



# JV CAPITAL SERVICES PVT. LTD

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Sunflag Iron

CMP: 31.85

BUY

INDUSTRY: Metals

RISK PROFILE: High

TARGET: 45.00

## Data Table

CMP (Rs)	31.85
Target price(Rs)	45.00
Upside (%)	41
52 Week H/L (Rs)	36.00 / 21.70
P/E Ratio	4.86
P/BV Ratio	1.24
Dividend Yield %	1.60
Market cap (Rs. Cr)	511.2
6m Avg volume (nos)	63245
No. of o/s shares (nos)	77910000
FV (Rs)	10
NSE code	SUNFLAG

Sunflag Iron and Steel Co. Ltd. Sunflag is an India based sponge iron and special steel products manufacturing company. The company is a part of Kenya based Sunflag Group. The company is engaged in the production of automobile spring steel. The company provides its automobile spring steel to the automobile and railway suspension in the grade of silico manganese, chrome and vanadium steel. Sunflag offers its products in various diameters and serves to various industries. The company distributes its steel products in Africa, Asia, and the Middle East. The company operates two subsidiaries namely Sunflag Special Steels Ltd. and Sunflag Power Ltd.

## Relative Performance Analysis



## Key Investment Themes

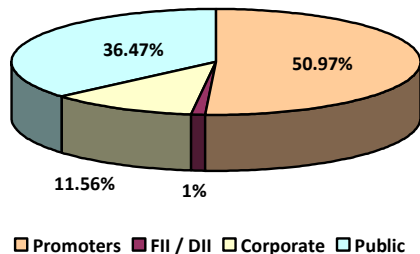
### Good Outlook from End-User Industries

The main product of the company, Spring Steel, is used for manufacturing various types of springs and components for use in suspension mechanism of automobiles and railways like leaf spring, coil spring, stabilizer bars and torsion bars etc. Given the buoyancy in demand for automobiles the end-user industry demand is likely to be robust in coming years.

### High Capacity Utilisation Levels

Sunflag also has a 2,00,000 TPA bar and section rolling mill. In the last five years, capacity utilisation of Steel Melt Shop (SMS) and rolling mill has been in excess of 90% and 89% respectively, while utilisation at DRP has exceeded 75%.

## Shareholding Pattern



### Energy Generation would reduce operating costs

Sunflag has a 25 MW captive power plant (CPP) that generates power from waste heat recovery process using waste gases emanating from the sponge iron plant. However, at current production levels, the CPP meets roughly half of Sunflag's energy requirements and balance requirement is met by purchasing power from Maharashtra State Electricity Board.

### Coal Mine's lease would help to get cheaper raw materials

Coal requirements are met from South Eastern Coal Fields (subsidiary of Coal India), Korba in Chhattisgarh. However, the company has been sanctioned coal mines on lease in Belgaum. The development of the mines is under progress and they are expected to be commissioned by December.

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### **New plant at Bhandara to help in capacity expansion**

Sunflag had set up a 'state of the art' integrated Steel plant at Warthi Bhandara Road to produce high quality special steel with manufacturing facilities like Sponge Iron plant, Mini Blast Furnace, Sinter plant and Captive Power Plant.

The company has set up a state of art integrated plant at Bhandara, India to produce 2,00,000 tonnes per annum of high quality steel using iron ore and non-coking coal as basic inputs. The main products of the company are spring steel rounds flats, carbon steel and alloy steel. They are used by automobile leaf spring manufacturers, engineering goods manufacturers and the forgings industry. Spring steel forms 70% of the total production. The plant comprises a 1,50,000 tonnes per annum Direct Reduction Plant, to produce sponge iron for captive consumption in the Steel Melting Shop.

This apart, the Company is in the process of executing new projects viz. Blooming Mill, additional Sponge Iron and Captive Power plant. The company has established its brand name and has become a reputed supplier in Flat Bars, Round Bars, Bright Bars and Wire Rods of Alloy Steel, Spring Steel and Stainless Steel and captured better position in these market segments. It is also embarking on an export thrust and is regularly supplying to various customers in South East Asian, African, Middle East and South American countries.

### **Opportunities in other grades of alloys**

Sunflag Steel sees more opportunities in the years to come due to continuous developments of new grades of high alloy steel as well wire rod and cold rolling sheets. Further, venturing into the self dependency of raw material and power in decreasing in the cost of production and enhancing the profitability.

### **Performance improved in FY10**

- The Direct Reduction Plant produced 126,336 MT as against of 115,299 MT in the previous year, which is about 9.6% higher than the previous year.
- The Steel Melt Shop produced 326,141 MT as against of 207,757 MT in the previous year, which is about 57% higher than the previous year.
- The total production of Rolled products was 309,596 MT, which is about 52% higher than the previous year production of 203,663 MT.

- The total production of Hot Metal / Pig Iron was 205,502 MT which is about 62% higher than the Previous Year production of 127,002 MT.
- Sinter Plant commenced its operation on 4th September 2009 and produced 191,385 MT in FY10.
- The Power plant generated 1,461.03 lakhs kWh as compared to 1,500.02 lakhs kWh in the corresponding previous year.
- The total coal production at Belgaon Coal Block was 140,147 MT as against of 51,234.41 MT in the previous year, which is about 174% higher than the previous year.

#### **Emerging Opportunities in other Areas**

Sunflag Steel sees more opportunities in the years to come due to its developments of new grades of high alloy steel as well as wire rod and cold rolling steels. Further, the venturing into self dependency of raw material will help in decreasing the cost of production and enhancing profitability. This has even proved advantageous during the global recessionary period under review which is a very good sign.

#### **Concerns**

The only matter of concern is the price of raw materials. Iron ore prices are rising, while coal prices are up and expected to remain firm. Raw material self sufficiency may be the solution for Sunflag to bring its overall cost down. That is best achieved through backward integration. We have already seen Tata Steel and JSW achieve more stable core income and superior margins post backward integration.

#### **Background**

Sunflag manufactures flats in silico manganese, chrome and vanadium steel; rounds in carbon, free-cutting, spring and alloy steels; and round cornered squares (RCS) in carbon, free-cutting and alloy steels. These products with sizes up to 90 mm diameter rounds, 75 mm RCS and up to 120x25 mm flats are used for manufacturing springs and components for suspension mechanisms in automobiles and railways, crank shafts, axle beams, connecting rods, piston rods, steering components, axles, gears, bolts and nuts, shafts, keys, machine components, anti-friction bearings, and other products. It exports its products to

Australia, West Germany, Spain, China, Hong Kong, Bangladesh, Indonesia, Iran, Japan, Kenya, Malaysia, Nepal, Philippines, Singapore, Taiwan, Thailand and UAE.

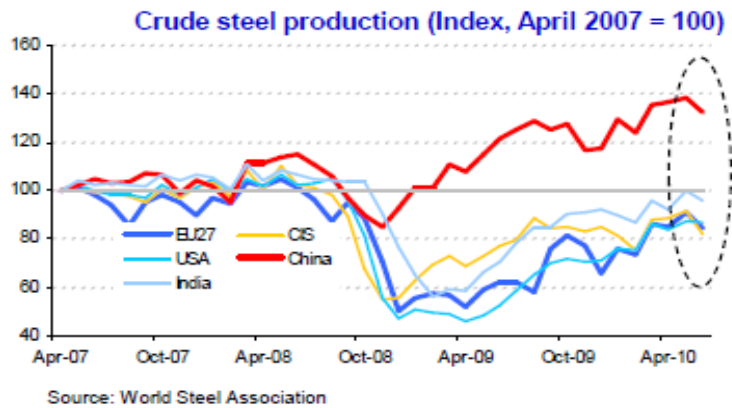
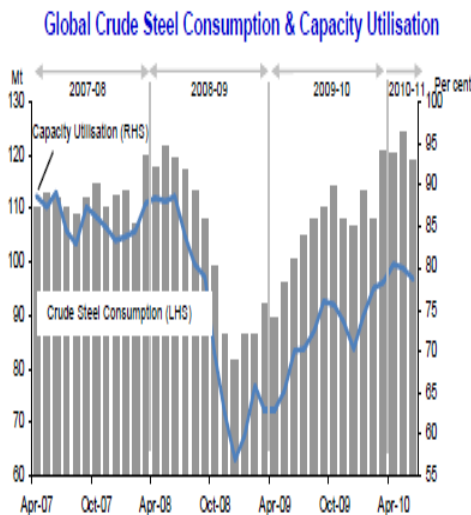
Sunflag uses direct reduction plant (DRP) electric arc furnace (EAF) route for manufacturing. DRP produces 1,50,000 tonnes per annum (TPA) of sponge iron, which is used as input along with purchased pig iron, scrap and other charges in a 2,20,000 TPA EAF within the steel melt shop (SMS). Sunflag also has a 2,00,000 TPA bar and section rolling mill. In the last five years, capacity utilisation of SMS and rolling mill has been in excess of 90% and 89% respectively, while utilisation at DRP has exceeded 75%.

Sunflag has now entered into the areas of manufacturing of wire rod and bars of alloy and special steel, after commissioning vacuum degassing, has been able to thwart off the effects of slowdown to a greater extent.

**INDUSTRY PROFILE**

**Global Scenario:**

The crude steel production for 66 countries was 1220 million metric tonnes for calendar year 2009, lower by 8% against that of 2008. Because of economic downturn, the drop in production was nearly in all steel producing countries barring positive growth recorded in China, India and the Middle East. In most countries including the developed steel markets of EU, U.S.A., Japan, Brazil, CIS deterioration in the economy resulted in a sharp decline of demand in key steel using sectors.



The following table shows the growth in terms of crude steel production for the top ten steel producing nations:

COUNTRY	2009	2008	%CHANGE
China	568	500	13.6
Japan	88	119	(26.3)
Russia	60	69	(12.5)
US	58	91	(36.4)
India	57	55	2.7
South Korea	49	54	(9.4)
German	33	46	(28.7)
Ukraine	30	37	(20.2)
Brazil	27	34	(21.4)
Turkey	25	27	(5.6)

*mn tonnes*

Global steel consumption was up 45% y-o-y in the June'10 quarter, with continued strength in China and India and end of de-stocking in mature markets

Steel using sectors likely to slow in coming quarter as inventory adjustment boost and fiscal stimulus wanes

Increased uncertainty around near term outlook in China and further slowdown is expected with policy tightening having an impact.

#### **INDIAN SCENARIO**

Industrial climate during the year has improved particularly for the Steel Industry, Automobile and Auto Components Sectors. The Indian Steel Industry also witnessed the recessionary conditions during the financial year 2008 -2009, but recovered in the latter part of the year and the trend continued in the financial year under review. The Alloy steel industry in general also showed good improvement in production, commensurate with the demand of steel for automobile application. The growth in the manufacture of commercial vehicles during the year was significant. In other areas of automobile industry, motorcycle production has shown tremendous growth which improved the demand of alloy steel for component manufacture for this industry.

- Indian steel using sectors remain strong. World Steel forecasts Indian finished steel consumption to rise by 13.9% to 63 mmt in CY10

- Domestic market remains tight as supply response remains constrained
- India continues to be net importer of steel

## VALUATIONS

At the CMP of Rs.31.85, the stock trades at a TTM P/E ratio of 4.85. We expect the company to post an EPS of Rs.8.13 for FY11. As the company's size increases, it would be a candidate for re-rating and begin to command higher valuation ratios. Peer – set companies of Sunflag such as Kalyani Steels, ISMT etc trade at higher P/E multiples. Adjusting for capital structure and value of assets we impart a conservative P/E multiple of 5.5 to the company. This gives us a price target of Rs.45.

<b>Earning Estimates</b>				
<b>Particulars (Rs. Crores)</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011E</b>
<b>Net Sales</b>	994.06	1102.47	1349.63	1687.00
<b>Other Operating Income</b>	0.00	0.00	0.00	0.00
<b>Other Income</b>	3.78	4.95	4.96	4.50
<b>Total Income</b>	997.84	1107.42	1354.59	1691.50
<b>Total Expenditure</b>	885.19	988.16	1158.57	1448.00
<b>PBIDT</b>	112.65	119.26	196.02	243.50
<b>Interest</b>	20.67	30.44	30.04	36.00
<b>Depreciation</b>	38.42	30.94	37.88	38.5
<b>Tax</b>	12.70	10.53	29.04	37.18
<b>Fringe Benefit Tax</b>	0.17	0.24	0.00	0.00
<b>Deferred Tax</b>	(-2.94)	3.51	4.15	0.00
<b>Adjusted PAT</b>	43.63	43.60	94.91	131.82
<b>EPS</b>	2.69	2.69	5.85	8.13

*Company, JV Capital Estimates*

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### Risk Profile

**Low Risk:** Fundamentally sound companies, with low beta. Expected market out performance is 0-10%

**Medium Risk:** Expected market out performance is 10-20%. Preferably for investors with a maximum time frame of about 6 months.

**High Risk:** High Beta Stocks, expected market out performance is more than 20%, preferably for the investors willing to take advantage of market momentum & are aggressive in nature.

### Disclaimer Appendix

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