Initiating Coverage

Shree Precoated Steels (SHRPRE)

Current price Rs 353	Target price Rs 456
Potential upside 29%	Time Frame 12 months

OUTPERFORMER

Moving towards realty …

Shree Precoated Steels Ltd (SPSL), a value-added steel manufacturer, is part of the Ajmera Group. The group has consolidated its real estate businesses under SPSL to capitalise on the opportunities emerging in the sector. The restructuring and amalgamation is expected to SPSL emerge as one of the leading real estate developers in India with exposure to steel business. We initiate coverage on the company with an OUTPERFORMER rating.

- **Huge land bank in Mumbai to boost shareholder value**

SPSL has the third largest land bank in Mumbai, whose value has witnessed a huge surge in prices in recent years. The company is developing nearly 19 million sq ft of saleable real estate over the next 7-8 years. The land bank is relatively low risk as most of it is already in the company's possession. Further, the acquisition cost of the land is low at about Rs 75 per sq ft.

- **Redevelopment rights: A huge opportunity**

The company has developed nearly 17 million sq ft area in and around Mumbai in the last 25 year. It has the opportunity of redeveloping previously developed properties. Redevelopment could result in an additional 5 million sq ft of saleable area. We believe that this could provide major upside to company profitability in coming years as the margins in redevelopment are nearly 55-60%

- **New thrust on steel with capacity expansion to drive top line**

The company operates in a niche segment of manufacturing colour-coated galvanized steel sheets and plans to expand and consolidate the business. It has doubled its capacity to nearly 1 million tonnes, and the benefits would start accruing in the coming years.

VALUATIONS

SPSL is transforming itself from a steel manufacturer to a realty developer. Using the NAV (net asset value) methodology for the real estate business and P/E for the steel business, we arrive at an estimated fair value of Rs 456 per share. We have been conservative in estimating realisations from real estate business and factored in a 4% upside in construction costs annually.

Exhibit 1: Key Financials

Year to March 31	FY06	FY07	FY08E	FY09E
Net Profit (Rs crore)	15.41	210.29	284.00	492.58
Shares in issue (crore)	7.68	11.83	11.83	11.83
EPS (Rs)	2.01	17.78	24.01	41.65
% Growth		784.53	35.05	73.44
P/E (x)	164.18	18.56	13.74	7.92
Price/Book (x)	14.07	8.67	5.83	3.25
RoNW (%)	10.50	38.83	52.89	34.73
RoCE (%)	11.07	36.11	40.85	45.65

Source: ICICIdirect Research

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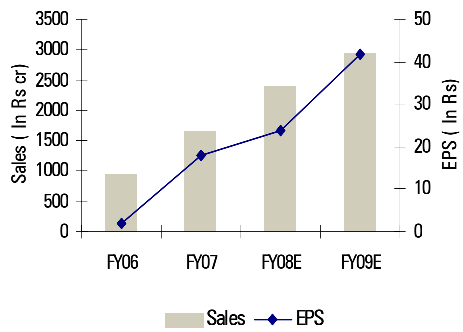
Sales & EPS trend

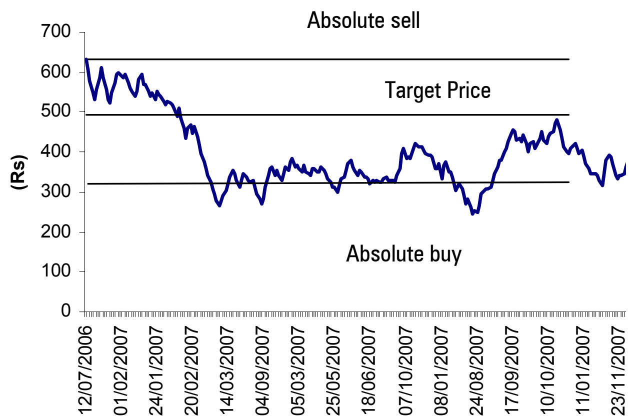


Promoters holding	62.33%
Market Cap	Rs 3908 crore
52 Week H/L	623 / 222
Sensex	19100
Average volume	240,880

Comparative return metrics

Stock return	3 M	6M	12M
DLF	23%	100%	NA
Unitech	52%	70%	123%
HDIL	22%	NA	NA

Price trend



Company Background

Shree Precoated Steels Ltd (SPSL) is a member of the Ajmera Group. The group has established itself as one of India's leading residential and commercial property developers. The group also has strong presence in the fields of cement, textiles, printing, and information technology and entertainment parks.

SPSL has a reputation for producing and supplying the best quality coated flat steel products and has grown up as on the leading manufacturers. The Ajmera Group has successfully completed several mega housing residential complexes to serve the needs of diverse groups of people. These mega projects comprise of more than 17 million sq ft.

SPSL was promoted as RVS Steels and Allied Industries Ltd in March 1985 by V Shah, D Prabhu and others. CS Ajmera and Associates took over the company in 1986 and changed the name to Shree Precoated Steels Ltd.

Share holding pattern

Share holder	% holding
Promoters	62%
Institutional investors	13%
Other investors	4%
General public	21%

Promoter and Institutional holding trend

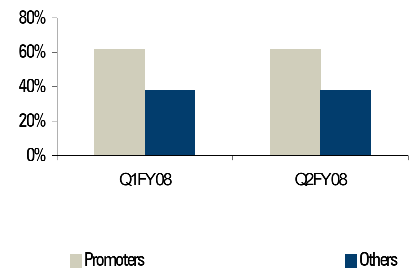
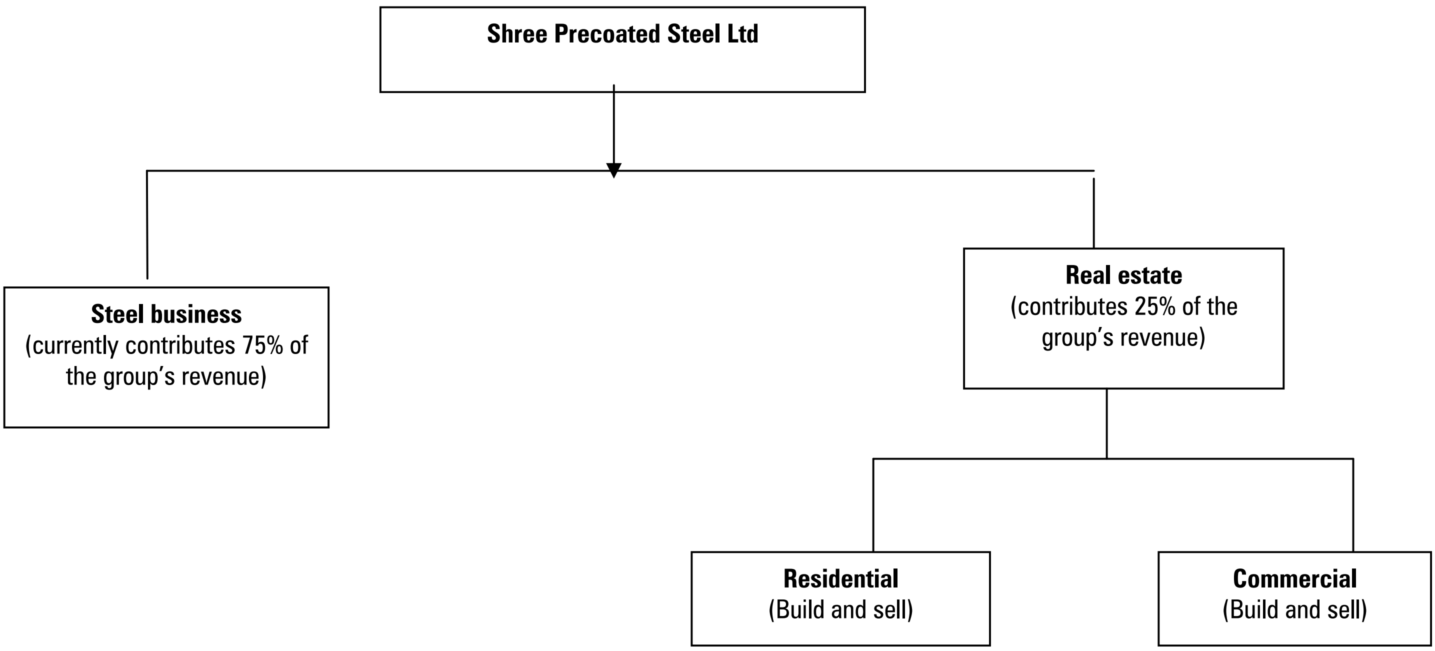


Exhibit 2: Business chart



Investment Rationale

- **Huge land bank in Mumbai to boost shareholder value**

SPSL has huge land bank of 19 million sq ft of developable are in Mumbai, the country's financial capital. The land bank will be available for sale over the next 7 to 8 years. The land bank is relatively low risk, as most of it is already in possession and with clear land titles. Further, the acquisition cost of the land under development is low at about Rs 75 per sq ft. We believe that this land bank would boost shareholders' value going forward. Mumbai will retain its status as the country's financial capital, which would generate huge demand for residential and commercial buildings.

Most of the land bank in mumbai is historical and has clear titles, which will help in faster development.

Exhibit 3: SPSL's land bank details

City	Region	Project	Developable area (million sq ft)
Mumbai	Kanjurmarg	Commercial	8
Mumbai	Wadala (Bhakti Park)	Residential	5.7
Mumbai	Kalyan	Residential	0.7
Mumbai	Andheri	Residential	0.4
Mumbai	Ghatkopar	Residential	1
Mumbai	Kamshet	Residential and commercial	100 acres
Bangalore	Bangalore -Residential	Residential	2.5
Bahrain	Bahrain Bay Project	Residential and commercial	0.4

Source: Company, ICICIdrect Research

Project status details

Bhakti Park (Wadala)

Bhakti Park is well connected to the city's central and suburban pockets. New freeways roads and flyovers are being constructed adjacent to the land, which would improve connectivity and boost keep stable with an upward bias.

Exhibit 4: Bhakti Park details

Status	On-going project
Total developable area	5.7 million sq ft
In progress	1.7 million sq ft
Project duration	4 years
Product mix	Residential (high and mid segment)

Source: Company, ICICIdirect Research

Kanjurmarg

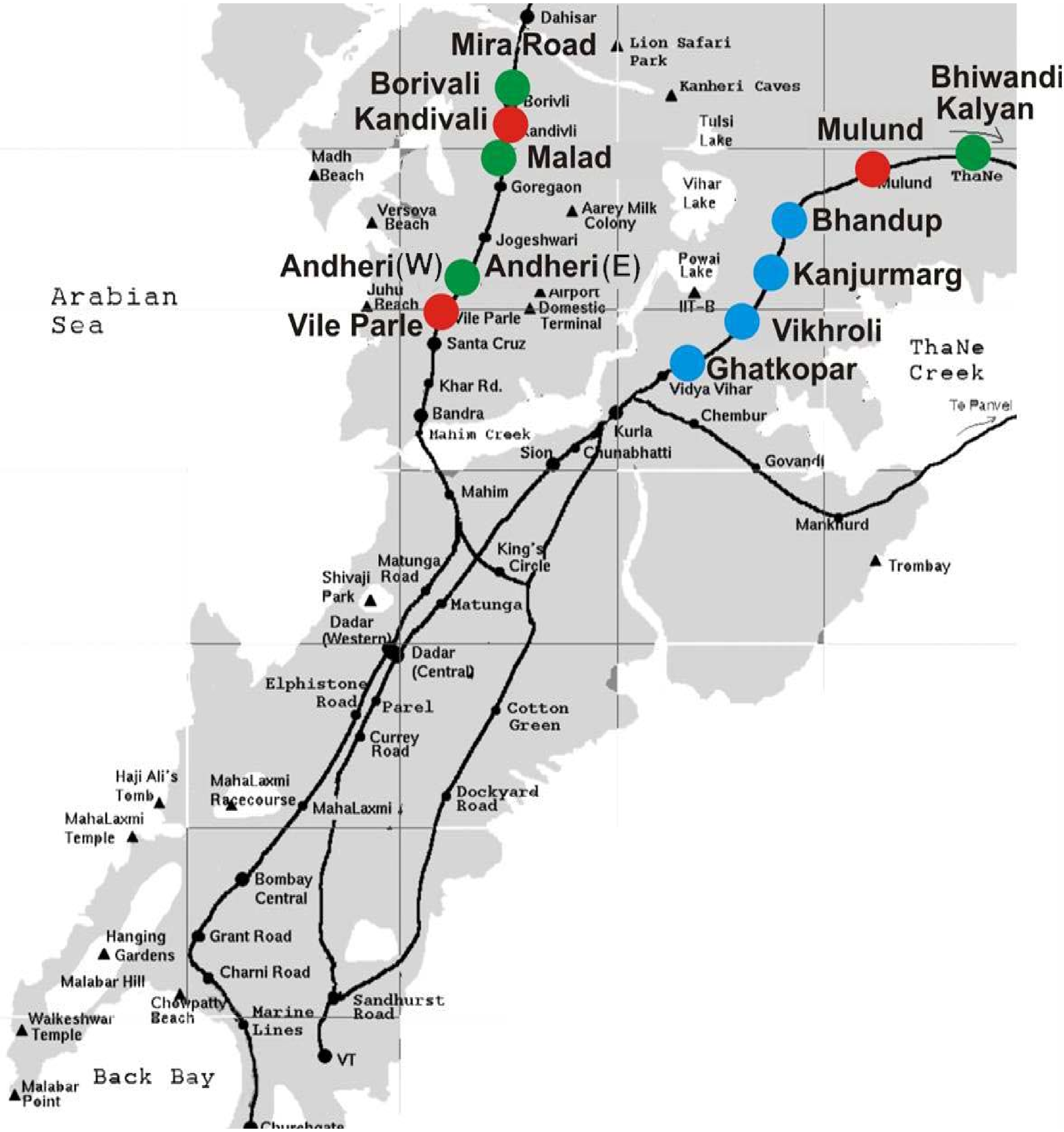
Kanjurmarg is slated to become the next commercial business district (CBD) in Mumbai after Nariman Point and the Bandra-Kurla Complex. The area will soon have proper logistics facilities and a well developed infrastructure with proximity to the upcoming metro and new airport. The area is also adjacent to the Jogeshwari Link Road. The non-availablity of large plots required for malls and offices in the main suburbs make Kanjurmarg a hot spot.

Exhibit 5: Project details (Kanjurmarg)

Status	Conceptualisation stage
Total developable area	8 million sq ft
Project duration	5 years
Product mix	Corporate offices and elite residential homes

Source: Company, ICICIdrect Research

Exhibit 6: Pictorial representation of SPSL's Mumbai land bank



Source: Company, ICICIdirect Research

Red dotted:	Projects completed till date
Green dotted:	Under progress
Sky blue:	Planned projects

Bahrain Project

The property is on unique waterfront district, located north of Manama, the capital city of Bahrain. The entire development is on 43 hectares of reclaimed land. The area is surrounded by other ongoing projects such as the Ritz Carlton, Bahrain Financial Harbour and City Centre. Land prices in the area have doubled in last one year and this trend is expected to continue.

Exhibit 7: Project details (Bahrain)

Status	Will start from FY09
Total developable area	5.7 million sq ft
In progress	4.0 million sq ft
Project duration	3 years
Product mix	Residential (85%) and commercial (15%)

Source: Company, ICICIdirect Research

Bangalore property

The project is located close to Electronic City which houses several IT companues, including Infosys Technologies and Wipro.

Exhibit 8: Project details – Ajmera Infinity (Bangalore)

Project Status	Ongoing
Total developable area	2.5 million sq ft
Project duration	3-4 years
Product mix	Commercial

Source: Company, ICICIdrect Research

Exhibit 9: Project details – Ajmera Green Acres (Bangalore)

Project status	Ongoing
Total developable area	0.5 million sq ft
Project duration	1 year
Product mix	Residential

Source: Company, ICICIDirect Research

- ### Cash flow visibility from real estate development

The developmental plan would provide the company visiblity of stable cash flows, which will have a positive impact on its net profit as profits are higher from the real estate business.

Exhibit 10: Projected cash flows from real estate projects (Rs crore)

Project Name	FY08E	FY09E	FY10E	FY11E
Bhakti Park	300	350		
Kanjurmarg		500	2300	2400
Bahrain Bay			200	800
Other Projects				

Source: Company, ICICIdrect Research

- ### Merger of real estate business to create shareholder value

The Ajmera group has taken initiatives that would unlock the value to the investors by integrating its steel business with real estate business. The group has transferred the land bank to the books of SPSL at book value. Earlier all the group's real estate projects were operated through SPVs (special purpose vehicles). These initiatives are expected to fetch the group cash flows to the tune of Rs 20,000 crore by 2015.

Exhibit 11: Expected cash flows from real estate business

Project	Revenue (Rs crore)
Kanjurmarg	12,100
Bhakti Park	5,450
Kalyan	150
Andheri*	330
Ghatkopar*	800
Kamshet*	530
Bangalore - Residential*	650
Bahrain Bay Project	625
Total	20,635

**Yet to be transferred*

Source: Company,ICICIdrect Research

The expected revenue from these projects is on current market price, any changes in macro conditions may affect the cash flows

- **Sound execution capabilities**

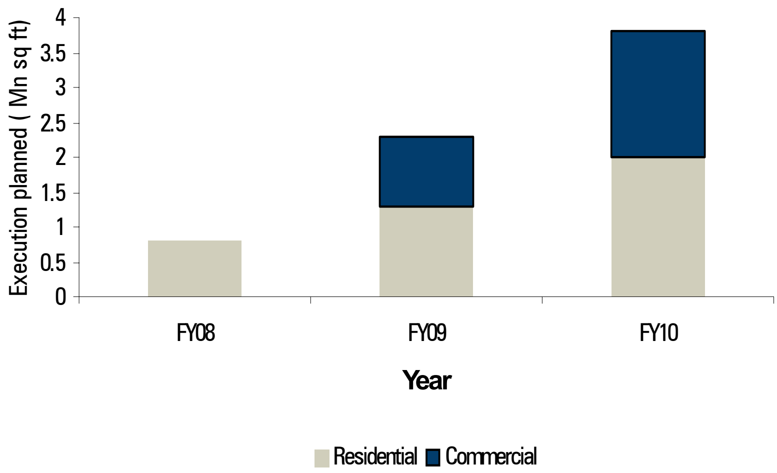
The company has developed 17 million sq ft till FY07 in and around Mumbai. It is one of the biggest realty developers in Mumbai, which gives its competitive advantage over its peers. The Ajmera Group has under its belt number of construction projects. In all these projects the in-house infrastructural supports such as architects, engineers and other support service functions have been put to use. The successful execution of these mega projects confirms the adequacy and competency of these to carry out mega projects.

Exhibit 12: Execution planned (in million sq ft)

Type of property	FY07	FY08	FY09
Residential	0.8	1.3	2.0
Commercial		1.0	1.8

Source: Company,ICICIdrect Research

Exhibit 13: Project execution increasing



Source: Company,ICICIdrect Research

- **Potential of 8 million sq ft of extra saleable area**

The company is expected to earn incremental revenue Rs 10,000 crore if Kanjurmarg gets CBD status from local authorities. The FSI will increase to 4 from the current base of 2, which will increase the developable and saleable area to 16 million sq ft, an increment of 8 million sq ft. The additional NAV per share will be Rs 253. However due to extra FSI, there might some decrease in the realizations.

Exhibit 14: Additional NAV (if Kanjurmarg gets CBD status)

Free cash flow to firm	Rs 4,000 crore
Debt	Rs 250 crore
Free cash flow to equity-post tax	Rs 3,000 crore
Equity capital	11.828 crore
NAV per share	Rs 253

Source: ICICIdirect Research

- **Redevelopment potential of 5 million sq ft**

The company has developed nearly 17 million sq ft area in and around Mumbai in the last 25 years. It has the potential opportunity of redeveloping its previously developed properties and this opportunity could result into an additional 5 million sq ft of saleable area. The company has already successfully implemented pilot projects for redevelopment.

Redevelopment of existing properties to trigger margin expansion.

Exhibit 15: Average realisations in redevelopment

Area for redevelopment	Price per sq ft (Rs)
Andheri	10000-12000
Malad	6000-6500
Borivali	5500-6000
Bhiwandi	3500-4000
Kalyan	3200-3500

Source: ICICIdirect Research

We believe that this could provide major upside to company profitability in coming years as the margins in redevelopment are nearly 55-60%.

- **New thrust on steel business**

SPSL has taken new initiatives to ramp up its steel business. Demand for steel in the country has increased due to sustained growth in the economy. The company has been primarily been a steel manufacturing company with facilities of cold rolled steel coils, galvanized and pre painted galvanized steel coils and sheets. The company has technology collaboration with Thyssen Krupp Steel. It has doubled its steel capacity in past 3 years and the benefits would start to have positive impact on the balance sheet.

Exhibit 15: Steel capacity (Product-wise)

Product	Capacity (tpa)
Pre painted galvanized coils	100,000
Galvanized coils	180,000
Cold rolled coils	240,000
Hot rolled products	300,000

Source: Company, ICICIdirect Research

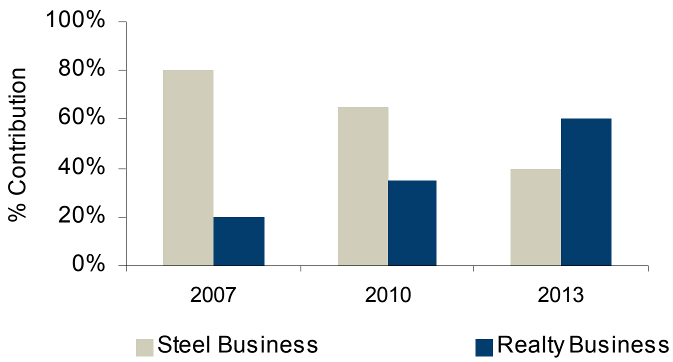
- **Margins to improve from steel business**

Margins from the steel business are expected to improve, primarily due to two reasons. Firstly company will boost its capacity utilization. Secondly, it will curtail its trading activities, where margins were lower. With the enhanced capacity, the operating margins will see an improvement from 2-3% to 6-7%. These margins are still lower than compared to industry peers; this is due to high interest burden.

- **De-risked business model**

Due to its diversification into real estate, the company would be less vulnerable to a slowdown into any one of the businesses. It expects to steel business to contribute 35% of the total revenue of the company by FY12. Going forward, we believe the company would witness revenue growth in both the businesses. However, real estate development would become the main business of the company

Exhibit 16: Revenue contribution projection



Source: ICICIdrect Research

- **Recent developments**

Repeal of ULCRA to bring more land for development

The Urban Land Ceiling and Regulation Act (ULCRA) was enacted in 1976 and was repealed by the Maharashtra state legislature recently. This implies that there is no ceiling to the ownership of land in Maharashtra and in Mumbai. The act stated that no individual could own more than 500 sq meters of vacant space in Mumbai or up to 2,000 sq meters in smaller towns. However, the individual was allowed to own the land if used for certain purposes approved by the government or the individual had taken the Government approval for a specific purpose.

Impact on SPSL

In our view, residential property prices in the Mumbai are dependent on the location and vary from Rs 2,500/sq ft in Navi Mumbai to Rs 50,000/sq ft in prime localities in South Mumbai like Napean Sea Road, Colaba, etc. We expect these companies to benefit from the repeal of the act. Also, the repeal of the act is expected to simplify and speed up the processing of the regulatory requirements. This is all the more important as the group has sizeable land bank which is yet to be transferred in the SPSL books.

Risks & Concerns

Interest rate and NAV sensitivity

The key risk associated with our calculation is any change in property prices and construction costs. A 100 bps increase in interest rate from our base estimates could decrease the NAV to Rs 411 per share. A 100 bps decline in interest rates could hike the NAV to Rs 432 per share.

Exhibit 17: Sensitivity analysis of real esate business NAV

	Sale price escalation		
Interest Rate	**0%**	**2.50%**	**5%**
12%	439	444	449
13%	427	432	437
14%	416	421	426
15%	406	411	417
16%	396	401	406

Source:ICICIdrect Research

Kanjurmarg, Bhakti Park account for 85% of real estate revenue

The Kanjurmarg and Bhakti Park projects will contribute towards 85% of the revenue and any negative impact on the prices in these regions might significantly affect the cash flows.

Business cycle risk

Real estate prices have gone up drastically in last two years and there is possibility that prices may correct in coming months and that might have a significant impact on company cash flows and profitability.

Execution risks

Multifold jump in development activity, poses significant execution challenges. The company execution plans might be impacted due to shortage of resources.

Regulatory risks

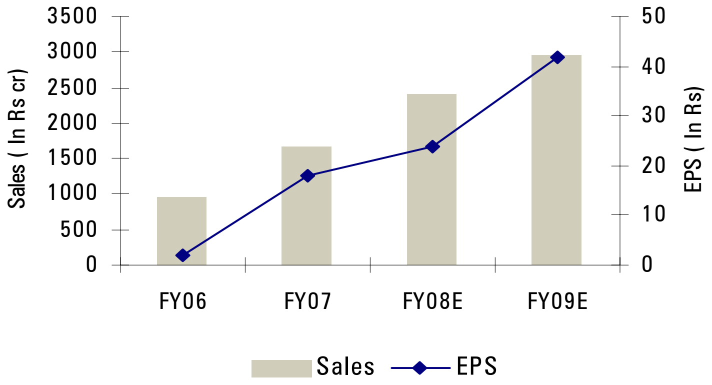
Changes in local land laws or regulations governing the real estate sector can adversely affect a real estate developer as can be seen in the recent budget announcement of the withdrawal of tax benefits to real estate developers. With vested interests in the promotion of select regions vis-à-vis others, changes at the helm of the political system can disrupt the equation significantly.

Financials

▪ Robust growth in revenues, net profit

SPSL expects to develop 19 million sq ft of residential, commercial by FY12-13. We expect a 47% CAGR in revenues over FY06-09E to Rs 2,950 crore from Rs 960 crore. Net profit is expected to witness a 220% CAGR to Rs 492 crore from Rs 15.41 crore. While we believe the company will be progressively scaling up its execution capabilities, we have assumed flat sales realizations and a 4% increase in construction costs to be on conservative side. We believe due to in-house capabilities and resources, the company would be able to deliver the growth.

Exhibit 18: Healthy growth in net sales

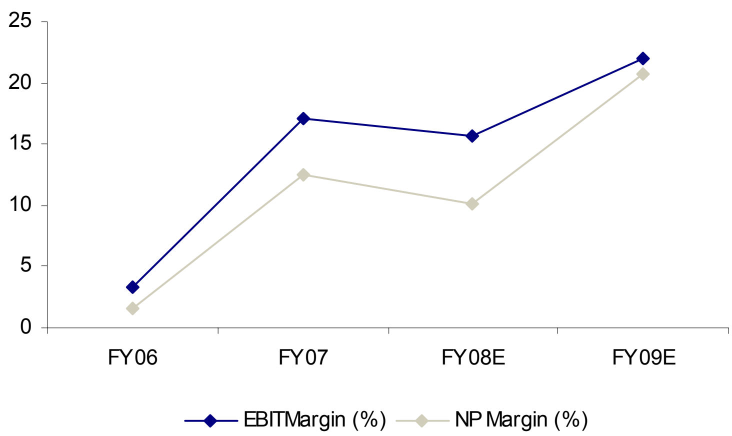


Source: ICICIdirect Research

▪ Higher margins to boost profitability further

The company is expected to perform well on the margin front and its EBIT margins will be around 22% by FY09. Higher contribution of real estate business to total sales and better capacity utilization of the steel business will boost margins. The EBIT margins are expected to decline in FY08 on account of higher contribution from the steel business. However, going forward the business mix will slowly turn in favour real estate development and thus witness the higher margins.

Exhibit 19: EBIT and net profit margins to rise



Source: ICICIdirect Research

Valuation

We have valued the company on a SOTP (sum-of-the-parts) methodology. The company is present in two businesses: real estate development and steel business. For the real estate business, we have followed NAV (net asset value) methodology. We have arrived at the value of the company's real estate vertical by discounting the free cash flows from all projects.

We have valued the steel business on comparable P/E basis with its peers in the industry. In this approach we have calculated the net profit contribution of the steel business to the total net profit. We have given it a multiple which is at a 20% discount to its peers as company is yet to demonstrate it ability to drive the steel business at higher margins.

- ### Real estate business

Real estate business valued at Rs 421 per share
We have assumed that the company will develop 19 million sq ft of residential projects by FY12. We estimate the total free cash flow to equity at Rs 5262.38 crore and discounting this figure at 13%, we arrive at Rs 421 per share.

Exhibit 20: Cash flow timings

Cash flows (Rs crore) - Timeline				
Project Name	FY08E	FY09E	FY10E	FY11E
Bhakti Park	300	350		
Kanjurmarg		500	2300	2400
Bahrain Bay			200	800
Other Projects				

Source: ICICIdirect Research

Exhibit 21: NAV from real estate business

Real estate NAV matrix	
Free cash flow to firm	Rs 5262 crore
Debt	Rs 280 crore
Free cash flow to equity-post tax	Rs 4982
Equity capital	11.828
NAV per share	Rs 421

** The NAV has been calculated of the developmental till FY12 only*
Source: ICICIdirect Research

Stock to trade at a par to NAV
Since the company is not a pure play real estate player, and due to its diversified interest business, we believe the stock will trade at par with NAV. Thus, we have valued the real estate business will be valued at Rs 421 per share

- ### Steel business

Steel business is valued at Rs 57 per share
The steel business is estimated to generate a top line of Rs 2,000 crore in FY08, Rs 2,400 crore (FY09) and Rs 2,880 crore (FY10).

Exhibit 22: Projected cash flows from steel business

	FY08E	FY09E	FY10E
Steel Business sales (Rs crore)	2000	2400	2880
Net profit (Rs crore)	70	84	100.8
EPS (Rs)	5.92	7.1	8.52
Number of shares (crore)	11.83	11.83	11.83

Source:,ICICIdirect Resaerch

We have given it a P/E of 5x on estimated EPS of FY09.The PER multiple is at 20% discount to its peers in the industry. We believe the discount is justified, as the company is yet to demonstrate operating efficiency on sustainable basis.

- **Sum of parts valuation at Rs 456 per share**

Exhibit 23: Total share value matrix

Business Vertical	Contribution to total value
Real estate NAV per share	421
Steel business value per share	35
Total Value per share	**456**

Source: ICICIdirect Research

Financial Summary

Profit and Loss Account

(Rs crore)

Year ending March 31	FY06	FY07	FY08E	FY09E
Sales	959.22	1667.81	2400.00	2950.00
% Growth		173.87	143.90	122.92
Op Profit	54.35	332.93	430.23	720.00
% Growth		612.57	129.23	167.35
Depreciation	21.98	48.31	55.10	72.58
EBIT	32.37	284.62	375.13	647.42
% Growth		879.27	131.80	172.59
Interest	14.53	34.01	42.09	31.19
Profit before Tax	17.84	250.61	333.04	616.23
% Growth		1404.76	132.89	185.03
Taxation	2.43	41.58	48.32	123.65
Net Profit	15.41	209.03	284.72	492.58
% Change YoY			136.21	173.01

Top line to grow steadily due to robust execution and growth in steel business

Net profit to see manifold increase due to realty business higher margins

Ratio Analysis

Year ending March 31	FY06	FY07	FY08E	FY09E
EPS (Rs)	2.01	17.78	24.01	41.65
Book Value (Rs crore)	23.46	38.05	56.65	101.45
Net Profit Margin (%)	1.61	12.53	11.86	16.70
RONW (%)	10.50	38.83	52.89	34.73
ROCE (%)	11.07	36.11	40.85	45.65
Sales to Equity (x)	49.11	4.66	4.26	2.65
Market Cap (Rs crore)	2517.24	3903.24	3903.24	3903.24
Market Cap to sales	2.62	2.34	1.63	1.32
Price to Book Value	14.07	8.67	5.83	3.25
P/E	164.18	18.56	13.74	7.92

RATING RATIONALE

ICICIdirect endeavors to provide objective opinions and recommendations. ICICIdirect assigns ratings to its stocks according to their notional target price vs current market price and then categorises them as Outperformer, Performer, Hold, and Underperformer. The performance horizon is 2 years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Outperformer: 20% or more;
Performer: Between 10% and 20%;
Hold: ±10% return;
Underperformer: -10% or more.

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