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UPSTREAM PICK

June 2018

THINK DIFFERENT PROFIT MORE

Company Name	:	**Godawari Power & Ispat Limited**
BSE Code	:	**532734**
Time Duration	:	**2 year**
CMP	:	**₹392.35 (as on 07 June, 2018)**
Target Price	:	**₹582**

Our Upstream Pick for the month of June is Godawari Power & Ispat Limited (GPIL). The company is engaged in captive mining of iron ore and manufacturing and selling of iron ore pellets, sponge iron, steel billets, rolled products, ferro alloys, and hard black (HB) wires with captive power generation. It is also engaged in generation of solar thermal power.

Iron ore pellets are used in the production of steel and alloys. Sponge iron too is a vital input for the steel industry. Silico-manganese, which is a form of ferro-alloy, is also used in the production of steel. GPIL's core business includes production of these products which suggests that growth in steel industry will have a direct impact on the growth of the company. The demand for pellets from China is robust, which will drive the company's growth.

We see this company as our Upstream Pick as we found a turnaround story in the company's operational and financial performance. A debt-ridden company whose profits were declining and which incurred heavy losses, especially in the past two years, generated profits in FY18 and reduced its debt levels. Although 2016 was a tough year for the steel industry globally, the company maintained its EBITDA margin at 10-11%. The industry recovered in early 2017 and pricing policies also changed, which led to a turnaround in FY18. With capacity ramp-up, its production was at the highest levels, realisations had improved, and cash flows had improved and turned positive, and its debt had reduced considerably. In FY18, debt-equity ratio improved to 2.1x as against 3.1x in FY17. With improved margins and deleveraging strategy, the company has strong prospects for growth.

Turnaround story

Over the years, especially from FY13, the company relied heavily on debt-funded growth. In FY12, the company's borrowings stood at Rs 960.82 crore, which alarmingly rose to Rs 1,683.88 crore in FY13. Further, debt was as high as Rs 2,214.48 crore in FY17. This rise in debt was on account of creation of 2.1 million tonne capacity of pellets and other capex plans. Also, it invested its meagre cash on non-core business segments like solar, which had under-performed. In FY17, while its debt-equity ratio stood high at 3.18x. However, in FY18, higher demand for pellets and revival in stressed steel companies led to generation of positive cash flows. Also, higher volumes, better realisations and lower input costs led to reduction in its debt. The proposed plan of divesting the solar business could also help the company in reducing its debt. The company plans to reduce debt by Rs 600 crore over the next two years. The company's credit rating had improved from D to BB+ in February 2018 and further improved to BBB- in April 2018.

The company now is eligible for bio-mass power generation, which will be an additional source of revenue and lead to cost reduction. The captive railway siding near its manufacturing facility at Siltara will lead to low procurement cost of raw materials and would generate additional revenue.

Highest ever production and realisation levels in FY18

During FY18, the company ramped up the mining output significantly and mined 15,79,693 MT, which is the highest ever production and 34.43% higher over FY17 output. The production of iron ore pellets also has been the highest in FY18 at 18,41,050 MT as against 14,95,100 MT in FY17, an increase of 23% YoY.

Also, the realisation of iron ore pellet has increased by 23% on a YoY basis. The realisations for sponge iron and steel billets rose by 35% and 27% YoY, respectively. Higher price realisations in pellets and sponge iron products will drive the topline of the company and with efficient cost cutting measures, margins would also improve further.

Capacity ramp-up and expansion

The company is one of the low-cost producers of iron ore pellets as large part of its raw material, i.e. iron ore, is sourced locally in Chhattisgarh. It has iron ore facilities with annual production capacity of 2 million tonnes, which meets its 70% of the captive requirement. Recently, in FY17, it has ramped up its capacity to 1.5 million tonnes and has a target to raise it up to 1.8 million tonnes in FY19. Very soon, 100% of its captive requirement will be met through its iron ore mines, which will further lower its cost of production.

Also, GPIL has long term coal linkages with Coal India Ltd. of 7.37 lakh MTPA. In the next phase of linkage auction, it is expecting linkage of 35,000 MT. It is also planning for full integration from sponge iron to finished steel segment up to 4 lakh tonnes per annum by commissioning 2 lakh TPA and integration of 25 MW power plant, which will improve its operating margins.

Demand for steel heading northwards

As per the World Steel Association (WSA) estimates, the global steel demand will reach 1.616 billion tonnes in 2018, and in 2019, it will touch 1.627 billion tonnes. As per WSA, the growth in demand for steel would be 4.9% in 2018 and 4.5% in 2019 in the developing economies, excluding China. India being the third largest steel consumer, the demand for steel in India is expected to grow at 5.5% in 2018 (previous estimated 4.4%) and by 6% in FY19.

By the end of FY17, the global steel consumption was spread over sectors such as construction (50%), mechanical engineering (16%), automotive (13%) and others (21%). In India, building and construction account for 35% of steel demand and the upcoming spurt in affordable housing segment will also trigger the demand for steel. In the automobile sector, passenger and commercial vehicles are expected to grow at CAGR of 8-10% for which the demand for steel will remain northwards. Also, the metros and railways projects in India are estimated to grow at 8-10% CAGR till FY22 and will consume 30% of the total steel demand in India.

Stellar financial performance in FY18

In Q4FY18, GPIL's revenue was up by 17.7% YoY to Rs 743 cr from Rs 631 cr due to high volume sales of iron ore mining, pellets and sponge iron. Its EBITDA for the quarter doubled from Rs 105 cr to Rs 211 cr driven by rise in topline. The EBITDA margin improved from 16.6% in Q4FY17 to 28.45% in Q4FY18. Its PAT jumped exceptionally by ~498% from Rs 17.20 cr to Rs 102.80 cr on a YoY basis. The PAT margin expanded from 2.7% to 13.8% on a YoY basis.

FY18 has been an exceptional and turnaround year for the company. The topline grew by 29.8% YoY from Rs 1994 cr to Rs 2589 cr. The EBITDA grew from Rs 306 cr to Rs 606 cr, an upside of ~98%. Its EBITDA margin expanded from 15.35% in FY17 to 23.39% in FY18. In FY17, the company incurred net loss of Rs 73.90 cr, while in FY18, the company generated net profit of Rs 211 cr.

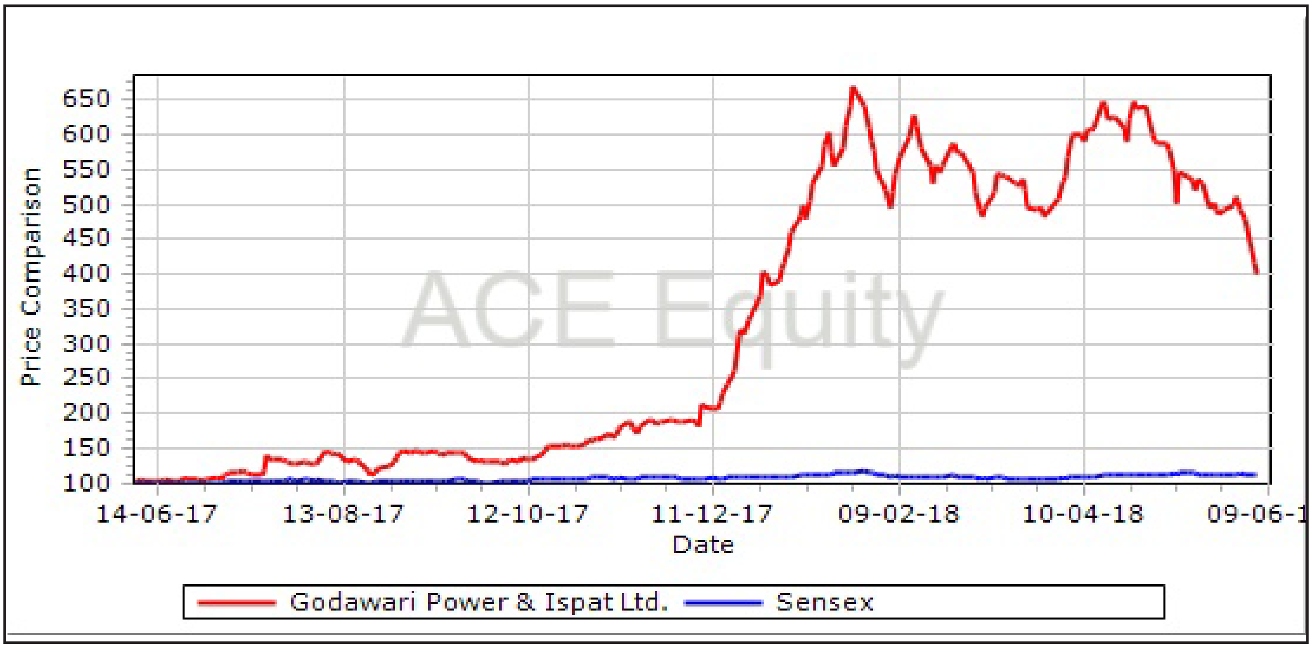
Valuation

On a TTM basis, the company is trading at P/E of 6.04x with EPS of Rs 58.93. For FY18, it delivered ROE and ROCE of 22.8% and 16.7%, which is much higher than its peers. With ramping up and expansion of iron ore mines and sponge iron capacities, the cost of production is expected to reduce significantly, which would improve margins. The outlook of steel industry is very strong and demand for pellets from China is increasing. Also, the company is focusing heavily on deleveraging strategies. The company's stock price has corrected recently and is thus trading at attractive valuations. We recommend investors to **BUY** this scrip in tranches with potential upside of 48% to reach the target price of Rs 582 over the next two years.

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

Description	201803	201703	201603	201503	201403
Net Sales	2588.84	1804.41	1979.73	2394.98	2118.05
Total Income	2597.50	1821.55	2007.11	2455.20	2133.60
Total Expenditure	1991.94	1515.49	1771.09	2036.77	1770.81
PBIDT	605.56	306.06	236.03	418.43	362.79
PAT	211.29	-73.89	-95.34	70.73	69.97
Dividend %	0.00			10.00	25.00
Adj. EPS(Rs)	60.87	-21.84	-28.03	20.21	17.66

Quarter On Quarter (Consolidated) (Rs in Crore)					
Particulars	201803	201712	Q on Q Var%	201703	Y on Y Var%
Net Sales	742.93	672.08	10.54	631.37	17.67
Total Expenditure	535.51	503.37	6.38	529.19	1.19
PBIDT (Excl OI)	207.42	168.71	22.94	102.18	102.99
PAT	102.79	73.68	39.51	17.20	497.62
PBIDTM% (Excl OI)	27.92	25.10	11.24	16.18	72.56
PBIDTM%	28.45	25.18	12.99	16.65	70.87
PATM%	13.84	10.96	26.28	2.72	408.82
Adj. EPS(Rs)	29.48	21.14	39.45	4.51	553.66



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