.74	-	-	-	-	-
PAT (Adjusted)	55.03	62.99	70.56	78.71	89.33	98.36
Change %	-	14.46%	12.01%	11.55%	13.50%	10.11%
EPS (Rs.) after prior period items	17.71	20.19	22.61	25.22	28.62	31.52

Source: Company Reports, SKP Estimates

Balance Sheet

Year Ending on 31st December

PARTICULARS (Rs. In Crores)	FY01	FY02	FY03	FY04E	FY05E	FY06E
Sources of Funds:						
Shareholders' Funds						
Share Capital	31.19	31.19	31.21	31.21	31.21	31.21
Reserves and Surplus	525.14	564.11	610.74	663.88	728.76	802.76
Total Shareholders' Funds	556.32	595.29	641.95	695.09	759.97	833.97
Secured Loans	135.72	152.03	136.53	130.00	120.00	110.00
Unsecured Loans	145.88	163.79	150.60	140.00	130.00	125.00
Loan Funds	281.60	315.82	287.13	270.00	250.00	235.00
Minority Interest	3.06	3.88	3.28	4.00	4.50	5.00
Net Deferred Tax Liabilities	25.20	20.89	18.76	17.00	15.00	13.00
TOTAL	866.19	935.89	951.11	982.09	1024.97	1081.97
Application of Funds :						
Fixed Assets						
Goodwill on Consolidation	282.97	274.70	274.70	274.70	274.70	274.70
Gross Block	539.43	683.60	771.29	850.00	945.00	1015.00
Less: Depreciation	217.22	275.90	337.85	406.85	483.85	566.85
Net Block	322.21	407.70	433.44	443.15	461.15	448.15
Capital Work in Progress	25.53	18.23	31.13	25.00	30.00	35.00
Investments	43.17	43.27	41.50	41.50	41.50	41.50
Current Assets, Loans & Advances						
A. Current Assets						
(a) Inventories	53.52	56.97	60.12	77.00	79.00	88.00
(b) Sundry Debtors	54.09	60.78	81.25	81.62	91.50	101.50
(c) Cash and Bank Balances	81.23	71.29	39.02	50.00	67.00	95.00
(d) Other Current Assets	0.01	0.00	0.00	0.00	0.00	0.00
Total Current Assets	188.85	189.04	180.39	208.62	237.50	284.50
B. Loans and Advances	80.56	89.47	109.95	120.00	135.00	151.00
Total (A+B)	269.41	278.51	290.33	328.62	372.50	435.50
Less: Current Liabilities and Provisions						
A. Current Liabilities	60.64	67.47	95.84	101.00	122.00	116.00
B. Provisions	19.94	24.25	29.28	35.00	38.00	42.00
Total (A+B)	80.58	91.72	125.11	136.00	160.00	158.00
Net Current Assets	188.83	186.79	165.22	192.62	212.50	277.50
Miscellaneous Expenditure	3.48	5.20	5.13	5.13	5.13	5.13
TOTAL	866.19	935.89	951.11	982.09	1024.97	1081.97

Source: Company Reports, SKP Estimates

Ratio Analysis

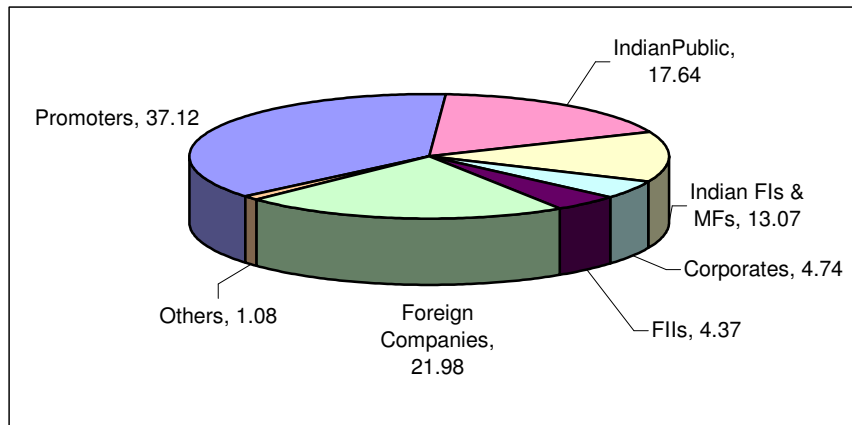
Ratios	FY01	FY02	FY03	FY04E	FY05E	FY06E
Profitability (%)						
PBIDTA Margin	34.35%	36.23%	32.05%	30.02%	29.64%	27.45%
PAT Margin	14.36%	8.72%	8.08%	8.85%	9.47%	9.80%
ROE	-	10.94%	11.41%	11.77%	12.28%	12.34%
ROCE	-	12.75%	12.97%	13.45%	14.57%	15.20%
Growth (%)						
Net sales	-	32.00%	22.23%	14.92%	13.57%	8.90%
EBIDTA	-	39.21%	8.14%	7.63%	12.15%	8.91%
Adj. Net Profit	-	14.46%	12.01%	11.55%	13.50%	10.11%
Capital Employed	-	8.05%	1.63%	3.26%	4.37%	5.56%
Valuation (x)						
EPS (Rs.)	17.71	20.19	22.61	25.22	28.62	31.52
P/E (x)	12.11	13.47	9.11	8.90	7.84	7.12
BV/Share (Rs.)	178.39	190.89	205.69	222.71	243.50	267.21
P/BV (x)	1.20	1.42	1.00	1.01	0.92	0.84
EV/EBIDTA (x)	7.62	4.97	6.07	4.77	4.25	3.79
EV/Net Sales (x)	2.62	1.80	1.94	1.43	1.26	1.12

Assumptions:

1. RoCE and RoE are calculated using avg. capital employed and avg. equity respectively
2. Earnings used for RoCE are before interest and tax payments.
3. EBIDTA includes other income

Shareholding Pattern (As on 30th June, 2004)

Category	No. of Shares held	% of Shareholding
Promoter's Holding		
Promoters		
Indian promoters	11590529	37.12
Sub Total	11590529	37.12
Non Promoters Holding		
Institutional Investors		
Mutual Funds and UTI	2799590	8.97
Banks, Financial Inst., Insurance Company	1280480	4.10
FII's	1363842	4.37
Sub Total	5443912	17.44
Others		
Private Corporate Bodies	1478520	4.74
Indian Public	5508553	17.64
NRI's /OCB's /Foreign Nationals	335763	1.08
Foreign Company	6863322	21.98
Sub Total	14186158	45.44
Grand Total	31220599	100.00



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