

## Prakash Industries (Steel & PVC Pipes)

### Company Profile:

Established in 1980, Prakash Industries (PKI) is a low cost steel producer having an integrated steel plant at Champa, Chhattisgarh. The sponge iron kilns installed at Champa work on latest SL/RN technology developed by German company Lurgi. SL/RN is the only renowned technology in coal based Sponge Iron manufacturing.

PKI is self reliant in power through its captive power plant at Champa, with existing capacity of 230 MW. Additional 15MW capacity is to be commissioned by September 2018 for up-coming capacity in steel.

For Iron Ore requirements, PKI owns mines at Sirkaguttu (Odisha) & Kawardha (Chhattisgarh). It has secured 100% requirements of coal through long term coal linkages for next 5 years.

The company has a PVC pipes division at Kashipur (Utharkhand) with existing capacity of 55,000 tonnes.

### Investment Rationale:

PKI is a low cost, fully integrated steel producer. It has linkages for coal up to 1.56 MTPA for next 5 years. Post regulatory clearance, two third of Iron Ore requirement which is currently procured from outside will be fulfilled from company owned mines. Sirkaguttu Iron Ore mine is estimated to start in April 2018 while Kawardha mine in April 2019.

It stands out among its peer with 0.32x debt to equity while its competitors are struggling with highly leveraged balance sheet & NCLT proceedings.

Currently running at 1MTPA, PKI is doubling its steel capacity to 2 MTPA in a phased manner. Installation of 6th kiln will add 0.2 MT additional capacity by September 2018. Further additions would be to the tune of 0.2 MT every six month going forward. In next 5 years management has a vision to become 3MTPA company. Capacity utilization to reach 100% in Q4FY18 from 80% in Q3FY18.

High margin PVC pipes business will be separated & listed as a separate entity for focused approach keeping in mind the expansion from 50,000 TPA to 1,10,000 TPA.

Increase in public infrastructure spending provides a boost to Prakash Industry's steel and PVC pipes businesses.

Being a low cost & fully integrated steel manufacturer with operations focused only on domestic market makes Prakash Industries an ideal stock in midcap metal space.

**Valuation:** Our TP of 272/325 is based on 7.3x FY19/20e EV/EBITDA on back of full utilization of steel capacity, strong steel prices in domestic market & uninterrupted supply of Iron Ore from Odisha.

Particulars	FY16	FY17	FY18E	FY19E	FY20E
Net Sales (Rs. Mn)	20,533	21,735	26,821	32,091	40,939
EBITDA Margin	9%	12%	19%	20%	18%
PAT (Rs. Mn)	234	810	3,243	4,212	5,052
PAT Margin	1%	4%	12%	13%	12%
P/E (x)	16.96	13.09	10.01	7.70	6.42
EPS (Rs.)	1.77	5.89	20.67	26.85	32.20

Source: Company, ULJK Research

## Initiating Coverage

### BUY

Bloomberg	PKI.IN
CMP	Rs. 204.9
Target	Rs. 272
Potential Upside	33%

### Market Data

Market Cap. (Rs. Mn)	31,760
Market Cap. (\$ Mn)	489
Outstanding Shares (Mn)	157
52 Week High / Low (Rs.)	276/76
Avg. Daily Volume	118,071,397
Face Value (Rs.)	10

### Shareholding

Promoters	40.76%
India Public/ Others	59.21%

### Financial Ratios

ROE	3.65%
ROA	2.54%
ROCE	5.5%
P.E (TTM)	7.27
D/E	0.32

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*Please refer to the important disclosures and analyst certifications at the end of the document*

### Product Mix:

Wire rod which is highest margin product contributes 59% to the overall revenue while other products are in the range of 8 to 12%.

Product offering in Steel	Product offering in PVC
Wire Rods	UPVC Pipes
HB Wire	UPVC Fittings
Structural Steel	Column Pipes
TMT Bars	SWR Pipes
Ferro Alloys	Casing Pipes

Capacity utilization at 80% in Q3 is expected to rise to 100% in fourth quarter.

### Business Performance:

Rising steel prices have helped Prakash Industries to post excellent results in recent quarters. In 9M FY18 topline has gone up by 22% to INR 20,960 Mn as against INR 24,150 Mn for full year 2017, that is, PKI has already achieved 87% of 2017 revenue with one quarter to spare. Similarly bottom line in 9M of FY18 was at INR 2,320 Mn as against INR 810 Mn for FY17, an increase of 186% over full year 2017 PAT.

EBITDA margin at the end of Q3FY18 was 21% with 80% capacity utilization. Post regulatory clearance of Sirkaguttu (Odisha) & Kawardha (Chhattisgarh) Iron ore mines, as well as saving of INR 1,000 Mn a year on account of securing of coal linkages for next 5 years, EBITDA margin has further scope to expand. Capacity utilization for Q4FY18 is expected to be at 100%.

EBITDA margin to expand by 300 bps in Q4 to 25%.

	9M FY18	9M FY17	Change	FY17
Revenue	20,960	17,161	22%	24,148
EBITDA	3,863	1,763	119%	2,645
Margin	18.3%	10.3%		10.9%
PAT	2,346	472	398%	811
Margin	11.1%	2.7%		3.4%
<b>Profitability</b>				
ROE	11%		EBITDAM	17%
ROCE	12%		NPM	10%
ROA	8%		D/E	0.32

Although return ratios ROE/ROCE/ROA for full year 2017 were very poor at 3.65%/5.5%/2.54%, they have improved to 11%/12% & 8% after stellar results posted by the company for the first nine months of FY2018. EBITDA & PAT margins both expanded by ~750 bps during this period. EBITDA margin & NPM were 11% & 3% for FY17. Up cycle in steel & highest ever realization for Prakash Industries has pushed the EBITDA & NPM to 18.3% & 11% currently.

Company is expected to grow its top line by 19% and 30% for FY19/20e to INR 34,364 Mn & INR 44,538 Mn respectively, while bottom line is expected to rise by 13% & 12% to INR 4,212 Mn & INR 5,052 Mn for the same period.

**Debt Reduction:** Approximately INR 1600 Mn debt which is approximately 22% of FY17 total debt was repaid in 9M of FY18.

Debt reduced by INR 1,600 Mn in first 9M of FY 2018. Further 420 Mn reduction on account of FCCB conversion.

### FCCB Prepayment:

PKI has in March 2018 fully prepaid the outstanding obligation of \$17.85 million cash consideration due towards 5.25% April 2015 FCCB's. Accrued interest for October 17 to February 18 due on the above outstanding obligations has been waived off by the bondholders. Company's debt has reduced further by INR ~420 Mn on account of conversion of the \$6.5-million 5.95% January 2023 FCCBs into equity shares out of the total \$24.30 million FCCBs issued.

### Expansion Plans:

Under the capacity expansion in steel, PKI is adding 0.2 MT of additional capacity every two quarter in a phased manner in order to double its existing capacity from 1MTPA to 2MTPA. Installation works for 6th Kilns is currently on & it will be ready by September 2018. The company is planning to double its PVC pipes production capacity to 1,10,000 tonnes per annum by September 2019 in phases at its existing plant in Kashipur, Uttarakhand.

Product	Location	Existing Capacity	Future Capacity	Total Capacity	Timeline
<b>Integrated Steel</b>					
Finished Steel	Raipur, Chhattisgarh	1.1 MT	-	1.1	-
Sponge Iron	Champa, Chhattisgarh	1.0 MT	0.2	1.2	Sep, 2018
Steel Billets	Champa, Chhattisgarh	1.1 MT	-	1.1	-
Ferro Alloys	Champa, Chhattisgarh	0.13 MT	-	0.13	-
<b>Power</b>	Champa, Chhattisgarh	230 MW	15 MW	245 MW	Sep, 2018
<b>PVC Pipe</b>	Kashipur, Uttarakhand	55,000 Tons	Phase I – 10,000 Tons	65,000 Tons	Mar, 2018
			Phase II – 45,000 Tons	1,10,000 Tons	Sep, 2019

*Steel capacity to double from 1MTPA to 2MTPA while PVC capacity to increase from 55,000 tones to 1,10,000 tones.*

**Coal Linkages:** The company had secured coal linkages of additional 2.10 lakh tonnes per annum through fuel supply agreement (FSA) in October 2017. Coal requirement for the sponge iron plants was earlier being met through spot auctions. With this additional quantity, the company has fulfilled its 100% requirement for the sponge iron plants from linkages.

*Saving of 1000 Mn a year on procurement of coal from linkages allotted to the company.*

### Iron Ore Mines:

Company has been allotted Iron Ore mines in the state of Chattisgarh and Odisha, which will ensure consistent availability of quality Iron ore for the integrated steel plant. Procurement from these has not yet started as PKI has not received regulatory clearance.

Post regulatory clearance, two third of Iron Ore requirement which is currently procured from outside will be fulfilled from company owned mines itself. Sirkaguttu Iron Ore mine is estimated to start in April 2018 while Kawardha mine in April 2019.

*Sirkaguttu Iron Ore mine is estimated to start in April 2018 while Kawardha mine in April 2019.*

### Business Updates:

**Demerger of PVC Business:** Company has decided to demerge the PVC pipe business which will allow both businesses to grow with focused vision, strategies, vision & unlock the potential value of the businesses independently. Company has already received no objection from exchanges for demerging its PVC pipe unit. The proposed demerger shall also protect the respective businesses from each other's risk, including industrial and economic slowdown, change in regulatory policies and other market forces.

**Flexible Plastic Packaging Business:** PKI recently announced that it is venturing out into flexible plastic packaging business. The company will be manufacturing high performance barrier films and laminates that find application in packaging of food, beverages, oil, personal care and pharmaceutical products.

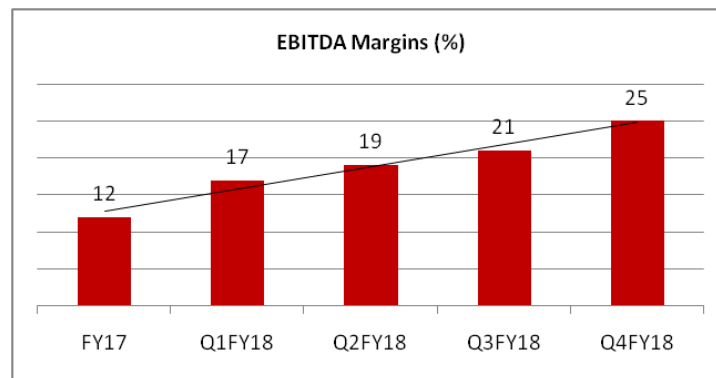
*PVC business to be demerged, company to foray into flexible plastic packaging business*

**QIP:** The Company had taken enabling approvals/ resolutions to raise funds through issue of adequate securities in Indian and/or International markets including by way of Qualified Institutional Placement. The purpose of raising funds was to augment the Company's capital base and financial position, and towards the growth of the business & other general corporate purposes from time-to-time.

**Q3 FY18 Result Highlights:** Better sales realization on account of 20% surge in steel prices, higher volume & cost savings helped company to post strong Q3 results. Revenue rose by 55% in third quarter to INR 7,260 Mn while EBITDA was at INR 1,520 Mn, an increase of 143% from same quarter previous year. Net profit margin was at 13.9% at INR 1,010 Mn, an increase of 460%.

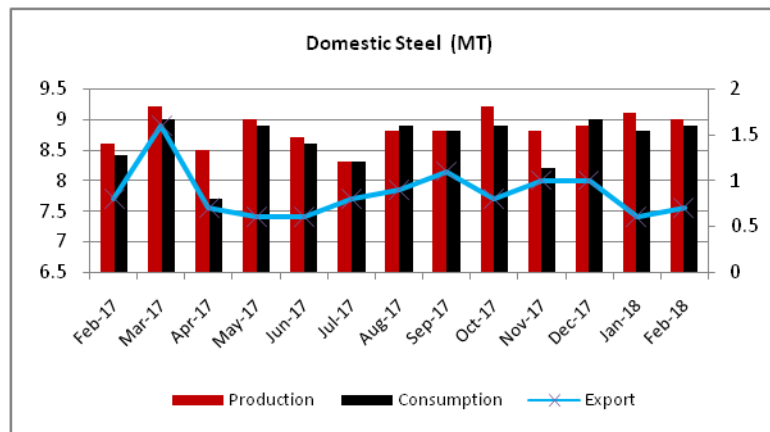
Sales volumes for the company's steel business grew by 39% YoY for Q3FY18, while volumes for its PVC pipes business grew by 45% YoY. As a result, Profit After Tax for 9MFY18 has grown by 401% YoY to INR 2,340 Mn. EBITDA margin for Q4FY18 is expected to rise to 25% from the current 21%. Company has reduced its debt by INR 1,600 Mn during the nine months ended 31st December 2018.

9M FY18 Revenue at INR 20,960 Mn has increased by 22%, EBITDA has soared by 119% to INR 3,860 Mn. PAT for the same period was at INR 2,340 Mn, an increase of 401%. Realization was at an all time high: Steel & Ferro Alloy prices witnessed more than 20% rise in domestic market in Q3FY18. In Q4FY18 capacity utilization will be 100% from the current 80%.

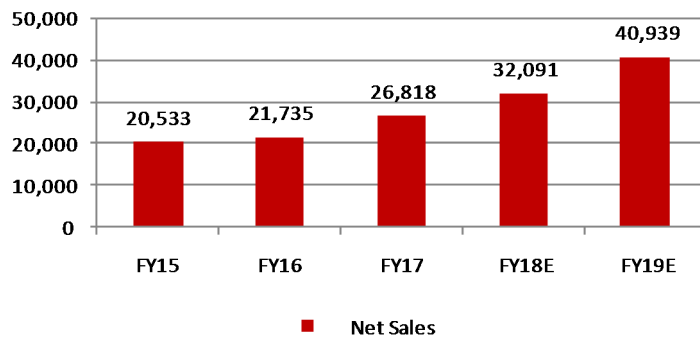


#### Sector Outlook:

Domestic steel demand is expected to remain strong and will keep steel prices firm in near future driven by the government's infra push as we head towards an election year. Moreover the waning effect of GST transition and demonetization is expected to support the prices as well. There is no price hike expected in domestic steel prices from here onwards as prices are already near landed prices. Unlike global prices, Indian domestic steel prices have maintained their strength. Seasonality has helped long product prices and prices are likely to remain firm in Q1FY19 as well. Improvement in the Automotive sector is expected to support the prices of flat products.

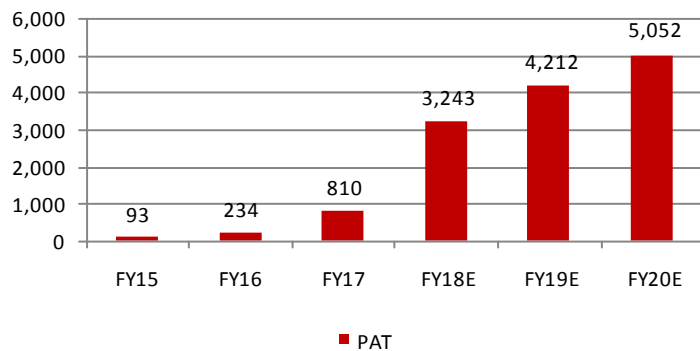


Many mines in Odisha which meet about 50% of country's iron ore need for steel making had been shut for defaulting in payment of compensation for overproduction. The rate for ore fines since then had increased from INR 1,400/tonne to INR 2,200/tonne; lumps had risen from INR 2,700/tonne to INR 4,500 a tonne between October and January. Iron Ore prices declined by 19% mom in Mar 18 after major miners resumed operations, and further cuts are expected for Apr 18. Coking coal prices are expected to see significant reduction on the back of oversupply & low demand. Prices declined by 15% month on month in March 18.

**Net Sales (INR Mn)**


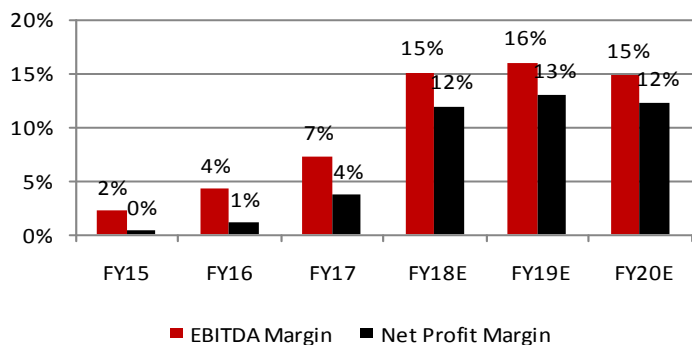
In 9M of 2018 net sales rose by approximately 30%.

On back of undergoing expansions aimed at doubling the Steel & PVC capacity, for FY 2019 & 2020, net sales is expected to clock a growth of 19% & 28% respectively

**PAT (INR Mn)**


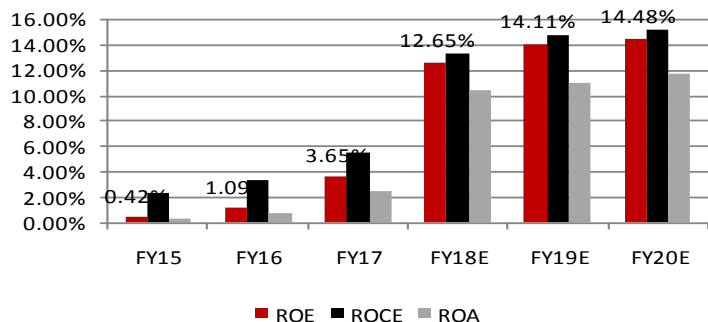
On the back of highest ever realization in recent quarters as well as on going modernization works to increase the efficiency, 9M PAT rose by 398% compared to 9M of FY 2017.

Net profit of the year 2019e to grow by 30% to INR 4,212 Mn and by 20% in FY 2020e to INR 5,052 Mn.

**Margins**


EBITDA margin to improve to 16% from 7% at the end of FY17 as the company starts procuring raw material (i.e Iron ore & Coal) from its own mines.

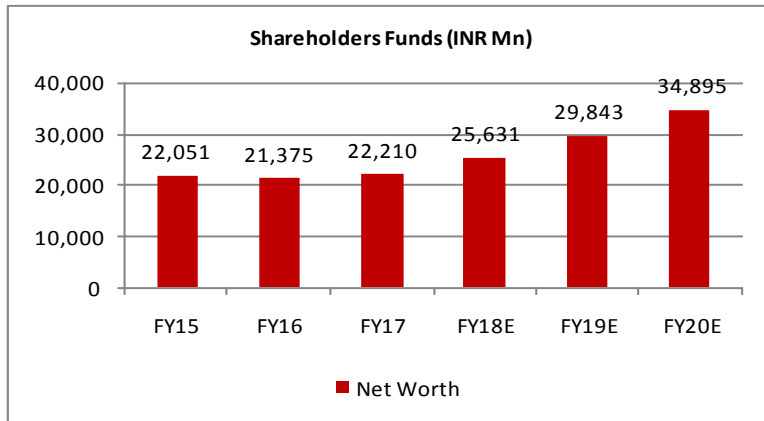
Sirkaguttu Iron Ore mine is estimated to start in April 2018 while Kawardha mine in April 2019.

**Profitability**


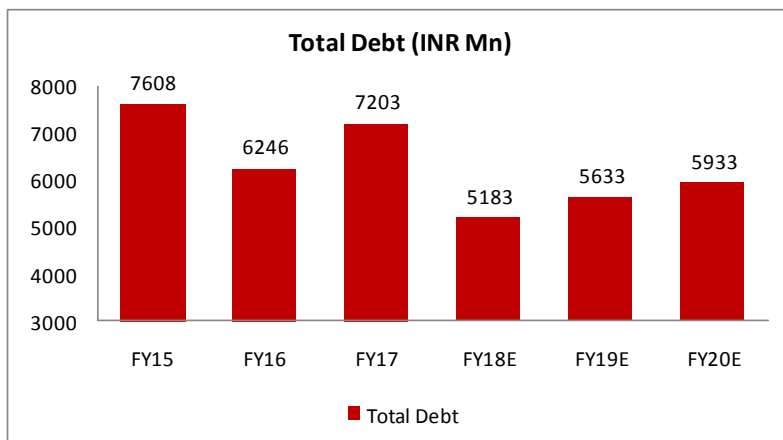
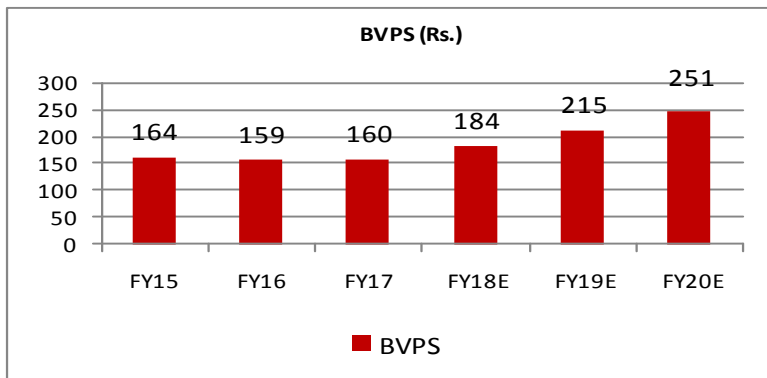
Return on equity to improve by FY19e/20e to 14% & 14.5% respectively from 3.65% for FY17.

ROCE to rise to 14.8% & 15.2% for FY19e/20e from 5.5% for FY17.

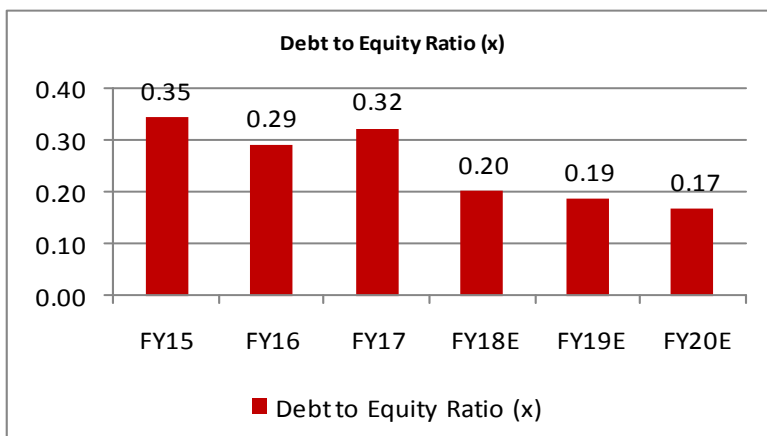
Return on assets to improve to 11% & 11.74% by FY



Net worth to compound by CAGR of 16% over FY17 to reach INR 34,895 Million by FY20e as against a mere 0.36% CAGR growth from FY15 to FY17.



PKI with 0.32x Debt/Equity has the lightest balance sheet among its peers. Company has reduced its debt by INR 1,600 Mn & further INR 420 Mn (FCCB Conversion) in FY 2018. Apart from INR 700 Mn working capital loan, company will not be borrowing any debt in near future.



For the expansion plans, PKI is using capital from internal accruals.



**Income Statement (INR Mn)**

Period Ended	FY15	FY16	FY17	FY18E	FY19E	FY20E
<b>INCOME :</b>						
Sales Turnover	31,607	22,812	24,148	27,540	32,091	40,939
Excise Duty/GST	3,243	2,279	2,413	719	-	-
<b>Net Sales</b>	<b>28,364</b>	<b>20,533</b>	<b>21,735</b>	<b>26,821</b>	<b>32,091</b>	<b>40,939</b>
<b>Change</b>		<b>-28%</b>	<b>6%</b>	<b>23%</b>	<b>20%</b>	<b>28%</b>
Other Income	77	48	33	57	68	88
<b>Total Income</b>	<b>28,585</b>	<b>20,521</b>	<b>21,873</b>	<b>26,935</b>	<b>32,231</b>	<b>41,120</b>
<b>EXPENDITURE :</b>						
Raw Materials	19,678	14,542	14,927	16,337	19,796	26,547
Power & Fuel Cost	938	1,085	1,162	1,206	1,356	1,511
Employee Cost	1,491	1,439	1,549	1,678	1,808	2,009
Other Mfg Expenses	1,566	918	952	1,043	1,130	1,538
Selling and Admin Exp	645	505	538	624	743	823
Misc. Expenses	2,581	86	101	862	1,027	1,191
<b>Total Expenditure</b>	<b>26,900</b>	<b>18,575</b>	<b>19,228</b>	<b>21,750</b>	<b>25,860</b>	<b>33,619</b>
Operating Profit	1,686	1,947	2,645	5,185	6,371	7,501
Interest	607	695	731	518	563	593
<b>Gross Profit</b>	<b>1,078</b>	<b>1,252</b>	<b>1,914</b>	<b>4,667</b>	<b>5,808</b>	<b>6,908</b>
Depreciation	985	1,018	1,030	1,063	1,128	1,295
<b>Profit Before Tax</b>	<b>93</b>	<b>234</b>	<b>884</b>	<b>3,604</b>	<b>4,680</b>	<b>5,614</b>
Tax	0	0	74	360	468	561
<b>PAT</b>	<b>93</b>	<b>234</b>	<b>810</b>	<b>3,243</b>	<b>4,212</b>	<b>5,052</b>
<b>Change</b>		<b>150%</b>	<b>246%</b>	<b>300%</b>	<b>30%</b>	<b>20%</b>
<b>PAT Margin</b>	<b>0.30%</b>	<b>1.02%</b>	<b>3.35%</b>	<b>11.24%</b>	<b>12.26%</b>	<b>11.34%</b>
EPS	0.69	1.77	5.89	23.32	30.29	36.33

**Balance Sheet (INR Mn)**

Period Ended	FY15	FY16	FY17	FY18E	FY19E	FY20E
<b>SOURCES OF FUNDS :</b>						
Share Capital	1,345	1,345	1,391	1,569	1,569	1,569
Reserves Total	20,706	20,030	20,819	24,062	28,274	33,326
<b>Total Shareholders Funds</b>	<b>22,051</b>	<b>21,375</b>	<b>22,210</b>	<b>25,631</b>	<b>29,843</b>	<b>34,895</b>
Total Debt	7,608	6,246	7,203	5,183	5,633	5,933
Other Liabilities	176	238	291	235	455	577
<b>Total Liabilities</b>	<b>31,361</b>	<b>30,179</b>	<b>31,853</b>	<b>31,049</b>	<b>38,220</b>	<b>43,020</b>
<b>APPLICATION OF FUNDS :</b>						
<b>Gross Block</b>	<b>29,845</b>	<b>28,311</b>	<b>28,739</b>	<b>30,489</b>	<b>34,989</b>	<b>38,439</b>
Less : Acc. Depreciation	12,512	11,961	12,957	14,021	15,149	16,443
<b>Net Block</b>	<b>17,332</b>	<b>16,349</b>	<b>15,781</b>	<b>16,468</b>	<b>19,840</b>	<b>21,995</b>
Capital Work in Progress	9,441	9,552	11,415	9,136	10,034	9,995
Investments	22	22	22	450	658	1,028
Inventories	1,941	1,826	1,878	2,287	3,917	4,529
Sundry Debtors	970	799	763	1,022	1,217	1,577
Cash and Bank	355	200	281	845	972	1,693
Loans and Advances	671	1,284	1,171	1,042	1,283	1,364
<b>Total Current Assets</b>	<b>3,937</b>	<b>4,110</b>	<b>4,092</b>	<b>5,196</b>	<b>7,389</b>	<b>9,164</b>
Trade Payables	772	889	970	1,216	1,450	1,676
Other Current Liabilities	1,415	1,518	1,025	1,319	1,287	1,210
Provisions	90	150	313	484	316	371
<b>Total Current Liabilities</b>	<b>2,277</b>	<b>2,556</b>	<b>2,308</b>	<b>3,020</b>	<b>3,052</b>	<b>3,257</b>
Net Current Assets	1,660	1,554	1,785	2,176	4,337	5,906
Deferred Tax Liability	810	889	865	853	1,400	582
Other Assets	3,715	3,591	3,716	3,665	4,411	4,678
<b>Total Assets</b>	<b>31,361</b>	<b>30,179</b>	<b>31,853</b>	<b>31,049</b>	<b>38,220</b>	<b>43,020</b>

**Cash Flow Statement (INR Mn)**

Particulars	2014	2015	2016	2017	2018E	2019E	2020E
<b>Profit before tax</b>	<b>2035</b>	<b>93.</b>	<b>233</b>	<b>884</b>	<b>3603</b>	<b>4679</b>	<b>5613</b>
Depreciation & Amortization	1177.6	984.9	1018.1	1030.3	1063.3	1128	1294
Cash flow from Opr.	2319.7	2436.3	2421.7	2692.3	4666.8	5807	6908
Purchase of FA	-1806.1	-1620.4	-1584.2	-2288	-4456.7	-4370	-5360
Int & other income	67.6	48.8	48.8	33.5	49.67	45.19	44.29
<b>Cash flow from investing</b>	<b>-1088.7</b>	<b>-1539.5</b>	<b>-1492.2</b>	<b>-2476.7</b>	<b>-4407.0</b>	<b>-4324</b>	<b>-5315.7</b>
Loan Proceed/Repayment	-571.8	-446.4	-497.3	224.4	-505.16	-480	-430
Finance Expense Paid	-354.2	-565.5	-536.2	-366.4	-578.3	-607.3	-694.5
<b>Cash flow from financing</b>	<b>-1080.8</b>	<b>-1011.9</b>	<b>-1033.5</b>	<b>-142</b>	<b>518.31</b>	<b>-1087.3</b>	<b>-1124.5</b>
<b>Net Inc/Dec in C&amp;CE</b>	<b>-47.5</b>	<b>150</b>	<b>-155</b>	<b>81</b>	<b>563.7</b>	<b>467.2</b>	<b>381</b>
Beginning C&CE	252.5	205	355	200	281	844.8	1312
<b>C&amp;CE at end of year</b>	<b>205</b>	<b>355</b>	<b>200</b>	<b>281</b>	<b>844.8</b>	<b>1,312</b>	<b>1,693</b>

**Key Ratios**

Particulars	FY15	FY16	FY17	FY18E	FY19E	FY20E
<b>Profitability Ratios (%)</b>						
EBITDA Margin	2%	4%	7%	15%	16%	15%
Net Profit Margin	0%	1%	4%	12%	13%	12%
ROE	0.42%	1.09%	3.65%	12.65%	14.11%	14.48%
ROCE	2.4%	3.4%	5.5%	13.4%	14.8%	15.2%
ROA	0.30%	0.77%	2.54%	10.45%	11.02%	11.74%
<b>Growth Ratios (%)</b>						
Net Sales	9%	-28%	6%	23%	20%	28%
PAT	-95%	150%	246%	300%	30%	20%
<b>Per Share Data</b>						
EPS	0.69	1.77	5.89	23.32	30.29	36.33
BVPS	164	159	160	184	215	251
<b>Leverage Ratio (x)</b>						
Debt to Equity Ratio (x)	0.35	0.29	0.32	0.20	0.19	0.17

Research Desk

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## Disclosure Appendix

**ULJK Financial Services Pvt Ltd: (Time range– 12 months)**

**BUY:** Returns>20%; **ACCUMULATE:** 5%<Returns<20% ; **HOLD:** -5%<Returns<5%, **REDUCE** -20%<Returns<-5% and **SELL:** Returns<-20%

**Analyst(s) holding in the Stock :** Nil

**Analyst Certification**

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