Srikalahasthi Pipes Ltd

BSE: 513605 **| Sector: Steel-Pig Iron**

21st April 2017

vScore : 60 | Gain% : **20.03%**

Buy Date: 21-Apr-2017 | **Buy Price** : Rs.362.00

Exit Date: 27-Nov-2017 | **Exit Price** : Rs.434.5

BUSINESS BACKGROUND

Apart from this, SPL has a power generation capacity of 14.5MW, comprising of 12MW waste heat recovery of coke oven plant and 2.5MW captive power plant, which runs of blast gas furnace. Around 75% of the power requirement is internally met, while the rest is procured from the state government. On raw material front, the company sources key raw material from the open market. Iron ore is procured via open market purchase in Karnataka through an auction process. Coking coal is imported from Australia. For lime stone, it has three long term mines on lease.

The company primarily caters to drinking water infrastructure projects and its clientele includes names such as Larsen & Toubro Ltd., Hyderabad Metro Rail, VA Tech Wabag Ltd., Sriram EPC, NCC Ltd. etc. SPL generates majority of its revenue from the sale of DI pipes and rest from the sale of pig iron, cement etc.

INVESTMENT HIGHLIGHTS

v:

Q1FY18 results: It recorded net sales of INR 440 Cr, compared to INR 439 Cr in Q4FY17. EBITDA of INR 64 Cr compared to INR 55 Cr in Q4FY17. Net profit of INR 36 Cr compared to INR 31 Cr in Q4FY17. Adj. EPS: INR 9.16/share compared to INR 7.84/share same year previous quarter. (All figures are on standalone basis.)

Segment Highlights:

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KEY DATA

FACE VALUE Rs	10
DIVD YIELD %	1.49
52 WK HI/LOW	210.8/356.45
NSE CODE	SRIPIPES
MARKET CAP	Rs. 1335 Cr

SHAREHOLDING PATTERN

PROMOTERS	-	50.78%
BANKS, MFs & DIIs	-	3.67%
FIIs	-	0%
Others	-	45.55%

KEY FUNDAMENTALS

Year Ending	FY17A	FY18E	FY19E
Rev Gr%	3	13	14
Net Profit Gr%	-12	20	36
ROE%	17	17	18
ROCE %	25	22	23
EPS (Rs)	35	42	58
P/E (x)	9.9	8.2	6

Anti Dumping on TDI, fuels the growth of the company:

Heavy push on improving water infrastructure:

As DI pipes are finding increased acceptance among the customers, we feel that the sector is at a fine position to grab the demand arising from key flagship programs such as AMRUT, Smart Cities, Telangana water grid project and Maharashtra water grid projects etc. One of the key objectives of these projects is to enhance & improve the water pipeline network and supply tapped drinking water to the population. Around 26 cities in South India are covered in the Smart Cities program, while around 85 cities are covered under the AMRUT program. In the last five years, national DI pipe production has increased by 12% CAGR. On the back of huge investments in drinking water and sanitation projects, we anticipate a sustainable double digit growth the DI pipe demand. Over FY15-18, the demand of DI pipes is likely to increase from 1.5mn tonnes in FY15 to 2mn tonnes in FY18, translating into a growth of 16.4% CAGR. While on supply front, it is expected to increase by 11.4% CAGR over the same period to 1.7mn tonnes. SPL being a key player in the South India is expected to benefit from these programs.

Higher demand to derive top-line, stable material cost to ease pressure on the profitability:

With DI pipe demand growth outstripping supply, we anticipate a favorable pricing gain for a market leader like SPL. We expect the company to report a top-line growth of 9.3% CAGR over FY16-18 amounting to Rs. 13,689.5mn. DI pipe sales volume and realization to increase by 5.9% and 6.2% CAGR, respectively, during the same period. We believe that the prices of key raw materials, namely, iron, coking coal etc. have bottomed out. With uptick in the US economy and stability in the China, we anticipate a modest recovery in the raw material prices. Consequently, we see a relatively smaller increase in raw material cost as compared to the revenue growth. Total operating expenditure to increase by 9.1% CAGR with 10.2% CAGR rise in EBITDA to Rs. 3,233.7mn. EBITDA margin to expand by 36bps over FY16 to 23.6%. Reported PAT to increase by 9.6% CAGR over FY16-18 to Rs. 1,906.1mn, while PAT margin to report a modest expansion by 6bps to 13.9% during the period.

One of the low cost producer DI pipe manufacturers in India:

Over the years, SPL has taken various cost reduction measures such as reduction in coke consumption, usage of iron ore fines as compared to iron ore lumps, reduction in power consumption and effective utilization of sinter plant. High raw material in the past has affected the performance of the industry. With the recent correction in the raw material prices, cost of production has drastically declined for the industry. SPL with its integrated operations was able to reduce the cost of production relatively better as compared to other players in the industry. Going forward, we feel that with the increased pricing power and further improvement in operating efficiency, SPL is likely to sustain its position as a low cost producer of DI pipes in India.

Strengthening balance sheet:

Over FY13-16, SPL has generated an average operating cash flow of Rs. 1,600mn per year, while average free cash flow per year stood at Rs. 650mn. Additionally, efficient working capital management, mainly through drastic reduction in inventories days from 88 days in FY13 to 38 days in FY16, led to a lower requirement of funds. Thus, assisted with sustainable cash flow generation over the years, SPL's was able to reduce its debt levels and improve the debt equity ratio to 0.9 in FY16 from 2.2 in FY13. Over the same period, interest coverage ratio increased from 0.5 in FY13 to 5.7 in FY16. In FY16, the company has approved a capex of Rs. 1,800mn for various expansion projects. With sustainable operating cash flow of Rs. 2.2bn per year in FY17 and FY18, we feel that the company will be in a position to internally fund its future capex requirement. Further we forecast the debt equity ratio and interest coverage ratio to improve to 0.4 and 6.1, respectively, over FY16-18.

Business Outlook and Valuation :

At the moment at current price of **365** the stock is trading at (TTM) P/E of 9.98. Going ahead we expect revenue growth of 13% for FY18 and 14% FY19. Hence our expectations for revenue for FY18 and FY19 are INR 1324 Cr and INR 1509 Cr respectively.

We expect company to maintain EBITDA margin around 19-22% for next two years. Going ahead we expect PAT margins of 12-15% for next two years. Our PAT expectations for FY18 and FY19 are INR 169 Cr, INR 230 Cr respectively. Our EPS expectations for FY18 and FY19 are INR 42 and INR 58 Cr respectively.

We believe Srikalahasthi Pipes Ltd at PE of 9.98 with ROCE around 21-23% with superior margins than peers is attractively valued. For FY 18 EPS expectations of 42, we expect target price of **434.5/share** with a stop loss at 285.

FINANCIALS:

For the Year Ended March (INR)	FY16A	FY17A	FY18E	FY19E
Net Sales (Cr)	1146	1203	1324	1509
EBIDTA (Cr)	266	267	252	328
EBIDTA %	23.26	20.08	19.06	21.7
Profit Before Tax (Cr)	215	191	206	280
Interest (Cr)	42	39	35	36
Depreciation (Cr)	27	37	31	35
Tax (Cr)	56	51	37	50
Profit After Tax (Cr)	159	140	169	230
PAT%	13.86	11.93	12.77	15.23
Diluted EPS (INR)	39	35	42	58
Shareholder's Funds (Cr)	428	813	1016	1270
Borrowings (Cr)	401	451	329	224
Gross Block (Cr)	799	909	1045	1254

Key Risks and Concerns:

- Lower than expected economic growth to limit the growth in the DI pipe industry.
- Currently SPL is enjoying a dominant market position in the South and West India. Anticipating huge growth opportunities in the region, many other players might get attracted, which will increase the competition for the company, putting pressure on profitability.
- The commodity prices, especially, iron ore have bottomed out. Moreover, with uptick in the US economy and stability in the China, we anticipate a modest recovery in the raw material prices going forward. Thus any unexpected increase in the raw material prices will impact the profitability of the company.

vScore: Value Score is our proprietary company rating system based on last 5 years of historical data and value investing philosophy at its core. v360 combined with Macroeconomic indicators, projections, fundamental and technical trigger makes it a 360 degree view.

Source: Niveza Research Desk