



Between the Lines

Daily Corporate News Analysis

Dec 12th, 2006

Kalyani Steels Ltd. (KSL)

Initiating Coverage

Key Data

CMP	Rs 395
Date	Dec 12 th , 2006
Sector	Speciality Steel
Face Value	10/-
BSE Code	500235
52 Week H/L	Rs 560 / 192
Market Cap	Rs 1725 Cr

Investment Rationale

Kalyani Steels Ltd is a leading producer of Alloy Steel having a 240000 Tonnes steel making plant (Through Blast Furnace route) in Hospet Karnataka Ltd. The company is an integrated steel player with a captive source of Iron Ore, Coal (Bharat NRE Coke) and a pig iron facility (Leased Unit) that produces 90,000 tpy of pig iron which is used for captive consumption and 8 MW power plant for both captive as well as export purpose. The company has a strong clientele list (Auto and Forging majors), amongst which Bharat Forge and its group companies form the largest buyers group. KSL has been doing exceedingly well in terms of revenue and profitability growth in the last 3 to 4 years. The company would be enhancing its steel melting capacity to 490000 by June 07 as a part of its ongoing Capex in Hospet. The recent acquisition of SJK steel is expected to further expand KSL's steel making capacity to 740,000 Tonnes by 2008. Moreover, the company has ambitious plans to expand the combined capacity of the group (Kalyani Steels + Kalyani Carpenters + SJK steel) to One Million Tonnes by 2010. With these capacities in place and the growing demand for alloys steel, the company would be able to post a substantial earnings growth in the years to come. On the other hand, the company, through its 3 wholly owned subsidiaries holds a substantial equity stake in group companies like BF utilities, Bharat Forge and Hikal Ltd. The value of these investments (As per latest market prices in 12th Dec 06) is Rs 700 per equity share of Kalyani Steels Ltd (which is more than the current price of KSL).Hence, considering the long term potential and the extent of investment holding in group companies ,long term investors can buy the stock.



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Key Developments:**Kalyani Steels aims to have a 1 million tonnes capacity by FY10**

The company plans to double crude steel capacity to 500,000 tpy at its Ginigeera plant in the Koppal district of Bellary Hospet, Karnataka state, by adding another 350 cubic metre mini-blast furnace and a 6MW power plant. The plant's steel meltshop and rolling mills will be expanded so they handle the extra hot metal. The existing steel meltshop and rolling operations will be upgraded to handle the extra hot metal generated by the third MBF. This is anticipated to be operational by June 2007. Steel making capacity will rise by 250,000 tonnes, of which Kalyani Steel will receive 100,000 tonnes, with the remaining 150,000 to go to Kalyani's partner in the project, Mukand Steel. Both projects are expected to come on stream by June 07. Apart from its brownfield expansion SJK steels acquisition will add another 250,000 Tonnes. The company plans to increase the capacity of this plant to 500,000 Tonnes in FY09.

Financial Performance:**Operating profit rises by 13 % to Rs 35.74 crore in Q2FY07**

Raw material as a percentage of Sales declined from 50.9% to 44.5% in the Sep 06 quarter. However there was a substantial jump in the goods purchased for conversion which grew by 762 % to Rs 44.46 crore. Staff Cost and Other Expenses grew by 27% and 31 % respectively. With total expenditure going up by 59% the EBITDA margins fell by 500 basis points to 15.91% in Q2FY07 due to higher proportion of traded items in the sales.

Valuations:

At current market price of Rs 395, KSL Ltd. is quoting at a PER of 23.3x. On EV/Sales and on EV/ EBITD basis it is quoting at 2.53x and 14.11x of its Sep TTM earnings respectively. But these valuations also include the value of the huge investments which are held by KSL and its wholly owned subsidiaries in group companies. The investment value of its holdings in BF utilities, Hikal Ltd and Bharat Forge which itself is Rs 700 per equity share of KSL. (This is much higher than the current CMP of KSL) Even if we take this at 30% of its market value (Rs 210 per share) and value its steel business at Rs 5.5 crore per tonne of current capacity (Rs 283 per share) , there is a substantial scope for price appreciation in the stock.

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