Kalayani Steel Ltd

Kalyani Steels Limited was established in 1973 and is engaged in the manufacture and sale of forging and engineering carbon and alloy steel in India. The company provides steel products for engineering, seamless tube, and aluminium industries; and pig iron products for steel making, foundry and casting, and aluminium industries.

It also markets various components for commercial vehicles, two wheelers, diesel engines, bearings, tractors, turbines, and rail. The company also exports its products. In addition, the company is involved in power generation business.

Over the years, Kalyani Steels has been continuously and extensively upgrading its technology and infrastructure. Today the integrated steel complex has hot metal capacity of 2,90,000 TPA of carbon and alloy steels, a with three Mini Blast Furnaces, two Rolling Mills, Sinter plant, Power plant, BFG fired re-heating furnaces, state-of –the-art testing facilities and many such modern equipment, in a sprawling green 375 acre campus. The company has earned the status of preferred steel supplier for engineering, seamless tube and aluminium-smelting industry.

Products

Application

• Rolled Bars for Automotive Application

• Rolled Bars for Engineering Application

• Round Cast for Seamless Tube Industry

• Machined Bars for Aluminium Smelting Industry

Industry Overview

In FY16, crude steel production in India was 89.8 MT, with the total crude steel production growing at a CAGR of 12.61 per cent over the last five years and reached 88.98 MT in FY15. Crude steel production by private sector grew at a CAGR of 7.87 per cent between FY15-16. Finished steel production increased at a YoY of 5.11 per cent from 87.68 MT in FY14 to 92.16 MT in FY15; analysts expect production figures to improve rapidly over the next five years, with the Ministry of Steel forecasting production levels at 115.3 MT by FY17. In September 2016, steel production in India grew by 8.5 per cent to 7.8 MT as compared to 7.2 MT in the same month last year

Steel contributes to nearly two per cent of the gross domestic product (GDP) and employs over 600,000 people. The total market size of the Indian steel sector stood at 91.46 million tonnes in 2015 and is expected to touch 300 million tonnes by 2025. The infrastructure sector is India's largest steel consumer, thereby attracting investments from several global players. Owing to this connection with core infrastructure segments of the economy, the steel industry is of high priority right now. Also, steel demand is derived from other sectors like automobiles, consumer durables and infrastructure; therefore, its fortune is dependent on the growth of these user industries.

The liberalisation of the industrial policy and other government initiatives has given a definite impetus for entry, participation and growth of the private sector in the steel industry. Allowing foreign direct investment (FDI) has been a positive step since India is heavily dependent on foreign technologies. These foreign technologies generally add life to the plant and production units, which ultimately lead to the country's economic growth.

Financial Performance

Crores(Rs.)	FY12	FY13	FY14	FY15	FY16	CAGR
Net Sales	976.85	809.07	1115.98	1226.62	1180.48	3.86%
EBITDA	43	77	129	167	235	40.73%
EBIT	17	53	95	136	183	61.81%
Net Profit	1	17	47	81	111	180.33%
EPS	-	4	11	18	25	60%

- Despite sales growth at a CAGR of 3.86% company has manage to grow the profit at a CAGR of 180.33%
- As a company operates in iron & steel, interim product which has an impact of cyclical nature of economy in his business, despite this company has expand his profit and cutting down the other expenses which reflect in their numbers and going further company is able to grow because of increasing their product demand which is used as a raw material for defence, railway and we expect to increase government spending in this sector.
- EPS of company has increased significantly which means company is profitable and company has more profit to distribute to its shareholders.

Margin

Ratio/Year	FY12	FY13	FY14	FY15	FY16
Gross Profit Margin	44%	44.9%	50.7%	52.9%	63.7%
EBITDA Margin	4.4%	9.5%	11.5%	13.6%	19.9%
EBIT Margin	1.7%	6.6%	8.5%	11.1%	15.5%
Net Profit Margin	0.01%	2.1%	4.2%	6.6%	9.4%

- Gross profit margin has increased since last five year which means that company is reducing their raw material price.
- Company is growing every year which increase their margin, which is good sign for investment purpose.

Valuation

	FY12	FY13	FY14	FY15	FY16
P/E	-	10.95%	5.58%	7.20%	6.72%
EV/EBIT	26.176	7.05	4.54	5.57	5.44
ROE	-	5%	12%	17%	19%
ROCE	1.2%	5.3%	10.1%	13.8%	14.1%

- ROE is increasing because of increasing net profit margin and not due to financial leverage which is good sign for the company.
- ROCE is increasing which means every capital put into the business is giving good return and company is going at the right path to improve their business.

Investment Rational

Commodity price crash; an Opportunity

- The meltdown of the Chinese economy and dumping of commodities by them has led to the global commodity index to crash by over 65% from FY08 to FY15.
- Commodity prices have fallen to their lowest levels since almost a decade, providing margin expansion opportunity for companies like Kalyani Steels Ltd. with its major inputs being iron ore and coking coal.
- The further drop of iron ore prices is possible because of expansion of mining in Australia and Brazil and Indian government is also helping the various companies to open a new mining or expansion of their capacity.
- The crash in commodity prices have expanded KSL's EBITDA margins from 4.4% in FY12 to 13.6% in FY15 and further improved their margins in H1FY16 to 18.7%. With further possibility of a commodity price fall led by Chinese hard landing and additional downward pressure from lowering of dry bulk freight rates, we believe that the company has high opportunity of further betterment of its margins.

Strong Parentage; ensuring revenue growth

- Kalyani Steels Ltd. was established in February 1973 as a part of the Kalyani Group with the primary objective of fulfilling the group's in-house requirements of forging quality steel. The Kalyani Group has an annual turnover of ~USD 3bn and along with being the parent company of KSL; it also parents the world's largest forging company, Bharat Forge Ltd. It contributes 30-35% of its revenue to the Kalyani Group.
- Kalyani Steels Ltd. is a supplier of high quality steel to Bharat Forge Ltd. which caters to several critical business verticals such as Defence, energy, oil & gas, aerospace, rail & marine and other infrastructure related businesses. It has huge plans of doubling its revenue to Rs. 70bn by FY18.
- We believe, with the support of such a strong parent with the world's largest forging company, KSL will grow in coming year.

Indian Railways; Engine of Growth

- Infrastructure development is the primary requisite for the growth of an economy, especially for a country like India which is on the road to development. Indian Railways (IR) forms a significant part of this development as it is a key mode of connectivity spread throughout the country.
- Indian Railways is the third largest rail network in the world. As of FY15, Indian Railways had 12,617 passenger trains carrying over 23 million passengers daily. On the commercial front, 1101 million tonnes of freight was transported via trains in FY15 and is targeted to reach 1,186 million tonnes in FY16.
- Indian Railways has strong plans of spending ~Rs. 8.56tn as per Indian railways budget FY16 for modernisation and expanding railways over the next five years. It has a target of commissioning 2500 km BG track for FY16.
- Steel being one of the most crucial component for infrastructural development in railways, we believe that such high amount of investments in the Indian Railways will open a wide range of opportunities for manufacturing companies, especially for a company like Kalyani Steels Ltd. which provides high quality medium carbon, medium alloy and micro alloyed steels. These products find usage in the forging of crankshaft, axel, connecting rod and claw lock & piston railway locomotives.
- Also, having a strong parentage of the Kalyani Group and the support from Bharat Forge (railway among the four sectors identifies by them under the 'Make in India' initiative), KSL's opportunity in the railway sector will only grow stronger and provide a revenue/earnings to be grow in coming year.

Defence spending; Boost from 'Make in India' initiative

Apart from Railways, Defence is another sector for which KSL provides high quality steel and is expected to contribute highly in the revenue mix going forward.

The Government is emphasizing on modernization, self-dependence and 'Make in India' in the defence sector and has allocated Rs 2467.27bn in the budget allocation of FY15-16. Defence has huge investment opportunities in

- Defence products manufacturing
- Supply chain sourcing opportunity
- Defence offsets

India's current requirements for defence are fulfilled through imports. The opening of the strategic defence sector for private sector participation will help foreign original equipment manufacturers to enter into strategic partnerships with Indian companies and leverage the domestic markets and also aim at global business. Besides helping build domestic capabilities, this will bolster exports in the long term.

We believe that due to the boost being provided in the defence sector, through initiatives like 'Make in India', Kalyani Steels Ltd. has another opportunity developing in this sector for its rolled steel bars.

Risk and Concern

Raw material price trend: KSL is in to the manufacturing of steel and allied products, any movement in raw material prices would directly affect the company's operating profit. The crash in commodity prices has augur well for the company, any upward trend in the commodity would be the risk for the operating margin.

Currency risk: Rs/USD has depreciated in last one year, KSL imports ~45% of its raw material. However, considering that Indian economy is one of the most promising economies in the world and the likely growth is expected to be in upwards of 7.5-8% for next few years, we feel that Rs has a fair chance of appreciating from the current level in the medium term.

Anti-dumping duty: Currently Government has imposed anti-dumping duty on cold rolled stainless steel. Any change in the government policy about bringing more products under anti-dumping duty may pose risk to the company's financials.