Stock Note

Electrosteel Castings Ltd.

Aug 26, 2024

Electrosteel Castings Ltd.

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Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
DI Pipes	Rs. 217.9	Buy in Rs. 216-220 band and add on dips in Rs. 193-196 band	Rs. 241.5	Rs. 257	2-3 quarters

HDFC Scrip Code	ELECASEQNR
BSE Code	500128
NSE Code	ELECTCAST
Bloomberg	ELSC:IN
CMP Aug 26, 2024	217.9
Equity Capital (Rs Cr)	61.8
Face Value (Rs)	1
Equity Share O/S (Cr)	61.8
Market Cap (Rs Cr)	13470.6
Book Value (Rs)	82.7
Avg. 52 Wk Volumes	297079
52 Week High	224
52 Week Low	60.1

Share holding Pattern % (June, 2024)	
Promoters	46.22
Institutions	21.83
Non Institutions	31.95
Total	100

* Refer at the end for explanation on Risk Ratings

Fundamental Research Analyst
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Our Take:

Electrosteel Castings Ltd.(ECL) is engaged in the business of manufacturing Ductile Iron (DI) Pipes, Ductile Iron Fittings (DIF) and Cast Iron (CI) Pipes. The Company is the first to set up a Ductile Iron Pipe Plant in India. It is India's leading pipeline solution provider and has a strong brand presence around the Globe. Since 1994, the Company has maintained its edge over its competitors. Owing to the high reliability and durability of its products, the Company has always remained the distinct choice for water engineers and domain experts in Ductile Iron Pipes and Fittings. It caters to a large customer base spread in the Indian subcontinent, South East Asia, Middle East, Africa, USA etc. More than 13,000 water supply projects have already been implemented in India and abroad with ductile iron spun pipes and fittings made by ECL.

Valuation & Recommendation:

We remain positive on the stock due to 30 years of vast experience in DI pipes segment with significant market share, expanded production capacities and backward integration. It is also expanding further by adding capacity of more than 2.5 lakh metric tons per annum over the next 2 years. It has a strong order book visibility of 11 months along with limited competition owing to large capital requirement.

Promoters have been raising their stake in the company and reducing the pledged shares.

We think the base case fair value of the stock is Rs.241.5 (15.5x Mar'26E EPS) and the bull case fair value is Rs.257 (16.5x Mar'26E EPS) over the next 2-3 quarters. Investors can buy the stock in the band of Rs 216-220 and add more on dips to the band of Rs. 193-196.

Financial Summary:

(Rs cr)	Q1FY25	Q1FY24	YoY (%)	Q4FY24	QoQ (%)	FY23	FY24	FY25E	FY26E
Operating Income	2012	1685	19.4	2004	0.4	7,276	7,478	7,945	8,867
EBITDA	354	160	120.5	311	13.6	738	1,178	1,343	1,483
APAT	226	75	201.8	227	-0.5	316	740	842	963
Diluted EPS (Rs)	3.7	1.3	190	3.7	0	5.3	12.0	13.6	15.6

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RoE-%						7.4	15.6	15.3	15.3
P/E (x)						41.0	18.2	16.0	14.0
EV/EBITDA						21.2	12.9	11.0	9.8

(Source: Company, HDFC Sec)

Q1FY25 Result Review:

The revenue from operations grew by 19.4% YoY and 0.4% QoQ to Rs. 2012 cr in the quarter. EBITDA reported was Rs. 353.6 cr, which increased by around 120.5% YoY and increased by 13.6% QoQ. EBITDA margin reported was at 17.6%, an increase of 806 bps YoY. Net profit was Rs. 226 cr, which represents an increase of 201.8% YoY. PAT margin for the quarter stood at 11.2%.

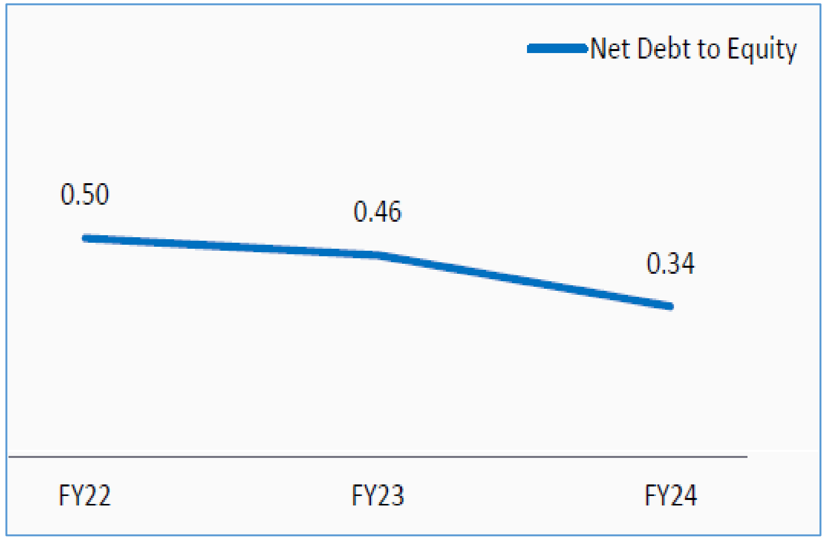
Concall takeaways:

- The company was able to sustain its growth trajectory in the first quarter of FY25 achieving a notable 19.4% YoY increase in consolidated revenue to Rs. 2,012 cr driven by strong demand of DI pipes and fittings in water infrastructure projects in the domestic markets. EBITDA increased by 120.5% YoY on account of company's consistent focus on maintaining operational excellence and improving cost efficiency through economies of scale and other initiatives. Management expects to hit ~8.5 lakh tons of DI sales, 36,000 tons in cast iron and 22,000 to 24,000 tons in fittings in FY25.
- The DI Pipe sales volume stood at 1.93 lakh tons in Q1FY25. Export contributed 12% of this volume at about 24,000 tons. Company sees an increase in demand from Middle east and Europe and expects to reach an export share of 20% of total sales volume. It is also exploring markets like Singapore, Vietnam, Thailand etc.
- EBITDA margins are expected to sustain on account of coal prices softening. Management expects to maintain an EBITDA per ton of ~Rs. 15,000-18,000.
- ECL is in the process of acquiring land in Odisha for the upcoming greenfield DI Pipe and fittings project. This will help in maintaining its leadership in domestic DI pipes and fittings industry. With respect to its Capex plan, the ongoing Capex of approximately Rs. 700 cr is progressing as per schedule. The Company spent nearly Rs. 410 cr till Q1FY25 and targets to enhance its overall DI pipe manufacturing capacity to 1 million tons in the year 2026. Capacity augmentation of 5.5 lakh tons will be done in south and 3.5 lakh tons in the eastern units, totaling upto ~9 lakh tons for FY25. For FY26, further 1 lakh tons will be added to the capacity.
- The current long term debt is around Rs. 489 crores as on 30th June 2024 and the short term is Rs. 1,367 crores. Net Debt is approximately Rs. 1,500 crores.

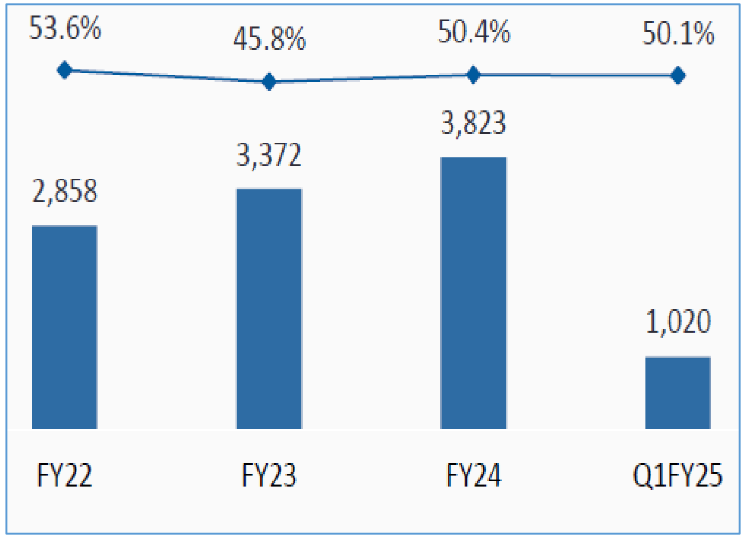
Key Triggers:

Established position in the pipes industry with significant backward integration: The three-decade-long experience of the promoters in the ductile iron (DI) pipes industry has helped them establish significant market presence, expand production capacities, and undertake backward integration over the years. The facility is already utilised by over 90% and ECL plans to further add capacity of more than 2.5 lakh metric tonne per annum (MTPA) over the next two fiscals. This will enable the company to retain its leadership position in the DI pipe market. The company maintains strong trade relationships with reputed overseas customers and all major players in the domestic market. Limited competition owing to large capital requirement and necessity to have critical accreditations and customer approvals, bolster the business risk profile. Performance is further supported by improving global and domestic demand, as reflected in a strong order book providing healthy revenue visibility.

Net Debt to Equity (x)

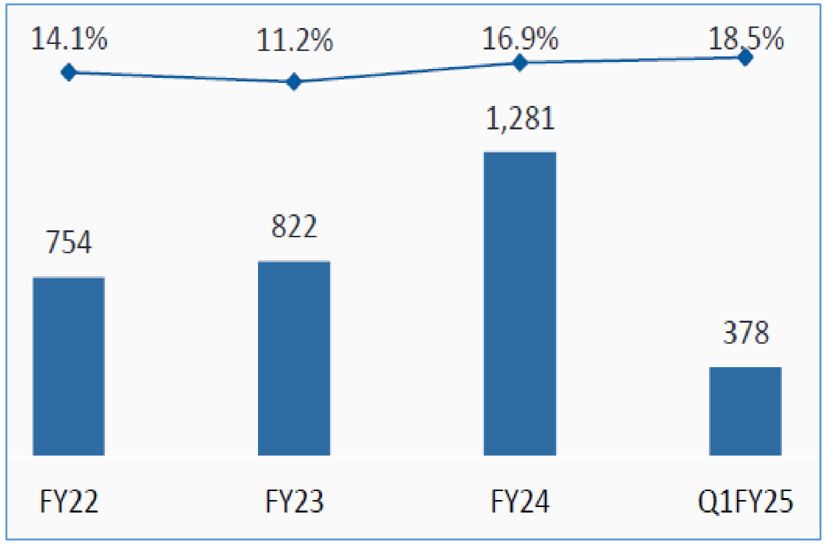


Gross Profit (Rs. crs) and Margin (%)

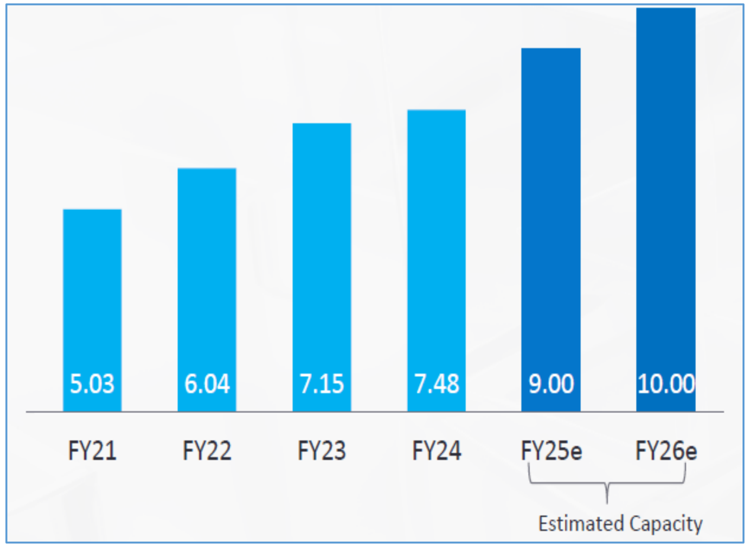


(Source: Company, HDFC Sec)

EBITDA and EBITDA Margin (%)



Production in Lakh MT:



(Source: Company, HDFC Sec)

Industry Triggers: The demand for water has been increasing at a high pace in the past few decades. The sustained economic growth has triggered more industrialization and rapid urbanization all over India. With only around 31% of India's population currently urbanized, along with high population density, India's urbanization trends have scope to significantly accelerate and likely to be around 40% by 2030. The rural India still remaining largely uncovered with piped water network alongside only about one-third of the Indian homes are connected with a sewerage network.

In response to this staggering problem, the Govt. of India initiated the largest ever water supply initiative anywhere in the world, the 'Jal Jeevan Mission', with an aim to connect all the rural house hold with piped water. At the same time AMRUT mission has been initiated to augment the urban water supply and sewage disposal. To cater to this growing need, the Indian pipe and fittings market is growing at a fast rate for more than a decade now.

Under the 'Jal Jeevan Mission', India has undertaken a very ambitious initiative and is already geared up for major expansion in water supply and distribution infrastructure in all the states. The government is to spend Rs. 3.6 lakh crores by 2024 to provide tap water connections to every household. However so far Rs. 3.10 lakh crores have been spent and in spite of that in many states, the providing of home tap connections are still on the lower side. So, more government spending is expected under 'Jal Jeevan Mission'.

Demand for Sewerage pipes : At present only about 30% of the waste water generated in India gets treated. Meanwhile with rapid urbanization, the sewage generation in India has witnessed an increasing trend over the past few years registering a CAGR of about 4.7%. The government has been instrumental in introducing a plethora of programmes and schemes over the past four–five years. The main aim of these programmes is to improve the wastewater and sewerage infrastructure in the country. ECL is well positioned to capture this opportunity with its extensive DI pipes range of products.

Demand drivers for DI Pipes:

1. Har Ghar Nal se Jal programme (Jal Jeevan Mission) and Swachh Bharat Mission/ Namami Gange – It is a declared goal of the Central Government to provide drinking water and sanitation to 100% of the population and making funds available to achieve it. The State Governments are expected to contribute in a similar manner.
2. In case of urban water supply schemes, AMRUT–2.0 initiative and Smart City projects will continue to keep up the demand for DI pipes and fittings.
3. A distinct push from the Government to adopt 24X7 water supply system in the urban conglomerates. 24x7 water supply implementation will require durable and leakage free pressure pipes like DI pipes.
4. Currently only about 36% of agricultural land in India is readily irrigated. The shift towards pipeline–based irrigation system from canal–based irrigation system is creating promising sector, which is going to add to the DI pipe demand.
5. As rapid industrialization is taking place, keeping up with the economic development, in many cases, DI pipes and fittings are being preferred over other pipes for conveying bulk Industrial water as these are sturdier and more durable.
6. Waste water recycle and reuse is gradually gaining ground in India, particularly in water scarce areas.
7. Special pipeline system like restrained joint is gradually getting acceptance, as it eliminates the need for concrete thrust blocks and makes the project execution faster.
8. Unaccounted–for water (UFW) is high in India due to several reasons including old water systems, poor maintenance, illegal connections, frequent leakage and lack of proper mapping of distribution system. The Government is keen to reduce UFW and this will encourage use of more reliable pipe material like DI.

Risks & Concerns:

Raw Material: Company largely depends on prices of key inputs like iron ore and imported coking coal. Prices may be volatile and realizations may fluctuate impacting the topline and margins. As ~90% of contracts are on fixed price basis, the company is currently benefitting due to falling iron ore and coking coal prices; however, any major reversal could impact its margins going forward.

Geographical Risk: Some challenges being faced by the company in export markets are, the imposition of Anti–dumping/Anti–subsidy duties on Indian DI Pipes by European Commission in European Union countries. Regulatory mechanism related to carbon emission like CBAM may have an adverse effect on the operating margin.

Competition: Company faces competition from players like Jindal Saw, Jai Balaji, L&T etc. If the competitive intensity rises due to entry of new players or increase in capacity by existing players, it could impact the topline growth and margins. Despite additional capacities announced by new/existing players, there is still a situation of high demand in the industry. Capacity in FY25 is expected to be 4.6 mn MT in FY25 and is expected to increase to 5.7 mn MT in FY26.

High Debt: The gross D/E is high at 0.46 and the net D/E is at 0.33. The absolute number of debt is also large. Although the current profits and cash flows are sufficient to service the debt, any adverse period could impair its ability to service these. The capex program undertaken by the company also requires more borrowings.

Coal block litigation: JSW Steel Limited ('JSW') had been declared as successful bidder for Parbatpur Coal Block in and vesting order dated June 08, 2023 was issued by the Ministry of Coal in favour of JSW. JSW as being claimed by them took over the physical possession of said coal block and has therefore requested to initiate negotiations for utilization of movable property/ assets used in coal mining. Pending determination of the amount of claim, the Company has approached Hon'ble Delhi High Court and the matter is pending currently. The company's management is actively pursuing to revise and determine the amount of entire compensation for the coal block including mine infrastructure, land and all other related assets in terms of Coal Mines Act, 2015 and is taking all the necessary legal and other steps for the same.
Pending finalisation of the matter; (1) Rs.128884.11 lakhs incurred pertaining to the coal block till March 31, 2015 after setting off income, stocks etc. there against as per the accounting policy then followed by the Company has been continued to be shown as freehold land, capital work in progress, other fixed assets and other respective heads of account; (ii) Interest and other finance cost for the year ended March 31, 2016 against the Fund borrowed and other expenses directly attributable in this respect amounting to Rs. 9514.74 lakhs has been considered as other recoverable under current assets; and (iii) Compensation of Rs. 8312.34 lakhs so far received and net realisations/claims against sale of assets, advances, input credits etc. amounting to Rs. 2090.04 lakhs have been adjusted. Bank guarantee amounting to Rs. 920.00 lakhs has been given against the compensation received.

Company Background:

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It caters to a large customer base spread in the Indian subcontinent, South East Asia, Middle East, Africa, USA etc. More than 13,000 water supply projects have already been implemented in India and abroad with ductile iron spun pipes and fittings made by ECL.

Subsidiaries:

Sl. No.	Name of the Company	Status
1.	Electrosteel Europe, S.A.	Subsidiary
2.	Electrosteel Castings (UK) Limited	Subsidiary
3.	Electrosteel Algerie SPA	Subsidiary
4.	Electrosteel USA, LLC and its wholly owned subsidiary, WaterFab LLC, USA	Subsidiary
5.	Electrosteel Trading, S.A.	Subsidiary
6.	Electrosteel Doha for Trading LLC	Subsidiary
7.	Electrosteel Castings Gulf FZE	Subsidiary
8.	Electrosteel Bahrain Holding W.L.L. and its wholly owned subsidiary, Electrosteel Bahrain Trading WLL	Subsidiary
9.	Electrosteel Brasil Ltda. Tubos e Conexoes Duteis	Subsidiary
10.	North Dhadhu Mining Company Private Limited	Joint Venture

(Source: Company, HDFC Sec)

Key Products:

(Source: Company, HDFC Sec)

Key Clients:

ISRO

Vikram Sarabhai Space Centre

Kargil

India's New Parliament Building

Boeing Corporation

Pfizer Facility

BMW (Wallersdrof, Germany)

Ras Abu Aboud Stadium, Qatar

Doha Metro

Hamad International Airport

WWTP, Okhla

French Atomic Centre

(Source: Company, HDFC Sec)

Applications:

Drinking water/ irrigation

- Clear and Raw Water Transmission
- Distribution Network of Potable Water
- Irrigation Application

Industrial applications

- Ash-Slurry Handling & Disposal System
- Fire-Fighting Systems (Onshore & Offshore)
- Desalination Plant

Sewage and Wastewater Disposal

- Gravity Sewage Collection & Disposal
- Effluent Disposal of Domestic & Industrial Waste
- Storm Water Drainage

Miscellaneous applications

- Vertical Connection to Utilities & Reservoirs
- Piling for Ground Stabilization
- Protective Piping under Major Carriage Ways

(Source: Company, HDFC Sec)

Financials (Consolidated)

Income Statement

(Rs cr)	FY23	FY24	FY25E	FY26E
Net Revenues	**7276**	**7478**	**7945**	**8867**
Growth (%)	***37.8***	***2.8***	***6.2***	***11.6***
Operating Expenses	6538	6300	6603	7384
EBITDA	**738**	**1178**	**1343**	**1483**
Growth (%)	***5.7***	***59.8***	***13.9***	***10.5***
EBITDA Margin (%)	***10.1***	***15.8***	***16.9***	***16.7***
Depreciation	121	125	139	157
Other Income	85	102	103	115
EBIT	**701**	**1156**	**1307**	**1441**
Interest expenses	286	219	184	158
PBT	**415**	**937**	**1123**	**1284**
Tax	99	197	281	321
PAT	**316**	**740**	**842**	**963**
Share of Asso./Minority Int.	0	0	0	0
Adj. PAT	**316**	**740**	**842**	**963**
Growth (%)	***-9.1***	***134.3***	***13.9***	***14.3***
EPS	5.3	12.0	13.6	15.6

Balance Sheet

Particulars	FY23	FY24	FY25E	FY26E
SOURCE OF FUNDS				
Share Capital	59	62	62	62
Reserves	4323	5051	5807	6683
Shareholders' Funds	**4383**	**5113**	**5869**	**6745**
Minority Interest	1	2	2	2
Total Debt	2667	2332	2037	1907
Net Deferred Taxes	320	305	305	305
Other Non-curr. Liab.	66	274	291	324
Total Sources of Funds	**7437**	**8025**	**8503**	**9283**
APPLICATION OF FUNDS				
Net Block & Goodwill	2733	2930	3505	3805
CWIP	1302	1229	614	307
Investments	161	204	204	204
Other Non-Curr. Assets	103	313	333	372
Total Non Current Assets	**4300**	**4677**	**4657**	**4689**
Inventories	2269	2273	2394	2696
Debtors	1056	1365	1524	1943
Cash & Equivalents	412	400	602	634
Other Current Assets	481	392	435	486
Total Current Assets	**4218**	**4432**	**4956**	**5760**
Creditors	587	548	544	534
Other Current Liab & Provisions	495	536	566	632
Total Current Liabilities	**1082**	**1083**	**1110**	**1166**
Net Current Assets	3137	3348	3846	4594
Total Application of Funds	**7437**	**8025**	**8503**	**9283**

(Source: Company, HDFC Sec)

Cash Flow Statement

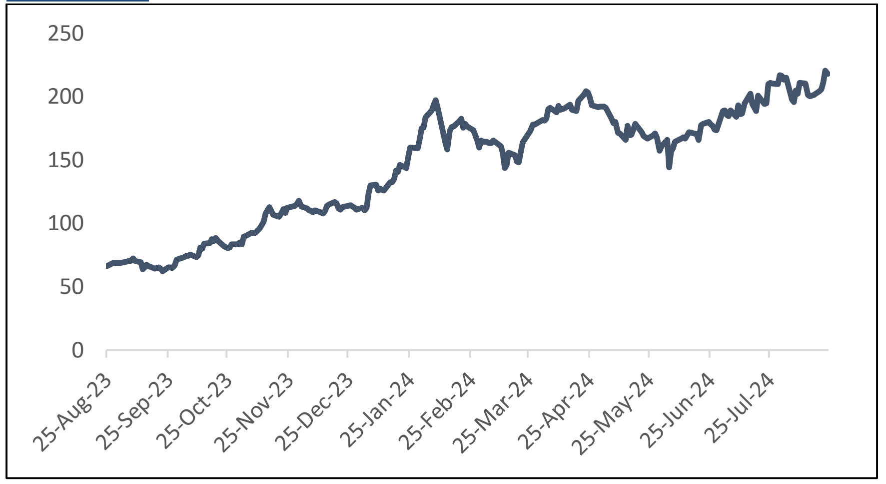
(Rs cr)	FY23	FY24	FY25E	FY26E
Reported PBT	415	937	1,123	1,284
Non-operating & EO items	65	6	-3	-5
Interest Expenses	237	160	184	158
Depreciation	121	125	139	157
Working Capital Change	-257	-190	-296	-716
Tax Paid	-128	-233	-281	-321
OPERATING CASH FLOW (a)	**452**	**806**	**867**	**556**
Capex	-184	-240	-100	-150
Free Cash Flow	268	565	767	406
Investments	269	-35	0	0
Non-operating income	83	239	0	0
INVESTING CASH FLOW (b)	**168**	**-37**	**-100**	**-150**
Debt Issuance / (Repaid)	-331	-512	-295	-130
Interest Expenses	-256	-210	-184	-158
FCFE	34	48	288	118
Share Capital Issuance	0	0	0	0
Dividend	-48	-84	-87	-87
Others	31	85	0	0
FINANCING CASH FLOW (c)	**-604**	**-720**	**-565**	**-374**
NET CASH FLOW (a+b+c)	**17**	**49**	**202**	**32**

Key Ratios

(Rs cr)	FY23	FY24	FY25E	FY26E
Profitability Ratios (%)				
EBITDA Margin	10.1	15.8	16.9	16.7
EBIT Margin	9.6	15.5	16.4	16.3
APAT Margin	4.3	9.9	10.6	10.9
RoE	7.4	15.6	15.3	15.3
RoCE	9.9	16.0	17.0	17.4
Solvency Ratio (x)				
Net Debt/EBITDA	3.1	1.6	1.1	0.9
Net D/E	0.5	0.4	0.2	0.2
PER SHARE DATA (Rs)				
EPS	5.3	12.0	13.6	15.6
CEPS	7.3	14.0	15.9	18.1
BV	73.7	82.7	94.9	109.1
Dividend	0.9	1.4	1.4	1.4
Turnover Ratios (days)				
Debtor days	50.1	59.1	66.4	71.4
Inventory days	113.2	110.9	107.2	104.8
Creditors days	30.5	27.7	25.1	22.2
VALUATION				
P/E	41.0	18.2	16.0	14.0
P/BV	3.0	2.6	2.3	2.0
EV/EBITDA	21.2	12.9	11.0	9.8
EV / Revenues	2.1	2.0	1.9	1.6
Dividend Yield (%)	0.4	0.6	0.6	0.6
Dividend Payout (%)	16.9	11.7	10.3	9.0

(Source: Company, HDFC Sec)

Price chart



(Source: Company, HDFC sec)

RISHAB A JAIN

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HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

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