Good Luck Steel Tubes

View: Positive

Viewpoint

Charged up with strong vision

CMP: Rs81

Key points

- Good Luck Steel Tubes Ltd (GLSTL), a domestic manufacturer of steel tubes, forgings and structured products, is reaping the benefits of moving up the value chain and expanding its reach to newer industries like auto, railways and power (thermal and solar) among others.
- Given its improving product portfolio and customer base, the company has set out on a phased expansion in all the three business segments and is positioning itself for the pick-up in demand resulting a revival in the economy. It has already doubled its capacity in the auto tubes segment and the next phase of expansion is coming up in the metal structure division (transmission towers, boiler support and solar support structures) with a cumulative investment of close to Rs125 crore. The expansion of its forging unit is scheduled for commissioning in the first half of 2016.
- After a muted financial performance over the recent years (OPM of 6.5-7.5% and negative earnings growth during FY2012-14), GLSTL is expected to register revenues and earnings CAGR of 15% and 39% respectively over FY2014-17. Further, its OPM is expected to expand by 150-200 BPS (by FY2017) due to focus on high-margin products. At the current market price, the stock is trading at an attractive multiple of 3.2x its FY2017E EBITDA. We expect a 20-25% upside from the current levels, valuing the stock at 4.5x its FY2017E EBITDA (broadly in line with three years' average EV/EBITDA of 4.8x).
- **Key risk:** Delay in pick-up in industrial cycle could put severe pressure on the balance sheet as the debt/equity ratio would balloon to 1.8:1 on the back of its expansion plans. Also, the margins are susceptible to volatility in line with sharp movements in raw material prices and consequently would affect its financial performance.

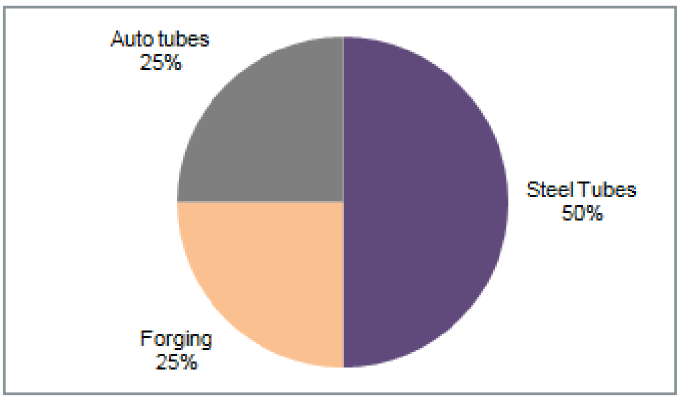
Valuations

Particulars	FY12	FY13	FY14	FY15E	FY16E	FY17E
Revenues (Rs cr)	**691**	**975**	**1,001**	**1,091**	**1,255**	**1,506**
Y-o-Y Growth (%)	*21*	*41*	*3*	*9*	*15*	*20*
EBITDA (Rs cr)	**50**	**72**	**70**	**81**	**99**	**134**
Margin (%)	*7.3*	*7.4*	*7.0*	*7.5*	*7.9*	*8.9*
Reported PAT (Rs cr)	20	22	18	26	31	48
Adj PAT (Rs cr)	**21**	**22**	**18**	**26**	**31**	**48**
Margin (%)	*3.0*	*2.2*	*1.8*	*2.3*	*2.5*	*3.2*
Adj EPS (Rs)	**11.0**	**11.7**	**9.5**	**12.2**	**14.9**	**22.7**
BV(Rs)	52	63	73	81	96	118
P/E (x)	7.6	7.2	8.8	6.9	5.7	3.7
P/B (x)	1.6	1.3	1.1	1.0	0.9	0.7
Ev/EBITDA	8.4	5.9	6.1	5.2	4.3	3.2
D/E (x)	2.3	2.2	1.8	1.7	1.7	1.6
RoE (%)	20.5	18.3	12.1	14.9	15.5	19.3
RoCE (%)	11.9	13.9	11.9	12.2	12.7	14.6

Diversified revenue stream

GLSTL is engaged in the manufacturing of steel tubes, auto tubes and forging products with three manufacturing facilities in India. It offers a wide range of products and has presence across 70 countries (generating 40% export revenues), which mitigates the risk of dependence on particular geography. It also manufactures structured products (customised and high-end technical products) used in oil & gas fields and infrastructure projects, which generate high margins. Its client base includes state governments, Reliance Industries, BHEL, TRF, Ashok Leyland, SML, Gabriel India, Honda, Maruti Suzuki India and Larsen & Toubro among others.

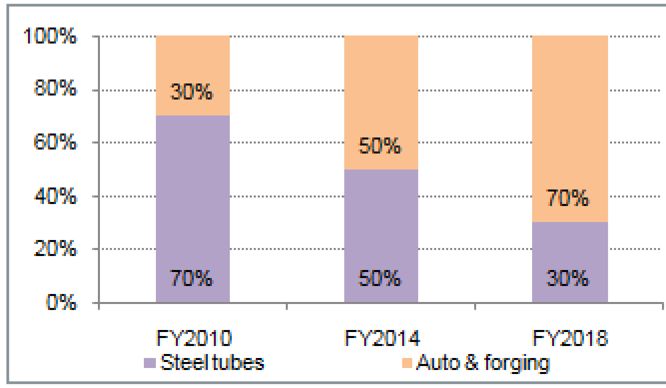
Revenue mix: division-wise (FY14)



Reducing exposure in steel tube business; focus on high-margin verticals

The company's steel tube business, which contributes 50% of the revenues of the company's overall topline, witnessed pressure on volume growth and margins due to slowdown in infrastructure spending, fluctuation in raw material prices and challenging economic environment, which have restricted the overall company's operating profit margin (OPM) to around 6.5-7.5% over the past few years. However, the company has made an effort to reduce its revenue contribution from 70% (FY2010) to 50% (FY2014) and it is further targeting to reduce it upto 25-30% by FY2018. At the same time, it is strengthening its position in other verticals (auto and forging businesses) by increasing the product portfolio to improve the margin profile.

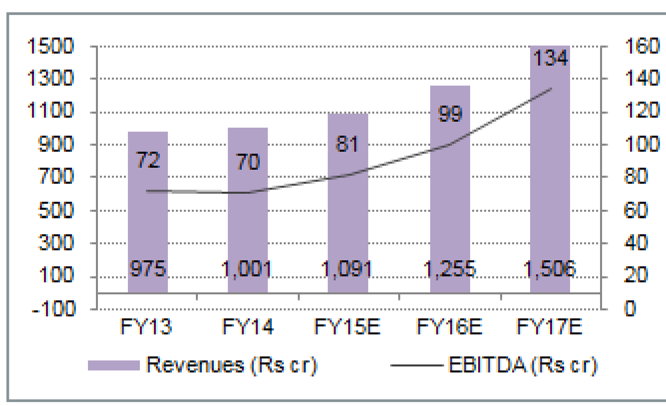
Increasing contribution of high-margin product mix



Capacity expansion in high-margin auto and forging businesses

The company has strategically shifted its focus towards high-margin auto and forging businesses by doubling the capacity in the next two years (it has a total capital expenditure [capex] of Rs200 crore). GLSTL will invest in (1) structured division with a capex of Rs50 crore and (2) Rs100 crore on forging division (both the expansions to be completed by December 2015). During Q3FY2015, it commissioned a new auto tube plant, which has already started yielding revenues. Currently, it is planning to diversify its forging business to cater to defence (gun barrels), aerospace and oil & gas industries. It is continuously monitoring the existing facilities for technical upgradation and modernisation to restructure its product mix for better operating performance. Given the strong client base, revival in auto sector and government's thrust to push infrastructure spending, we expect the company to witness a revenue compounded annual growth rate (CAGR) of 15% during FY2014-17.

Revenue and EBITDA growth trend (Rs cr)



Expansion plan across verticals with EBITDA contribution

Divisions	Capacity utilisation (%)	Installed capacity (FY14 in tonne)	Post expansion (After FY16)	Current order book	EBITDA (%)
Steel tubes	80	9,000	9,000	2 months	5
Forging	80	1,000	2,500	3 months	12
Auto tubes	80-85	30,000	60,000	6 months	13-15

Entry in other verticals with strong intention

It is in the process of getting registered with Indian Railways to offer steel tube fabrication products (coaches, flanges and brakes) in the coming years. It is currently registered with Rail Coach Factory (RCF) Kapurthala and is going to get registered with Integral Coach Factory (ICF) Chennai and Diesel Locomotive Works (DLW) Varanasi for different parts of coaches/bogies used in all trains. In the coming years, it proposes to make under frame, bogie frame, body bolster, front part, head stock and fiat bogie parts. Further, it is also focusing on new structured products for solar business. Recently, it has supplied products to two major solar projects and is already working with big conglomerates such as Lanco Infratech, ABB, Tata Projects, GMR Infrastructure and Rays Power Experts to design the plant as per STAAD calculations and fabricate its supporting structure using square pipes and purlins (Z, C and Sigma) for profile type structure.

Opportunities and outlook: solar, railway projects

Recently two world majors China and Japan have committed investments of USD100 billion and USD35 billion respectively in India, of which 50% is earmarked for Indian Railways. Further, the government has projected to achieve 22,000MW solar power (green energy revolution) by year 2019 with a whopping investment of Rs17,000 crore. We believe the thrust of the government on solar energy initiatives and higher spending on public transportation system (railways) would create a win-win situation for the company.

Detailed of segments

Segments	Products	Clients
Railway	Coaches/bogie, under frame, bogie frame, body bolster, front part, head stock and fiat bogie	RCF Kapurthala and is going to get registered with ICF Chennai, DLW Varanasi and different state governments
Solar	Square pipes and purlins (Z, C and Sigma)	Lanco Infratech, ABB, GMR Infrastruture, Tata Projects, Rays Power Experts, Sterling & Wilson, Alstorm and Larsen & Toubro

Marquee client list; better product mix with strong geographic reach

The company has strong product portfolio across divisions in which it operates. It operates in the USA, Europe, Spain, Germany, Belgium, Latin American and African countries. It is constantly enhancing its product mix by increasing its share of value-added products which not only helps to create a strong brand image but also generates better margin. With a major chunk of customer base across three verticals in 70 countries, it is now ramping up its product portfolio by modifying and developing new products to cater to both domestic and export markets. We believe the company will see strong export revenue traction ahead, given the strong recovery in major developed countries.

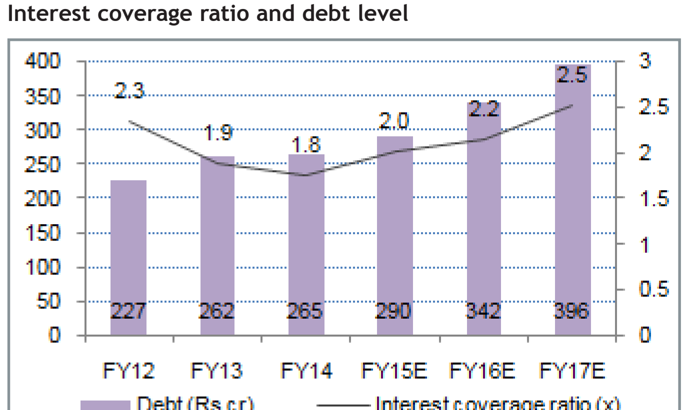
Clients across division

Divisions	Clients
Steel tubes	State governments, SML, TRF, BHEL, Rico Auto, Siemens, Ashok Leyland, etc
Forging	RIL, L&T, BHEL, Engineers India, etc
Auto tubes	Munjal Showa, Bajaj, Gabriel, Honda, Maruti Suzuki, etc

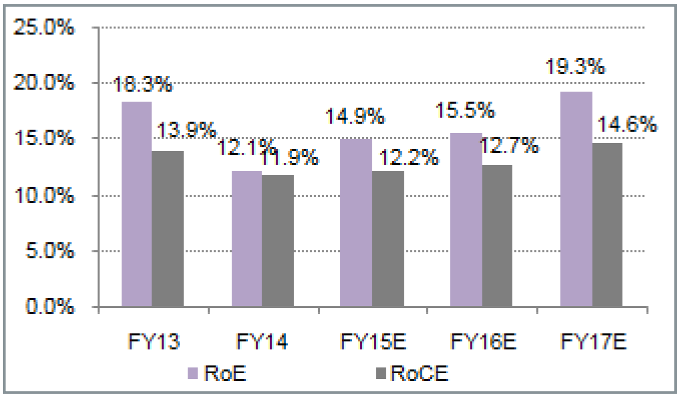
Better margins ahead and return ratios to improve substantially

Though the debt level will remain at a higher level (to fund its existing expansion plan), we believe that a better operating performance and focus on high-margin verticals (structured products, auto tube and forgings) would help to generate better cash flow and margin profile, which would ease the pressure of higher interest outgo in the coming years. We expect the company's OPM to improve by 190 basis points (BPS) by FY2017 while its net earnings are expected to grow at a CAGR of 39% during FY2014-17. Consequently, it will translate into a substantial improvement in return on equity (about 19% by FY2017 from 12% in FY2014).

Interest coverage ratio and debt level



RoE and RoCE trend



Valuation

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About the company

Incorporated in 1986 with headquarters in Ghaziabad, Good Luck Steel Tubes Ltd (GLSTL), a part of Good Luck Group of companies, is engaged in the production and export of black and galvanised pipes and tubes, cold-rolled coils, strips and galvanised sheet roofing sheets, transmission towers, bright bars, industrial forgings & flanges, auto tubes, etc. The products are being used world-wide by end-customers in the automobile, infrastructure, engineering and oil & gas industries. It has diversified business interests in the national and international markets. It has a strong customer base with a diversified product portfolio, catering to various industries at domestic as well as international levels. It operates with three manufacturing facilities and has warehouses in Pune, Nasik, Faridabad, Ludhiana and Chennai.

Business description

Segments	Products	Usage
Steel tubes	Galvanised pipes, welded tubes, hot dip pipes, black pipes	Gas and sewage applications, drinking water supply, oil & petroleum industry, gas industry and hydro industry, transmission of natural gas and heating water
Auto tubes	Seamless tubes, precision tubes, CDW/DOM tubes	Automobile, bicycle, textile, shock absorber industries
Forgings	Forged flanges, weld neck flanges, bright bars	Pipe & fitting, oil & gas and construction industries
Structured products	Fabricated steel structures	Bridges, walkways, girders, rail-over bridges, foot-over bridges, boiler support structures, pipe rack structures, chimney structures and secondary support structures for power, oil & gas, refineries, fertiliser & chemicals and cement industries

Disclaimer

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