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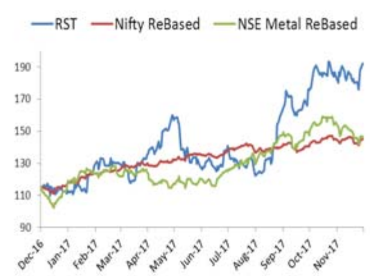
Rama Steel Tubes Limited

11 December 2017

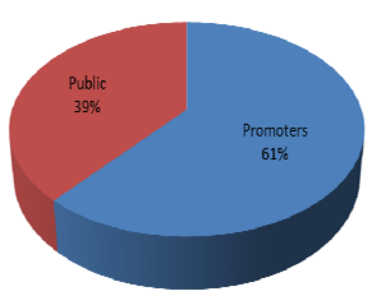
Topline growth and margin accretion to drive value — BUY

Sector	: Steel Tubes/Pipes
Target Price	: Rs 243
Current Market Price	: Rs 192
Market Cap	: Rs 3,257 mn
52-week High/Low	: Rs 193/110
Daily Avg. Volume	: 148,707
Face Value	: Rs 5
Beta	: 0.93
Pledged Shares	: 0%
Year End	: March
BSE Scrip Code	: 539309
NSE Scrip Code	: RAMASTEEL
Bloomberg Code	: RASTL IN
Reuters Code	: RAMA.NS
Nifty	: 10,322
BSE Sensex	: 33,456
Analyst	: Research Team

Price Performance



Shareholding Pattern



Results Update: 2Q FY18

- Rama Steel Tubes (RST) reported net revenues of Rs 906 mn in 2Q FY18, growing by 54% y-o-y and 27% q-o-q
- EBITDA increased 28% y-o-y and 32% q-o-q to Rs 70 mn while EBITDA margin came in at 7.7% compared to 7.4% in 1Q FY18. The marginal improvement in EBITDA margins comes on the back of 220 bps sequential increase in 1Q FY18, mainly contributed by reduced power cost. This reduced power cost is attributable to the commissioning of a solar power plant at Khopoli. According to management, this had helped the company to achieve operational efficiency and increase EBITDA margin by 0.5-0.7% in 1Q FY18.
- PBT increased 41% y-o-y and 17% q-o-q to Rs 51 mn.
- The company reported a PAT of Rs 35 mn which represented a 32% y-o-y and 6% q-o-q growth. PAT margin came in at 3.8% compared to 4.5% in the previous quarter primarily due to higher tax expenses of Rs 17 mn as against Rs 11 mn in 1Q FY18. EPS for the quarter was reported at Rs 2.06.

Focus on expansion and value-added products to drive growth and margins

RST, through its wholly-owned subsidiary Lepakshi Tubes Private Limited, is setting up a plant at Lepakshi in Anantapur district of Andhra Pradesh. The commencement of production at Lepakshi (expected during 2H FY18) will contribute to the company's topline going forward. With the commissioning of the solar plant at Khopoli in 1Q FY18, the company has achieved reductions in power costs leading to improved EBITDA margins sequentially. Further, as capacity utilisation improves at the new plant in Lepakshi in the medium term, margins are expected to benefit further.

With management focusing on value-added products such as pre-galvanised tubes and looking to expand the distribution network as the new capacity comes on-stream, we expect continued topline growth and margin expansion in the medium term.

Valuation and Recommendation

At current levels, the RST stock trades at a P/E of 23.7x/19.8x FY18e/FY19e EPS. With management's focus on value-added products, increase in sales volume with new capacity coming on-stream and margin accretion over the medium term, we expect the company to report strong results going forward. Based on a P/E multiple of 25x, we value RST at Rs 243 (representing an upside potential of 26%) and assign a **BUY** rating.

Exhibit 1: 2Q FY18 Results Comparison

Rs mn	2Q FY18	1Q FY18	2Q FY17	Q-o-Q	Y-o-Y	FY17
Gross Revenue	**906**	**770**	**651**	18%	39%	**2,844**
Excise Duty	-	55	63	N/A	N/A	247
Net Revenue	**906**	**715**	**588**	27%	54%	**2,597**
Total Expenditure	837	662	534	26%	57%	2,399
Cost of Raw Materials	702	623	448	13%	57%	1,962
(Increase) / Decrease In Stocks	(12)	(57)	6	-78%	-297%	8
Purchase of Stock-in-Trade	107	52	44	105%	143%	284
Employee Cost	10	10	8	1%	34%	34
Other Expensess	30	33	28	-9%	6%	111
EBITDA (Excl OI)	**70**	**53**	**54**	32%	28%	**198**
EBITDA Margin (%)	*7.7%*	*7.4%*	*9.2%*	*28bps*	*-157bps*	*7.6%*
Depreciation & Amortization	9.0	8.5	6.7	5%	34%	29
EBIT before Other Income	**61**	**44**	**48**	37%	27%	**169**
Other Income	7	14	3	-51%	113%	39
EBIT after Other Income	**68**	**59**	**51**	15%	33%	**208**
Interest Expenses	16	15	15	10%	11%	77
PBT	**51**	**44**	**36**	**17%**	**41%**	**131**
Tax	17	11	10	47%	65%	36
PAT	**35**	**32**	**26**	6%	32%	**95**
PAT Margin (%)	*3.8%*	*4.5%*	*4.4%*	*-73bps*	*-63bps*	*3.6%*
EPS	**2.06**	**1.97**	**1.75**	5%	18%	**6.34**

Notes:

With the introduction of the GST regime, excise duty has been subsumed into GST and consequently no excise duty has been reported for 2Q FY18; the gross revenue for the period is net of GST

Equity capital increased by Rs 3.8 mn during 1Q FY18 upon conversion of share warrants

Source: Company data, Khambatta Research

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Guide to Khambatta's research approach

Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

Stock ratings

Buy recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

Hold recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) between 5% and 15%.

Sell recommendations are expected to improve up to 5% or deteriorate, based on consideration of the fundamental view and the currency impact (where applicable).

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