

## “in principle” mining approval granted

 25<sup>th</sup> Jun 2008

### BUY

Price	Target Price
<b>Rs194</b>	<b>Rs418</b>

**Sensex – 14,107**

### Price Performance

(%)	1M	3M	6M	12M
Absolute	(4)	28	(42)	34
Rel. to Sensex	14	38	(18)	37

Source: Bloomberg

### Stock Details

Sector	Metals & Mining
Reuters	GDPI.BO
Bloomberg	GODPI@IN
Equity Capital (Rs mn)	281
Face Value (Rs )	10
Number of shares o/s (mn)	28
52 Week H/L (Rs )	377/142
Market Cap (Rsbn/USDmn)	5/116
Daily Avg Vol (No of shares)	99401
Daily Avg Turnover (US\$ mn)	0.5

### Shareholding Pattern (%)

	31/3/08	31/12/07	30/9/07
Promoters	56.2	63.4	63.4
FII/NRI	12.4	5.1	8.1
Institutions	12.1	11.1	13.7
Private Corp.	5.0	6.1	3.8
Public	14.3	14.3	11.0

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Godawari Power & Ispat Ltd (GPIL) has announced that it has received “in Principle” forest clearance for its 106.6 hectares Ari Dongri iron ore mine in Chhattisgarh (having reserves of 6-7mt). As per the terms and conditions of “in Principle” forest approval, (a) GPIL will be required to make total payment of Rs103.9mn towards land acquisition and afforestation charges, and (b) upon payment of the said amount, the state government will send a letter to the central government recommending allotment of mining lease in favor of GPIL. The company expects these procedures to be completed over a period of next 3 months and start the preliminary work of fencing, removing overburden bringing the mine in workable condition. We expect the company to start mining in 4QFY09 nearly 9 months ahead of our expectation.

Forest clearance has been the key overhang on the stock marking a strong underperformance vis-à-vis the broader markets. Over the last six months, while the market has corrected by 24%, the stock has corrected by over 42% as concerns over forest clearance for its mines loomed over the stock. However, with the forest approval in place, we expect the stock to outperform the broader market significantly. We believe the option value of mining benefit will generate incremental EPS of Rs22.9 for FY10 when the major benefit of mining will accrue.

Including the option value of the savings from captive mining, the stock currently trades at significantly low levels of 2.1x FY10 FDEPS of Rs92.5 and EV/EBITDA of 1.5x FY10 estimates. We maintain BUY on the stock with target price of Rs418. We will revise our target price upon company formally receiving mining lease for the mine.

### Why mining lease will translate into early monetization?

Logically speaking, grant of mining lease does not translate into cash flows as the time taken from receiving mining lease to actual output from mines typically varies from 1-2yrs depending upon whether (a) rehabilitation has been done as per the terms and conditions of the lease, (b) whether requisite infrastructure is in place to support mining, (c) how long will it take to remove the initial over-burden and start the mine, among other things.

We believe GPIL will be able to make this mine operational faster as compared to other mines that will be opening up post forest clearance. This is mainly because this mine (Ari Dongri) was previously an operating mine used by Bhilai Steel Plant of SAIL. This signifies that the entire mining related infrastructure is already in place. Further, the mine is close to the existing operational iron ore mine of Sarda Energy & Minerals which further corroborates the fact that the infrastructure including roads, bridges are in place and operational. GPIL's mining plan has already been approved and sites for taking out the ore already identified. We expect GPIL to monetize the mine starting from 4QFY09 itself assuming a conservative scenario. The management expects to extract about 50,000t per month from the mine. Assuming the cost differential of Rs2,063/t, GPIL will likely save Rs1.2bn on pre-tax basis.

### What does GPIL need to do further to secure the mining lease?

GPIL needs to pay Rs104mn towards NAV of the forest land granted and afforestation charges. Further, it needs to hand over land equivalent to 2x the land granted for mining (i.e., 212 hectare). GPIL already has the requisite cash in hand to pay the government and has the land in ready possession to hand over to the government. Upon completion of this process, the state government will recommend to the central government for grant of mining lease in favour of GPIL.

### Early forest clearance to improve EPS and margins significantly

GPIL has received the forest clearance about nine months ahead of our expectation. In our base case, we have assumed GPIL to be only 15% captive for iron ore in FY10. However, now we believe GPIL will be 70% captive for iron ore in FY10. This will likely bring down the blended cost of iron ore for GPIL in FY10 from our earlier estimated Rs4,590/t to Rs2,527/t., a significant decline of Rs2,063/t. This is expected to generate post tax savings of Rs846mn in FY10E. This will lead to an upward revision of our FDEPS estimates of FY10 from Rs69.6 to Rs92.5.

### Valuation

We have valued GPIL under 2 scenarios. In our base case scenario, we have assumed GPIL to be only 15% captive for iron ore in FY10. On base case, our target price stands at Rs418, which is 6x FY10E FDEPS of Rs69.6, signifying a potential upside of 115%. However, considering the savings from captive iron ore mine, (assuming GPIL to be 70% captive for iron ore in FY10), GPIL will likely report FY10 FDEPS of Rs92.5, (33% higher than our original estimates) at which our new target price will be Rs555 (6x FY10E FDEPS of Rs92.5), signifying a potential upside of 186% without considering the fact that the captive iron ore should lead to re-rating of the stock.

At the CMP of Rs194, the stock is trading at 2.8x FY10E FDEPS of Rs69.6 and at 2.4x FY10E EV/EBITDA. We maintain BUY on the stock with a Target Price of Rs418. We will revisit our target price upon company receiving mining lease.

### Savings on account of captive iron ore mining

	Existing valuation	If iron ore starts before FY10 beginning
% Captive for iron ore	15%	70%
Blended cost of iron ore (Rs/t)	4,590	2,527
% savings per tonne of iron ore		44%
Total Cost of iron ore	Rs2,897mn	Rs1,595mn

Source: Emkay Research Estimates

### Valuation table of GPIL

	Existing valuation	If iron ore starts before FY10 beginning
FY10E FDEPS (Rs)	69.6	92.5
% change in FDEPS		33%
Multiple assigned	6x	6x
Target Price of GPIL (Rs/share)	418	555
Change in target price		33%
Potential Upside	115%	186%

Source: Emkay Research Estimates

**Further, having a captive mine will likely re-rate the P/E multiple higher to 8x; in line with partly integrated steel producers which will further increase the valuations of GPIL**

## Financials

Income Statement					Balance Sheet				
	Rs Mn					Rs Mn			
	FY07	FY08E	FY09E	FY10E		FY07	FY08E	FY09E	FY10E
Gross External Sales	5,456	9,193	12,496	13,793	Equity Capital	237	279	279	279
Less: Excise	734	1,195	1,375	1,517	Reserves & Surplus	1,837	3,985	5,372	7,141
Net Sales	4,722	7,998	11,121	12,276	Networth	2,074	4,264	5,651	7,421
Raw Material Consumption	3,433	5,694	7,922	8,403	Total Debts	2,894	2,594	2,594	2,594
As a % to Net Sales	72.7	71.2	71.2	68.5	Net def Liabilities	19	19	19	19
Power & Fuel	82	130	158	167	Capital Employed	4,991	6,881	8,267	10,037
As a % to Net Sales	1.7	1.6	1.4	1.4	Gross Block	3,117	3,817	4,117	6,517
Staff Cost	56	80	111	123	Less Depreciation	-344	-574	-891	-1,317
As a % to Net Sales	1.19	1.00	1.00	1.00	CWIP	1,034	700	1,600	800
Other Expenses	354	544	767	859	Net Fixed Assets	3,852	3,988	4,871	6,046
As a % to Net Sales	7.5	6.8	6.9	7.0	Investments	49	49	49	49
Total Exp	3,926	6,448	8,958	9,552	Inventory	761	1,094	1,518	1,738
EBITDA (Core)	796	1,550	2,163	2,724	Debtors	281	504	753	945
EBITDA (%)	16.9	19.4	19.5	22.2	Cash and Bank	125	1,236	951	982
Other Income	71	82	149	149	Loans & Advances	407	603	894	1,076
Depreciation	122	230	317	425	Total Cur. Assets	1,575	3,437	4,116	4,740
EBIT	674	1,320	1,846	2,298	Current Liabilities	258	337	467	497
Interest	125	296	265	255	Provisions	228	257	301	301
PBT	621	1,107	1,731	2,193	Total Cur. Lia. & Prov.	485	594	769	798
Tax	79	141	220	279	Net Current Assets	1,090	2,843	3,347	3,942
ETR (%)	12.7	12.7	12.7	12.7	Misc. Assets	0	0	0	0
A PAT	533	967	1,511	1,914	Total Assets	4,991	6,881	8,267	10,037

  

Cash Flow Statement					Ratios				
	Rs Mn								
	FY07	FY08E	FY09E	FY10E		FY07	FY08E	FY09E	FY10E
PBT	612	1,107	1,731	2,193	EBITDA - Core (%)	16.9	19.4	19.5	22.2
Depreciation	122	230	317	425	EBIT (%)	14.3	16.5	16.6	18.7
Net Chg in WC	-405	-643	-789	-563	NPM (%)	11.3	12.1	13.6	15.6
Others	-51	-141	-220	-279	Adj ROCE (%)	16.9	21.3	23.4	23.7
CFO	277	553	1,038	1,776	Adj ROE (%)	34.8	30.5	30.5	29.3
Capex	-1,893	-366	-1,200	-1,600	ROIC (%)	19.5	26.6	27.2	27.5
Net Investments made	-5	0	0	0	Adj EPS	22.9	35.2	55.0	69.6
Others Investing Activities	1	1	1	1	Cash EPS	28.2	43.5	66.5	85.1
CFI	-1,897	-366	-1,199	-1,599	Book Value	89.2	155.1	205.6	269.9
Change in Share capital	736	1,574	350	450	DPS	3.1	3.1	3.9	4.5
Change in Debts	1,168	-300	0	0	Payout (%)	13.6	8.9	7.0	6.5
Div. & Div Tax	-54	-101	-124	-145	Net Debt to Equity (x)	1.3	0.3	0.3	0.2
Others	-150	-250	-350	-450	PE (x)	8.4	5.5	3.5	2.8
CFF	1,700	923	-124	-145	P/BV (x)	2.2	1.2	0.9	0.7
Total Cash Generated	81	1,110	-286	32	EV/Sales (x)	1.5	0.9	0.7	0.6
Cash Opening Balance	44	125	1,236	951	EV/EBITDA (x)	8.4	4.4	3.3	2.4
Cash Closing Balance	125	1,236	951	982	Div Yield (%)	1.6	1.6	2.0	2.3

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