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BIG BET Co may see good revenues, margins if its bet on capacity expansion to manufacture alloy wheels pays off

Steel Strips to Ride the Wheels of Recovery

MIDCAP MANTRA

Ashutosh.Shyam@timesgroup.com

ET Intelligence group: Investors in Steel Strips Wheels, a manufacturer of wheel rims for vehicles, may have a reason to cheer. Expected positive growth in all segments of vehicle categories is seen benefiting the company, which derives nearly 66% of sales volumes from passenger cars, about 20% from two-wheelers and the remaining from tractors and commercial vehicles.

Over the last few years, there has been a huge variation in growth in the verticals Steel Strips services. However, an ETIG analysis shows that it may change in the current fiscal as all verticals are expected to record positive growth, while an increase in the proportion of contribution from heavy rims on account of rising demand from the commercial vehicles and tractors segments is expected to boost the company's average realisation.

In view of this, Steel Strips Wheels has been guiding for 11-13% growth in volume in FY17 (as compared with 5% in FY16), while revenue growth is expected to touch 20% in the same period. In the current year, tractor growth is expected to pick up on a good monsoon and commercial vehicle sales are likely to remain 10-15%, aiding its realisation. CV sales contributed 12% of the total volume in FY16 and are expected to touch 15% in FY17. A set of tractor rims sold for ₹4,000-5,000, while CV rims fetched ₹4,000 per tyre, car rims sold for ₹700-800 each and scooter rims went for ₹350.

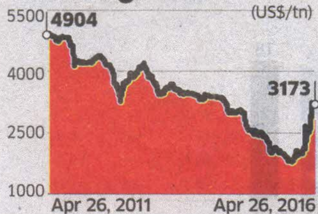
In addition to this, the company will benefit from lower fixed cost per unit production as utilisation level goes up. Its operating margin for FY16 stood at 13.67% while that for the March quarter was 14.89%. Besides this, the company is building a hot steel rolling mill in Jameshpur to reduce it raw material cost. The combined effect of higher utilisation and backward integration may augment margins by 25-50 basis points.

The company could see robust revenues and margins if its bet on capacity expansion to manufacture alloy wheels pays off. At present, alloy wheels fetch almost four times higher value than conventional steel rims, and nearly 60% of the demand is met through imports. The company is putting up a new plant in equity collaboration with South Korean company Kalink, the world's seventh-largest maker of alloy wheels which supplies to most big automakers around the world.

The new alloy wheels facility is expected to commence production in June 2017 with an initial capacity of 1.5 million units a year. Over the last five years, alloy wheel volumes have grown at a compounded rate of 25% and currently, account for 12% of passenger car wheels. This is likely to increase to 20% by 2020 in proportion with the expected increase in sales of premium cars. At full utilisation of the upcoming alloy wheels unit, it will have incremental revenues of ₹450 crore in the first phase and ₹750 crore in the second phase.

However, the worry among investors is that Steel Strip had a debt of ₹583 crore at the end of FY16, and its debt to equity ratio was 3.42 times. Although the company has been able to reduce its debt from a peak of 5.34 in FY12 as revenue growth picked up, it has been able to bring average interest cost of ₹70 crore a year down to only ₹55 crore in the last two years.

China Domestic HR Steel Avg Price



Scrips	Target Price*	CMP
JSW Steel	1,157.5	1,367.9
Tata Steel	271.5	358.6
SAIL	33.4	46.2

Target Price* is from bloomberg consensus
source: Bloomberg

ON EXPECTATIONS

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