SINCE 1986
DALAL STREET INVESTMENT JOURNAL
DEMOCRATIZING WEALTH CREATION

The Trick Is To **Spot Them** At The **Larval Stage**

BSE Code	:	**500235**
Time Duration	:	**1 year**
CMP	:	**₹336.50 (as on 24 January, 2017)**
Target Price	:	**₹440**

Kalyani Steel

BURN THE FURNACE

Our Tiny Treasure for the month of January 2017 is Kalyani Steel Ltd (KSL). KSL is a leading manufacturer of forging and engineering quality carbon and alloy steel. It has application across several critical sectors such as automotive, oil & gas, power, locomotive, marine, aerospace, construction and mining etc. KSL, which belongs to the Kalyani Group, fulfils the requirement of group businesses through backward integration. KSL has grown at a CAGR of 4 per cent over the last the five years, led by rising demand through strong client portfolio, strong R&D, pan-India foothold and strong parentage of the Kalyani Group.

Going forward, change in MIP norms for steel products, revival in industry demand and strong client portfolio will fuel the growth of KSL at CAGR of 6 per cent over FY16-18E. Considering these factors we see upside of ~30 per cent in the scrip from the current level.

Investment Rationale

Countrywide foothold due to strategic location : KSL is a Pune-based company having steel mill at strategic location of Hospet, Karnataka with hot metal capacity of 2,90,000 TPA. The company has locational advantage as southern region is bourgeoning automotive hub and Karnataka is rich in iron ore. It also enjoys the benefit of having adjacent Mangalore port for imports of other raw materials. The company's head office is in Pune and its plant is in South, so the company has countrywide foothold.

End of MIP on steel products to lower operating costs : A minimum import price (MIP) was imposed on some steel products for almost a year to discourage cheap imports from China, South Korea, Japan, Russia, Europe and Ukraine. However, the MIP will come to an end on February 4, 2017. KSL will benefit from cheap imports in terms of improved operating profit margins as its major raw material is iron ore. We see improvement of more than 500 bps in EBITDA margin on account of cheap imports. However the prices of coking coals have firmed up which can partially offset the benefits accruing from lower iron ore prices.

Strong Clientele: Kalyani Group has joint ventures with Bharat Forge, Automotive Axles, Kalyani Hayes Lemmerz and Kalyani Carpenter Special steels. KSL caters to all business requirement of these JVs through backward integration. It also has big brand name in its clients list from the automotive, energy and aluminium smelting segments, such as Eicher, Hyundai, Force, Ford, Tata, Maruti Suzuki, Renault, Nissan, Mahindra, Volvo, Eaton, AMW, 7F India, BHEL, Jindal Saw, MSL, UST etc. In addition, KSL is a supplier to the Indian defence segment for steel used in bomb shells, barrel applications and components in heavy vehicles. Traction in clients benefits the company through higher volumes. Diverse client base also alleviates risk of client concentration and offers opportunity to be quality vendor to strong OEMs.

Revival in industry demand : Alloy steel has wide application in consumer durables, automobiles and light weight machineries. KSL is a tier-1 quality vendor to many automobile giants. The Indian economy experienced degrowth in auto sales in the third quarter of the year due to cash crunch on account of demonetisation. Going forward, we see pace picking up in auto sales volumes as economy has factored in the cash crunch and is getting back to normal. The automobile industry should witness double digit growth in Q4FY17 and FY18 on the back of pre-buying before implementation of BS-IV norms from April,17, reduced cost of financing and new product launches by OEMs and expected additional incentives from forthcoming budget. All these factors along with rising per capita income will press the foot on growth accelerator for an economic revival. These macro factors bode well for KSL's growth in coming years.

Financial Performance : During H1FY17, KSL recorded increase in gross sales by 7.42 per cent to Rs 817cr, as compared to Rs 761cr in the same period of last fiscal. The EBITDA of the company surged 37.9 per cent to Rs.160cr YoY led by improvement in stocks and muted raw material expenses. The EBITDA and PAT margins expanded by 432 bps and 265 bps to 19.55 per cent and 10.31 per cent, respectively. Despite increase in iron ore and international coking coal prices, the company has recorded tremendous improvement in profit margins. The PAT of the company soared by 44.6 per cent to Rs 84.4 cr as against Rs 58.36cr in H1FY16.

The company reported continuous improvement in inventory turnover ratio and sales/working capital ratio since last four years at 10.98x and 10.28x, respectively, in FY16 which shows the financial strength of the company. The company also has a healthy debt to equity ratio of 0.55x. The company delivered ROCE and ROE of 23.11 per cent and 21.32 per cent, which is healthy as compared to its peers.

Valuation: The company is trading at FY18E P/E of 8.15x on FY18E EPS of Rs.41.21, which looks attractive at the current level. We recommend investors to BUY this scrip in the range of Rs 290-350 (CMP-335) with target of Rs 440.

Inc/Exp Statement(Standalone) (Rs in Crore)

Description	201603	201503	201403	201303	201203
Net Sales	1180.47	1227.01	1115.99	809.07	976.85
Total Income	1183.12	1229.33	1127.78	816.22	998.65
Total Expenditure	945.18	1059.53	987.36	732.44	934.26
PBIDT	237.95	169.81	140.42	83.78	64.39
PAT	113.58	83.31	58.59	23.87	22.04
Dividend %			60.00	30.00	20.00
Adj. EPS(Rs)	26.02	19.09	13.42	5.47	5.05

Quarter On Quarter (Standalone) (Rs in Crore)

Particulars	201609	201606	Q on Q Var%	201509	Y on Y Var%
Net Sales	329.83	344.43	-4.24	318.00	3.72
Total Expenditure	257.23	257.88	-0.25	259.75	-0.97
PBIDT (Excl OI)	72.96	87.09	-16.22	58.47	24.78
PAT	37.60	46.80	-19.65	29.47	27.61
PBIDTM% (Excl OI)	18.20	20.84	-12.67	15.09	20.61
PBIDTM%	18.37	21.06	-12.77	15.19	20.93
PATM%	9.38	11.20	-16.25	7.60	23.42
Adj. EPS(Rs)	8.61	10.72	-19.68	6.75	27.56