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INITIATING COVERAGE

Godawari Power and Ispat Ltd

# Backward integration to cushion margins

**CMP:** Rs.105

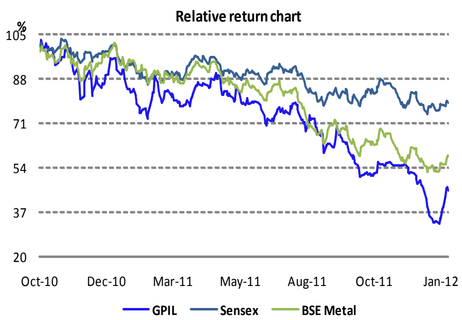
**Target Price:** Rs.134

**Recommendation:** BUY

| Stock Info | |
|---|---|
| BSE Group | B |
| BSE Code | 532734 |
| NSE Symbol | GPIL |
| Bloomberg | GODPI.IN |
| Reuters | GDPI.BO |
| BSE Sensex | 16644 |
| NSE Nifty | 5018 |

| Market Info | |
|---|---|
| Market Capital | ₹ 333cr |
| Equity Capital | ₹ 31.8 cr |
| Avg. Trading Vol. (NSE Qtly) | 15384 |
| 52 Wk High/ Low | 200/70 |
| Face Value | 10 |

| Shareholding Pattern (%) | (31st Dec. 2011) |
|---|---|
| Promoters | 63.7 |
| Domestic Institutions | 7.6 |
| Foreign Institutions | 1.6 |
| Non Promoters Corp. | 5.6 |
| Public & Others | 21.5 |
| Govt. Holdings | - |




January 20, 2012

## Key Investment Positives

- **Integration crucial for margin's sustenance**

  GPIL is one of the few steel producers in India with backward integration into iron ore and met 85% (FY11) of captive iron ore requirement. We estimate company to be the main beneficiary of ongoing mining issues where supplies of iron ore has deteriorated and prices strengthen despite them falling globally.

- **Pellet units to drive profitability going forward**

  GPIL's 0.6mn tonne pellet unit got commissioned during 4QFY10. Initially plant was running at lower utilization levels owing to teething issues, which subsequently got rectified resulting in improved utlisation. We estimate pellet volumes to increase 133% yoy and 14% yoy in FY12E and FY13E. For its 0.6mtpa pellet unit at Ardant Steel (*75% subsidiary),* we expect utilization levels to improve gradually and expect it to reach 35% in FY12E and 90% in FY13E. Accordingly, we are factoring in pellet volume growth of 284% yoy and 157% yoy in FY12E and FY13E at Aradnt steel.

- **Steel business to come back in focus**

  Until now GPIL was able to garner higher EBITDA margins through arbitrage switch between power and steel, as merchant power tariffs were higher and fuel cost lower. With decline in merchant tariffs and substantial jump in fuel cost, merchant power sale has become unprofitable. With revenues from merchant power sales expected to decline, we expect company to once again focus on steel business and expect volumes to improve going forward. We expect steel volumes to increase 5% yoy in FY12E and 3.2% in FY13E, respectively.

- **Valuations:**

  At current market price of Rs 105/share, the stock trades at PE(x) of 2.5x and EV/EBITDA(x) 3.9x times its FY13E EPS and EBITDA, respectively which is at ~35% discount to large steel companies. GPIL's current valuation looks attractive in our view, given its backward integration and increased emphasis on value addition that would help maintain margins even during troubled times. **We initiate on Godawari power and Ispat with buy recommendation and price objective of Rs 134 per share.**

**Financials**

| Y/E March, (₹ in Cr) | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| Net Revenue | 822 | 1116 | 1614 | 1925 |
| EBITDA | 131 | 232 | 223 | 332 |
| PAT | 57 | 86 | 48 | 107 |
| EPS | 21 | 27 | 15 | 34 |
| EPS Growth (%) | (8.2) | 50.1 | (44.1) | 122.8 |
| RONW (%) | 12.1 | 15.6 | 7.5 | 14.9 |
| P/E (x) | 3.9 | 3.1 | 5.5 | 2.5 |
| EV/EBITDA (x) | 6.3 | 4.6 | 5.8 | 3.9 |

*Source: Arihant Research*

*GPIL is an integrated steel producer with captive iron ore mine*

## Company Profile

Godawari Power & Ispat Ltd, a flagship Company of Raipur-based Hira Group of Industries, is an integrated steel manufacturer. The company is mainly engaged in business of manufacturing of sponge Iron, pellets, billets, ferro alloys, mild steel, H.B. Wire. It is backward integrated through captive power units and Iron ore mines. Company's manufacturing facilities are located at Siltara in Raipur district of Chhattisgarh.

| Product | Capacity (tonne) |
|---|---|
| Pellet | 600000 |
| Sponge Iron | 495000 |
| Billet | 400000 |
| MS round | 100000 |
| HB Wire | 150000 |
| Ferro Alloys | 16500 |
| Power (MW) | 76.3 |

| Resources | Mine | Reserves (mn tonne) | Capacity(mn tonne) |
|---|---|---|---|
| Iron ore | Ari Dongri | 7 | 0.6 |
| Iron ore | Boria Tibu | 8 | 0.6 |
| Iron ore | Dhalli Rajhara | 50 | - |
| Coal | Nakia | 63 | - |

*Source: Company. Arihant Research*

*GPIL has ventured into areas like thermal and solar power.*

GPIL has been awarded three iron mines for captive consumption of which Ari Dongri is operational and meets 70-80% of its captive iron ore requirement. Other mine, i.e Boria Tibu, the company is awaiting physical handover from forest department. It has also been awarded prospecting license for Dhalli Rajhara mine, in Durg District of Chhattisgarh and is spread over ~760acres. In case of coal, it has been awarded Nakia coal mine in conjunction with four other players and has 26% stake. Mine is expected to be operational in next two years and will meet requirement of DRI and captive power unit.

### Other operations

GPIL is parent company for its other business' like Ferro alloys, Pellet, Power (thermal + non conventional) and infrastructure. Other than its standalone operations, only Hira ferro alloys (51% stake) and Ardant steel(75% stake) has established operating facilities, while other subsidiaries are in the process of setting up operations and are at various stages of implementation.

| Company | Stake(%) | Location | Operations | Capacity (tonne) | Status |
|---|---|---|---|---|---|
| **Hira Ferro Alloys** | 51 | Raipur | Ferro Alloys | 52,000 | Operational |
| **Ardent Steel** | 75 | Keonjhar | Pellet | 6,00,000 | Operational |
| **Godawari Energy.** | 100 | Raigarh | Thermal Power | 1320MW | Entered into MoU with the Government of Chhattisgarh for setting up a 1320MW Thermal Power Plant at an estimated capex of Rs 7000cr. |
| **Godawari Green Energy** | 100 | Jaisalmer | Solar Power | 50MW | To set up 50MW of solar based power plant by May-13. |
| **Godawari Integrated Steel (SPV)** | 100 | Rajnandgaon | Integrated steel unit | 20,00,000 | The Company has executed a MoU with Government of Chhattisgarh for setting up an integrated steel plant along with captive power units in the state of Chhattisgarh with proposed investment of Rs.5,920cr |

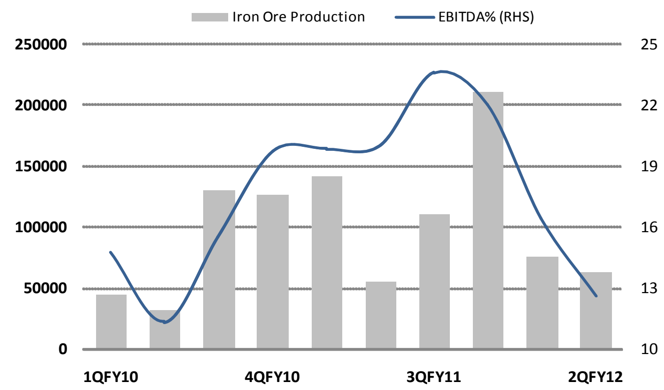
*Source: Company, Arihant Research*

## Investment Arguments:

### Integration crucial for margin's sustenance

*Captive iron ore mine to meets 56% of its requirement in FY12E, followed by 86% in FY13E.*

GPIL is one of the few steel producers with backward integration and has captive Ari Dongri iron ore mine. Mine got operational in 1QFY10 and met 85% of FY11 requirement. In recent times mining operation has got impacted due to mining issues and has resulted into reduced output. Nonetheless, issues have been resolved now and company is expected to mine 0.5mn tonne of iron ore in FY12E.




| Cost Savings-Iron ore | FY12E | FY13E |
|---|---|---|
| Iron ore Requirement | 689286 | 722734 |
| % Captive | *56%* | *86%* |
| Market prices *(Fines+Sized)* | *3800* | *3450* |
| Wtd Avg Cost (Rs/t) | *2565* | *1463* |
| Savings (Rs/t) | 1235 | 987 |
| **Total savings (Rs cr)** | **77** | **72** |

*Source: Company, Arihant Research*

We expect company to achieve ~56% integration level in FY12E, followed by 86% in FY13E. We don't foresee any significant contribution coming in from Bori Tibu mine and expect it to become operational by mid FY13E. We expect company to save Rs 77cr in FY12E and Rs 72cr in FY13E on account of captive iron ore.

**Commencement of Boria Tibu mine to be EBITDA accretive**

GPIL's second iron ore mine, Boria Tibu, has received all environmental clearances and is awaiting physical hand over of the same by forest department. We sense, owing to current issues surrounding the iron ore mining, it will take a while before the mine being handed over to the company. Post this it will take another 4-6 months before commercial production can be started. We expect mine to get operational by mid of FY13E and expect to reach production level of 0.12mn tonne in FY13E, at which it should be able to fulfill ~15% of captive ore requirement.

*Boria Tibu mine to get operational by mid of FY13E.*

**Other resource: Benefits to accrue over long term**

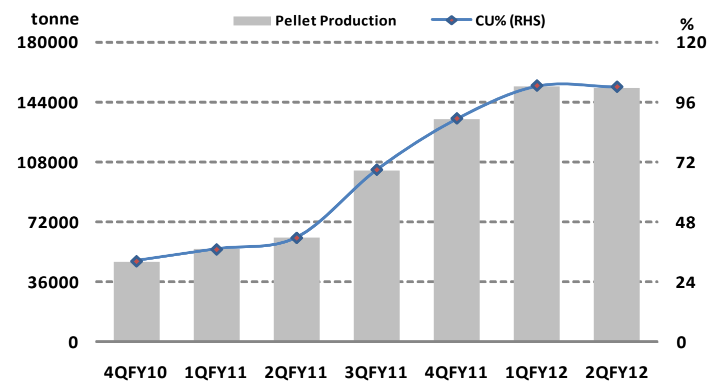
***Dhallia Rajhara iron ore mine****: GPIL has been awarded iron ore mine in Durg district of Chhattisgarh and has estimated 50mn tonne of iron ore reserves. The mine is awaiting forrest and environmental clearance and is expected to become operational in next couple of years.*

***Nakia coal mine****: GPIL has been, in conjunction with other four players, allocated coal mine in Durg district. Company has attributable share (26%) of 63mn tonne (out of 243mn tonne). The coal from the mine will be used to feed its DRI and captive power units. We believe commencement of mine is important for long term profitability as captive coal will bring down overall power generation and DRI production cost.*

**Pellet unit: To drive profitability going forward**

*Pellets to generate saving of Rs 74cr and Rs 75cr in FY12E and FY13E, respectively.*

GPIL's 0.6mn tonne pellet unit got commissioned during 4QFY10. Initially plant was running at lower utilization levels owing to teething issues, which subsequently were rectified resulting into improved utlisation levels *(102% during 1HFY12)*. Company use fines (63 grade) from its Ari Dongri mine and convert it into 64% grade pellets. Fines for pellet unit is sourced from captive mine and outside sources. Pellet produced is first utilised for DRI production with balance being sold in open market. The company uses mix of both pellet (~70%) and lumps (~30%) in DRI production and this enable the company to improve the yield of DRI unit through lower iron ore and coal consumption. We estimate savings to the tune of Rs 74cr and Rs 75cr in FY12E and FY13E, respectively, through use of pellets in DRI production.

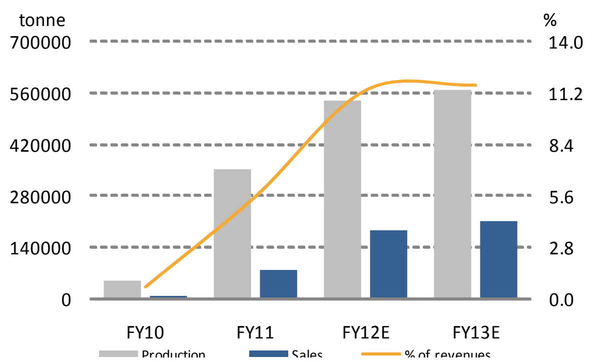



| Pellet Plant | FY12E | FY13E |
|---|---|---|
| DRI Production | *287100* | *316800* |
| Iron ore Required | 536303 | 595584 |
| Pellets | 353960 | 357350 |
| % Share | *66%* | *60%* |
| **CoP Pellets** | **4180** | **4180** |
| **Total Pellet cost** | **7524** | **7524** |
| *Wtd avg Sized ore (Rs/t)** | *5142* | *5070* |
| **Total Sized ore cost** | **10284** | **10141** |
| **Blended Iron ore Cost** | **7699** | **7789** |
| **Total Savings (Rs cr)** | **74** | **75** |

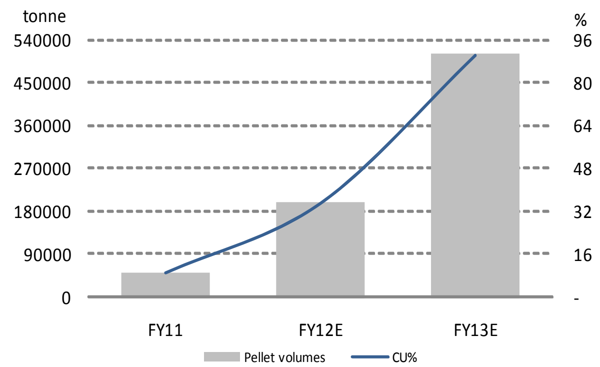
*Source: Company, Arihant Research*

We estimate post commencement of Boria Tibu mine, utilization of lumps in DRI production to increase and will result into higher pellet sales. We estimate pellet volumes increase 133% yoy and 14% yoy in FY12E and FY13E.

**Pellet volume trend (GPIL)**




**Pellet volume trend (Ardant Steel)**




**Pellet capacity to be expanded by 1.2mn tonne**

*GPIL pellet volumes increase 133% yoy and 15% yoy in FY12E and FY13E.*

Post successful commissioning of 0.6mtpa pellet unit, GPIL is expanding its pellet capacity by 1.2mtpa at its existing location. Estimated capex for the project is around Rs 350cr and would be funded through debt and equity mix of 3:1. Project is likely to get commissioned by Oct-13, post which total pellet capacity stands to be increased to 1.8mn tonne i.e an increase of ~70% from current levels.

| Unit | Capacity | Project Cost(Rs cr) | Debt/Equity (x) | Schd commissioning |
|---|---|---|---|---|
| Pellet | 1.2mtpa | 350 | 75:25 | Oct-13 |

*Source: Company, Arihant Research*

The unit will consume fines from captive mines and is contingent upon commissioning of Boria Tibu mine on time. In the interim, the company may resort to buying fines from open market if mine does not start operations on time. Nevertheless, we believe new pellet unit to be EBITDA accretive even on non captive resource base, as we expect prices of lower grade fines to remain weak; due to increased supply post export duty hike, and that of lump ore to remain high due to its scarcity.

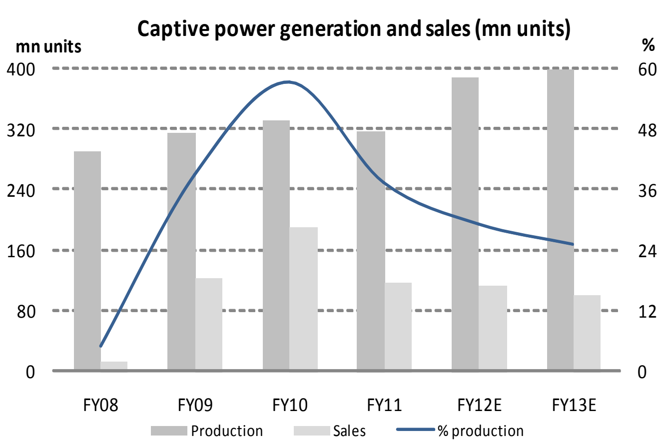
**Ardant Steel: Pellet unit utilization rate to improve going forward**

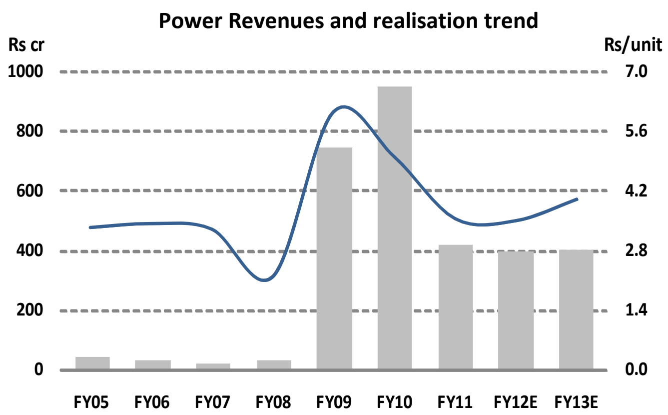
GPIL operates another 0.6mn tonne pellet unit thorough its 75% subsidiary; Ardant Steel at Keonjhar district of Orissa. The unit got commissioned in August-2010. The unit was operating at lower capacity utilizations *(9% in FY11)* due to teething issues. Also in recent times, operations got hampered due to non availability of ore in Orissa. We expect utilization levels to remain subdued at 35% in FY12E before improving to 90% in FY13, as supply situation has improved considerably in last one month. Accordingly, we are factoring in pellet volumes to grow ~4x in FY12E and by ~2.5x in FY13E.

## Captive Power: Higher fuel cost to keep merchant power sale muted

| Unit | Capacity (MW) | Gen Cost (Rs/unit) |
|---|---|---|
| WHRB | 45.3 | 0.45 |
| Thermal | 11 | 3.5 |
| Biomass | 20 | 4.7 |

GPIL has 76MW of captive power unit based on waste heat recovery (45.5MW), coal (11MW) and Bio mass (20MW) modules. In the past the company was able to enjoy arbitrage switch between steel and power as merchant power rates were higher and power generation cost was lower. Last one year has, however, seen this advantage being getting eroded as linkage coal availability has reduced *(thus increase dependence on costlier e-auction and imported coal)*, and both coal and rice husk prices have increased resulting into power generation cost going beyond Rs 4-5/unit from Rs 2-2.5/unit earlier. Also, merchant power rates crashed from a peak of Rs 8 per unit to Rs 3.5-4 per unit in recent times there by reducing the margins. We estimate, share of merchant power in standalone revenues will decrease from 11.4% in FY10 to 2.8% in FY12E and 2.6% in FY13E and expect it to generate revenue of Rs 42cr and Rs 41cr in FY12E and FY13E, respectively.




*Source: Company, Arihant Research*

## Steel Business: Back in focus

*Steel volumes to increase 5.2% yoy and 3.2% yoy during FY12E and FY13E, respectively.*

With revenues from merchant power sales expected to decline, we expect steel volumes to improve going forward. In recent times it has restructured its steel business by merging RR Ispat with itself. The erstwhile RR Ispat had MS coil & CTD bar capacity of 0.1mn tonne and HB wire capacity of 30,000tonne. Post merger, billet capacity now stands at 0.4mtpa, mild steel capacity at 0.1mtpa and HB wire capacity at 0.15mtpa. We expect utilization levels of steel business to increase steadily due to increased integration levels. We expect steel volumes to increase 5.2% yoy and 3.2% yoy in FY12E and FY13E, respectively.

**GPIL-Expected production over FY12E-13E**

| GPIL (tonne) | FY11 | FY12 | FY13 |
|---|---|---|---|
| *Sponge Iron* | *279441* | *287100* | *316800* |
| *Billets* | *85252* | *128000* | *152000* |
| *Wire Rod* | *68297* | *82000* | *83000* |
| *HB Wire* | *77122* | *90000* | *97500* |
| *Pellet* | *354561* | *540000* | *570000* |
| *Ferro Mn* | *5727* | *7425* | *7425* |
| *Power (mn units)* | *318* | *388* | *402* |

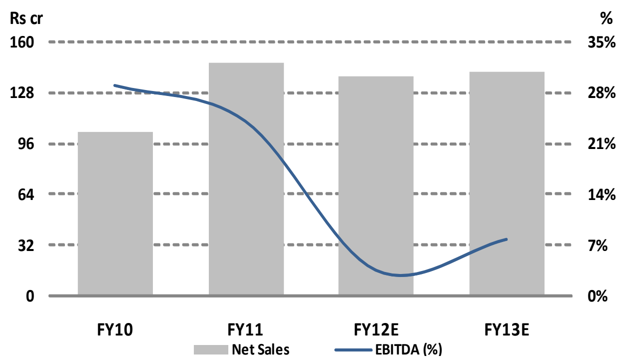
*Source: Company, Arihant Research*

## Hira Ferro alloys (HFAL): Margins to remain suppressed

*Capacity utilization level at ferro chrome division to improve to 53% in FY12E and 55% in FY13E compared to 45% in FY11.*

Hira ferro alloys became a subsidiary (51%) of GPIL posts the merger of Hira Industries *(100% promoter owned)* with GPIL. HFAL has ferro-alloy capacity of 52,200 tpa and 20MW of captive power unit. It also has 1.5MW of wind mill in Tamilnadu, which help it to get tax benefit on renewable energy sources. Recently, HFA in May 2011, has acquired 8.2MW bio-mass power plant *(Rice husk based)* on slump sale basis from M/s Shivalik Power and Steel Pvt Ltd, there by taking its power generation capacity to ~30MW. We believe due to higher rice husk prices, contribution from the unit to be limited and expect 20% PLF for the same. For its 20MW of captive power unit, we don't foresee incremental revenues due lower merchant tariffs and higher power generation cost. With no arbitrage opportunity available between ferro alloys and power sale, we expect utilization level at ferro chrome division to improve to 53% in FY12E and 55% in FY13E compared to 45% in FY11.

**Net sales and EBITDA (%) trend for HFAL**




| Volumes | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| Ferro Alloys (tonne) | 15841 | 20471 | 27389 | 28136 |
| Power (mn units) | 75.4 | 57.3 | 4.9 | 1.8 |

*Source: Company, Arihant Research*

## Future plans:

*GGEL is setting up 50MW of solar power unit at an estimated capex of Rs 800cr.*

**Godawari Green Energy Limited (100% subsidiary):**

GPIL through its 100% subsidiary Godawari green energy limited is setting up 50MW of solar thermal power plant under Jawaharlal Nehru solar mission of government of India. Plant is coming up in Jaisalmer district of Rajasthan with an estimated capex of Rs 800cr and will be funded through debt and equity mix of 70:30. The company has achieved the financial closure for the project and expected to commence operation by May 2013E. The company has entered into long term power purchase agreement with NTPC vidyut vyapar nigam ltd *(subsidiary of NTPC)* at Rs 12.2 per unit and expects to generate IRR of 18-19% on project. Current power generation cost from solar sources is Rs 15-16 per unit, which is well below long term price realisation of Rs 12.2 per unit. However, recent bid rates for solar power projects in India have been quoted as low as Rs 7.5 per unit implying capital cost of Rs 11cr per MW indicating 30% decline from company's implied capital cost of Rs 16cr per MW. We expect technological advantages should bring down the power generation cost going forward. However, we have not factored in any contribution from the project, as we would await further clarity on the same.

| Capacity | Energy source | Location | Project Cost(Rs cr) | Debt/Equity (x) | Financial closure | Schd commissioning | PPA |
|---|---|---|---|---|---|---|---|
| 50MW | Solar | Jaisalmer | 800 | 70:30 | Achieved | May-13 | 25 years |

*Source: Company, Arihant Research*

**Godawari Energy Limited (100% subsidiary):**

*GPIL's other future investment plans includes 1320MW merchant power unit and 2mn tonne integrated steel unit.*

To set up 1320MW thermal power plant in Raigarh district of Chhattisgarh. The company is currently in the process of land acquisition which is expected to be completed by FY12. The company has applied for coal linkages and other regulatory approvals. The project is at initial stages of development thus we are not factoring in any contribution from the same.

**Godawari integrated steel limited (100% subsidiary)**

The company has entered into MoU with the Government of Chhattisgarh for setting up an integrated steel unit at an estimated investment of Rs 5920cr. The project is at initial stages and thus has not factored in any contribution.

| Location | State | Project | Facility | Capacity (mn tonne) | Project Cost (Rs cr) |
|---|---|---|---|---|---|
| **Rajnandgaon** | Chhattisgarh | Green field | DRI | 1 | **5920** |
| | | | PI | 1 | |
| | | | Sinter | 1.5 | |
| | | | Billets | 2 | |
| | | | Rolled steel | 0.5 | |
| | | | Ferro alloys | 0.2 | |
| | | | Calcination | 0.1 | |
| | | | Pellet | 3.5 | |
| | | | Power | 300 | |

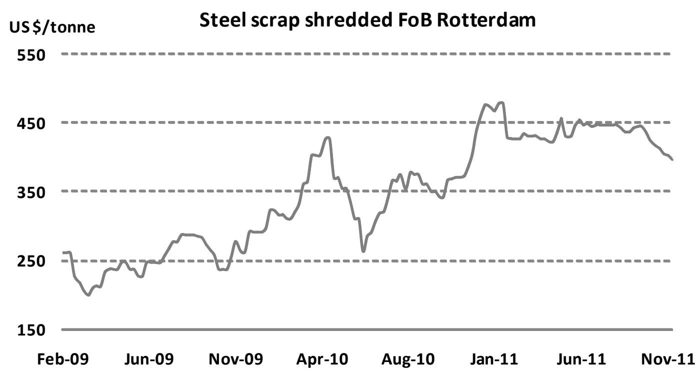
*Source: Company, Arihant Research*

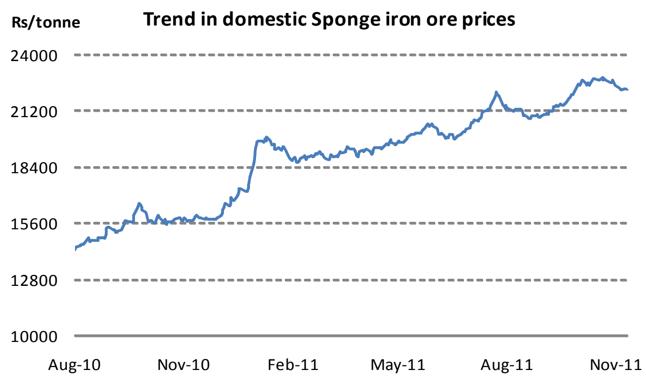
## Industry Scenario

### DRI prices to stay firm

*DRI prices have jumped 40% yoy*

India is the largest producer of sponge iron with annual production capacity of more than 30mn tonnes. Sponge iron finds its application in secondary steel making through EAF/IF route. Over the years the usage of DRI in secondary steel making is on rise due to reduced availability of scrap and its higher prices. Also increased steel making through EAF route *(due to its inherent cost advantage)* has pushed usage of sponge iron. Historically DRI prices have closely followed scrap prices. However recent times have seen trend changing as global scrap price have declined, while domestic sponge iron prices have gone up *(Domestic DRI prices have rose 40% yoy and scrap prices by 8% yoy,)*.Primary reason for higher DRI prices was increased cost of production as thermal coal and iron ore prices have gone up in domestic market resulting into closure of marginal DRI producers. Shortage of iron ore in states like Chhattisgarh and Orissa has further accentuated the problems of DRI producers there by reducing the output and closure in some cases.



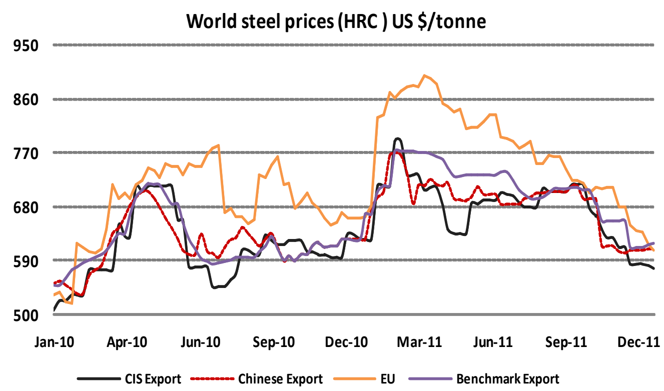



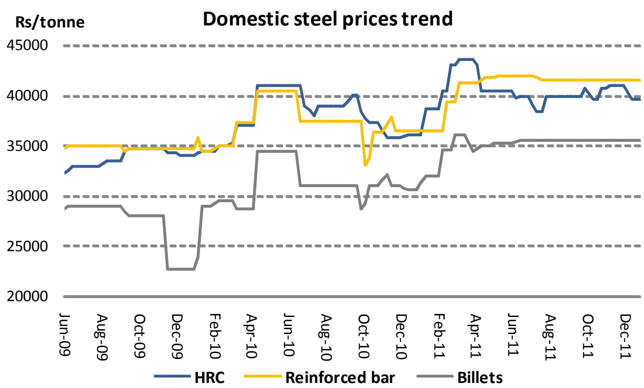

*Source: Bloomberg, Arihant Research*

### Global steel prices correcting……..

*Steel prices have corrected 20-30% globally in last one year.*

Uncertain global economic environment has resulted into decline in steel prices as demand from end user industries has come down considerably. Benchmark export prices have corrected ~20% in last one year. Similarly, CIS and Chinese export prices have corrected between 20-30% in the same period. We also note here that falling prices of raw materials like iron ore and coking coal have also resulted into drop in prices.



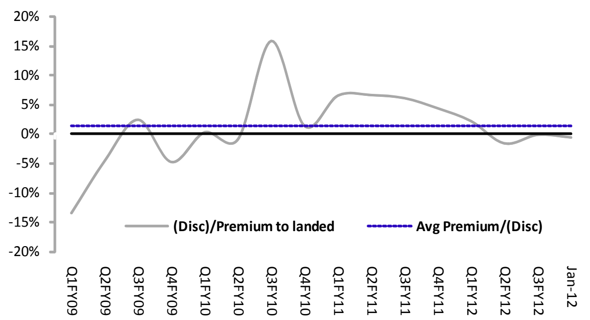

*Source: Bloomberg, Arihant Research*

## …Domestic prices are holding firm on weak rupee

*Domestic steel prices are 5-6% premium to landed prices.*

Steel prices in India; post monsoon season, have inched up as major steel producer have hiked steel prices between 3-4% during October-11. This was despite steel prices falling globally. Pick up in end user consumption and 20% depreciation of rupee has helped domestic steel prices to remain at parity with landed cost.

**Domestic Vs landed steel price movement**



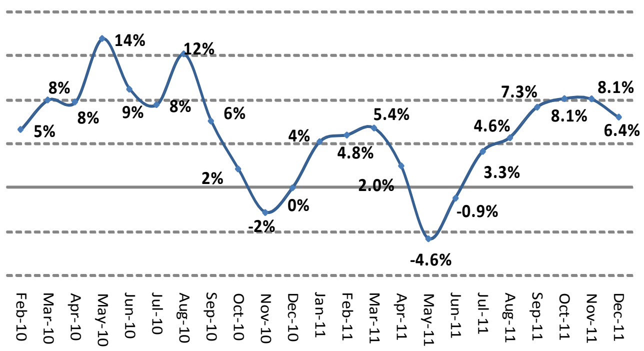

**Rupee-Dollar exchange rate movement**


*Source: Bloomberg, Arihant Research*

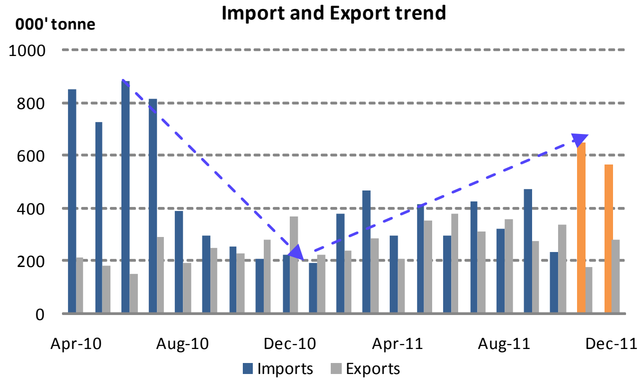
## Domestic demand showing uptick.... ; albeit under the shadows of import threat.

Steel consumption growth in India has been tepid since last one year due to do decline in demand from end consuming sector and grew 0.1% over April-August period. Since then demand has improved considerably partly due to favorable base effect and uptick in demand post monsoon season. Steel demand growth has averaged 7.5% yoy over last four months and has helped prices to stay firm at times when prices have fallen globally. On ytd basis, till December, steel consumption has grown by just 3.3% yoy, while production has gone up by 6.7%. This has resulted into increased export that grew 23% yoy to 2.7mn tonne, while imports declined 21% to 3.7mn tonne during the same period. Though imports have declined considerably over last one year, its pace of deceleration has come down in last two months and they have jumped ~2x on yoy basis and its continued trend could disrupt the demand supply balance and thus prices in domestic market.

**Indian steel consumption growth trend**




**Import and Export trend**



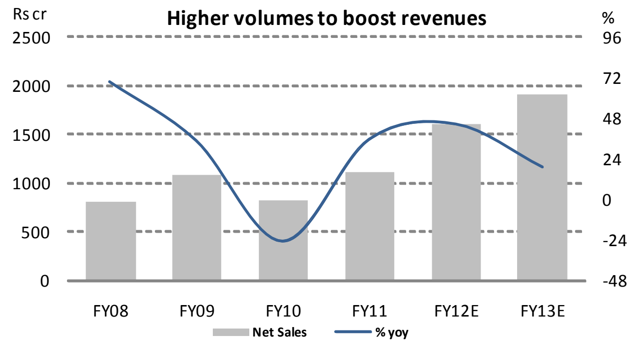

*Source: JPC, Arihant Research*

## Financials

**Net sales to grow at cagr of 31% over FY11-13E**

*Cons. Net sales to grow 45% yoy in FY12E and 19% yoy in FY13E.*

We expect consolidated net sales to grow at cagr of 31% over FY11-13E largely on account of increased steel volumes and increased contribution coming in from pellet unit; both at GPIL and Ardant steel. We expect steel (Billets + Finished steel) to contribute ~55% of standalone net sales and expect contribution from pellet to gradually increase up from 5.6% in FY11 to 12% in FY13E. We however, are factoring in reduced contribution from merchant power sale; i.e from 3.5% in FY11 to 2.6% in FY13E, factoring in higher coal cost and declining merchant tariffs.

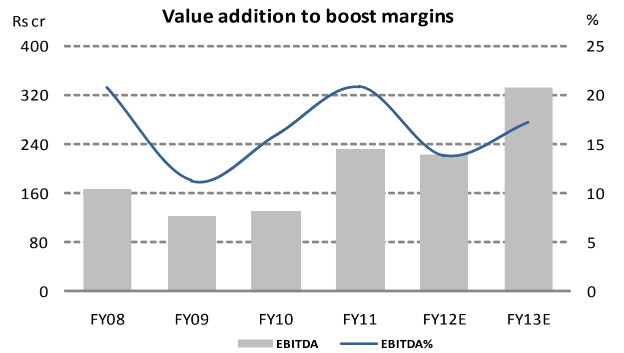



*Source: Company, Arihant Research*

**Margins to decline in FY12E and is expect it to improve there on**

*Margins are likely to come under pressure in FY12E before improving in FY13E.*

We expect EBITDA margins to come under pressure on account of higher raw material cost as captive iron ore mining operations got impacted during FY12E, resulting into increased iron ore sourcing from outside. We are estimating standalone EBITDA margin of 14% in FY12E and 17.6% in FY13E, While EBITDA margins at Ardent Steel to come in at 21% in FY12E and FY13. In case of Hira ferro alloys margins are likely to fall significantly to 3.5% in FY12E and then improve to 7.8% in FY13E, as ferro alloy demand and priced are expected to remain week and power revenues are expected to remain muted over FY11-FY13E. On consolidated basis EBITDA margins to come in at 13.8% and 17.3% in FY12E and FY13E, respectively.

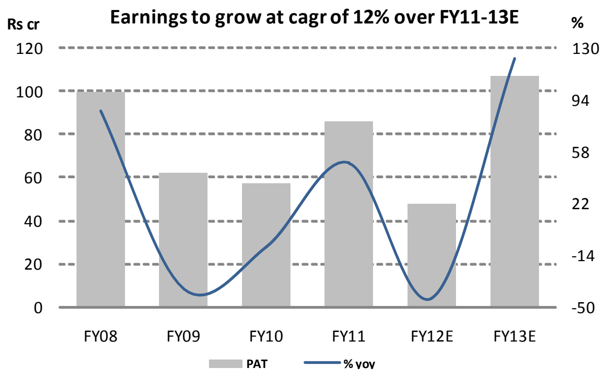


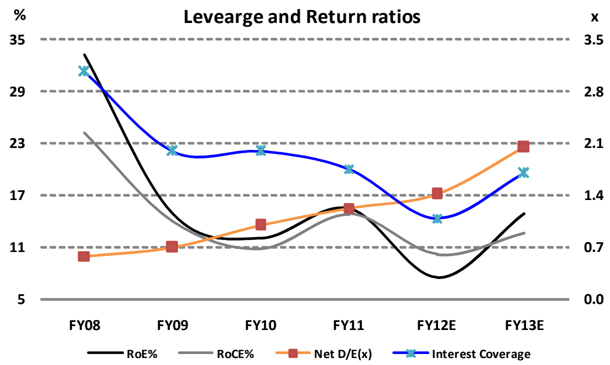

*Source: Company, Arihant Research*

**Earnings to grow at cagr of 12% over FY11-FY13E**

*Cons. net profit to decline 44% yoy in FY12E.*

We expect earnings to remain subdued near term owing to declining margins and higher interest and depreciation cost. Consolidated profit after tax for FY12E is expected to decline by 44% yoy to Rs 48cr followed by 123% yoy growth in FY13E to Rs 107cr, implying consolidated EPS of Rs 15 and Rs 34 during FY12E and FY13E, respectively.




*Source: Company, Arihant Research*

**Return ratios to remain suppressed on higher leverage and lower margins**

GPIL's consolidated Net debt/equity (x) to increase from 1.5x in FY11 to 2.1x in FY13E on account of incremental debt for its 1.2mtpa pellet unit and 50MW of solar power project. GPIL has also undertaken new project which are at very nascent stage of commissioning, any significant improvement on those from could further increase leverage on the balance sheet.

## Important Assumptions

| Sales Volumes | FY11 | FY12E | FY13E |
|---|---|---|---|
| *Sponge Iron* | *184039* | *155798* | *194105* |
| *Billets* | *85251* | *83673* | *84694* |
| *MS Round* | *53018* | *54481* | *53261* |
| *HB Wire* | *76966* | *88235* | *95588* |
| *Pellet* | *79736* | *185933* | *212650* |
| *Pellet (ASL)* | *51937* | *199500* | *513000* |
| *Ferro Alloy* | *5069* | *7425* | *7425* |
| *Ferro Alloy (HFA)* | *20471* | *27389* | *27562* |
| *Power (mn units)* | *118.8* | *119.4* | *102.8* |
| *Power (HFA)* | *57.3* | *4.9* | *1.8* |

| Realisations (Rs/t) | FY11 | FY12E | FY13E |
|---|---|---|---|
| *Sponge Iron* | *16619* | *20182* | *19173* |
| *Billets* | *26485* | *29275* | *27772* |
| *MS Round* | *30038* | *33399* | *30858* |
| *HB Wire* | *31307* | *36071* | *33327* |
| *Pellet* | *7621* | *8200* | *7790* |
| *Pellet (ASL)* | *7545* | *7818* | *7427* |
| *Ferro Alloy* | *53354* | *50145* | *47637* |
| *Ferro Alloy (HFA)* | *60506* | *49614* | *49614* |
| *Power (Rs/unit)* | *3.5* | *3.5* | *4.0* |
| *Power (HFA)* | *3.5* | *3.5* | *4.0* |

*Source: Company, Arihant Research*

## Risk and Concerns

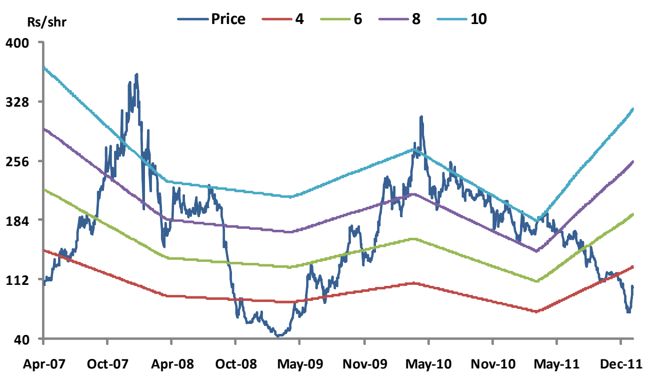
- **Enactment of mines and mineral development act (MMDRA):** Central government cabinet recently cleared new Mines and Mineral development and Regulation (MMDR). Under the bill coal miners would have to pay 26% of the profit to project affected people, while non-coal miners *(iron ore, bauxite, alumina, zinc ore, chrome ore etc)* would now have to pay an amount equal to the royalty they pay to states or 100% royalty to people affected by the project. Though the bill is required to be passed in the parliament and there is no clarity on whether the companies would be given any tax exemptions or any other kind of offsetting, the impact of bill in its current form is likely to be detrimental to the profitability and cost competitiveness of companies.

- **Delay in commencement of Boria-Tibu mine:** We have modeled ~15% integration level from Boria Tibu mine in FY13E. Any significant delay in commissioning of the same would certainly put pressure on margins of the company.

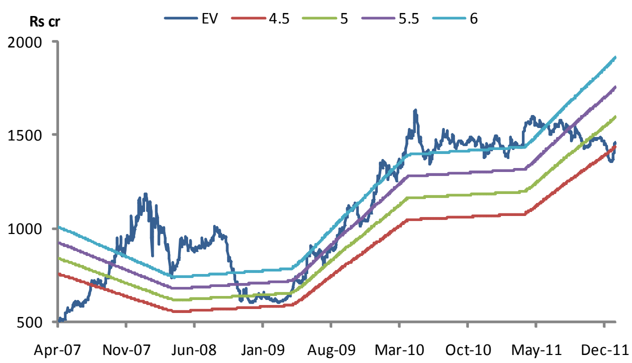
- **Significant drop in steel demand:** Steel demand in India off late has been sluggish owing to reduced demand from construction and Automobile sector. Consumption India has grown by 3.3% during 9mFY12, which is significantly lower than last two years demand growth of 8-10%. Though demand has picked up in last few months it has grown at the back of lower base effect.

## Valuation Bands

*1- Year forward P/E (x) band*




*1-Year forward EV/EBITDA(x) band*




*Source: C-Line, Arihant Research*

### Valuations:

At current market price of Rs 105, the stock trades at PE(x) of 2.5x and EV/EBITDA (x) of 3.9x times its FY13E EPS and EBITDA, respectively, which is at ~35% discount to large steel companies. GPIL's current valuation looks attractive in our view, given its backward integration and increased emphasis on value addition that would help maintain margins even during troubled times. **We initiate on Godawari power and Ispat with buy recommendation and price objective of Rs 134.**

| Company (Rs cr) | FY13E EBITDA | EV/EBITDA(x) | EV(Rs cr) | % Holding | GPIL's Share |
|---|---|---|---|---|---|
| GPIL | 250 | 4.5 | 1125 | 100% | 1125 |
| Hira Ferro Alloys | 11 | 4 | 44 | 51% | 23 |
| Ardant Steel | 77 | 4 | 307 | 75% | 231 |
| **Net Debt (Cons)** | | | | | **951** |
| **Implied Market Cap (Rs cr)** | | | | | **427** |
| **No of Shares (cr)** | | | | | **3.2** |
| **Target price (Rs/share)** | | | | | **134** |

### Peer Comparison Table

| Company | Mkt Cap | EBITDA (%) | | EV/EBITDA (x) | | P/E (x) | | P/B (x) | | RoE (% ) | | RoCE (%) | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Rs cr | FY12 | FY13 | FY12E | FY13E | FY12E | FY13E | FY12E | FY13E | FY12E | FY13E | FY12E | FY13E |
| **GPIL** | **333** | **13.8** | **17.3** | **5.8** | **3.9** | **5.5** | **2.5** | **0.4** | **0.3** | **7.5** | **14.9** | **10.2** | **12.7** |
| **Monnet Ispat** | 2760 | 26.1 | 28.4 | 11.5 | 6.5 | 9.7 | 6.4 | 1.2 | 1.0 | 12.7 | 17.1 | 8.1 | 12.1 |
| **Adhunik Metaliks** | 519 | 23.7 | 29.6 | 9.0 | 6.5 | 8.7 | 3.8 | 0.4 | 0.3 | 4.3 | 8.4 | 7.4 | 9.1 |
| **Sarda Energy *** | 378 | 13.3 | 16.1 | 8.3 | 6.2 | 5.0 | 5.0 | 0.4 | 0.4 | 7.3 | 8.2 | 4.6 | 5.6 |
| **Jai Balaji Ind*** | 200 | 17.2 | 22.3 | 2.7 | 2.0 | 2.4 | 1.2 | 0.4 | 0.3 | 5.6 | 13.5 | 5.3 | 11.2 |
| **Visa Steel** | 632 | 12.2 | 17.4 | 10.4 | 5.5 | 31.1 | 7.1 | 1.8 | 1.5 | 5.7 | 15.6 | 5.2 | 9.9 |
| **Ind Average** | | **17.7** | **21.8** | **7.9** | **5.1** | **10.4** | **4.3** | **0.8** | **0.6** | **7.2** | **13.0** | **6.8** | **10.1** |

**Bloomberg estimates*

| Profit & Loss Statement (Consolidated) | | | | |
|---|---|---|---|---|
| Y/E March (Rs Cr) | FY10 | FY11 | FY12E | FY13E |
| Net Sales | 822 | 1116 | 1614 | 1925 |
| % Chg | (24.7) | 35.7 | 44.6 | 19.2 |
| Total Expenditure | 692 | 884 | 1391 | 1593 |
| % chg | (28.6) | 27.7 | 57.4 | 14.5 |
| EBITDA | 131 | 232 | 223 | 332 |
| EBITDA Margin % | 16 | 21 | 13.8 | 17.3 |
| Other Income | 4 | 15 | 16 | 12 |
| Depreciation | 34 | 55 | 67 | 73 |
| EBIT | 100 | 192 | 172 | 272 |
| Interest | 34 | 73 | 105 | 107 |
| PBT bfr excep Items | 67 | 119 | 67 | 165 |
| Exceptional Items | - | - | 12.0 | - |
| PBT after EI | 67 | 119 | 55 | 165 |
| Tax Provisions | 11 | 20 | 9 | 50 |
| Reported PAT | 57 | 86 | 48 | 107 |
| Adj PAT Margins (%) | 7 | 8 | 3 | 6 |

| Cash Flow Statement (Consolidated) | | | | |
|---|---|---|---|---|
| Y/E March (Rs Cr) | FY10 | FY11 | FY12E | FY13E |
| Profit before tax | 67 | 119 | 55 | 165 |
| Oper. Profit Before Work. Cap. | 134 | 237 | 211 | 332 |
| Changes in WC | (23) | (174) | (60) | 78 |
| Net Cash From Oper. Act | 101 | 44 | 142 | 361 |
| Net Cash From Investing Act | (250) | (241) | (257) | (876) |
| Cash flow from Financing Act | 125 | 312 | 105 | 429 |
| Net increase in cash & Equiv | (24) | 116 | (10) | (86) |
| Opening Cash Balance | 44 | 20 | 135 | 125 |
| Closing Cash Balance | 20 | 135 | 125 | 40 |

| Balance sheet (Consolidated) | | | | |
|---|---|---|---|---|
| Y/E March (Rs Cr) | FY10 | FY11 | FY12E | FY13E |
| Equity Capital | 27 | 32 | 32 | 32 |
| Reserve & Surplus | 471 | 573 | 638 | 734 |
| Total Loans | 518 | 884 | 1065 | 1595 |
| Minority Interest | 10 | 76 | 77 | 103 |
| Deferred tax | 1 | -5 | -5 | -5 |
| Total Liabilities | 1027 | 1560 | 1806 | 2458 |
| Gross Block | 752 | 1172 | 1218 | 1319 |
| Less Acc. Depreciation | 122 | 202 | 268 | 341 |
| Net Block | 630 | 971 | 950 | 978 |
| CWP | 194 | 94 | 322 | 1109 |
| Investments | 12 | 22 | 23 | 23 |
| Net Current Assets | 188 | 474 | 511 | 347 |
| Misc Exp | 0 | 0 | 0 | 0 |
| Total Asset | 1027 | 1560 | 1806 | 2458 |

| Key Ratios (Consolidated) | | | | |
|---|---|---|---|---|
| Y/E March ( Rs Cr) | FY10 | FY11E | FY12E | FY13E |
| Per Share data (Rs) | | | | |
| EPS | 21.2 | 27.0 | 15.1 | 33.7 |
| Cash EPS | 33.9 | 44.5 | 36.3 | 56.6 |
| DPS | 2.5 | 2.7 | 2.9 | 2.9 |
| Book value | 185 | 190 | 211 | 241 |
| Operating, Returns Ratio | | | | |
| Debt/ Equity (X) | 1.0 | 1.5 | 1.6 | 2.1 |
| Current Ratio (X) | 3.5 | 5.7 | 3.9 | 2.7 |
| RoE (%) | 12.1 | 15.6 | 7.5 | 14.9 |
| RoCE (%) | 10.9 | 14.9 | 10.2 | 12.7 |
| Dividend Yield (%) | 3.0 | 3.2 | 3.5 | 3.5 |
| Valuation Ratio (X) | | | | |
| P/E | 3.9 | 3.1 | 5.5 | 2.5 |
| P/BV | 0.4 | 0.4 | 0.4 | 0.3 |
| EV/ Sales | 1.0 | 1.0 | 0.8 | 0.7 |
| EV/EBITDA | 6.4 | 4.7 | 5.8 | 3.9 |

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## Stock Rating Scale

| | Absolute Return |
|---|---|
| BUY | >20 |
| ACCUMULATE | 12-20 |
| HOLD | 5-12 |
| REDUCE | <5 |