

Dear Member,

We are pleased to inform you that Value Pick of July 2018 is released by our team today on 02nd Sept 2018. Value Pick stock of the month is Sarda Energy and Minerals Ltd (**BSE Code: 504614, NSE Code: SARDAEN**). Sarda Energy and Minerals has a market capital of Rs. 1527 crores and operates in steel & Iron industry.

1. Company Background:

Sarda Energy & Minerals Ltd is one of the lowest cost producers of steel (Sponge Iron, Billets, Ferro Alloys, Mining, Power, Pellets, Iron Ore, Wire Rod Mill, Eco Bricks) and one of the largest manufacturers and exporters of ferro alloys in India. Headquartered in Raipur, Chhattisgarh, the company merged Chhattisgarh Electricity Company Limited (CECL) with itself in 2007 with a vision to becoming a leading energy and minerals company.

Over the last three decades the company has continuously diversified its product portfolio to include many customized value added products. The company firmly believes in benchmark product quality, customer centric approach, people focus, ethical business practices and good corporate citizenship. Building on these values, SEML has become the supplier of choice for many domestic and international customers across more than 60 countries.

Sarda Energy has consciously built its facilities at Raipur and Visakhapatnam. Raipur has proximity to the mineral base and Visakhapatnam gives the company easy access to the seaport. Both these facilities enable the company to be close to its customers in India and abroad. With these facilities at strategic locations, Sarda Energy has improved reach across India and considerable savings in logistics.

On the backdrop of a favourable positive steel cycle for next five to seven years, the company has initiated expansion programs of its steel-production capacity at Raipur and ferro alloys production capacity at Visakhapatnam. Besides, the company is also enhancing its pellet production capacity by 2 lakh metric tonne without incurring any additional capex.

Mr. Kamal Kishore Sarda is the Chairman and Managing Director of the company. He holds mechanical engineer degree with nearly 42 years of experience in Iron and steel industry. He is responsible for steering the company on the path of growth. Mr. Pankaj Sarda is Joint Managing Director. He has done Master of Science in Industrial Administration from Purdue University, USA, with nearly 15 years of industrial experience. Mr. Padam Kumar Jain is the Wholtime Director and CFO of the company. He is a CA, CS with a rich experience of 32 years in the field of accounting, finance, taxation, costing and corporate laws.

2. Recent Developments:

i) Rising Prices of Iron Ore Pellets to augur well for the Company

Prices of iron ore pellets jumped to their highest in three years in August, benefiting exporters of the key steelmaking raw material. Indian steelmakers too stand to gain as they remain insulated from the hike since they produce their own pellets.

Prices of pellets rose 29 percent over the last one month to Rs 8,100 a tonne. This has also pushed up prices of finished goods. Such rates are likely to persist over the next few months, benefiting steelmakers

There are three reasons that are driving pellet prices:

- i) Environmental concerns are driving China's appetite for high-grade pellets.
- ii) Outage at Brazil's Samarco mines. The mines are unlikely to start operations this year.
- iii) Force majeure by Swedish player LKAB disrupted third-party supplies.

Average price of pellets is Rs 6,797 per tonne in the ongoing September quarter, higher than the Rs 4,000-5,000 a tonne level in financial years through March 2016 and 2017

Some correction is now possible in pellet prices after the sharp rally due to Chinese demand but the prices are expected to settle at significantly higher levels than in the first quarter of the ongoing financial year.

Increasing crude steel production ahead of more stringent winter cuts (compared to last year) led to a steep hike in export of pellets, creating a supply shortage in the domestic market which will lead to better pricing for local producers like Sarda Energy & Minerals Ltd.

ii) Hydro Power Projects to de-risk the Company's Steel Business

On the hydropower front, the company commissioned its 24-megawatt hydropower plant at Gullu, in Chhattisgarh. The company's strategic foray into hydropower is a conscious attempt to generate green energy and add perennial stream of cash flow to sustain the down turn and de-risk itself from the cyclical effect of the steel industry. There has been very low capacity addition in the hydropower generation as against a sequential rise in demand over the past few years.

This would allow the company to fetch higher realisations per unit going ahead. The company is quite optimistic about its upcoming hydro project in Sikkim. It will significantly add to the company's revenues and strengthen its bottom line, once it comes in stream in the financial year 2019-20.

3. Financial Performance:

Sarda Energy & Minerals consolidated net profit declines 15.92% in the June 2018 quarter

Net profit of Sarda Energy & Minerals declined 15.92% to Rs 44.58 crore in the quarter ended June 2018 as against Rs 53.02 crore during the previous quarter ended June 2017. Sales rose 26.98% to Rs 618.40 crore in the quarter ended June 2018 as against Rs 487.00 crore during the previous quarter ended June 2017.

Sarda Energy & Minerals standalone net profit rises 199.13% in the March 2018 quarter

Net profit of Sarda Energy & Minerals rose 199.13% to Rs 54.98 crore in the quarter ended March 2018 as against Rs 18.38 crore during the previous quarter ended March 2017. Sales rose 70.84% to Rs 389.99 crore in the quarter ended March 2018 as against Rs 228.28 crore during the previous quarter ended March 2017.

For the full year, net profit rose 43.19% to Rs 187.87 crore in the year ended March 2018 as against Rs 131.20 crore during the previous year ended March 2017. Sales rose 43.89% to Rs 1470.75 crore in the year ended March 2018 as against Rs 1022.11 crore during the previous year ended March 2017.

4. Investment Rationale:

i) India will require huge investment for infrastructure development. Investment will be required across all sectors ranging from road, airports, shipping, power, logistics and telecom. Steel consumption for housing construction is also likely to rise due to the housing for all initiatives which aims to build around 12 million units in urban areas over next three years and 10 million units in rural areas by 2019. Additionally, demand from automobile industry and expansion of the pipeline network for transporting petroleum products is also set to increase the demand for steel.

ii) Favourable domestic demand and remunerative prices in both domestic and international markets are likely to bolster steel production further in the years to come, resulting into more demand for sponge iron. The captive mineral resources provide competitive advantage to the company with scope for sustainable expansion.

iii) Various steps taken during tough times have led the company to reduce wastage, cut overall costs and maintain quality. The initiatives have resulted in improving the production levels without altering the raw material mix or allocating any additional resources. Sarda Energy financial prudence and cost rationalisation has further allowed the company to maintain low leverage, thus providing a cushion in adverse market scenario.

iv) Company's operational Iron Ore mine has potential reserves of 180 Lakh MT and annual production output of 4 Lakh MT. Iron ore business act as a feeder to Pellet & Sponge Iron Plants. As per company's growth strategy, iron ore production will be increased up to 5 Lakh MT in FY2019 based on requirement from Sponge and Pellet plant.

v) The company has pellet production capacity of 6 lakh tonnes. Total 65% of the production is sold externally and remaining processed internally for further downstream production. The company has applied for environmental clearance for 8.0 lakh tonne, expected to received during the year. Pellet are consumed as raw materials by local sponge iron plants.

vi) The company has sponge Iron production capacity of 3.6 lakh tonnes. Since India has ample supply of thermal coal, sponge iron is preferred route of steel making in the country. 40 to 45 percent of iron ore is used internally by the company and remaining is sold in local markets.

vii) In steel business, the company produces billet, wire rod and HB wire. The company has production capacity of 2 lakh tonne of billet, 1.8 lakh tonne of wire rod and 30,000 tonne of HB wire. The company plans to expand steel billet capacity to 3 lakh tonne in FY19, increase in billet production capacity will lead to rise in production of wire rods without any incremental capex. The company is well positioned with complete back end integration to enhance capacity.

viii) Under Ferro Alloy business, the company has two operational plants of Ferro Alloys which are located at Raipur and Vizag with a total installed capacity of 111 MVA. The company manufacturers manganese based Ferro Alloys which is sold domestically as well exported to other countries.

ix) The increasing environmental awareness and Govt. push provides a lot of opportunity in renewable energy sector. Sarda Energy is having allocation of multiple small hydro power projects and plans to execute all these projects. Having gained experience in this field, the company is well placed to take advantage of emerging opportunity in hydro power segment. The company's Sikkim Hydro Power plant (96 MW) will be commissioned by FY 2020 and Chhattisgarh power plant (24 MW) will be commissioned by FY 2022.

x) Sarda Energy & Minerals has registered sales CAGR of 7.3%, profit CAGR of 14.3% during last 3 years with ROE of 8.3%. As on June 2018, promoter's shareholding in the company is at 72.50% without any pledging of shares. Institution shareholding in the company is at 2.83%. The company is paying regular dividend since FY2003-04. The company has paid highest dividend of Rs. 5 per share for FY17-18, dividend yield at current price is at 1.18%.

xi) As per our estimates, Sarda Energy can deliver PAT of 214.50 crores for full financial year 2018-19 with annualized EPS of Rs. 59.5. At current price of Rs. 423.45, stock is available at forward P/E multiple of 7.1X based on FY18-19 earnings which makes it attractively valued at current levels.

5. Key Concerns & Risks:

i) Steel imports from South Korea and Japan may surge due to the US imposition of a 25 percent duty. Chinese exports have also slowed down considerably. In the current scenario where steel demand is slowing down in China and exports to the US are restricted, Chinese exports may seek to re-enter a growing Indian market directly or indirectly which can adversely impact the domestic players in the Industry.

i) Ferro Alloys is purely dependent on the demand for steel in the country, cheaper steel imports from countries like China can cause havoc to the domestic steel companies which can impact the demand for Ferro Alloys.

ii) Highly volatile prices of Chrome ore and manganese ore also pose a risk to the realizations of the domestic ferro alloy producers.

6. Saral Gyan Recommendation:

The Company foresees a good opportunity and base for growth in its core area of operations owing to strong manufacturing base, developed infrastructure, sufficient land in possession, environmental clearances, strong financials and available mineral resources. Moreover, with the Government focusing on increasing the non-renewable energy, the company with its presence into the hydro power segment through its subsidiaries offers a bright future in this segment. The company, being an integrated steel and ferro alloys producer, expects to improve its profitability margins owing improved efficiency of plants, improved revenue stream from its products.

Considering overall positive outlook of steel sector with rising demand domestically, company's initiatives towards backward integration to compliment its different business divisions to improve efficiency and profitability, expansion plans of the company for steel and ferro alloys production capacity and comfortable debt to equity ratio with stable financials, Saral Gyan team recommends "Buy" on Sarda Energy & Minerals Ltd at current market price of Rs. 423.45 for target of 700 over a period of 12 to 24 months.

Buying Strategy:

- 80% at current market price of 423.45
- 20% at price range of 350 – 380 (in case of correction in stock price in near term)

Portfolio Allocation: 3% of your equity portfolio.

LEGAL DISCLAIMER: Saral Gyan Capital Services (hereinafter referred as 'Saral Gyan') is an independent equity research Company. Use of the information herein is at one's own risk. This is not an offer to sell or solicitation to buy any securities and Saral Gyan will not be liable for any losses incurred or investment(s) made or decisions taken/or not taken based on the information provided herein. Information contained herein does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual investors. Before acting on any recommendation, investors should consider whether it is suitable for their particular circumstances and, if necessary, seek an independent professional advice. All content and information is provided on an 'As Is' basis by Saral Gyan. Information herein is believed to be reliable but Saral Gyan does not warrant its completeness or accuracy and expressly disclaims all warranties and conditions of any kind, whether express or implied. As a condition to accessing Saral Gyan content and website, you agree to our Terms and Conditions of Use. The performance data quoted represents past performance and does not guarantee future results.

DISCLOSURE WITH REGARDS TO OWNERSHIP AND MATERIAL CONFLICTS OF INTEREST:

- a. 'subject company' is a company on which a buy/sell/hold view or target price is given/changed in this Research Report
- b. Neither Saral Gyan, it's Associates, Research Analyst or his/her relative have any financial interest in the subject company.
- c. Neither Saral Gyan, it's Associates, Research Analyst or his/her relative have actual/beneficial ownership of one percent or more securities of the subject company
- d. Neither Saral Gyan, it's Associates, Research Analyst or his/her relative have any other material conflict of interest at the time of publication of the research report.

DISCLOSURE WITH REGARDS TO RECEIPT OF COMPENSATION:

- a. Neither Saral Gyan nor it's Associates have received any compensation from the subject company in the past twelve months.
- b. Neither Saral Gyan nor it's Associates have managed or co-managed public offering of securities for the subject company in the past twelve months.
- c. Neither Saral Gyan nor it's Associates have received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months.
- d. Neither Saral Gyan nor it's Associates have received any compensation for products or services from the subject company.
- e. Neither Saral Gyan nor it's Associates have received any compensation or other benefits from the subject company or third party in connection with the research report.

GENERAL DISCLOSURES:

- a. The Research Analyst has not served as an officer, director or employee of the subject company.
- b. Saral Gyan or the Research Analyst has not been engaged in market making activity for the subject company.

Definitions of Terms Used:

- a. Buy recommendation: This means that the investor could consider buying the concerned stock at current market price keeping in mind the tenure and objective of the recommendation service.
- b. Hold recommendation: This means that the investor could consider holding on to the shares of the company until further update and not buy more of the stock at current market price.
- c. Buy at lower price: This means that the investor should wait