

9 April 2007

Sector: Metals



Sanjeev Panda

sanjeev.panda@karvy.com

Adhunik Metaliks (Rs38)

Outperformer

Target Price: Rs45

Integration to ensure better profitability

Adhunik Metaliks Ltd (AML) is a Kolkata based integrated steel company, engaged in manufacturing finished and semi finished steel products. Currently, AML is adding significant capacity and going in for forward as well as backward integration, which will be completed by FY08. On one hand, the company is moving up the value chain with manufacturing value added products (Rolled and Stainless steel); on the other hand, it is going to have better control over raw material through captive mines and captive power plant. We therefore expect net sales to grow at a CAGR of 40% for next three years with better realization and capacity addition. We expect its earnings to grow by 43% CAGR for next three years with improving margin, thanks to backward integration. However, we believe the expected integrated status of AML is not fully priced in the current stock price. Hence, we rate it a Outperformer with 12 month price target of Rs45.

Significant capacity addition: AML is setting up a new rolling mill (capacity of 220,000 MT) and ferro alloy division (capacity of 33,760 MT). It is also adding a Steel Melting Shop (SMS) plant of 156,300 MT. As a result, AML's annual steel production capacity will increase to 406,300 MT by FY08 from the current capacity of 250,000 MT.

Integration in process, better control over value chain: AML is in the process of forward as well as backward integration to increase presence over value chain. As part of forward integration, it is moving up the value chain by adding value added products (Rolled and stainless steel) for better realization. At the same time, it is going for captive iron ore and coal mines and captive power plant. This is likely to insulate AML from raw material price volatility.

Margin expansion: Better realization from value added products coupled with lower raw material cost as a result of backward integration is expected to increase EBITDA margin. We estimate EBITDA margin to be around 21% in FY 09 compared to 16.7% during FY06.

Attractive valuation: We expect AML's bottomline to grow at CAGR of 43% over next three years on a topline CAGR of 40% during the same period. The stock is attractively trading at 3.5x EPS of FY08E and 3.2x EPS of FY09E. It is available at EV/EBIDTA of 4x of FY08E and 3x of FY09E while ROCE is estimated to be above 21% for both the years. We believe the current market price is attractive considering its expected transformation to a fully integrated steel player. Hence, we rate the stock **Outperformer** with a 12 month target price of Rs 45/share, based on 4.5x FY08E EPS.

Adhunik Metaliks		Rsmn	FY2005	FY2006	FY2007E	FY2008E	FY2009E
Reuters/Bloomberg Code	ADME.BO/ADML IN	Net Sales	1,301	4,238	7,461	10,616	11,435
Market Cap. (RsMn)	3,193	EBITDA	156	708	1,226	2,090	2,403
Market cap. (US\$mn)	72	Net Profit	71	338	624	907	990
Shares Outstanding (mn)	91	EPS (Rs)	0.8	3.7	6.8	9.9	10.8
52-week High/Low (Rs)	50/26	EPS Growth (%)	NA	373.2	84.6	45.5	9.1
		EBITDA margin (%)	12.0	16.7	16.4	19.7	21.0
		PER (x)	44.7	9.5	5.1	3.5	3.2
Major Share Holders (%)		P/BV (x)	2.4	1.5	1.1	0.9	0.7
Promoter/Majority	63.9	Price/sales (x)	2.5	0.8	0.4	0.3	0.3
FII's	6.6	EV/EBITDA (x)	26.1	5.9	6.1	4.0	3.0
Banks/Fis/MFs	11.4	Dividend Yield (%)	-	1.4	2.4	3.6	3.9
Others	7.2	ROCE (%)	11.5	20.2	18.0	21.4	21.1
Public	11.1	ROE (%)	13.6	22.8	25.1	28.2	23.9

Source: Company and Karvy Estimates

Investment Positives

Capacity addition; Capacity to almost double in FY08

AML is in the process of a major expansion plan. Post expansion, capacities are going to be almost double. The expansion plan includes setting up a new rolling mill with an annual capacity of 220,000 MT and ferro alloy division with a capacity of 33,760 MT. This also includes addition of a Steel Melting Shop (SMS) with Vacuum Degassing (VD) plant of 156,300 MT which would increase AML's annual steel production capacity to 406,300 MT compared to present 250,000 MT. We believe these capacities would be ready by Q2FY08 and output of these capacities will reflect in FY08.

Exhibit 1: Capacity Addition

Capacities	2006	2007	2008	2009
Sponge Iron	150,000	150,000	150,000	150,000
Additions			-	-
Pig Iron	178,160	185,160	214,000	214,000
Additions		7,000	28,840	-
Sinter Plant	-	-	102,000	102,000
Additions			102,000	-
Ferro Alloys	-	-	32,076	32,076
Additions			32,076	-
SMS	250,000	250,000	406,300	406,300
Additions	-	-	156,300	-
Rolling Mills (unit -I & II)			220,000	220,000
Additions			220,000	-
Stainless Steel			119,000	119,000
Additions			119,000	-
Power Plant		17	35	35
Additions			18	-

Source: Company and KSBL Research

Expansion Plan Cost and Funding

AML has earmarked Rs4,373mn for the expansion plan. This would be funded through a mix of debt, equity and internal accruals. AML had raised Rs1,000mn through IPO during 2006 for the expansion plan. For the same, it has raised debt worth Rs2,843mn from various financial institutions and the rest is funded from internal accruals.

Exhibit 2: Planned Project Cost

Divisions	Rs Mn
Ferro Alloys Division	404.9
SMS - II with VD	806.6
AOD & Concast	307.0
Rolling Mill	771.3
Sinter Plant	64.8
CPP - 2nd	725.1
Oxygen Plant	114.4
Railway Siding	115.0
Captive Iron Ore Mines	82.0
Captive Coal Mines	176.0
General*	806.6
Total	4,373.6

* General expenditure includes interest cost during construction, margin money for working capital, general land and factory space development, preliminary and pre operative expenses etc.

Source: Company and KSBL Research

Exhibit 3: Source of Fund for the expansion

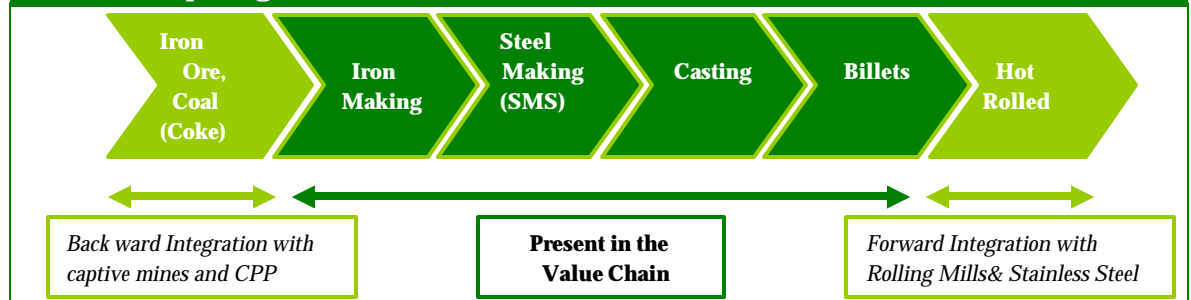
Source of Fund for the expansion	Rs Mn
Equity from IPO	1,000
Internal Accruals	531
Debt (term loan)	2,843
Total	4,374

Source: Company and KSBL Research

Integration in progress; Better control over value chain

AML is in the process of expanding its existing steel manufacturing facilities by way of forward as well as backward integration. As part of forward integration, it is setting up a rolling mill to produce rolled products and going for stainless steel products. Also, it is going for captive iron ore and coal mines and captive power plant.

Exhibit 4: Completing value chain



Source: Company and KSBL Research

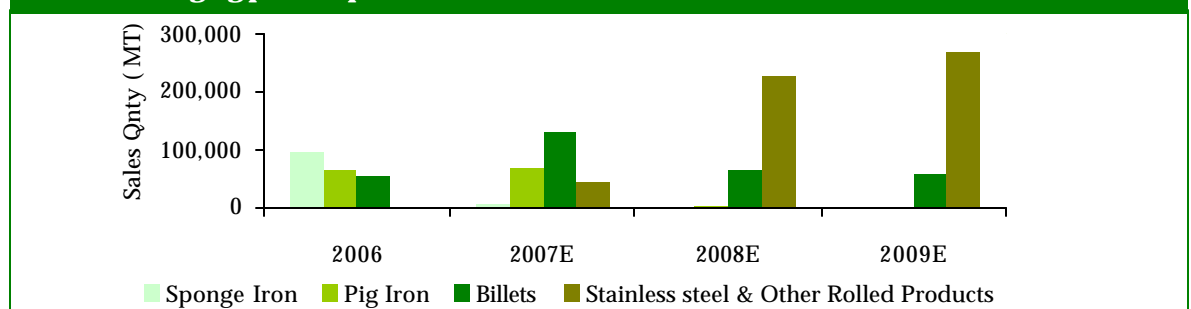
Forward Integration - moving up value chain

As per the forward integration process, AML is moving up the value chain and going to produce value added finished (rolled) products compared to current semi finished products, billets. With this expansion, AML will have in its product portfolio finished specialty steel and alloy steel (also stainless steels) for automotive, engineering and forging applications. This is in line with AML's strategy of supplying raw material to OEMs (Original Equipment Manufactures) in the automotive segment, engineering segment and supplying stainless steel for household and industrial/engineering purpose.

Hence, the product portfolio of AML will skew towards value added rolled products compared to current semi finished products like billets.

In long run, the company aims at supplying specialty steels to high value auto grade steels to auto and forging companies. To pursue this, they are open for inorganic route to foray into forging business.

Exhibit 5: Changing product portfolio



Source: Company, KSBL Research

Backward Integration-Way to cost control

In steel making, raw materials like iron ore and coal constitute a significant portion (around 30%) of total cost of steel companies hence cost control through backward integration is very crucial. Under the current expansion plan, AML is going for backward integration by acquiring ore mines and coal mines, setting up captive power plant (CPP) and laying private railway sliding. These steps would help the company to save cost of raw material leading to margin expansion. This is also expected to insulate AML against volatility of raw material prices and transport cost.

We expect almost all of these expansions (except the CPP-II and captive iron ore mines) would commence from Q1 FY08 making AML a fully integrated steel company. CPP-II is expected to be ready by Q3 FY08 while the captive iron ore mine is likely to get operational from Q2 FY08.

Exhibit 6: Backward integration in progress

Backward Integration Progress	Status	Operational by	Nature	Specification	Location
Iron Ore Mine	Allotted	Q2 FY08	Partly used mines, not virgin	Fe content in excess of 64%	200 km from plant
Coal Mine	Allotted	Q2 FY09	Virgin coal block		230 km from plant
Captive Power Plant-II	In Process	Q3 FY08	Coal based plant	18MW	With in plant
Railway Sliding	In process	Q1 FY08	Private railway lines	NA	Adjacent to plant

Source: Company, KSBL Research

Iron ore mines

AML is allotted iron ore mines at Keonjhar district (200 Km from AML's plant) of Orissa from which it is expected to excavate ore from Q2 FY08. The mine is a partly used mine with estimated reserves of 20mn ton which will be adequate to meet AML's requirement for next 30 years. We estimate due to captive iron ore mine, AML is expected to save Rs 821 per ton during FY08 over FY07 as we expect the mine to be operational from Q2 FY08. In FY09, saving is estimated to the tune of Rs 1079 per ton during FY09 over FY07. This saving is inclusive of lower transport cost (saving due to own rail slide).

Exhibit 7: Savings due to Own Iron Ore mines

Savings due to Own Iron Ore mines	2007E	2008E	2009E
Iron Ore Requirement	545,426	533,054	544,020
Rate (Rs/ton)	2,250	1,429	1,171
Savings Per tonne (Rs)		821	1,079

Non-coking coal mine

As part of it backward integration plan, AML is going for captive non coking coal mine. The company has been allotted coal mine at Talcher district (230 Km from AML's plant) of Orissa in 2006. The coal block is estimated to have reserves of 40 million ton. However, the mine would be shared among other parties. It is expected to start mining from Q2 FY09. We estimate, due to this integration AML is going to save Rs 580 per ton of non coking coal during FY09 over FY07. This gain is inclusive of saving from own railway sliding. However, in FY08, the savings worth Rs 150 per ton would come due to own railway sliding only.

Exhibit 8: Savings due to Own Coal mines

Savings due to own Coal mines	2007E	2008E	2009E
Coal requirement (MT)	270,000	270,000	285,000
Rate (Rs/ton)	1,350	1,200	770
Savings per tonne		150	580

Power

Steel companies being power intensive, usually go for Captive Power Plants (CPP). AML as part of its backward integration is setting up two CPPs, CPP-I with 17 MW and CPP-II with 18MW capacity. The CPP-I, which is part of previous expansion plan is expected to be commissioned by end FY07. The CPP -II is likely to be operational during Q3 FY08. Hence we believe the maximum gain from these power plants will be during FY09 with both the plants getting operational. With CPPs getting operational, the per unit power cost of AML is likely go down to Rs 1.50 in FY08 and Rs 1.17 in FY09 from the current rate of Rs 2.24 per unit. We believe, in FY08 almost 50% of its power requirement is likely to be met from captive generation while 90% during FY09.

Exhibit 9: Power

Power	2007E	2008E	2009E
Power requirement (Mn units)	162	369	404
Rate	2.2	1.5	1.2
Savings per unit		0.7	1.1

Railway Sliding

AML is also setting up own railway sliding near its plant to reduce dependence on external transport system and reduce transportation cost. The railway sliding is expected to be over by end of Q1 FY08. We believe because of the railway sliding, AML raw material costs would be reduced. We estimate total saving due to this is likely to be in the tune of Rs 107 mn in FY08 and Rs 110 mn in FY09.

Exhibit 10: Saving due to railway sliding

Saving due to railway sliding (Rs mn)	2008E	2009E
Saving (Rs mn)	107.2	110.7
Saving as % of net sales	1.2	1.1

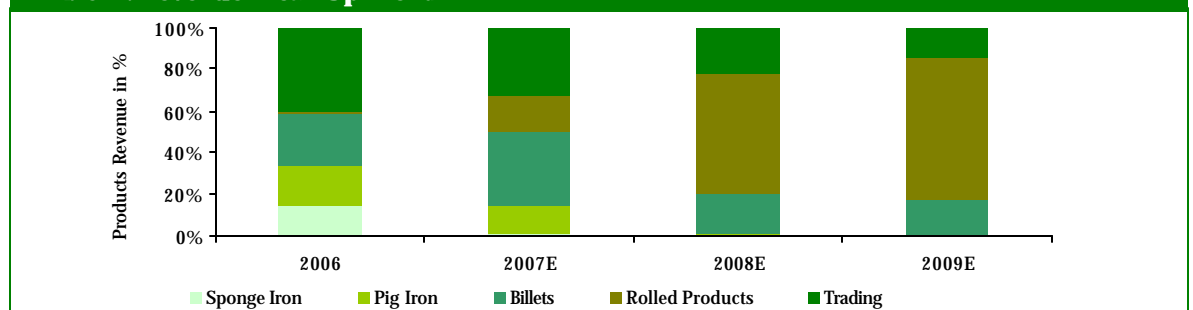
Margin Expansion

As a result of integration coupled with volume growth, we believe AML's EBITDA margin is likely to expand by 326 bps in FY08 over that of FY07 (16%). During FY09, EBITDA margin is likely to expand from 19.7% to 21%, an expansion of 133 bps. Both forward and backward integration are likely to help AML in margin expansion.

Margin improvement with better realization

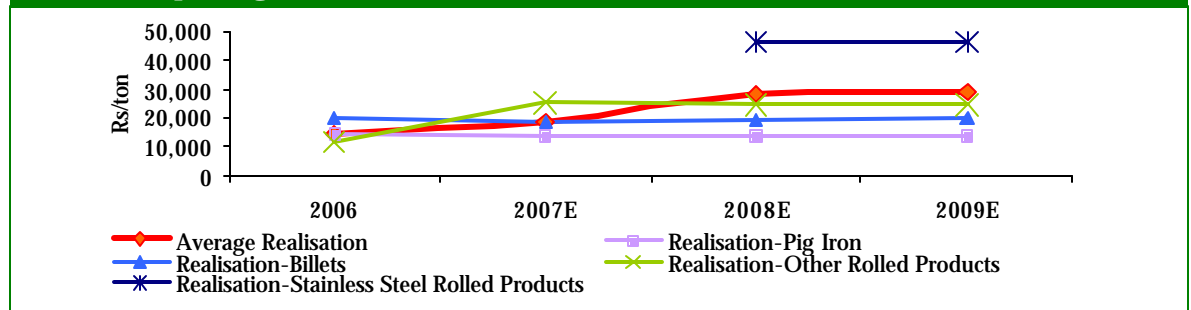
With forward integration, AML is expected to sell more of value added rolling products in future with better realization. We believe during FY09, revenue from value added rolled products are likely to be around 80% (inclusive of 35% of stainless steel) of net manufacturing sales. This will be consequently improving realization driven by higher value added products.

Exhibit 11: Revenue Break Up Trend



Source: Company, KSBL Research

Exhibit 12: Improving Realisation



Source: KSBL Reserach

* The realization is only of manufacturing sales

Margin improvement as lower raw material Cost

At the same time cost savings due to backward integration will be crucial for AML to improve operating margin. We believe raw material cost as percentage of net manufacturing sales is expected to come down from 54% in FY06 to 45% in FY07 and around 43% in FY08 and onwards. This would be on account of cost savings of raw material from backward integration. We estimate due to backward integration, saving in raw material would be around Rs335 mn in FY08, contributing around 4% to bottomline. Like wise, in FY09, we estimate a saving of around Rs 546 mn, contributing to bottomline by 5%.

Exhibit 13: Savings in Raw Material Cost

Savings in Raw Material Cost (Rs mn)	2008E	2009E
Savings in Iron Ore Cost	268.2	353.2
Savings in Coal Cost	40.5	165.2
Savings due to own railway sliding *	26.9	27.8
Total savings	335.6	546.2

* Benefit/saving in coal and iron ore due to own rail slide is not included as that is already considered under respective material headings

** The indicative saving during FY09 is over FY07

The staff cost of AML is estimated to increase (though remain almost same as % of net sales) which will be on account of additional employees (we estimate total staff to be around 1320 till FY09 Vs 378 in FY06) to support the expansion plan. Against these, manufacturing cost as percentage of net sales is likely to go up from current 12% to 22% which will be justified as usually higher power and consumable required for value added products. Put all together, EBITDA margin is likely to expand by more than 400 bps in next 3 years (FY07-FY09).

To fund the on going expansion plan, AML has infused equity capital as well as debt. We estimate AML to add long term debt of around Rs2365mn in FY07 and around Rs745mn in FY08 from various financial institutions. This increasing debt is estimated to push financial cost for FY07 and FY08 to Rs 236mn and Rs673 mn respectively. Going forward in FY09, we believe, AML is likely to repay some part of its debt (Rs 790mn) which may bring down its financial cost to Rs 595mn for FY09.

During next 3 years, AML's depreciation charges are also increasing which can be attributed to gross block addition pertaining to the expansion plan.

We believe AML will continue to pay current tax at Minimum Alternative Tax (MAT) rate for next two years. However, the company is likely to carry higher deferred tax in FY07 and FY08 due to aggressive gross block addition. However, we estimate normal tax rate for FY09.

Taking all into account, we estimate AML to report net profit margin of 8.5% and 9% against current net margin of 8%. We believe during FY08, the margin expansion of 500bps will largely be contributed by EBITDA margin expansion (400 bps) while during FY09, the net margin expansion will be mainly on account of lower financial cost.

UGFL - A Powerful Move

AML has acquired Unistar Galvanising and Fabrication Ltd (UGFL), a Kolkata-based transmission tower manufacturing company, for a consideration of Rs 45 mn. UGFL is engaged in the production of electrical and telecom towers and would be wholly owned subsidiary of AML. UGFL enjoys product approvals from major power and telecommunication players like Power Grid Corporation of India, NTPC, BHEL, Bangladesh Power Development Board, Grid Corporation of India. It has customers like Tata Projects, Tata Power, Cromton Greaves and Areva T&D system.

UGFL has undertaken a capex programme to increase its production capacities and expected to complete expansion plan by March 2007. It has plans to reach production target of 3500 MT per month of transmission towers by December 2007. Its products include transmission towers, galvanized substation / switchyard structures, ground based and roof top galvanized telecom towers, welded structure / masts for Railways and lighting masts, pipe structures, foundation bolts and accessories.

The power sector is poised to grow by leaps and bounds backed by governments program called " Power for all by 2012". We expect AML to take advantage of the opportunity through UGFL.

We see this as a strategic move to transmission business as some of its current products are used as raw material in transmission tower business. We believe this will be a forward moving step for AML which will add value to bottomline going forward. Recently UGFL bagged order worth Rs 530 mn from India Wireless Technology Ltd., (IWT) Mumbai. The order is to manufacture and supply of complete Telecommunication Towers.

Financials

Quarterly Results

Y/E March (Rs mn)	Q3FY06	Q2FY07	Q3FY07	YoY	QoQ	9M FY06	9M FY07	YoY
Net Sales	1,385	1,764	2,006	44.8	113.7	2,391	5,477	129.0
Total Expenditure	1,169	1,453	1,661	42.1	114.3	1,990	4,574	129.8
EBIDTA	216	310	345	59.5	111.1	401	903	125.1
EBITDA Margin	15.6	17.6	17.2	-	-	16.8	16.5	-
Other Income	6.5	15.4	14.9	130.1	96.7	13.1	43.9	236.6
Interest	41.9	59.8	82.3	96.4	137.7	64.9	188.8	190.8
Depreciation	24.0	28.5	28.6	19.4	100.5	43.8	83.8	91.3
PBT	156.8	237.6	248.8	58.7	104.7	305.6	674.7	120.8
Tax	61.2	35.5	47.4	-22.6	133.5	137.5	115.7	-15.8
Tax Rate	39.0	14.9	19.0	-	-	45.0	17.2	-
PAT	95.6	202.1	201.5	110.8	99.7	168.1	558.9	232.4
Net Margin	6.9	11.5	10.0	-	-	7.0	10.2	-

9 Month Results- For the nine-month period, AML's topline witnessed a growth of 129% to Rs 5477 mn as against Rs 2392 mn in 9m FY06. EBITDA grew by 125% in the same period from Rs 401 mn to Rs 903 mn. However, there was a slight decline in EBITDA margin from 16.8% to 16.5%, a dip of 30 bps due to higher raw material cost. In this period, substantial higher interest cost (190%) and depreciation cost (91%) have been witnessed as a result of the expansion plan. AML posted PAT to the tune of Rs 559 mn exhibiting 232% growth over that of 9M FY08 with a net margin expansion of 317 bps. This translates into EPS of Rs6.1 for 9M F07 against Rs2.6 of previous year.

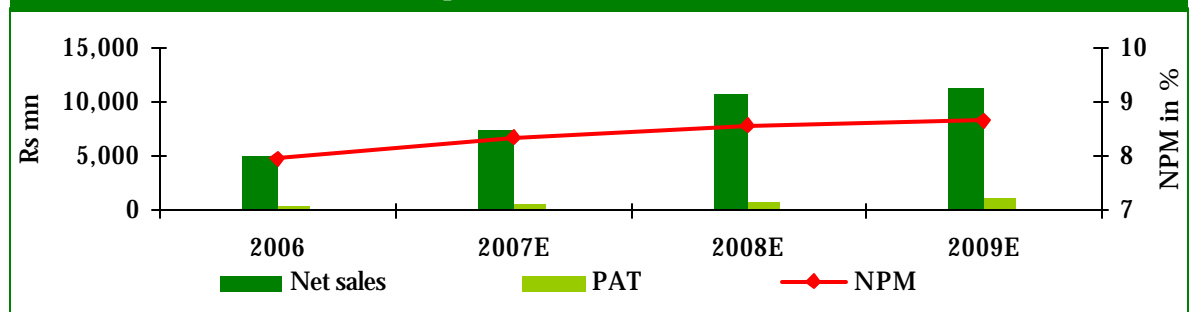
Q3 Results-In Q3 FY07, AML registered a topline growth of 45% over that of Q3 FY06 while EBITDA grew by 60% during the same period. In the third quarter, sequentially net sales grew sharply by 114% due to improved realization. However, EBITDA grew by 111% over previous quarter. EBITDA margin of Q3 FY07 expanded by 58 bps over previous year while sequentially margin contracted by 40 bps. AML posted PAT to the tune of Rs 201 mn exhibiting 111% growth over that of Q3 FY06 with a net margin expansion of 315 bps. However on sequential basis, PAT improved by 100% due to slight dip in margin (40 bps). This translates into EPS of Rs2.21 for Q3 F07 against Rs1.49 of previous year.

Annual Results; Revenue to grow at a CAGR of 40%

We believe AML's topline should grow at a CAGR of 40% over the next 3 years to touch Rs 11635 mn in FY09. As per our estimates AML is likely to report a net sales of around Rs7460 mn during FY07 registering an impressive growth of 76% over that of FY06. Out of this, 56% growth will come from manufacturing sales while rest represents growth in trading sales. We believe primarily this growth will be driven by higher realization (33%) as a result of rolled products (rolled from outside rolling companies, as its own rolling mill is likely to come in FY08). During FY08, manufacturing sales volume is likely to incline by 17%, while trading sales is expected to decline (we see it as a good sign) by 26% during FY08. We expect AML to exhibit 45% higher net sales in FY08 over previous year to touch net sales of around Rs 10616 mn. This would be primarily on account of better realization (50% higher per ton) derived from rolled (value added) products and substantial increase in volume of value added products. We believe most of its expansion will be factored in FY08 and the realization per ton will remain within the same range (from Rolled Products), hence during FY09, AML's top line is likely to exhibit a moderate growth of 8% primarily driven by volume growth with better capacity utilization. We estimate AML's net sales for FY09 at Rs11,435mn.

We believe EBITDA margin of AML is likely to improve from current 17% in FY06 to 21% in FY09. This is expected to be primarily on account of benefit derived from lower raw material cost. However, increasing manufacturing cost and selling & administrative cost are negating some of those benefits. Put all together, EBITDA margin is likely to expand by more than 500 bps in next 3 years (FY07-FY09).

Exhibit 14: Financial Performance Snapshot



Source: Company and KSBL Research

Increasing debt to partly fund the expansion plan is estimated to push financial cost for FY07 and FY08 to Rs 236mn and Rs673 mn respectively. However, we believe, AML may repay some part of its debt (of worth Rs 790mn) in FY09. So, the financial cost is estimated to be around Rs 595 mn in FY09. In line with increasing gross block, AML's depreciation charges are likely to go up. The company is likely to carry higher deferred tax in FY07 and FY08 due to aggressive gross block addition. Taking all into account, we estimate AML to report net profit margin of 8.5% and 9% against current net margin of 8%.

We estimate AML to report net profit of around Rs 907 mn in FY08 and Rs990 mn in FY09, representing a net margin of 8.5% and 9% against current net margin of 8%. This translates to EPS of Rs 6.8, Rs9.9 and Rs10.8 for FY07, FY08 and FY09 respectively.

Valuation

At a current price of Rs38, the stock is attractively trading at 3.5x FY08E and 3.2x FY09E earnings. It's available at EV/EBIDTA of 4x of FY08E and 3x of FY09E. We expect AML's bottomline to grow at CAGR of 43% on a topline CAGR of 40% over the next three years. The valuation looks attractive considering its transformation to a fully integrated steel player. We estimate ROCE is estimated to be above 21% in FY08 and FY09 while ROE for FY08 and FY09 to be around 28% and 25% respectively. Hence we believe that the changing status of AML as an integrated steel player is not fully priced in the current market price of the stock. In addition, going forward with improving EBITDA margin AML deserves a better valuation in the range of its peers. Even the current market price factors just 1.2x to its estimated BV on FY07E and 0.4x to its estimated sales of FY07.

Therefore, we rate the stock **Outperformer** with a 12 month target price of Rs 45/share, based on 4.5x FY08E EPS. The valuation is further supported by attractive P/BV of 1.1x of FY08E. Currently, there is no listed company strictly comparable to AML considering its expected product mix. However, AML could be comparable to Jindal Stainless Steel to some extent as going forward from FY08, more than 35% of AML's revenue is likely to come from Stainless steel business. We are valuing AML at 4.5x of FY08E, which is at a discount to the P/E multiple of 5.5x for Jindal Stainless Steel based on its consensus earnings estimate for FY08E as AML is yet to prove its execution

skills.

Key risks and observations

Our projections factor in savings from captive iron ore mines and non-coking coal mines, which are scheduled to commence operations from 1st July 2007 and 1st April 2008 respectively. Any delay in the commencement of mining could have adverse impact on the financial projections. Moreover, even after getting the iron ore and non-coking coal mines, it will still have to import metallurgical coke (or import coking coal and get it converted into coke in India). Chrome ore, the input required for producing ferro chrome, will also have to be bought from outside. We have assumed that all the phases of the proposed steel plants are executed as per schedule, which may not happen.

Stainless steel business is likely to account for more than 35% of the company's revenue after the proposed expansion is over. The business is vulnerable to the volatile nickel prices. One tonne stainless steel manufacturing standard formula is liquid steel (74%), ferro chrome (18%) and nickel (8%) - some manufacturers may use a slightly different mix. Moreover, even the sales volume of stainless steel industry does not grow very fast as globally the stainless steel consumption accounts for only 2%-3% of total steel consumption. Consequently, global producers do not have the pricing power and low demand means that the low EBIDTA margin can not be offset by increasing sales volume. These are precisely the reasons that so far Tata Steel has resisted getting into the stainless steel business.

Though the Nickel quantity accounts for only 8% of the required quantity of the total raw materials as explained above, it works out to more than 50% in terms of total raw materials cost. In the absence of pricing power, stainless steel producers have struggled to pass on the rising cost of nickel and ferro chrome to the consumer.

Nickel is ruling at \$15,000 or Rs 650,000 per tonne on LME. Even if 8% of that is taken, the cost per tonne of stainless steel comes to Rs 52,000. Basic steel is being sold at Rs 30,000 per tonne and if stainless steel is fetching Rs 85,000 per tonne, then the difference is just enough to cover for the nickel cost. In addition to that, the ferro chrome cost is also to be covered.

The company can claim that instead of using 8% nickel and making stainless steel - 300 series, it can make stainless steel of 200 -series with 0.3% of nickel per tonne of stainless steel (with inferior quality than 300 series) so that the cost of production can be reduced. However, the 200-series can fetch a price of Rs 33,000 per tonne, which is barely in line with the price of the basic steel. So we are not excited about the stainless steel business.

The company had negative cash flow from operations in FY06. We do not know whether the company has been able to reverse the trend of negative cash flow from operations during FY07. However, we have assumed that it will do so in FY08 and FY09, which seems very unlikely at the moment.

The company continues to engage in trading business with low EBIDTA margin, which accounts for more than 25% of its turnover in FY07E. Also, we are assuming that the current steel prices will sustain till FY2009. If we assume lower prices, then it could have an adverse impact even on the EBIDTA margin of steel manufacturing business.

Company Background

Adhunik Metaliks Ltd (AML) is a part of the Adhunik Group, based in Kolkota with presence in Eastern India. The group has been associated with various activities like manufacturing, processing, trading of iron & steel scrap since three decades. AML, the flagship company of the group, is engaged in manufacturing of finished and semi finished steel products. AML was incorporated in 2001 and set up an integrated steel plant at Rourkela, Orissa with signing MoU with Government of Orissa in 2003.

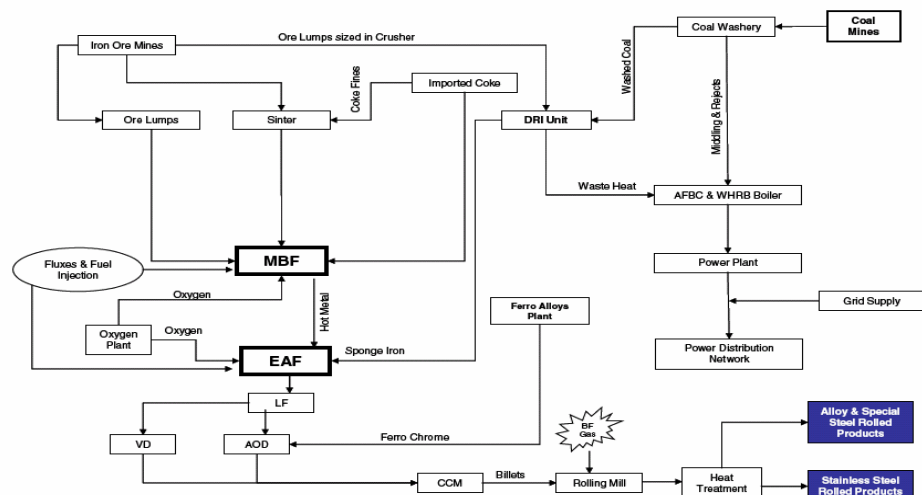
Facilities: The existing facilities located near Rourkela, Orissa is having five DRI units of 100 tpd capacity each in the Sponge Iron Division and one Steel Division, which consists of a Blast Furnace Complex, one Electric Arc Furnace (EAF), one Ladle Refining Furnace and one Billet Caster. The existing plant has been set up in a phased manner. They started operations with Unit I during 2003 and then Unit II was commissioned in the year 2005 and now the Unit III is almost ready as part of the current expansion plan. With this expansion plan, AML will be a fully integrated plant with having control over critical raw material and selling value added products like rolled (Hot Rolled) products.

Process: AML has adopted DRI (DRI - MBF - EAF - LRF - VD / AOD - CCM - RM) route for manufacturing at the integrated plant. AML's operations are ISO 9001 certified.

Product Profile: Adhunik metaliks manufactures a wide variety of Special Steels for several applications in Automobile, construction and Engineering sectors. AML was selling alloy billets and sponge irons but now the products are going to be value added products like stainless steel and alloy rolled products after the on going expansion.

Revenue Break Up: Currently AML's majority of business comes from OEMs that contribute close to 35% of the total revenues. This is followed by automobile contributing 30%, and other steel players contributing 25% and railways contributing 10% of total revenue.

Clientele: AML has entered into Memorandum of Understanding (MoU) with 11 OEMs in the automobile sector for the supply of auto grade special steel and recently entered into several MoU with customers having approvals from leading OEMs in the automobile sector for supply of various grades of special and Alloy steel products. Its clientele includes Jai parabolic Springs, JMT Auto, Coromondel Forge Pvt Ltd etc.



Process flow:

Industry Outlook

Indian steel sector is gaining ground in global arena which reflects in the improving global ranking of India. As per International Iron and Steel Institute (IISI), India's Global ranking in terms of steel crude production has improved consistently from 9th rank in 2004 to 8th in 2005 and 7th rank in 2006.

Indian steel production has reached to 400 mn in 2006 from 100 mn in 1995, registering an impressive growth. We believe the growth will continue backed by enormous expansion plans laid by several companies. In domestic market, consumption is also likely to improve lead by huge infrastructure growth planned ahead in India. A major part of that growth expected to come from India's domestic manufacturing sector, which is estimated to grow at around 11% this year compared to 9% of previous year. We believe this will enhance the domestic steel consumption. However, India's steel industry still has concern for coking coal availability. Currently coal demand has outpaced the production with much high numbers leading to a stretched supply scenario. Coal production has grown at 2 percent annually, but demand from steel companies has outpaced it at 8 percent.

Stainless steel to shine more

As per The International Stainless Steel Forum (ISSF), in 2006 global stainless steel production is expected to touch 27.8 million metric tons (mmt), up 14.3% compared to 2005.

India's stainless steel production has beaten the global growth rates consistently by registering a growth of around 12% against 6% of global growth. Indian per capita consumption of stainless steel is at 1.1 kg which is far lower than China (4.1 kg) and the developed countries (15-20 kg). This suggests about the huge potential to increase the consumption of stainless steel especially with increasing focus on sectors like construction, transport and processing industries. The expanding processing sectors like chemical, petro-chemical, oil and gas, food processing, transport, etc. require a large amount of stainless steel. It is estimated that stainless steel demand in India likely to go up to 1.69mn ton for 2006 - 2007.

Profit & loss statement

Rsmn	FY2005	FY2006	FY2007E	FY2008E	FY2009E
Net Sales	1,301	4,238	7,461	10,616	11,435
% growth	290	226	76	42	8
Raw Material	664	1,176	2,334	3,859	4,535
Purchase of Trading Goods	222	1,601	2,047	1,335	890
Staff	13	38	92	123	133
Manufacturing	107	504	1,282	2,386	2,524
Adm & selling	139	211	480	823	949
Total Expenditure	1,145	3,530	6,235	8,526	9,032
EBITDA	156	708	1,226	2,090	2,403
% growth	86	354	73	70	15
EBITDA margin (%)	12	17	16	20	21
Other income	3	28	51	45	52
Interest	30	115	237	673	596
Gross Profit	129	621	1,041	1,462	1,859
% growth	NA	382	68	40	27
Depreciation	22	69	118	246	378
Profit Before Tax	107	552	923	1,216	1,481
% growth	NA	417	67	32	22
Tax	35	214	299	309	491
Effective tax rate (%)	33	39	32	25	33
Net Profit	71	338	624	907	990
% growth	106	373	85	45	9
Extraordinaries	-	-	-	-	-
Reported Net Profit	71	338	624	907	990
% growth	106	373	85	45	9
EPS (Rs)	1	4	7	10	11
% growth	106	373	85	45	9
DPS (Rs)	-	1	1	1	1
Payout (%)	-	14	12	12	12

Ratios

	FY 2005	FY 2006	FY2007E	FY2008E	FY2009E
ROCE (%)	11	20	18	21	21
ROE (%)	14	23	25	28	24
Debt/Equity (x)	1	1	2	1	1
Interest cover (x)	4	6	5	3	3
Raw Material/Manf Sales (%)	0	54	45	42	44
Staff/Sales (%)	1	1	1	1	1
Others/Sales (%)	19	17	24	30	30
Cost Of Prod/Sales(%)	60	41	50	60	63
Trad sales/ Total Income(%)	NA	43	31	14	9
Trad Mat/Trad Sales(%)	NA	88	89	89	89
Manf Cost /sales(%)	8	12	17	22	22
Admn / Sales(%)	11	5	6	8	8

Balance sheet

Rsmn	FY2005	FY2006	FY2007E	FY2008E	FY2009E
Equity	596	912	912	912	912
Reserves	179	1,278	1,865	2,732	3,710
Net worth	775	2,191	2,778	3,644	4,622
Short-term Loans	124	993	1,350	1,600	1,600
Long-term Loans	816	1,167	3,174	3,668	2,876
Total Loans	940	2,159	4,524	5,268	4,476
Deferred Tax net	52	219	413	583	583
Liabilities	1,767	4,569	7,714	9,495	9,681
Gross Block	540	2,123	3,494	6,711	7,027
Depreciation	31	107	225	471	849
Net Block	509	2,015	3,269	6,239	6,178
Capital work-in-progress	977	479	1,646	804	317
Pre operative Expenses	43	22	71	35	14
Inventories	128	786	1,612	1,812	1,781
Debtors	136	964	2,559	2,454	2,946
Cash	59	1,179	230	141	354
Loans and Advances	180	336	555	817	888
Total Current assets	503	3,266	4,957	5,224	5,969
Creditors	261	1,143	2,114	2,650	2,614
Other current liabilities	2	69	114	157	182
Total current liabilities	264	1,212	2,228	2,807	2,795
Net current assets	240	2,053	2,729	2,417	3,173
Total Assets	1,767	4,569	7,713	9,495	9,681

Cash flow statement

Rsmn	FY2005	FY2006	FY2007E	FY2008E	FY2009E
EBIT	134	639	1,108	1,844	2,025
(Inc./Dec) in working capital	(23)	(694)	(1,624)	223	(544)
Cash flow from operations	111	(55)	(516)	2,067	1,481
Other income	3	28	51	45	52
Depreciation	22	69	118	246	378
Interest paid (-)	(30)	(115)	(237)	(673)	(596)
Tax paid (-)	(30)	(196)	(263)	(267)	(435)
Inc/(dec) in Deferred Tax Liability	27	167	194	170	-
Dividends paid (-)	-	-	(52)	(89)	(129)
Net cash from operations	102	(103)	(704)	1,499	751
Capital Expenditure (-)	(1,113)	(1,085)	(2,539)	(2,375)	171
Net cash after capex	(1,011)	(1,188)	(3,243)	(876)	922
Inc./(Dec.) in short-term borrowing	35	868	357	250	-
Inc./(dec.) in long-term borrowing	632	351	2,007	495	(792)
Inc./(dec.) in borrowings	667	1,220	2,364	744	(792)
Equity issue/(Buyback)	423	1,130	-	-	-
Cash from Financial Activities	1,091	2,350	2,364	744	(792)
Others	(34)	(42)	(70)	42	82
Opening cash	13	59	1,179	230	141
Closing cash	59	1,179	230	141	354
Change in Cash	46	1,120	(949)	(89)	212

Research Desk (Tel: 91-22-22895000)

Hemindra Hazari

Head of Research

hemindra.hazari@karvy.com

Stock Ratings	Absolute Returns	Stock Ratings	Absolute Returns
Buy	: > 25%	Market Performer	: 0 - 15%
Out Performer	: 16 - 25%	Under Performer	: < 0 - (24%)
Sell	: >(25%)		

Standard Disclaimer

The information and views presented in this report are prepared by Karvy Stock Broking Limited. The information contained herein is based on our analysis and up on sources that we consider reliable. We, however, do not vouch for the accuracy or the completeness thereof. This material is for personal information and we are not responsible for any loss incurred based upon it.

The investments discussed or recommended in this report may not be suitable for all investors. Investors must make their own investment decisions based on their specific investment objectives and financial position and using such independent advice, as they believe necessary. While acting upon any information or analysis mentioned in this report, investors may please note that neither Karvy nor any person connected with any associated companies of Karvy accepts any liability arising from the use of this information and views mentioned in this document.

The author, directors and other employees of Karvy and its affiliates may hold long or short positions in the above-mentioned companies from time to time. Every employee of Karvy and its associated companies are required to disclose their individual stock holdings and details of trades, if any, that they undertake. The team rendering corporate analysis and investment recommendations are restricted in purchasing/selling of shares or other securities till such a time this recommendation has either been displayed or has been forwarded to clients of Karvy. All employees are further restricted to place orders only through Karvy Stock Broking Ltd.

Karvy Stock Broking Limited

Regd Off : 46, Road No 4, Street No 1, Banjara Hills, Hyderabad – 500 034. Tel: 040-23351988, 23354283.
