

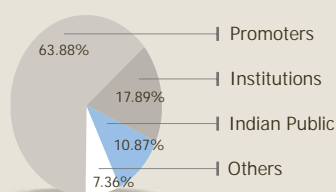
Adhunik Metaliks Limited

BUY | CMP Rs. 34.0 | Target Price Rs. 60.0

Stock Codes

Bloomberg	: ADML.IN
Reuters	: ADME.BO
BSE Code	: 532727
NSE Code	: ADHUNIK
BSE Group	: B1

Share Holdings (as on 31st Dec. 07)



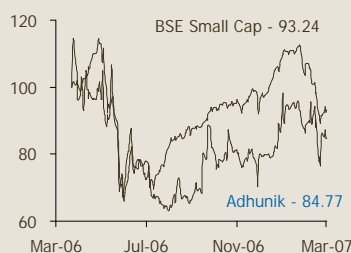
Stock Data

Benchmark	: BSE Small Cap
52 W High Rs.	: 50.0
52 W Low Rs.	: 25.80
Mkt Cap in Crs.	: 313.5
Face Value	: Rs. 10.0

Absolute Return

%	1m	3m	6m
Adhunik	-1.81	6.00	26.02
Benchmark	-14.24	-12.65	-10.52

Price Comparison



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Adhunik Metaliks Limited (AML) is the flagship company of Adhunik Group founded by late Mahadeo Prasad Agarwal. Incorporated in 2001, AML is a fully integrated alloy steel producer with presence in the complete value chain from iron ore and coal mining – to – auto grade alloy steel manufacturer; (capacity 0.25 Mn.tons going to 0.45 Mn. Tons). The company started its operation with trading in steel products and started the manufacturing of steel in the year 2005. The company came out with a public issue in March 2006, at an issue price of Rs 37.00 per share (premium of Rs 10.00) to mobilise Rs 100 crores for part-funding the capacity expansion program.

Valuation Summary

The current stock price of AML does not fully reflect the valuations of an integrated alloy and speciality steel producer. The stock is trading at Rs 35 which is below the IPO price of Rs 37. The benefits of the full capacity expansion are expected to come in the next 12-18 months and it is a good opportunity with a minimum risk of the price going down substantially from these levels. The stock is currently trading at P/E multiple of 4 on its trailing twelve months ended December 2006 earnings. **Even if the stock trades at a P/E multiple of around 4 we expect a FY2009 price of Rs 60.00 (a decent 70% appreciation from the current price of Rs 35).** In terms P/BV the stock is currently trading at a multiple of 1.3 (TTM Dec 2006), a multiple of 0.84 (FY2008) and 0.60 (FY2009). We expect a very limited downside in the stock price from the current levels.

Summary Financials

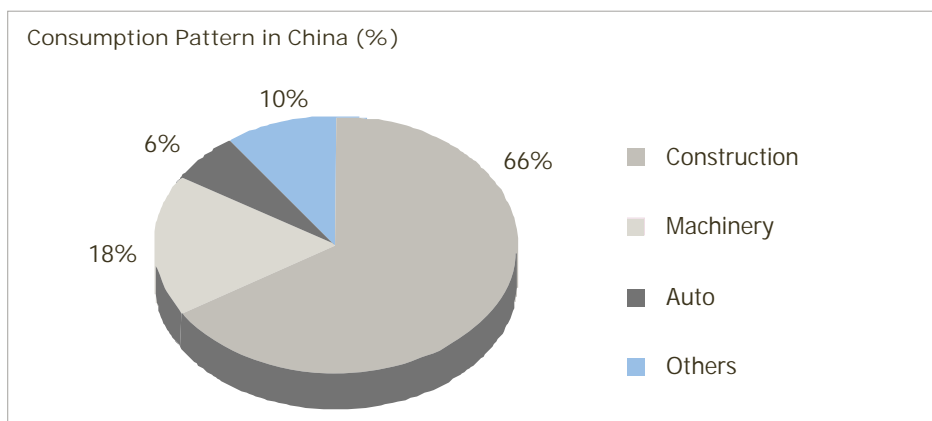
Summary Financials (Rs Crs)	FY06	FY07E	FY08E	FY09E
Net Sales	424.73	794.16	1,140.41	1,199.56
Total EBIDTA	70.41	135.52	264.96	332.70
Operating Margin (%)	16.58	17.06	23.23	27.74
PAT	33.73	65.17	104.73	155.53
EPS (Rs)	3.70	7.14	11.48	17.05
P/E (x)	9.21	4.77	2.97	2.00
EV/EBIDTA (x)	5.58	5.47	3.01	2.00
Market Cap/Sales (x)	0.82	0.43	0.29	0.28
ROCE (%)	14.51	16.54	23.82	28.73
RONW (%)	15.39	22.93	26.92	28.56

Global Steel Industry Outlook

The average international prices of steel, which were \$506 (fob) per ton during 2004-05, are expected to be in the same range during the next two years. Prices are expected to remain stable as the global demand capacity ratio, which was 85.5 % during 2005-06, is expected to remain more or less stable at 86-87 % during the next four years. China-accounting for 31% of the world steel consumption will continue the global demand during 2006-2009. The following factors will have a significant impact on China's demand for steel:

- As per the eleventh five year plan, the national economy is expected to grow at an average annual rate of 7.5% during 2006-10.
- An increase in the urban population and their per capita disposable income.

Steel demand in China is driven by the construction sector, followed by engineering and the auto. Although the growth in the economy is expected to slow down, steel consumption is expected to see healthy growth on the back of buoyant activity in construction, auto and general engineering sectors. These sectors are expected to see a positive growth rate due to factors like increasing urbanisation and growth in disposable incomes, among other things. Over the years, the number of urban households and their disposable incomes has increased. As per the sources, the urban population as a percent of total population is expected to climb to 47% in 2010, from 42% in 2004. This population typically drives the demand for consumer goods and residential houses. To tap this market, auto majors such as General Motors, Toyota, Honda, Hyundai etc are investing in the country.



Regions like NAFTA (North American Free Trade Association) and Europe are other major consumers of steel. As per the report of the IMF (International Monetary Fund), the economies of these regions are expected to grow positively, thereby restricting any negative growth in these countries. Regions like Central and South America and CIS countries have posted a moderate growth in the past, and the continued buoyancy in the economy will continue to keep steel demand steady in those regions. Hence the demand from the rest of the world, excluding China- is expected to grow at a CAGR of 2% (65 million tons) during 2006-09.

Consequently the global demand including China, for crude steel is expected to grow at a CAGR of 4.5% (219 million tons). On the other hand, capacities (235 million tons)

are expected to come up mostly in China and India followed by Brazil and CIS countries, while no major capacities are expected in rest of the world. While India is going to see huge capacity additions, incremental capacity in China is expected to be lesser than incremental demand. China's National Steel Policy may create an environment for the structured growth of the steel industry. During 2005, production cutbacks by major players like Mittal Steel and Bao Steel restricted steel prices from declining sharply. We expect the trend of production cutbacks by producers to continue as the industry becomes more consolidated.

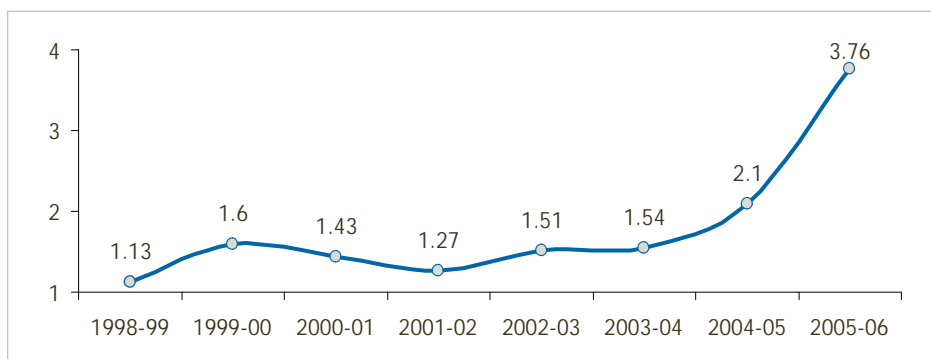
Domestic Steel industry Outlook

The domestic demand for steel is expected to grow at CAGR of 8.42% during 2006-07 to 2010-11 following buoyant activity in pipes and tubes and auto sector. Over the years, India has acquired a large scale globally for its volume sales. In 2004, India was the 12th largest manufacturer of cars and the fifth largest manufacturer of commercial vehicles. It is also the second largest market in terms of sales volume, for two-wheelers and tractors. The overall auto sector is likely to grow at a CAGR of around 11% (volume) over the next five years, though the cyclical changes in some segments, such as commercial vehicles, will continue.

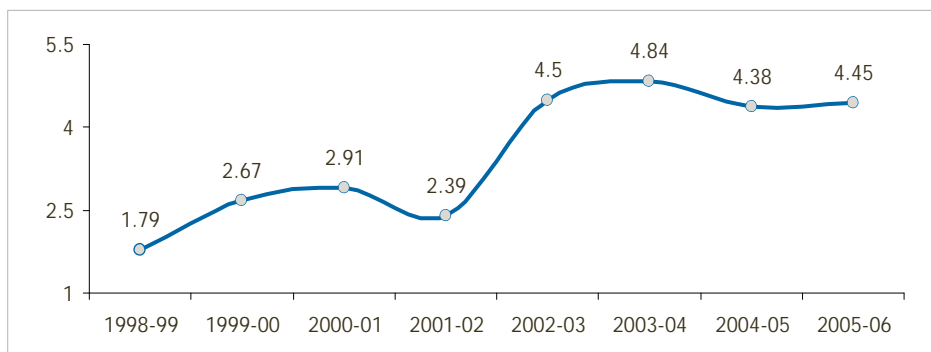
Over the past few years, growth in the automobile industry in developed countries has stagnated. However the sales in the countries like India and China have posted a double digit CAGR due to the strong growth in the IIP and service sector, increase in the working population and higher household incomes and a very low penetration rate. The four-wheeler sales per 1000 persons in India was below 1 and in China was 3.4 in 2004, as compared with 58 in USA and 49 in the UK. Hence, most global OEM (Original Equipment Manufacturers) are focusing on these Asian countries for their growth. Growth is helped along by the fact that these countries are low-cost manufacturing centres with readily available, high quality auto components and low-cost skilled manpower.

There has been a spate of capacity announcements by domestic and foreign companies, largely driven by large opportunities due to growing domestic demand and the availability of rich iron-ore deposits. To retain market shares, the companies had aggressively added capacities. The incremental capacities to the tune of 32 million tons are expected to come up during the next five years, weakening the demand capacity ratio from 80% in 2005-06 to 45-50% in 2008-09. Domestic demand will not be sufficient to absorb the over-supply scenario created by the capacity additions. India imported 3.8 tons of finished steel in 2005-06, the major types of steel that were imported are the steel used in automobiles such as panels, doors for multi-utility vehicles, electrical sheets and tin plates. Some of the capacities planned may be used for the production of these products that are currently imported. India would be able to export the surplus to the regions that are in deficit because of its low cost of production of steel.

India's Imports of Finished Steel (Mn Tonnes)



India's Exports of Finished Steel (Mn Tonnes)



The Market for Auto Grade Special Steel

According to Industrial Development Services Pvt Ltd (IDSPL, New Delhi) estimates, the availability of alloy and special steels in India is likely to fall short of requirements from 2008-09 onwards, though more or less balanced as of now. However India has imported a sizeable quantity of special and alloy steel in the last few years. The gap in domestic availability is likely to increase to almost 1.6-2.0 million tonnes per annum by 2013-14, unless new capacities come up. Iron-ore base units are accounting for an increasing share of domestic production of alloy steels in India during the past few years. The average cost at the liquid metal stage in the case of iron-ore based units is Rs 12000 to Rs14500 per ton as against Rs 17000 to Rs 18000 per ton in the case of scrap-based units. Iron-ore units have thus more flexibility in meeting the possible threat from imports.

The Stainless Steel Industry

Stainless steel is a value added engineering product with high corrosion resistance properties primarily due to the presence of Chromium and other alloying elements like nickel, manganese, molybdenum. It is used in production of utensils, household wares, automobiles, architecture, building, construction, surgical equipment, razor blades, industrial applications, railway wagons etc.

India has outpaced the global growth rates consistently over the last several years against world's average rate of 6%, the Indian production has grown over 16% during the last 15 years. India with an apparent consumption of 1.2 million tonnes is placed 7th in terms of global stainless steel consumption. The growth rate of consumption of stainless steel in India has been at 10-11% over the last decade. 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). Almost 75% of the stainless steel consumption in India is accounted for by the white goods and household goods sector.

There are primarily three distinct grades of stainless steel that are produced in the world, comprising the 200 series, 300 series and 400 series. The following table shows the chemical composition and end uses of different types of stainless steel:

Series	200	300	400
Chemical Composition			
Chromium	10.5% to 20%	15% to 25%	10% to 30%
Manganese	5.5% to 12%	2% maximum	1% maximum
Nickel	1% to 4%	6% to 25%	2% maximum
Iron	Rest	Rest	Rest
Key End Uses	Utensils and Household Wares	Refineries	Razor Blade
	Kitchenware / sinks	Petrochemicals	Exhaust System for automobiles
	Tubes and pipes	Nuclear Applications	Tower packing for petrochemicals
	Architecture / decoratives	Railway Coaches	Coinage
	Automobiles / railways /transport / furniture	Automobiles	Railway Coaches and Wagons
		Potable Water Tubing	Consumer Durables
		Power Plants	

Adhunik Metaliks Ltd

Highlights

- Commenced operations in 2005 with 2.5 Lakh Tons capacity at Rourkela.
- Owning iron ore mines (Keonjhar, Orissa) & Coal mines (Talchar, Orissa).
- Well located plant with availability of logistics to access the market network.
- Availability of cheap power (largely captive).
- Availability of skilled manpower.
- State of the Art technology implementation.
- Competitive cost resulting in insulation from market volatility.
- Emerging presence in Auto Alloy Steel segment.
- Well positioned for being one of the lowest cost producer.
- Strong operational results with consistent track record of profitability.

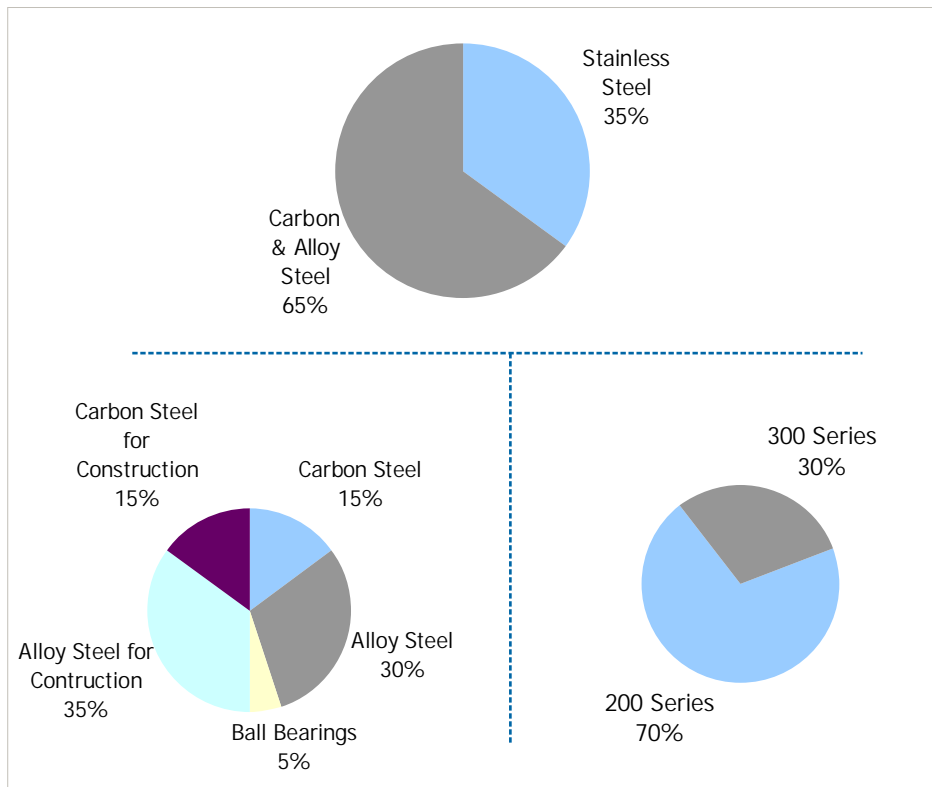
The following table shows the planned capex and the means to finance it:

Particulars	Rs (Crores)	Particulars	Rs (Crores)
Land & Site Development	23.0	Public Issue of Equity Shares	100.0
Internal Accruals	91.0	Internal Accruals	60.0
Plant & Machinery	257.0	Term Loans	277.0
Other Costs	66.0	Total Means of Finance	437.0
Total Project Cost	437.0		

Out of the total capex of Rs 437 crores the, the company has Rs 277 crores of long-term loans. With the interest rates heading north, the interest cost for the company would also go up impacting the bottomline of the company. However if the capex goes as planned it would not be a problem for the company. The first phase of the expansion was completed more in time so we expect the total capex to be completed by the end of FY2008. The company would start operating with its stabilised capacity along with the iron-ore and coal mines from the beginning of FY2009.

Proposed Product Mix

The company is well on track with its II phase of expansion, after the completion of II phase the company would become fully integrated player with captive iron-ore and coal mines reducing the impact of raw material prices on the margins. The new capacities would make AML a speciality steel producer. The product mix proposed after the completion of II phase would be:



Existing Facilities Of the Company

Facilities	Installed Capacity
Steel Melting Shop consisting of EAF, LRF, and Continuous Casting Machine For production of bloom, billet and rounds	250000TPA
Sponge Iron (100 x 5 TPD)	150000TPA
Blast Furnace (262 Cum)	180000TPA
Coal Washery	700000TPA
Oxygen Plant	6.53 Mn SM ³
Power Plant (17 MW)	124.85 MuPA

Upcoming Projects

	Facilities	Uses/Benefits
Capacity Expansion	Alloy Steel Making	Enhancement to 3.3 lakh TPA
	Stainless Steel making	New capacity of 1.2 lakh TPA
Improvement in product quality	Vacuum Degassing	Manufacturing clean specialty steel
	Billet/Bloom conditioning	To achieve desired reduction ratio as required in Auto and Bearing Steel and able to cater to niche Market.
	Rolling Mill with finishing facilities	New Capacity of 0.22Mn TPA
Backward Integration	Ferro Alloys (9MVA * 2)	Ferro Chrome 0.032Mn TPA will be captively consumed
	Sinter Plant	Sinter of 0.10MnTPa will be used for captive consumption
	Oxygen Plant	Oxygen prod of 9.7MnSM3 PA will be used in Steel melting shop
	Mines (Iron Ore & Coal)	100% of Iron ore and Coal mined will be captively Consumed in DRI & Blast furnace.
Cost Reduction	Power Plant (17MW)	Based on Coal Midlings from coal washery, for captive consumption, resulting in increase in energy self generation from 30% to 60%.
	Private Railway Sliding	For logistic Management for incoming and outgoing materials.

Human Resources

Name	Designation	Exp(Yrs)	Previous Company
H S Sandhu	COO	35	Kalyani, Tisco
Narendra Prasad	Sr. V.P. (Commercial)	25	Usha Martin, NELCO
A. K. Sharda	CFO	15	Usha Martin, Hindalco
Rajat Dutta	CIO	17	Usha Martin, IIT Kharagpur
C.S. Dongra	Sr. V.P. (SMS)	28	Usha Martin
Ajay Sharma	V.P. (Marketing)	21	Kalyani, Vardhman
Arun Bhaduria	V.P. (Marketing)	20	Vardhman, LML
Sanjay Pratap	V.P. (Mining)	23	TISCO
Ranjit Ghosh	Sr. G. M. (HR)	20	ACC, TISCO
Sougata Sengupta	Company Secretary	8	Webel Solar

Clientele

The company has already signed MoUs for the product off-take with more than 15 leading vendors of auto components OEMs. SKF Bearings, Fag Bearings India Ltd, Mico, Sundaram Fasteners Ltd, Siemens India Ltd, Hindalco Industries Ltd, Cummins India Ltd and Ashok Leyland are few of the clients. The company is in talks with leading automobile manufacturers like M&M and Tata Motors to sign MoUs for the product off-take.

Valuations

In the trailing four quarters (Mar 06 - Dec 06) the company operated at an OPM of 16.5% and NPM of 9.9%. The EPS of the company for the same period was Rs 8.74. The OPM is expected to improve considerably to 27.74 % (FY 09) with the completion of the II phase of expansion and the NPM would increase to 12.97%. With the increase in capacity the revenues are expected to more than double in FY2009. The utilisation of the captive iron-ore and coal mines would reduce the cost of the raw materials to a great extent and also shield the company from the increasing raw material prices which puts a huge pressure on the margins.

The EPS is also expected to increase to Rs 11.50 in FY 2008 and to Rs 17.00 in FY2009. The stock is currently trading at P/E multiple of 4 (TTM Dec 2006). All around the world there have been talks of re-rating of the sector. Even if the stock trades at a P/E multiple of around 4 we expect a FY2009 price of Rs 60.00 (a decent 70% appreciation from the current price of Rs 35). In terms P/BV the stock is currently trading at a multiple of 1.3 (TTM Dec 2006), a multiple of 0.84 (FY2008) and 0.60 (FY2009). We expect a very limited downside in the stock price from the current levels.

Recommendation

We recommend the investors to buy the stock with a two year target price of Rs 60.00 (a decent 70% appreciation from the current price of Rs 35). The risks associated with the investment are:

- Downturn in the steel cycle.
- Delay in the starting of the expanded capacities.
- Delay in the starting of the iron-ore and coal mines.

With the demand-supply balance in the steel industry placed well, we expect the steel prices to remain stable at least in the next two years and the chances of the prices falling drastically are very low. We visited the AML plant in Rourkela and were happy with the pace of the project. The management is also confident of taking the full advantage of the expanded capacities and integrated facilities from the mid of FY2008. We would monitor the performance of the company periodically and inform the investors about any major changes happening in the company.

Sensitivity

We examined the sensitivity of EPS to the changes in the raw materials and finished goods prices. The various cases are shown in the table below:

	%	% Decrease	%	% Decrease
Coke (Increase)	5%		5%	
Nickel (Increase)	5%		5%	
Steel (Decrease)	-5%		-10%	
EPS FY09E (Rs)	12.82	-24.8%	9.70	-43.1%
Coke (Increase)	10%		10%	
Nickel (Increase)	10%		10%	
Steel (Decrease)	-5%		-10%	
EPS FY09E (Rs)	11.71	-31.3%	8.59	-49.6%

It can be observed from the above table that if the coke and nickel prices go up by 10% each and the steel prices go down by 10% then the forecasted EPS goes down to Rs 8.59 which is close to the EPS of the company in trailing twelve months ended December 2006. Hence the downside in the stock seems to be very limited.

Financials

Income Statement (Rs Crs)	FY06	FY07E	FY08E	FY09E	Balance Sheet (Rs Crs)	FY06	FY07E	FY08E	FY09E
Net Sales (Mfg)	242.83	524.16	965.41	1,112.06	Share Capital	91.23	91.23	91.23	91.23
Growth (%)	-	86.98	43.60	5.19	Reserve & Surplus	127.87	193.04	297.77	453.30
Trading Sales	181.90	270.00	175.00	87.50	Total Shareholder Funds	219.10	284.27	389.00	544.53
Total Expenditure (Mfg.)	194.20	421.04	721.45	789.85	Total Debt Funds	215.94	452.36	551.81	472.62
% of sales (Mfg)	79.97	80.33	74.73	71.03	Deferred Tax Liability	21.89	21.89	21.89	21.89
Raw Materials	116.51	252.36	448.40	473.15					
% of sales (Mfg)	47.98	48.14	46.45	42.55	Total Liabilities	456.93	758.52	962.70	1,039.04
Purchase Of trading Goods	160.12	237.60	154.00	77.00	Fixed Assets	201.53	498.99	648.14	665.00
EBIDTA (Mfg)	48.63	103.12	243.96	322.20	Capital WIP	49.99	88.33	10.00	-
EBIDTA (Trading)	21.78	32.40	21.00	10.50	Current Assets	326.63	321.11	580.67	692.09
Total EBIDTA	70.41	135.52	264.96	332.70	Inventory	78.60	150.89	216.68	227.92
Other Income	2.77	2.50	0.25	-	Sundry Debtors	96.50	120.56	222.04	255.77
Depriciation	6.88	12.56	35.68	34.22	Loans&Advances	33.59	41.93	77.23	88.96
EBIT	66.30	125.46	229.28	298.48	Cash & Bank Bal	117.94	7.73	64.72	119.44
Interest	11.48	23.66	68.15	59.21	Current Liab. & Prov.	121.22	149.91	276.11	318.05
PBT	54.82	101.80	161.13	239.27	Sundry Creditors	114.28	141.52	260.66	300.26
Tax	21.09	36.63	56.40	83.75	Provisions	6.94	8.39	15.45	17.79
PAT	33.73	65.17	104.73	155.53					
EPS (Rs)	3.70	7.14	11.48	17.05	Net Current Assets	205.41	171.20	304.57	374.04
Growth (%)		193.23	160.71	148.50	Total Assets	456.93	758.52	962.70	1,039.04

Ratios	FY06	FY07E	FY08E	FY09E	Ratios	FY06	FY07E	FY08E	FY09E
Profitability					Valuation				
Operating Margin (%)	16.58	17.06	23.23	27.74	EV/EBIDTA (x)	5.58	5.47	3.01	2.00
NPM (%)	7.94	8.21	9.18	12.97	EV/Sales (x)	0.96	0.95	0.70	0.55
OPM Manufacturing (%)	20.03	19.67	25.27	28.97	Market Cap/Sales (x)	0.82	0.43	0.29	0.28
RONW (%)	15.39	22.93	26.92	28.56	P/E (x)	9.21	4.77	2.97	2.00
ROCE (%)	14.51	16.54	23.82	28.73	P/BV (x)	1.42	1.09	0.80	0.57
Leverage					Growth Rates (%)				
Debt/Equity	0.99	1.59	1.42	0.87	Net Sales (%)	225.84	86.98	43.60	5.19
Interest Coverage Ratio	5.78	5.30	3.36	5.04	EBIDTA (%)	362.27	88.61	91.97	25.57
					Net Profit (%)	375.03	93.23	60.71	48.50
					EPS (%)	99.83	93.23	60.71	48.50

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