

KLD mine loss a blessing in disguise; maintain Buy

Kirloskar Ferrous (KFIL) lost M/s Kanhaiyalal Duhderia (KLD mine) in the re-auction to MSPL which won the mine at 111% offer price. Earlier KFIL had won the mine at 110% offer price but the auction was revoked and mine was put for re-auction by the auction authorities due to some technical issues in bidding. KFIL was not expected to realise any material savings due to the high offer price paid by it in the auctions and we had infact estimated negative contribution in our calculations (refer our 10 Sep note "[Issues of ore, no more](#)"). We see the losing of KLD mine as a neutral to positive event for KFIL. We now expect savings of Rs250-360mn from the BMM mine which was won by KFIL earlier at 55.5% offer price providing it with 50% captive integration on iron ore. Maintain Buy with TP of Rs140.

- **KLD mine re-auction on technical ground allows KFIL to let go of the mine:** Kirloskar Ferrous (KFIL) lost M/s Kanhaiyalal Duhderia (KLD mine) in the re-auction to MSPL which won the mine at 111% offer price. Earlier KFIL had won the mine at 110% offer price but the auction was revoked and mine was put for re-auction by the auction authorities due to some technical issues in bidding. Our discussion with KFIL management indicated that KFIL decided to not bid further and let go of the mine in the wake of limited benefits beyond a particular bidding price. However, KFIL would continue to pursue mines in forthcoming auctions for long term security and realising savings on value in use basis.
- **Earnings to be impacted positively as KLD mine had negative contribution in our calculations due to high offer price:** In our 10 Sep note "[Issues of ore, no more](#)", we had estimated landed cost of ore for KFIL from captive mines and KLD mine was expected to result in higher landed cost thereby resulting in negative contribution of ~Rs200/t due to its high offer price. On the other hand, BMM mine (won at 55.5% offer price) was expected to provide savings of Rs800-1200/t. With negative contribution from KLD mine removed, we now expect annual savings of Rs250-360mn from the BMM mine providing it with 50% captive integration on iron ore. However, we see the positive impact on earnings only from FY21 given the time required for getting clearances and ramp-up in mining post that.
- **Earnings outlook – Strong volume growth in castings and better spreads to support earnings:** Volume growth in castings division remains solid and management remains confident of achieving 25%+ volume CAGR over FY18-20E. This is led by strong end-user demand and addition of new customers coupled with more products being supplied for existing customers. Management indicated that cost structure has improved in Q2FY19 led by better spreads in pig iron business and restart of captive power plants (associated with BF). As guided by the management in its recent analyst meet, the cost saving projects of coke oven & PCI are now on track after facing delays and would be commissioned by Q4FY20. Our earnings estimates of FY19E/20E remain unchanged as we expect positive contribution of iron ore mine to start only from FY21E.
- **Valuation and risks – maintain Buy:** We see iron ore mine acquisition as a long term positive event and with 50% integration achieved at attractive cost metrics, we expect significant savings in iron ore cost from FY21E. We expect KFIL to deliver strong earnings growth during FY18-20E, led by volume CAGR of 20% in the castings business coupled with cost efficiencies and operating leverage leading to higher margins and improvement in return ratios. We value KFIL using our conservative five-year AOCF/EV yield methodology to arrive at our TP of Rs140. Maintain Buy. Key risks are lower volumes and raw material volatility.

Target Price	Rs140	Key Data	
CMP*	Rs98.5	Bloomberg Code	KKF IN
Upside	42.1%	Curr Shares O/S (mn)	137.3
Previous Target	Rs140	Diluted Shares O/S(mn)	137.3
Previous Rating	Buy	Mkt Cap (Rsbn/USDmn)	13.8/192.4
Price Performance (%)*		52 Wk H / L (Rs)	121.9/72
	1M 6M 1Yr	5 Year H / L (Rs)	121.9/17
KKF IN	16.9 17.5 15.5	Daily Vol. (3M NSE Avg.)	106481
NIFTY	0.1 9.0 12.8		

*as on 12 September 2018; Source: Bloomberg, Centrum Research

Shareholding pattern (%)*

	Jun-18	Mar-18	Dec-17	Sep-17
Promoter	59.6	59.6	59.6	59.6
FII's	0.6	0.6	0.1	0.6
Dom. Inst.	8.3	6.2	4.0	2.6
Public & Others	31.6	33.6	36.3	37.2

Source: BSE, *as on 7 September 2018

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Y/E Mar (Rs mn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adj. PAT	YoY (%)	Adj. EPS (Rs)	RoE (%)	RoCE (%)	PE (x)	EV/EBITDA (x)
FY16	11,139	(18.4)	1,509	13.6	578	17.4	4.2	12.2	11.0	12.5	5.5
FY17	11,327	1.7	1,722	15.2	878	51.9	6.4	16.3	13.1	11.7	6.6
FY18	16,806	48.4	1,098	6.5	380	(56.7)	2.8	6.5	6.0	33.8	12.3
FY19E	19,849	18.1	1,973	9.9	888	133.8	6.5	14.2	12.3	15.5	7.8
FY20E	20,018	0.9	2,773	13.9	1,312	47.7	9.6	18.7	15.1	10.5	5.7

Source: Company, Centrum Research Estimates

In the interest of timeliness, this document is not edited

Centrum Equity Research is available on Bloomberg, Thomson Reuters and FactSet

Appendix A

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Kirloskar Ferrous price chart



Source: Bloomberg, Centrum Research

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		Kirloskar Ferrous
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