

Company Background

Kirloskar Ferrous Industries Limited is promoted by the flagship Kirloskar group and is a niche castings player in the domestic market with unique capabilities in production of Grey iron and Spheroidal Iron Castings.

It started as a Pig Iron business that has over the past five years forward integrated into high margin value added castings.

The company mainly caters to the Automotive segment especially CVs and diesel OEMs. The company over the past five years has invested substantially in its asset base developing niche technologies, lowering cost of inputs and rising much above competition to position itself as a niche player in a fragmented market.

Over the next few years we expect the company to deliver on its asset base as cost of inputs stabilize and end prices of its products normalise and grow. Higher Utilization's to deliver strong revenue and profit growth given negligible Capex and debt.

Castings volumes to grow significantly given higher capex and higher utilisation levels

	FY14A	FY15A	FY16A	FY17A	FY18E	FY19E	FY20E
Volume (Tons)	60,396	7,257	56,661	65200	81,000	98,000	1,12,000
Utilization (%)	0	0	0	0.49	1	1	1
YoY (%)	2.8	-5.2	1.0	163	14.2	20.9	14.3

***Source: Company Data, Consensus Estimates**

Investment Rationale

- Strong volume growth propelled by value added Castings and increased capacity utilization to deliver strong revenue
- The company has been investing over the past 5 years despite higher input cots. The front ended Capex has suppressed the

growth over next 3 years.

- Strong overall capacity improvement envisaged of over 50% in castings, and over 25% in Pig Iron
- Focus on value added higher margin castings to deliver strong EBIDTA margins . The blended margin to deliver huge improvement on overall business dynamics
- Huge cost saving as the company has tied up for captive supplies of 200 tons per annum captive coke oven plant with a domestic supplier. The company is also setting up a 15MW CPP
- Focus on reduced product cycles to reflect on higher volumes and margins

return ratios. As utilization improves going forward the return ratios are expected to improve substantially

- Gross block has grown by over 70% over the past 5 years while volumes and turnover was flat. Improvements in asset turnover to reflect in higher profitability
- The business is not working capital intensive and the company maintains the conversion cycle at 30 days average
- The Balance sheet is very strong with low net debt reflects low leverage and strong cash flows that aided the front ended Capex
- The company has a strong dividend Payout record over the years and we expect the strong payouts to be maintained.

EBIDTA CAGR OF 28%

	FY15A	FY16A	FY17A	FY18E	FY19E	FY20E
EBIDTA (mn)	1,490	1,509	1756	1,290	2,500	3,900
Margin (%)	11	14	15.5	8	5	21

*Source: Company Data, Consensus Estimates

PIG Iron Business

- The focus is on cost improvements in the Foundry Grade Pig Iron that fetches higher realisations and gross margins
- There is limited competition in this space
- Pig Iron demand – supply more or less balanced
- Capex undertaken to reduce Coke consumption and increased capacity
- Margin contraction in Pig Iron business over the past few years on higher input costs of Coke/ Recently input costs have stabilized and there is an expectation in margin improvement
- The company has been importing coke but now seems to have tied up with a domestic coke manufacturer for supplies at a fixed conversion rate. This will reflect in huge cost saving
- The company is planning low payback backward integration projects to improve costs across business cycles over the next few years.

CASTINGS Business

- The Pig Iron business is forward integrated into Castings. Castings is the high margin value added business for the company
- The company has invested heavily in its asset base and expect Castings to reach 50% of volumes over the next 3 years
- The company is a leading producer of castings for all components of the Automotive segment including the OEMs
- Casting business is focussed on the CV segment including tractors and boasts of marquee names as its client base
- Domestic Castings business to grow at a healthy pace of 5% CAGR
- The Castings business has high entry barriers and competition is fragmented, needs investments in R & D and high technology and innovation
- Castings volumes to grow significantly given higher Capex and expected higher utilization levels.
- The company expects to do a strong volume growth of 20% CAGR in castings and expect it to reflect in an

Revenue CAGR of 17%

Revenue growth aided by value added castings

	FY14A	FY15A	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue (Rs. Mn)	4,600	474	4,607	5191	6,900	8,420	9,580
YoY (%)	4	3	3	12.7	13	22	14

*Source: Company Data, Consensus Estimates

Key Risks

- Pressure on margins on increased competition
- Higher input costs
- Concentrated exposure to a few marquee clients can be risky
- Forex fluctuation as of now as key RM Coke is imported
- Transition of Auto sector to electric vehicles is a very long term risk

Valuation Summary (Rs. Mn.)	FY15	FY16	FY17	FY18E	FY19E	FY20E
Revenues (mn)	13,651	11,139	11,337	15,050	17,200	18,250
EBIDTA	1,490	1,509	1,756	1,290	2,500	3,900
EBIDTA (%)	10.9	13.6	15.5	835.0	14.8	21.2
PAT (mn)	493	578	907	480	1,190	2,010
RoE (%)	11	12	11	8	18	26
RoCE (%)	10.4	11.0	14.0	7.4	15.1	20.5
EPS (Rs.)	3.6	4.2	6.6	3.5	9	15.2
P/E (x)	28.9	24.8	15.8	29.7	11.6	6.8

*Source: Company Data, Consensus Estimates

Valuation

The stock has been dormant in the past as the earnings growth has been tepid. Earnings recovery led by higher share of value added castings and increasing utilization to reflect in higher blended margins.

On an average operating cash flow need to increase as capex has been initiated and is done with and this will reflect in surging return ratios. Given the growth in overall the markets could assign premium valuations.

Going forward we expect the company to deliver premium valuations and expect the company to trade at 12x FY20E, reflecting a target price of Rs.182 that is a 70% from current process of Rs.106.55.

Price	Value	Date	CAGR	Percentage	Years
All time High	115.25	07-Dec-2017	Since Inception -NSE	7.61	23
All time Low	1.10	31-Jul-2001	Dec-12	30.49	4
52 Week High	115.25	07-Dec-2017	Details		
52 Week Low	65.50	02-Jan-2017	Recommendation		
Latest Close	106.55	22-Dec-2017	Recommendation	Buy	
Average Closing CY 2017	90.51	22-Dec-2017	Closing Price	106.55	
EMA			Range	98-112	
	Value	Date	Expected Target Price	182.00	
Short Term	97.47	22-Dec-2017	Expected Return	70.81%	
Medium Term	91.18	22-Dec-2017	Stop Loss	83.00	
Long Term	87.82	22-Dec-2017	Expected Risk	-22.10%	
			Minimum Holding Period	9 months	

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