July 9, 2018

Vardhman Special Steels

₹ 125

Rating matrix

Rating	:	Unrated
Target	:	NA
Target Period	:	NA
Potential Upside	:	NA

Key Financials

₹ Crore	FY15	FY16	FY17	FY18
Net Revenues	661.6	656.6	673.8	859.0
EBITDA	15.9	50.0	59.8	61.9
PAT	-15.1	5.2	19.1	25.0
EPS (₹)	-8.1	2.3	10.3	7.9

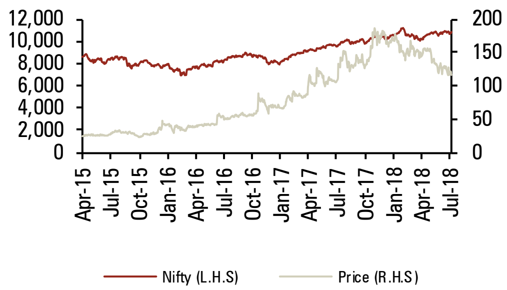
Valuation Summary

	FY15	FY16	FY17	FY18
P/E	NA	55.3	12.2	15.9
EV/EBITDA	35.8	10.5	8.0	10.7
P/BV	1.4	1.3	1.2	1.3
ROCE (%)	-0.7	2.9	5.5	5.6
RONW (%)	-8.9	3.0	9.7	7.4

Stock Data

Particulars	Amount
Market Capitalisation (₹ crore)	448.0
Total Debt (FY18) (₹ crore)	220.0
Cash and Investments (FY18) (₹ crore)	15.7
EV (₹ crore)	652.3
52 Week H / L (₹)	195 / 113
Equity Capital (₹ crore)	35.7
Face Value (₹)	10.0

Share Price Chart



Source: Bloomberg, ICICI Direct Research

Research Analyst

Dewang Sanghavi
dewang.sanghavi@icicisecurities.com

Akshay Kadam
akshay.kadam@icicisecurities.coms

Focusing on expansion…

Vardhman Special Steel (VSSL) is a part of the Vardhman Group engaged in manufacturing special auto grade steel. The company is a supplier of choice for leading auto OEMs given its focus on strong product quality. VSSL is equipped with capacity to manufacture 2 lakh tonne of steel billets and 1.8 lakh tonne of steel rolled products. The company also has a bright bar capacity of 36000 tonnes.

Expanding steel melting, rolling capacity, volume growth to follow…

VSSL is currently undertaking expansion wherein it is expanding its steel melting capacity to 240000 tonnes and rolling capacity to 220000 tonne over the next three years. The expansion is likely to entail a capex of ~₹ 200 crore. VSSL is also aiming to achieve full capacity utilisation soon after completing the aforementioned capex. The last capital investment undertaken in FY12-13 to set up new rolling mill facility enabled the company to clock healthy volume growth of ~15% in FY13-18 growing from ~76000 tonne in FY13 to ~152000 tonne in FY18. Revenues grew at a CAGR of ~11%. As a part of its ongoing capex, in October 2017, the company purchased ~8 acres of land at Ludhania at a cost of ₹ 36 crore plus government duties.

Strong, established clientele…

The company's steel operations date back to 1973 with initial capacity of ~50000 tonne. Over the years, through organic and inorganic opportunities, it has expanded its capacity to current levels. With an established track record of more than four decades and quality consciousness in terms of products, the company enjoys a healthy relationship with reputed automotive and automotive component players in the two wheeler and four wheeler, tractor, HCV, LCV and other segments. VSSL's clientele includes names like Hero, Maruti, Hyundai, TVS, Bajaj, Ashok Leyland, Daimler, John Deere, GNA Axles, etc.

Capex to provide visibility for medium term horizon…

During FY16-18, VSSL's topline and EBITDA have grown at a CAGR of 14% and 11%, respectively. Going forward, the company has planned a capex, which would provide healthy visibility for a medium term horizon. At the CMP, the stock is trading at 15.9x FY18 P/E and 10.7x FY18 EV/EBITDA.

Exhibit 1: Key Financials

(₹ Crore)	FY15	FY16	FY17	FY18
Total Operating Income	661.6	656.6	673.8	859.0
EBITDA	15.9	50.0	59.8	61.9
EBITDA Margin (%)	2.4	7.6	8.9	7.2
Net Profit	-15.1	5.2	19.1	25.0
EPS (₹)	-8.1	2.3	10.3	7.9
P/E (x)	-15.4	55.3	12.2	15.9
Price / Book (x)	1.4	1.3	1.2	1.3
EV/EBITDA (x)	35.8	10.5	8.0	10.7
ROCE (%)	-0.7	2.9	5.5	5.6
ROE (%)	-8.9	3.0	9.7	7.4

Source: Company, ICICI Direct Research

Management Meet Highlights

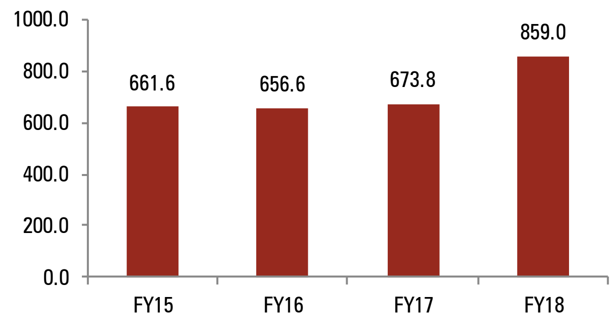
- During FY18, the company faced constraints on the capacity front. Hence, VSSL focused on higher margin customers (viz. passenger cars and two-wheelers)
- On the raw material front, graphite electrodes prices increased sharply. The consumable comprised ~5% of the total raw material cost (vs. ~1% earlier). Steel scrap is the primary raw material accounting for 65-70% of the cost
- The management has guided for sales volume of ~175000-180000 tonne for FY19
- Over a medium term, the management is aiming at RoCE of ~18-20%
- The management indicated they are aiming to increase the share of exports in revenues to 10% in two to three years from 4-5% currently. The export margins are similar to that of the domestic auto business
- On the leverage front, the company is looking to maintain the debt to equity ratio below 1x. The focus is now on balance sheet management and progressively reducing the working capital intensity
- FY19 is likely to be a zero tax year. The company will, however, have deferred tax. Accumulated losses are likely to get over this fiscal. The tax rate would be equal to MAT from the next fiscal year
- Vardhman is looking for a joint venture in downstream value added segments namely bright bars. It is also exploring value added products like high alloy steel through ingot casting route along with technical alliance/JV/acquisition. Over a medium term, it also plans to build a strong technical alliance with a global player for automotive steels
- In terms of sector wise revenue break-up, passenger vehicles contributed ~34%, two wheelers contributed ~32%, commercial vehicle contributed ~16%, engineering and off-highway contributed ~14% revenue while bearings contributed the balance ~4% of the revenue
- During the last three years, the company has reduced debt from ₹ 350 crore in FY15 to ₹ 228 crore in FY18
- During FY18, the company raised ₹ 68 crore through rights issue and ₹ 50 crore through QIP. The money was raised to repay debt and fund ongoing capex
- Auto-grade steel prices are negotiated to reflect changes in the raw material cost every six months (in April & March, respectively). During April 2018, the company has taken a price hike of ₹ 4100/tonne, so as to cover increasing raw material cost
- While the EBITDA per tonne of FY18 was at ₹ 4072/tonne, going forward, over the medium-term the company is targeting a higher EBITDA/tonne in the range of ₹ 4500-6000/tonne

Exhibit 2: Quarterly Performance

Particulars	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18
Total Operating Income	161.7	169.2	172.1	173.1	202.1	207.1	218.4	231.4
Raw Material Cost	78.9	88.9	94.3	90.5	114.7	113.5	114.4	127.2
Employee Benefit Cost	8.8	10.5	9.8	10.7	10.9	11.8	11.8	12.2
Power & Fuel Expenses	28.2	25.8	25.2	30.3	30.6	34.6	34.6	28.0
Other Expenses	32.0	26.8	28.2	27.2	34.6	32.6	38.8	46.8
Total Operating Expenses	148.0	151.9	157.4	158.7	190.8	192.5	199.5	214.2
EBITDA	13.8	17.3	14.7	14.3	11.3	14.5	18.9	17.2
EBITDA Margin	8.5	10.2	8.5	8.3	5.6	7.0	8.7	7.4
Depreciation	4.5	4.5	4.6	4.5	4.6	4.9	5.7	6.3
Interest & Finance Cost	6.5	6.7	6.8	8.3	5.7	5.2	4.6	5.9
Other Income	1.6	0.3	0.3	3.2	1.5	1.3	1.0	2.3
Exceptional Items	-	-	-	-	-	-	-	-
Profit before Tax	4.3	6.4	3.7	4.7	2.5	5.8	9.5	7.3
Tax	-	-	-	-	-	-	-	0.1
Profit After Tax (PAT)	4.3	6.4	3.7	4.7	2.5	5.8	9.5	7.2

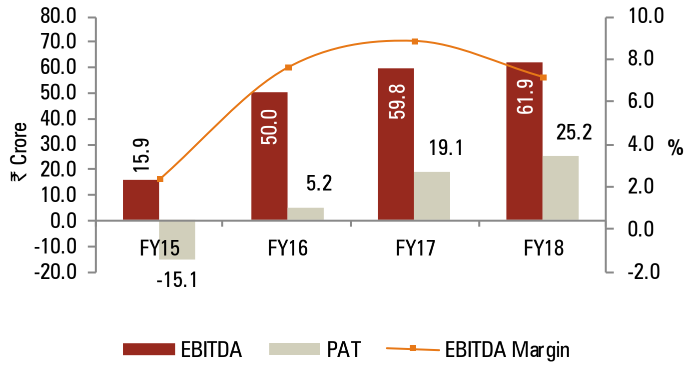
Source: Company, ICICI Direct Research

Exhibit 3: Revenue trend (₹ crore)



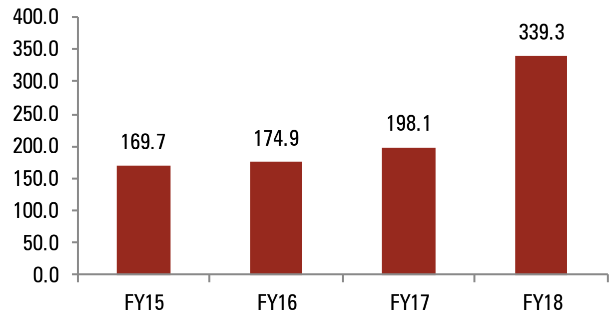
Source: Company, ICICI Direct Research

Exhibit 4: EBITDA (₹ Crore), EBITDA margin (%) and PAT (₹ crore)



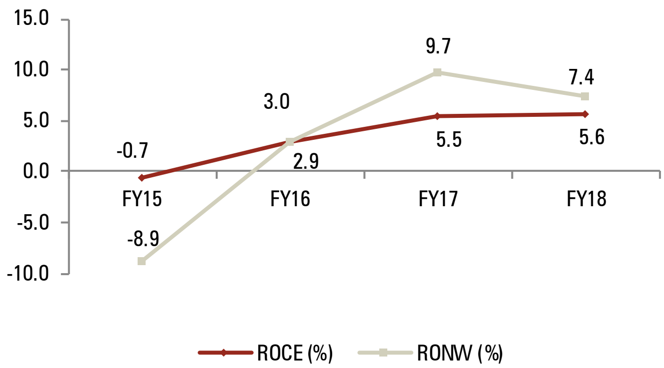
Source: Company, ICICI Direct Research

Exhibit 5: Networth trend (₹ crore)



Source: Company, ICICI Direct Research

Exhibit 6: RoCE & RoE trend



Source: Company, ICICI Direct Research

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Pankaj Pandey | Head – Research | pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No. 7, MIDC,
Andheri (East)
Mumbai – 400 093

research@icicidirect.com

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