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RESEARCH REPORT

23rd Nov 2017

RAMA STEEL TUBES LTD

BSE : RAMASTEEL | **Sector: ERW TUBES & PIPES** | **BSE: 539309**

View - BUY

CMP : Rs. 181

Target Price: Rs 235 (In next 12 to 15 mths)

BUSINESS BACKGROUND

Incorporated in 1974, Rama Steel Tubes Ltd. (Rama Steel), is one of the major player in the steel pipe tube in India. Having started with around 10,000 tonnes capacity at single location, today RSTL has a presence in three locations with total capacity of 1.32 lac tonnes annually.

RSTL is primarily engaged into the manufacturing of ERW black round pipes, galvanized pipes, pre-galvanized pipes, steel sheets and structures. It products are sold under the brand name “TTT Rama”.

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INVESTMENT HIGHLIGHTS

Healthy Growth seen in operations during FY18 –

RSTL reported healthy Q1FY18 numbers with Topline placed at Rs 76.93 crs from Rs 65.61 crs a EBIDTA of Rs 5. 29 crs with the the PAT for Q1FY18 placed at Rs 3.24 crs as compared to Rs 2.60 crs in Q1 last year – up by 24% YoY.

For FY17, RSTL reported a Topline of Rs 259.72 crs from Rs 241 crs last year, a EBIDTA of Rs 19.80 crs from Rs 14.57 crs last year followed by a PAT of Rs 9 crs from Rs 6 crs last year.

RSTL has capacities across West, North & South India –

RSTL is one of the oldest manufacturers of ERW pipes in India. The company is engaged in manufacturing ERW black pipes and tubes, ERW galvanised steel pipes, scaffolding pipes & tubes, swaged poles, structural steel products and hollow sections.

Demand for ERW pipes in India is growing by around 8-9% p.a driven by increased spend in Infrastructure (Airports, Metro stations, Skywalks), Automobile, Furniture, Power and Telecom sectors.

Until 2014, RSTL’s entire manufacturing operations were limited to North India, where they have a 60,000 MTPA capacity. Their supplies to the Western and Southern Markets were serviced from Delhi and given the distance, high freight costs formed up to 10% of the net realizations.

KEY DATA

FACE VALUE Rs	5.00
DIVD YIELD %	NA
52 WK HI/LOW	195/98
NSE CODE	RAMASTEEL
BSE CODE	539309
MARKET CAP	RS 305 CRS

SHAREHOLDING PATTERN

PROMOTERS	-	61%
BANKS, MFs & DIIs	-	%
FIIs	-	%
PUBLIC	-	39%

KEY FUNDAMENTALS

YE	FY18	FY19	FY20
Rev Gr%	35	42	30
EBIDTA Gr%	42	44	32
PAT Gr%	68	59	40
EPS Gr%	68	59	40
EPS (Rs)	9.55	15.23	21.35
ROE %	27	32	33
ROCE %	19	23	25
P/E (x)	19	12	8

Hence, RSTL has decided to expand their capacities to other parts of India and set up its first capacity of 72,000 MTPA at Khopoli (near Mumbai) in July 2015 and presently it is on the verge of commissioning their maiden capacity of 36,000 MTPA at Lepakshi near Bengaluru to cater to these regions.

With localized production, margins on the whole are likely to improve. Also, the new capacities have been established for manufacturing pre-galvanized pipes (GP) which enjoy higher EBITDA margins as compared to Black Pipes. Higher revenues from the West and South will help improve blended realisations and margins for the company as the Northern market is the most aggressive in pricing.

Overall Demand for ERW Pipes to grow at healthy pace –

RSTL manufactures ERW pipes ranging from half inch to two and half inches in diameter. Around 60- 70% of their product portfolio is square hollow sections, while 10% comprises of tubular pipes which are used as electricity poles. These pipes find application in Airports, Metro stations, Skywalks, Automobile, Furniture, Power plants and Telecom.

For RSTL around 50% of its production goes to Infra, 30% to Auto and balance 20% is exported. Government capex on infrastructure and power sectors will drive the demand for ERW pipes.

Demand for ERW pipes in India is around 9.5m TPA which is expected to grow by 8-9% every year (in addition to the replacement demand) driven by government capex in infrastructure and power as well as the rising auto demand due to higher disposable incomes. This is expected to lead to a higher demand for ERW pipes in the next 2-3 years.

ERW Pipe Industry in India –

Out of the 10mn tonnes of the Indian steel pipe and tube industry, ERW pipes and tubes form the largest segment with an estimated capacity of around 7mn tonnes. The ERW market is highly fragmented with around 30-40% of the market belonging to un-organized players. Major organized players in the ERW pipes are mentioned below:

APL Apollo Tubes Ltd. (APL)
Tata Pipes Ltd.
Jindal Group (Maharashtra Seamless Ltd., Jindal Pipes, Jindal Industries Ltd.)
Surya Roshini Ltd.
Ratnamani Metals & Tubes Ltd.
Swastik Pipe
Rama Steel Tubes Ltd.
Hi-Tech Pipes Ltd.
Goodluck India Ltd.
Welspun Corp

ERW steel pipe industry is largely dependent on the investment across sectors like residential and non-residential construction, urbanization, consumer goods manufacturer, infrastructure, automobiles and agriculture spending etc. And that is the main reason why the ERW pipe industry has maintained a positive growth rate despite the slowdown in the economy in the past. The investment in the infrastructure projects will be the demand drivers for the ERW steel pipe and tube market in India.

According to Global Industry Analysts Inc. report the global market of ERW pipes is estimated at 86.5mn tonnes by 2022. Asia Pacific region is expected to be the dominant force with 60.8% market share. Moreover, the region is also forecasted to lead the projected growth rate with 7.1% CAGR.

India will be the fastest growing market mainly due the emphasis on various initiatives such as Smart City project, improvement and expansion in the water and gas distribution system, low housing schemes, improving transportation system, expansion on the electricity capacity (namely solar capacity) and creation of modern infrastructures like malls, airports etc

Going ahead we believe that key demand drivers for ERW Pipes will come from the following sectors –

Construction & Infrastructure –

Steel pipes find a significant usage in the construction industry, where it is used in a variety of applications such as support structure, conduit, fencing, railing, etc. India needs around Rs. 65tn investment in the infrastructure over the 12th five year plan.

Infrastructure expansion is needed in all areas such as roads, ports, airports, metro rails, solar power plants etc. These are likely to create increased construction demand and this coupled with “Make in India” initiatives, which will boost the demand of ERW steel pipes in India.

Smart Cities and AMRUT Program –

The government of India has planned to construct 100 smart cities by 2020, whereby it has allotted Rs. 1bn for each smart city for a period of five years. The smart cities mission will also look at optimizing basic core infrastructure services such as clean drinking water supply, affordable housing etc.

Further, in order to provide basic services (e.g. water supply, sewerage, urban transport) to households in both urban and rural areas, the government has come out with a program named “Atal Mission for Rejuvenation and Urban Transformation“(AMRUT). One of the key purposes of this program is to provide each and every household with assured water supply and sewerage connection.

The total outlay for AMRUT is Rs. 500bn for five years from FY16 to FY20. The advantage of ERW pipes and tube in the household application is that it is cost effective. Thus the increased penetration of ERW pipes and replacement of the wood with steel pipes will increase the demand of ERW pipes and tube.

GST will also be beneficial for organised sector players here –

Within the ERW Pipe segment, the un-organized players accounts for 30-40% of the total ERW pipe market. With the implementation of the GST, these players will have the only option to move to the organized market. Being a producer of low quality product and at higher cost, most of the unorganized players will not be able to sustain the competition from the organized market. Thus it is very much likely that most of these players will vanish over a period, which will be beneficial for the organized players.

Due to lack of scale, the unorgainsed sector has to procure their steel requirements from distributors of steel mills, which results in higher raw material costs (3-4% higher). Further, the unorganised sector is unable to give credit to buyers versus a 30-45 days credit period offered by the larger players. As a result the organised players are able to increase their share in the market. The Northern markets have been traditionally controlled by smaller unlisted players. Hence post GST, RSTL is likely to be see a healthy uptick in overall volumes.

RSTL is planning to come up with a new plant in South India –

RSTL has planned a huge capacity expansion schedule. Over the next couple of years, it is aiming to increase the production capacity by 2.5x from the current 0.132mn tonnes.

the near term, the company has executed a brownfield capacity expansion project at Khopoli, Maharashtra and which has already started production taking the total capacity at Khopoli to 0.132mn tonnes. The Khopoli plant capacity can maximum go up to 0.3mn tonnes.

RSTL is targeting to replicate the Khopoli expansion strategy at Lepakshi Tubes in Andhra Pradesh. Through Lepakshi, it will enter in the fast growing South India market. The highest permissible capacity at Lepakshi is 0.3mn tonnes. Initially, 0.036mn tonnes and will be starting from Q4 of FY18 onwards.

The management is contemplating a further capacity addition of 60,000 MTPA in Mumbai at a cost of Rs53 crs and 36,000 MTPA in Lepakshi at a cost of Rs 16 crs both of which will come on stream by H2FY19E. This will take the total capacity to 264,000 TPA. All capex will be funded by way of internal accrual and debt.

The Southern market is growing faster than the national average and RSTL expects that it can participate in this growth. The South has a number of small single location mills but they are not able to compete with the larger players due to lower bargaining power with steel suppliers.

Over the last two years, RSTL has managed to move volumes as well as EBITDA/ton sharply upwards as margins in Western India are in double-digits. This is likely to continue going forward as revenues from South begin to flow in and its share of business from the low margin Delhi plant reduces, going forward

RSTL's entry in to Pre Galvanised (GP) pipes to improve profitability ahead –

In FY17, of the total pipe revenues, black pipes accounted for 84% and GI pipes the balance 16%. GI pipes are exported to EU, Africa and some parts of Middle East.

Pre-galvanised pipes (GP) are light in weight, comparatively cheaper and have longer replacement cycle (about 6 months). They are used in furniture, low cost housing, umbrellas etc. The new capacities at Mumbai and Lepakshi will be for pre-galvanized pipes and will enjoy higher margins of 9-9.5% (as compared to 8% on black pipes).

RSTL has strategically decided to sell through its dealer network & not directly to OEMs –

RSTL sells 100% of their products through their dealer network which helps them to keep their debtor days under check. RSTL gives a 25 days dealer credit.

At present RSTL has a network of 200 dealers and distributors in the North and the West and is working on hitting a number of 1000 over the next three years – the primary focus is South and Tamil Nadu.

RSTL has a well diversified product portfolio within its ERW Pipe product basket –

This includes –

ERW Galvanised Steel Pipes & Tubes – Applications in Water pipeline, Tubewells, Gas Pipelines, Oil Pipelines, Cross Country Pipelines

ERW Black Steel Pipes & Tubes – Applications in segments like Road Barriers, Temporary Fencing, Steel Gates and Windows, Horse Riding Fence, Parking Lots, Steel Buildings, Industrial Gates.

Scaffolding Pipes & Tubes – Used in Applications like Handrails, Piling, Sign Poles, Bumpers, Bracings, Towers, Supports, Rollers, Casing

Swaged Poles – Used in Applications like Traffic Lights Poles, Street Light Poles

Structural Steel Products – Used in Applications like Hollow Sections for Real Estate, Automobiles

Hollow Sections – Applications like Furniture, Automobile Chassis, Pallets, Staircases, Hydraulic Platforms, Columns, Trolleys

RSTL's Khopoli and Lepaskhi plants have close proximity to ports and market and cater to demand across Maharashtra, Gujarat, Madhya Pradesh, Andhra Pradesh & Tamil Nadu, Kerala, Karnataka, Goa, Telangana

Additionally RSTL enjoys fungible manufacturing facilities across all its plants which have an added locational advantage

Solid financial performance - topline growth and margin expansion –

We estimate RSTL's earnings to witness a CAGR of 55.-60% plus over FY17-20E.

Over the years, the company has improved its operational performance significantly with its operating margins having remained in a range between 7 to 7.5% since last 2 years. Also it has been able to increase the return on equity to 24% and a ROCE of 17% as on FY17.

At end of FY17, the total debt was Rs54.90 crs and a leverage of 1.47:1 and even though the company is planning expansion of capacities in the next 2-3 years, it will maintain the DER at the same levels.

In fact we expect that by FY20E the ROE to touch 32% from 24% currently while ROCE is also expected to increase to 25% from 17% in FY17.

RSTL has also recently won two new prestigious orders of supply and erection of transmission lines for rural electrification, in its joint venture company - Pir Panchal Construction Private Limited (PPCPL)

These two new orders won by Pir Panchal Construction Pvt. Ltd. - a joint venture Company of RSTL where in holds a 25% stake in PPCPL are for a orders awarded by Uttarakhand Power Corporation Ltd. and Himachal Pradesh State Electricity Board, amounting to Rs. 288 crs. These orders includes supplying and erecting transmission lines for rural electrification which are to be executed within 24 months.

Business Outlook & Stock Valuation –

On a rough cut basis, in FY18, Topline is expected to touch Rs 350.20 crs.

On the bottomline level we expect the company to record a PAT of Rs 15.20 crs in FY18E. Thus on a conservative basis, RSTL should record a EPS of Rs 9.55 for FY18E. For FY19E and FY20E our expectation is that earnings traction for RSTL would continue to remain strong wherein we expect a EPS of Rs 15 and Rs 21 respectively.

We expect RSTL to grow revenues and profits significantly opver the next 2 years led by a volume increase through its new plants in south and West and North plants wherein EBITDA margins will steadily rise from 7.62% in FY17 to 8.20% by FY20E on the back of better product mix, penetration in new markets and lower freight costs.

RSTL has recorded 14% volume growth in the first quarter and the management is confident to achieve sales volume of around 95000-100000 tonnes in current year. On the commencement of production at the expanded capacities Lepakshi (expected to be operational by Q4FY18) along with higher capacity utilisation rates, we believe that margin expansion will continue.

Also, the commissioning of solar plant at Khopoli has reduced the power cost and thus improving the EBITDA margins. As management focuses on value-added products such as pregalvanised tubes, along with a strategic plan to increase capacity, the number of dealers and the distributor network will not only improve the top-line but also expand overall margins.

RSTL operates in the same segment as per APL Apollo but APL Apollo is much larger in size. APL Apollo is the other listed player operating in the same business but at a much larger scale, however in terms of EPS growth we expect a strong trajectory of over 70-80% in the next 2-3 years as operating profitability is likely to get better as long as product prices remain high and capacity utilization also improves

Hence we believe that at the current price of 181 the RSTL stock looks undervalued at a PE of 12x and 8x based of FY19E and FY20E and should be purchased at the current price for a price target of around Rs 235 over the next 12 to 15 months.

FINANCIALS

For the Year Ended March RsCrs	FY16A	FY17A	FY18E	FY19E	FY20E
Net Sales	241.94	259.72	350.2	500.1	650.4
EBIDTA	14.57	19.8	28.1	40.5	53.33
EBIDTA %	6.02	7.62	8.02	8.10	8.20
Interest	6.18	7.62	8.5	10.1	9.00
Depreciation	2.84	2.91	3.9	4.5	4.8
Non Operational Other Income	3.08	3.84	2.5	2.5	2.5
Profit Before Tax	8.63	13.11	18.2	28.4	42.03
Profit After Tax	6.02	9.06	15.30	24.4	34.20
Diluted EPS (Rs)	3.76	5.66	9.55	15.23	21.35
Equity Capital	8.01	8.01	8.01	8.01	8.01
Reserves	18.25	40.15	55.45	79.65	113.85
Borrowings	54.34	54.9	52.00	47.00	44.00
GrossBlock	17.63	27.50	43.50	58.50	74.50
Investments	0.00	0.00	0.00	0.00	0.00

Source Company our Estimates

KEY CONCERNS

RSTL is largely a converter, the focus is on EBITDA/ton. Any increase or decrease in steel prices is passed on to the customer but with a lag of a month.

Any economic downturn if any will have a direct bearing on capital allocation for future projects and release of funds for on-going project, any drop in key economic ratios curtails the demand for key infrastructure items pipes and also stretches the gap between demand and supply.

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