

Prakash Industries

| | | | | | | | | | | | | |
|-------------------------------|------------------|-------------------|------------------|----------------|--------------|----------------|------------|-------------|------------|-------------|--------------|---------------|
| BSE SENSEX 17,605 | S&P CNX 5,326 | CMP: INR55 | TP: INR99 | Buy | | | | | | | | |
| Bloomberg Euity Shares (m) | PKI IN 134.5 | Year | Net Sales | PAT | EPS | EPS | P/E | P/BV | ROE | ROCE | EV/ | EV/ |
| 52-Week Range (INR) | 99/26 | End | (INR m) | (INR m) | (INR) | Gr. (%) | (X) | (X) | (%) | (%) | Sales | EBITDA |
| 1,6,12 Rel. Perf. (%) | 82/-12/-38 | 3/10A | 15,677 | 2,662 | 21.9 | 23.7 | - | - | 21.5 | 19.3 | - | - |
| M.Cap. (INR b) | 7.4 | 3/11A | 16,641 | 2,671 | 19.9 | -9.2 | 2.8 | 0.4 | 16.5 | 13.3 | 0.8 | 4.0 |
| M.Cap. (USD b) | 0.2 | 3/12E | 20,533 | 2,604 | 19.4 | -2.5 | 2.8 | 0.4 | 14.6 | 10.9 | 0.7 | 3.9 |
| | | 3/13E | 26,090 | 2,903 | 21.6 | 11.5 | 2.5 | 0.3 | 14.3 | 12.7 | 0.5 | 2.7 |

Prakash Industries 3QFY12 results were in-line; Greater focus on sponge iron and power sales boosts earnings

- Prakash Industries' 3QFY12 Adj PAT grew 20% QoQ to INR668m (v/s est INR668m) due to stronger market for sponge iron and power. EBITDA at INR910m was also broadly in line with our estimate of INR956m.
- Sponge iron realization increased 9% QoQ. PKI sold more sponge iron and power at the cost of steel production to capitalize on stronger market.
- PKI has entered into a contract with Andhra Pradesh SEB for sale of 27MW power at an average rate of INR3.75/kwh for next 5 months. Another 40MW capacity will be available for external sales after stabilization of all the units.
- New Fe-Mn capacity of 24ktpa is being planned in FY13 at a capex of INR600m to leverage on enhanced power.
- Steel production is now being optimized to gain from improved market.
- Stock trades at very attractive FY13E P/E of 2.5x, EV/EBITDA of 2.7x, and P/BV of 0.3x. Maintain **Buy**.

Quarterly Performance

| Y/E March | FY11 | | | | FY12 | | | | (INR Million) | |
|---------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4QE | FY11 | FY12E |
| Steel + Sponge Sales (000 tons) | 134 | 129 | 123 | 97 | 127 | 121 | 133 | 141 | 469 | 443 |
| Coal production (000 tons) | 260 | 250 | 240 | 250 | 247 | 236 | 261 | 255 | 1,000 | 998 |
| Net Sales | 4,645 | 4,210 | 3,823 | 3,964 | 4,985 | 4,581 | 5,207 | 5,760 | 16,641 | 20,533 |
| Change (%) | 27.3 | 11.5 | 6.1 | -14.6 | 7.3 | 8.8 | 36.2 | 45.3 | 6.2 | 23.4 |
| EBITDA | 929 | 903 | 717 | 850 | 907 | 769 | 910 | 948 | 3,398 | 3,534 |
| Change (YoY %) | 16.5 | 0.0 | -18.6 | -14.2 | -2.3 | -14.9 | 26.9 | 11.5 | -4.8 | 4.0 |
| As % of Net Sales | 20.0 | 21.4 | 18.8 | 21.4 | 18.2 | 16.8 | 17.5 | 16.5 | 20.4 | 17.2 |
| EBITDA per ton | 6,641 | 6,733 | 5,642 | 8,448 | 6,904 | 6,053 | 5,962 | 6,260 | 7,250 | 6,295 |
| Interest | 36 | 4 | 2 | 16 | 3 | 25 | 47 | 82 | 57 | 157 |
| Depreciation | 169 | 171 | 172 | 161 | 164 | 173 | 188 | 190 | 673 | 716 |
| Other Income | 18 | 8 | 7 | 55 | 5 | 4 | 13 | 62 | 87 | 84 |
| PBT (before EO Inc.) | 742 | 736 | 551 | 728 | 745 | 575 | 688 | 738 | 2,756 | 2,745 |
| EO Income(exp) | -7 | | -7 | -7 | -7 | -7 | -7 | | -20 | -20 |
| PBT (after EO Inc.) | 735 | 736 | 544 | 721 | 738 | 569 | 681 | 738 | 2,736 | 2,725 |
| Total Tax | 38 | 27 | 0 | 0 | 27 | 20 | 20 | 74 | 65 | 141 |
| % Tax | 5.2 | 3.6 | 0.0 | 0.0 | 3.6 | 3.6 | 2.9 | 10.0 | 2.4 | 5.2 |
| Reported PAT | 697 | 709 | 544 | 721 | 711 | 548 | 661 | 664 | 2,671 | 2,584 |
| Adjusted PAT | 703 | 709 | 550 | 728 | 717 | 555 | 668 | 664 | 2,690 | 2,604 |
| Change (YoY %) | 18.7 | 3.6 | -17.5 | -4.7 | 2.0 | -21.8 | 21.3 | -8.8 | -0.6 | -3.2 |

E: MOSL Estimates

Greater focus on sponge iron and power sales boosted earnings

- **Net sales increased 14% QoQ (up 9% YoY) to INR5.2b** due to higher steel realization, higher sponge iron sales tonnage and external sale of power. Sponge iron sales increased 137% QoQ on smaller base of 2QFY12 to 32kt. However, steel sales tonnage was lower 6% QoQ to 101kt.
- **Crude steel production decreased 6% QoQ to 93kt** as company resorted to external power sales to arbitrage between steel prices and power realization. However with current improvement in domestic steel prices, company has again producing steel at optimum levels.
- **Sponge iron production increased 8% QoQ to 117kt** while realization increased 9% QoQ at INR22,083/t.
- **EBITDA increased 18% QoQ to INR910m** on higher sponge sales volume, better steel realization and external sale of power. Company sold 73m units of power at average gross realization of INR3.6/kwh against negligible sales in 2QFY12.
- **Input scenario:** Landed price of e-auction coal from Coal India (CIL) is around INR2,400/ton while linkage coal cost is around INR1,600/ton. Iron ore landed cost continue to remain higher at INR7,000/ton among tight supply in domestic market. However company is not facing issue regarding supply of iron ore owing to long term relationship with the supplier.

Power Production up 42% QoQ on commissioning of new units

| | | 1QFY11 | 2QFY11 | 3QFY11 | 4QFY11 | 1QFY12 | 2QFY12 | 3QFY12 |
|----------------------|---------|---------|---------|---------|---------|---------|---------|---------|
| Production | | | | | | | | |
| Sponge Iron | MTPA | 94,966 | 104,015 | 114,354 | 92,757 | 116,511 | 107,765 | 116,227 |
| Steel | MTPA | 138,885 | 135,163 | 117,986 | 95,965 | 115,252 | 99,358 | 92,958 |
| Ferro Alloys | MTPA | 11,503 | 10,951 | 8,091 | 9,984 | 9,814 | 10,535 | 10,126 |
| Coal Mine | MTPA | 259,854 | 249,858 | 239,626 | 250,211 | 246,568 | 235,774 | 260,526 |
| Wire Rods | MTPA | 113,933 | 112,944 | 100,990 | 75,211 | 92,019 | 76,135 | 71,056 |
| Steel Structural/TMT | MTPA | 9,028 | | | 14,426 | 23,411 | | 4,300 |
| Power | m units | 149 | 159 | 162 | 155 | 162.4 | 156.2 | 223.2 |

Source: Company/MOSL

Phase I capacity to be over by 4QFY12; new 24ktpa Fe-Mn unit planned

- **Phase I capacity expansion** plans containing 5x25MW power plant and 200kt sponge iron kiln is expected to finish in the current quarter. However 150kt billet capacity, where construction was almost 70% complete, is put on hold due to insufficient demand.
- **New Fe-Mn capacity of 24ktpa is being planned in FY13** at a capex of INR600m to leverage enhanced power capacity which also enjoys Section 80IA tax benefits. Tax rate for the company is quite low as market driven prices for internal transfer of power, shift most of profits to power segment.
- **Iron ore mine is progressing slowly** due to increased vigilance in mining approvals in Orissa post mining ban in Karnataka.
- **Further capex for next phase of 100MW is being slowed down** in order to time it with opening of captive coal mine. Forest clearance is awaited, and it will take another 2-3 years for mines to be operational. Steel expansion is also being slowed down as utilization from existing facility is low on sluggish demand.
- **Capex guidance** for FY12, FY13 and FY14 stands at INR3.5b, INR 2b and INR1.5b.

Additional power of ~27MW being sold under open access; New capacities to further external power sales

- PKI has entered into a contract with Andhra Pradesh SEB for sale of 27MW power at an average rate of INR 3.75/kwh for next 5 months.
- Another 40MW capacity will be available for external sales after stabilization of all the units. Currently, one of the old units of 25MW is not operational due to high variable cost which is not commensurate with current power realization.

Valuations attractive; Maintain Buy

- **We expect FY11-13 EPS CAGR of 4%** despite much higher revenue growth (25% CAGR) on increased capacity. New capacity commissioning will also lead to higher depreciation and interest charges which will hit P&L; so, profit growth will not be commensurate with the sales growth.
- **Sluggish steel demand and lack of progress on mining** will also undermine benefits of enhanced capacity.
- **Attractive valuations:** However, stock trades at very attractive FY13E P/E of 2.5x, EV/EBITDA of 2.7x, and P/BV of 0.3x. Maintain **Buy**.

Prakash Industries: an investment profile

Company description

Prakash Industries (PKI) produces steel through the induction furnace route, in which it uses sponge iron and steel scrap or pig iron as input. With a steel making capacity of 700,000tpa, its sponge iron (capacity of 600,000tpa) meets 70-80% of its metal requirement. Most of its steel production is captively consumed to produce higher value added products like structural/ TMT and wire rods. PKI's operations are concentrated in the mineral rich state of Chhattisgarh. It has been allotted three coal mining blocks and two iron ore mines. Captive mines have reserves of 150mt of coal and 85mt of iron ore. Coal is produced from its captive mine at Chotia while iron ore mine at Kawardha is not yet started.

Key investment arguments

- PKI will spend INR33b over five years to increase steel capacity to 1mtpa, expand its sponge iron capacity to capitalize on iron ore integration and put up a 625MW power plant.
- Three units totaling 75MW out of 125MW expansion was commissioned recently and rest 50MW is expected to become operational in Q4FY12. Surplus power will be available for merchant sale from FY13.
- The Sirkaguttu and Kawardha iron ore mines once commissioning operation will make PKI 100% self sufficient in raw material.

Key investment risks

- An unexpected fall in steel prices would adversely impact earnings.

Recent developments

- New FeMn capacity of 24ktpa is being planned in FY13 at a capex of INR600m.

Valuation and view

- Stock trades at attractive FY12E 2.5x PE & 2.7xEV/EBITDA, and 0.3x P/BV. Maintain **Buy**.

Sector view

- Global steel demands still remains subdued due to European economic problems and slow down in construction in China. Global crude steel production is down 11% to 115m tons in November 2011 from peak production of 130m tons in May 2011 largely driven by China. Global economic growth slow down more particularly in China continues to cloud demand outlook. Indian real steel demand too has slowed down growing only 4.2% YoY to 45.2m tons during April-November 2011. We believe Indian demand will still grow 7-8% over couple of years. Depreciation of INR against USD and appreciating Yuan has increased competitiveness of Indian producer's vis-à-vis their Chinese counterparts, thereby lowering Chinese imports threat.

Comparative valuations

| | | Prakash Inds | Monnet Ispat | Sarda Energy |
|---------------|-------|-----------------|-----------------|-----------------|
| P/E (x) | FY12E | 2.8 | 10.4 | 7.0 |
| | FY13E | 2.5 | 8.1 | 5.3 |
| P/BV (x) | FY12E | 0.4 | 1.3 | 0.6 |
| | FY13E | 0.3 | 1.2 | 0.5 |
| EV/Sales (x) | FY12E | 0.7 | 3.2 | 1.3 |
| | FY13E | 0.5 | 2.1 | 1.0 |
| EV/EBITDA (x) | FY12E | 3.9 | 12.0 | 8.2 |
| | FY13E | 2.7 | 9.1 | 5.7 |

Shareholding Pattern (%)

| | Dec-11 | Sep-11 | Dec-10 |
|---------------|--------|--------|--------|
| Promoter | 46.5 | 46.6 | 49.3 |
| Domestic Inst | 3.8 | 3.8 | 4.1 |
| Foreign | 8.6 | 11.3 | 14.1 |
| Others | 41.1 | 38.4 | 32.5 |

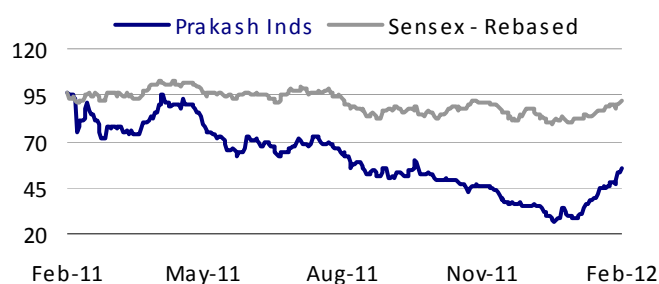
EPS: MOSL forecast v/s consensus (INR)

| | MOSL forecast | Consensus forecast | Variation (%) |
|------|------------------|-----------------------|------------------|
| FY12 | 19.4 | 18.0 | 7.5 |
| FY13 | 21.6 | 25.6 | -15.5 |

Target Price and Recommendation

| Current Price (INR) | Target Price (INR) | Upside (%) | Reco. |
|------------------------|-----------------------|---------------|-------|
| 55 | 99 | 79.6 | Buy |

Stock performance (1 year)



Financials and Valuation

| Income Statement (Consolidated) | | | | (INR Million) | |
|---------------------------------|--------------|--------------|--------------|---------------|--------------|
| Y/E March | 2009 | 2010 | 2011 | 2012E | 2013E |
| Net sales | 15,265 | 15,677 | 16,641 | 20,533 | 26,090 |
| Change (%) | 21.8 | 2.7 | 6.2 | 23.4 | 27.1 |
| Total Expenses | 12,289 | 12,152 | 13,263 | 17,000 | 21,476 |
| EBITDA | 2,976 | 3,525 | 3,378 | 3,534 | 4,615 |
| % of Net Sales | 19.5 | 22.5 | 20.3 | 17.2 | 17.7 |
| Deprn. & Amortization | 425 | 568 | 673 | 716 | 971 |
| EBIT | 2,552 | 2,957 | 2,706 | 2,818 | 3,644 |
| Net Interest | 605 | 255 | 57 | 157 | 529 |
| Other income | 101 | 30 | 87 | 84 | 111 |
| PBT before EO | 2,048 | 2,733 | 2,736 | 2,745 | 3,226 |
| EO income | 68 | | | | |
| PBT after EO | 1,980 | 2,733 | 2,736 | 2,745 | 3,226 |
| Tax | 6 | 71 | 65 | 141 | 323 |
| Rate (%) | 0.3 | 2.6 | 2.4 | 5.1 | 10.0 |
| Reported PAT | 1,974 | 2,662 | 2,671 | 2,604 | 2,903 |
| Adjusted PAT | 2,041 | 2,662 | 2,671 | 2,604 | 2,903 |
| Change (%) | 2.7 | 30.4 | 0.3 | -2.5 | 11.5 |

| Balance Sheet | | | | (INR Million) | |
|------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Y/E March | 2009 | 2010 | 2011 | 2012E | 2013E |
| Share Capital | 1,155 | 1,217 | 1,345 | 1,345 | 1,345 |
| Reserves | 9,137 | 13,091 | 15,843 | 18,211 | 20,800 |
| Share holders funds | 10,291 | 14,308 | 17,188 | 19,556 | 22,145 |
| Loans | 2,593 | 2,301 | 6,766 | 8,266 | 7,766 |
| Deffered tax liability (| 702 | 772 | 802 | 802 | 802 |
| Capital Employed | 13,587 | 17,381 | 24,756 | 28,624 | 30,713 |
| Gross Block | 15,242 | 17,829 | 18,264 | 25,324 | 30,397 |
| Less: Accum. Deprn. | 6,370 | 7,082 | 7,802 | 8,517 | 9,488 |
| Net Fixed Assets | 8,872 | 10,747 | 10,462 | 16,807 | 20,908 |
| Capital WIP | 2,413 | 3,026 | 8,765 | 5,205 | 2,183 |
| Investments | 22 | 22 | 270 | 270 | 270 |
| Curr. Assets | 4,153 | 5,226 | 7,102 | 8,546 | 9,936 |
| Inventories | 820 | 1,019 | 1,624 | 675 | 858 |
| Sundry Debtors | 1,085 | 820 | 864 | 1,969 | 2,502 |
| Cash and Bank | 313 | 1,018 | 630 | 1,918 | 2,592 |
| Loans and Advances | 1,935 | 2,370 | 3,984 | 3,984 | 3,984 |
| Curr. Liability & Prov. | 2,064 | 1,804 | 2,339 | 2,698 | 3,079 |
| Sundry Creditors | 1,349 | 1,023 | 1,047 | 1,406 | 1,787 |
| Other Liabilities & prov | 715 | 781 | 1,292 | 1,292 | 1,292 |
| Net Current Assets | 2,089 | 3,422 | 4,763 | 5,847 | 6,857 |
| Application of Funds | 13,587 | 17,381 | 24,756 | 28,624 | 30,713 |

E: MOSL Estimates

| Ratios | | | | | |
|-------------------------------|------|-------|-------|-------|-------|
| Y/E March | 2009 | 2010 | 2011 | 2012E | 2013E |
| Basic (INR) | | | | | |
| EPS | 17.7 | 21.9 | 19.9 | 19.4 | 21.6 |
| Cash EPS | 21.4 | 26.5 | 24.9 | 24.7 | 28.8 |
| BV/Share | 87.5 | 116.2 | 124.1 | 141.7 | 161.0 |
| DPS | | | 1.0 | 1.5 | 2.0 |
| Payout (%) | | | 5.9 | 9.1 | 10.8 |
| Valuation (x) | | | | | |
| P/E | | | 2.8 | 2.8 | 2.5 |
| Cash P/E | | | 2.2 | 2.2 | 1.9 |
| P/BV | | | 0.4 | 0.4 | 0.3 |
| EV/Sales | | | 0.8 | 0.7 | 0.5 |
| EV/EBITDA | | | 4.0 | 3.9 | 2.7 |
| Dividend Yield (%) | | | 1.8 | 2.7 | 3.6 |
| Return Ratios (%) | | | | | |
| EBITDA Margins | 19.5 | 22.5 | 20.3 | 17.2 | 17.7 |
| Net Profit Margins | 13.4 | 17.0 | 16.0 | 12.7 | 11.1 |
| RoE | 21.5 | 21.5 | 16.5 | 14.6 | 14.3 |
| RoCE | 20.2 | 19.3 | 13.3 | 10.9 | 12.7 |
| RoIC | 24.8 | 24.8 | 19.5 | 16.0 | 15.9 |
| Working Capital Ratios | | | | | |
| Fixed Asset Turnover (x) | 1.0 | 0.9 | 0.9 | 0.8 | 0.9 |
| Asset Turnover (x) | 1.1 | 0.9 | 0.7 | 0.7 | 0.8 |
| Debtor (Days) | 26 | 19 | 35 | 35 | 35 |
| Inventory (Days) | 20 | 24 | 12 | 12 | 12 |
| Creditors (Days) | 32 | 24 | 25 | 25 | 25 |
| Leverage Ratio (x) | | | | | |
| Current Ratio | 2.0 | 2.9 | 3.0 | 3.2 | 3.2 |
| Debt/Equity | 0.2 | 0.1 | 0.4 | 0.3 | 0.2 |

| Cash Flow Statement | | | | | |
|------------------------------|---------------|---------------|---------------|---------------|---------------|
| (INR Million) | | | | | |
| Y/E March | 2009 | 2010 | 2011 | 2012E | 2013E |
| Pre-tax profit | 1,980 | 2,733 | 2,736 | 2,745 | 3,226 |
| Depreciation | 302 | 712 | 720 | 716 | 971 |
| (Inc)/Dec in Wkg. Cap. | 371 | -629 | -1,729 | 204 | -335 |
| Tax paid | -6 | -473 | -65 | -141 | -323 |
| Other operating activiti | -61 | 593 | -1,017 | | |
| CF from Op. Activity | 2,586 | 2,937 | 645 | 3,524 | 3,539 |
| (Inc)/Dec in FA + CWIP | -2,058 | -3,200 | -6,175 | -3,500 | -2,050 |
| (Pur)/Sale of Investmer | -21 | 0 | -248 | | |
| CF from Inv. Activity | -2,080 | -3,200 | -6,423 | -3,500 | -2,050 |
| Equity raised/(repaid) | | 1,260 | 1,083 | | |
| Debt raised/(repaid) | -1,038 | -292 | 4,465 | 1,500 | -500 |
| Dividend (incl. tax) | | | -157 | -236 | -315 |
| CF from Fin. Activity | -1,038 | 968 | 5,390 | 1,264 | -815 |
| (Inc)/Dec in Cash | -532 | 705 | -388 | 1,288 | 675 |
| Add: opening Balance | 845 | 313 | 1,018 | 630 | 1,918 |
| Closing Balance | 313 | 1,018 | 630 | 1,918 | 2,592 |

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Prakash Industries

| | |
|---|-----|
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