



KALYANI STEELS

7th Oct 2014 Rating: **Buy**
CMP : Rs. 128 Target Price: Rs. 180

BUSINESS BACKGROUND

Kalyani Steels Limited (KSL) is a part of the Kalyani group. KSL is a leading manufacturer of forging and engineering quality carbon and alloy steels using the blast furnace route. KSL caters to engineering, automotive, seamless tube, foundry and casting industries and the primary aluminium industry. KSL is a quality supplier steel to engine components like Crankshaft, Camshaft, Connecting Rods, Axle Beams, Steering Knuckles, & Bearings. In the Energy space it caters to players which manufacture seamless Tube applications for High Pressure Boilers, Oil Lines, Casing and Tubing Pipes for Oil Exploration. KSL is also a certified supplier to the Indian Defence and supplies steel for bomb shells and barrel applications & components for heavy vehicles

INVESTMENT HIGHLIGHTS

Strong Q1 FY15 Performance –

KSL reported a sales growth of 28% yoy in Q1 FY15 led by better product mix. This was reflected in a higher EBIDTA growth of 48% at Rs 38.93 crs from Rs 26.36 crs in Q1 last year and a strong 51% increase in PAT. The PAT for Q1FY15 stood at Rs 15.28 crs as compared to Rs 10.14 crs in Q1 last year.

For FY14 the company has recorded a topline of Rs 1115.98 crs, - up by 38%, a EBIDTA of Rs 140.4 crs from Rs 83.77 crs – up by 68% while PAT is placed at Rs 58.58 crs from Rs 23.86 crs – up by 145% YoY. KSL declared a dividend of 60% for FY14.

KSL enjoys a diverse and marquee client base –

KSL's international clientele includes Alcan Iceland, Alcan Primary Metals (UK), Aluminium Bahrain, Arvin Meritor (USA), BF Klista (Sweden), BF Scottish Stampings (Scotland), Caterpillar Inc (USA), C.V.G. Venalum (Venezuela), Dubai Aluminium Co Ltd, Ford (USA), Hydro Aluminium (Norway), Scania (Sweden), Volvo (Sweden) and Rio Tinto (Australia). KSL's domestic clients include Ashok Leyland, Automotive Axles, Bharat Aluminium Co Ltd, Bharat Forge Ltd, Bharat Heavy Electricals Ltd, Indian Railways, ISMT, Jindal Saw Ltd, Kirloskar Oil Engines Ltd, Maharashtra Seamless Ltd, Mahindra & Mahindra, and Tata Motors. In addition KSL is a quality supplier to the Indian Defence segment for steel used to manufacture Bomb Shells and Barrel Applications, and components for heavy vehicles. Hence KSL's diverse client base mitigates the risk of client concentration and at the same time it offers strong growth opportunities as a quality Tier 1 vendor to such large OEMs.

KEY DATA

FACE VALUE	Rs 5.00
DIVID YIELD %	2.34
52 WK HI/LOW	153/43
NSE CODE	KSL
BSE CODE	KSL
MARKET CAP	RS 564 CRS

SHAREHOLDING PATTERN

PROMOTERS	- 60%
BANKS, MFs & DII's	- 1%
FII's	- 1%
PUBLIC	- 38%

KEY FUNDAMENTALS

Year Ending	FY14	FY15	FY16
Sales Gr%	38	25	20
PBT Gr%	137	35	22
PAT Gr%	145	33	27
EPS Gr%	145	33	27
Roe %	16	18	20
Roce %	12	14	15
EPS (Rs)	13.4	17.84	22.64

Focus on Integration, strong R & D and Pan India presence to benefit KSL going ahead –

Although the forging industry in India is the primary market for KSL's products, markets of various components for commercial vehicles, two wheelers, diesel engines, bearings, tractors, turbines and rail also form a substantial part of its clientele. KSL has also earned the status of preferred steel supplier for engineering, automotive, seamless tube and primary aluminium sectors. Also KSL enjoys a pan india presence and services customers in Punjab, Haryana, UP, UTK, Himachal, and also caters to customers in Gujarat, Rajasthan and across Maharashtra. In the South it caters to markets like Karnataka, TN, and AP while in the East it has customers based in WB and Jharkhand

Overall KSL's Business Outlook looks Bright –

In the last few years, applications of alloy steel have been increasing in consumer products such as consumer durables and automobiles. Use of alloy steels has enabled the industry to make light-weight machinery, thus making them energy efficient. The automobile industry is the largest consumer of alloy steel. In 2013-14 India's consumption of alloy steel increased by 10% wherein the automobile and auto components sectors consume around 70% of the alloy steel produced in India. In the auto component sector, around 60% of the total demand is derived from automobile original equipment manufacturers (OEM).

KSL also stands to enjoy a significant competitive edge based on the premise that its flagship company Bharat Forge Ltd (BFL) has a large global and domestic market presence and where KSL is a large vendor of special quality alloy & carbon steels. This to a large extent should benefit KSL sizeably going ahead also as BFL is a well-established auto component player to global and domestic OEMs which demand only the best steel inputs and where KSL scores highly. Additionally KSL management has making pro active investments in R & D which has helped it score highly in terms of product quality which is a must to nurture and service large OEM customers. Also with a revival in the domestic CV segment imminent in the next 6 months, we believe this would further boost KSL's revenues in the domestic market going ahead which should get fully visible in FY16.

Solid financial performance - topline growth and margin expansion –

We estimate KSL's earnings to witness a CAGR of 20-25% over FY13-16E. This will be driven by strong revenue growth (20% CAGR over FY13-16E) and a steady EBITDA margin expansion over the same period.

Over the last 3 years starting 2011 onwards, KSL has improved its operational performance with operating margins having been maintained despite increasing cost pressures ranging between 10% to 12% since last 3 years.

Also it has been able to maintain a return on equity of 16% and ROCE of 12%. Also, considering the fact that KSL business requires large working capital, it has a reasonably low high D :E of 0.46:1 as on Mar 2014 on a net worth of Rs 398 crs as on March 2014 which we believe looks low when compare to other comparable steel players which is a positive for KSL.

Business Outlook & Stock Valuation

On a rough cut basis, in FY15, Topline will see a steady rise wherein Topline is expected to touch Rs 1395 crs in FY15E.

On the bottomline level we expect the company to record a PAT of Rs 78 crs in FY15E. Thus on a conservative basis, KSL should record a EPS of Rs 18. for FY15E. For FY16E our expectation is that earnings traction for KSL would continue to be robust wherein we expect a EPS of Rs 23

We believe that the domestic Auto sector has just started to revive and is likely to gain traction on the positive side in the next 2 quarters. The recovery in sales volumes for Cars and CVs in last two months has shown strong signs of growth coming back and we expect that a full revival will be visible in FY16. On the valuation side KSL is that EPS growth over the next three years between FY14 to FY16 is expected to average 30% plus YoY but valuation multiples look quite low between 7x on FY15 and 6x on FY16E.

To add the current market cap of KSL at Rs 564 crs, the KSL stock trades a market cap to sales multiple of just 0.40x on FY15E whereas the potential revenue over the next 2 years is over Rs 1700 crs. Going ahead we expect KSL's ROE to increase to 20% by FY16 from 16% in FY14 coupled with a higher dividend possibility, this combination can get the stock re rated as the management bandwidth and credibility for KSL is well established.

Hence we believe that the KSL stock should be purchased at the current price for a price target of around Rs 180 keeping a financial stop loss of Rs 111.

FINANCIALS

For the Year Ended March RsCrs	FY13A	FY14A	FY15E	FY16E
Net Sales	809.06	1115.98	1395.0	1673.97
EBIDTA	83.77	140.4	174.4	209.2
EBIDTA %	10.35	12.58	12.50	12.50
Interest	22.48	17.0	20.0	22.0
Depreciation	23.56	33.95	39.0	45.0
Non Operational Other Income	7.15	11.79	5.0	5.0
Profit Before Tax	37.73	89.45	120.4	147.2
Profit After Tax	23.86	58.58	78.0	99.0
Diluted EPS (Rs)	5.46	13.40	17.84	22.64
Equity Capital	21.86	21.86	21.86	21.86
Reserves	332.73	375.99	438.49	521.99
Borrowings	151.37	185.08	200.08	220.0
GrossBlock	608.36	644.14	684.14	734.14
Investments	48.72	31.15	31.15	31.15

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