Surya Roshni Limited

Iron & Steel and Lighting Products

CMP: Rs 76.8/ CIV: Rs 95 Sensex: 20,865

October 23, 2013

Good Fundamentals, Moderate Upside Potential

Initiating Coverage

CARE EQUIGRADE Grid (CEG)

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Fundamentals					
Valuation					

CEG is explained on page 12

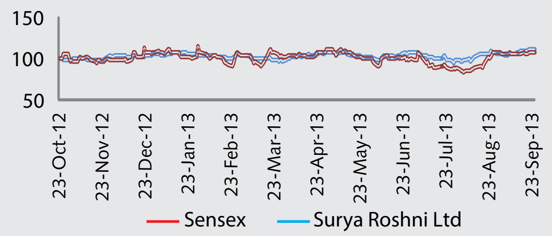
Key Equistats

Market Capitalisation	Rs. Crores	336.4
Enterprise Value	Rs. Crores	1,453.8
52 Week High / Low	Rs.	84/59
Diluted EPS (FY13)	Rs.	16.8
P/E (FY13)	times	4.6
Regression Beta	times	0.7
Average Daily Volumes*	Lakhs	0.5

*NSE+BSE for last 52 weeks

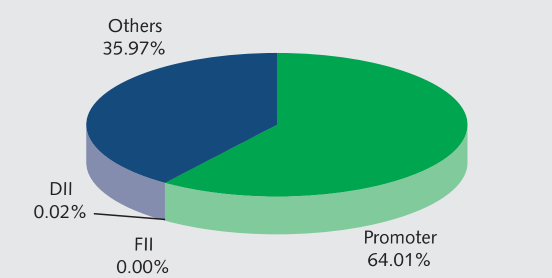
Stock Performance

Price Movement (rebased on 100)



Returns	1M	3M	6M	1 Yr
Absolute	0%	10%	5%	8%
Rel. to Sensex	(4%)	7%	(3%)	(3%)

Shareholding Pattern



Analytical Contacts

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*CMP: Current Market Price; CIV; Current Intrinsic Value

CARE Equity Research assigns a fundamental grade of 3/5 to Surya Roshni Ltd (SRL)

CARE Equity Research assigns a fundamental grade of 3/5 to SRL. This indicates 'Good Fundamentals'. The grading factors in the company's market position of being one of the largest players in the Electric Resistance Welded (ERW) pipes and lighting products in India with a strong reach of more than 200,000 retail outlets across country. The fundamentals of the company gain strength from healthy revenue diversification - steel (70%), and lighting (30%) which mitigates risk from slowdown from any one segment. Further the company has also diversified into manufacturing of Poly Vinyl Chloride (PVC) pipes, though the contribution to the total sales is still negligible. The company has high degree of vertical integration in the lighting division and is one of the leading manufacturers of lighting products i.e. FTLs, GLS Lamps and CFLs with significant market presence through its wide retailer network across the country. In the steel division, SRL has augmented its position by setting up a manufacturing capacity of 200,000 MTPA (Metric Tonne Per Annum) of spiral pipes and 172,000 MTPA of ERW pipes to cater to the export market and the western region of the country. The company has presence in international market also with exports constituting around 11.7% of the total turnover in FY13. Going forward, the revenue of the company is expected to grow at a CAGR of ~10.5% (FY13-15) on the back of healthy demand for Indian pipe industry in the long term, both on the domestic and global fronts, on the back of increasing demand arising from the oil and gas, infrastructure, water supply and sanitation projects. In the lighting division, the increasing penetration of electricity in the country and development of infrastructure both in the private and public sector shall also augur well for lighting product manufacturers which have products in home, commercial as well as industrial lightings in their portfolio.

Valuation

We have valued the equity shares of SRL at Rs.95 per share. The valuation has been arrived at using the discounted cash flow valuation methodology based on five year consolidated financial estimates. The CIV of Rs.95 per share is around 24% above the Current Market Price (CMP) of Rs.76.8 per share; hence we assign a valuation grade of 4/5 to the equity shares of SRL, indicating that equity shares of SRL have 'Moderate Upside Potential.'

Financial Information Snapshot (Consolidated)

(Rs. Crores)	FY12	FY13	FY14E	FY15E
Operating Income	3057	3569	3959	4380
EBITDA	231	310	344	374
PAT (After minority interest)	52	73	88	109
Fully Diluted EPS* (Rs.)	11.9	16.8	20.1	24.9
Dividend Per Share (Rs.)	0.0	4.7	1.1	1.1
P/E (times)	6.4	4.6	3.8	3.1
EV/EBITDA (times)	6.2	4.7	4.4	4.0

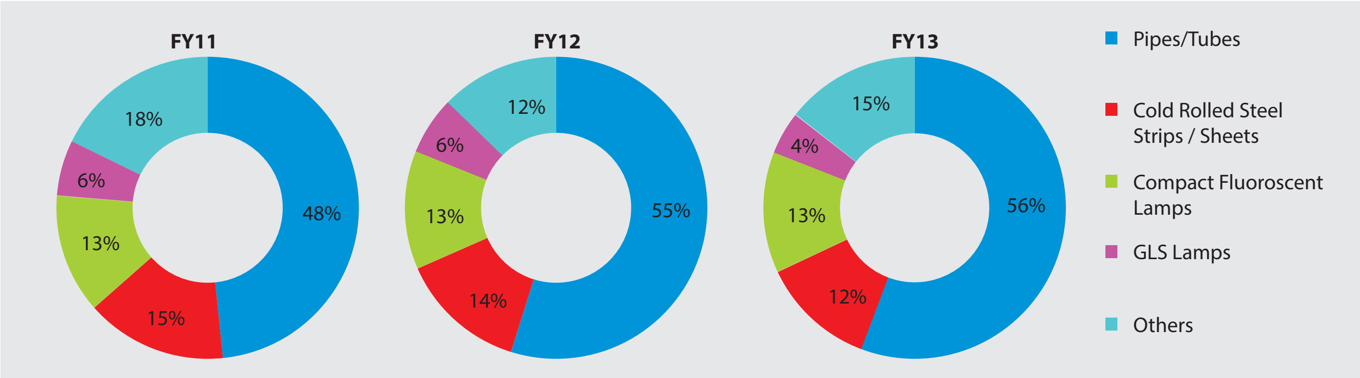
* Calculated on Current Face Value of Rs.10/- per share

FUNDAMENTAL GRADE	Good Fundamentals	3/5

Diversified product portfolio

The company has a diversified product portfolio which covers a range of steel products viz ERW pipes, Spiral Pipes, Cold Rolled (CR) strips, and lighting products. Among the lighting products, the company produces General Lighting System (GLS), Fluoroscent Tubular Lamps (FTLs), Compact Fluoroscent Lamps (CFLs), high mast luminaries (lights for commercial and industrial applications), etc. Apart from these the company also manufactures Poly Vinyl Chloride (PVC) pipes which are used in the housing segment. The steel product of the company find application in varied sectors such as domestic, agriculture, heating and ventilation, chemical, automobile industries, power, sugar, oil and gas, etc. The diversified product portfolio helps the company minimize the risk associated with slowdown in a single industrial sector and also provides better growth opportunities.

SRL (Standalone): Revenue share of various products



Source: Company and CARE Equity Research

As visible from the graph above, steel remains the mainstay of company's operations while lighting products supports the diversification. The sales of CFL forms around 13% of total sales since FY11. The company is focusing more on lighting products and added Light emitting diode (LED) bulbs to its lighting portfolio in FY13. The total share of steel pipes has witnessed an increase from 48% of revenue in FY11 to 56% in FY13. Others include various products such as FTLs, Filaments, PVC pipes, glass shells, scrap etc.

Established brand name and wide distribution network with presence in export markets

Apart from the product diversification mentioned above, the company also has significant market diversification. SRL has an established brand name of 'Surya' for its lighting products and 'Prakash Surya' for its steel products. The company also has a strong marketing network of around 1,500 dealers and 200,000 retailers spread across the country for its lighting portfolio while it has a dealer network of around 150 dealers and 20,000 retailers for selling its steel products. SRL exports its lighting products and American Petroleum Institute (API) certified ERW pipes to more than 45 countries across the world including the United Arab Emirates (UAE), Canada, Netherland, United Kingdom (UK), USA, Australia, etc. Exports constituted 11.7% of total sales of SRL in FY13. SRL has also received API certifications (API 5L, API 5CT) for its ERW and spiral pipes which helps the company secure orders from the oil and gas sector in the export market. The company has also got various other certifications i.e. ISO 9001:2008, ISO 14001:2004 and also the Organizational Health and Safety (OHSAS 18001:2007)

Subsidiary to strengthen SRLs presence in steel pipe segment

Surya Global Steel Tube Limited (SGL) established on May 9, 2008 is a 53.73% subsidiary of Surya Roshni Limited (SRL). SGL is engaged in the manufacturing of ERW steel pipes and API grade ERW and spiral steel pipes. These pipes find utility in oil & gas industry, agriculture, water transportation and civil construction, etc.

Subsidiary Information (Year ended Sept 30, 2012)

Rs. Crore

Company	Activity	Ownership of SRL %	Total Income	Net Profit	Tangible Networth	Total Debt
Surya Global Steel Tubes Ltd	Manufacturing of Steel pipes	53.73	610.3	7.8	157.3	385.4

Source: Company

The manufacturing facility of SGL is located at Kutch, Gujarat and started commercial operations in January 2010 for ERW pipes The company started production of spiral pipe in June 2010 and ERW pipe of API standard in July 2011. The company has an installed capacity of 2,00,000 Metric Tonne Per Annum (MTPA) of spiral pipes, 72,000 MTPA of ERW pipes and 1,00,000 MTPA of API grade ERW pipes. The company primarily caters to the domestic pipe demand from the western region of the country along with exports to the countries like North America, Europe and Middle East. During FY12 (A), export constituted around 34% of the total sales of SGL.

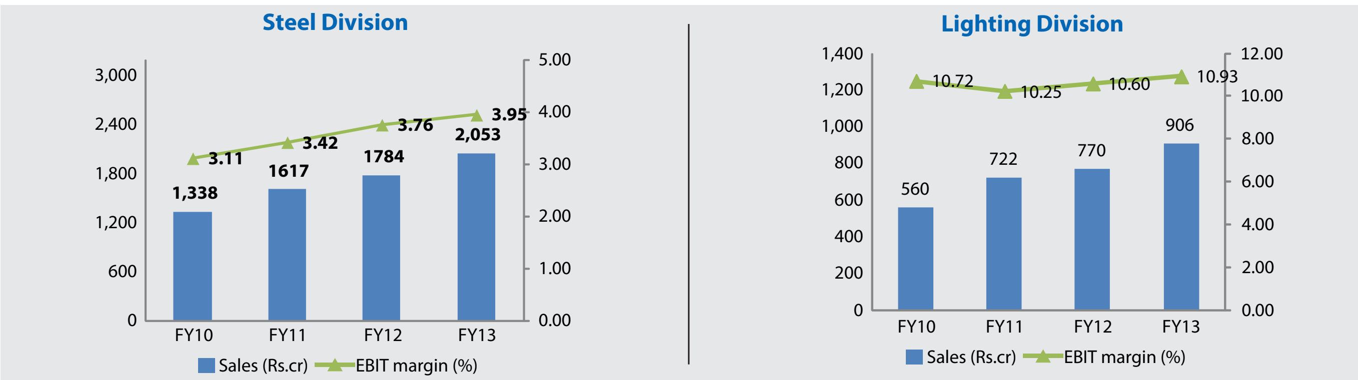
From 'Sand' to 'Light'; integrated lighting operations help post healthy margins

The company has inhouse manufacturing facility to manufacture glass from sand, Printed Circuit Boards (PCBs) for its CFLs and FTLs and most of the major components of lighting products viz. ballasts, filaments, caps etc. Furthermore, the company also manufactures the entire range of lighting products which finds application in domestic, industrial and commercial segments. This high level of integration helps the company achieve better control on the entire value chain and thus results in better profitability margins. The FTL of the company have also received the 5 star rating by the Bureau of Energy Efficiency (BEE) indicating high energy efficiency. The company also has in house Research & Development (R&D) laboratory in Noida (Uttar Pradesh) which is accredited by the Department of Scientific and Industrial Research (DSIR). The laboratory is involved in design and development of new products in the lighting segment viz. Light Emitting Diodes (LED) lights, induction lights, etc. The shifting focus on energy saving products in the country augurs well for the company which has significant presence in the CFL segments. Further, the company also expects stable demand from the GLS segments which finds high acceptability in the rural and semi urban areas due to the cost advantage attached to them.

Steel operations to fuel sales growth; however margins expected to continue to be low

In the steel division, the company acts as a converter where it converts the Hot Rolled (HR) coils into CR sheets and steel pipes. The steel division contributed majority of the total sales for SRL however, the margins for the steel division have remained low as the process for converting HR coils into pipe and CR sheet entails limited value addition. This low value addition coupled with lesser control over the raw material results in lower margins compared to the lighting division wherein the company has high degree of control over the value chain. The trend of EBIT margins for the company in the steel and lighting divisions is as below:

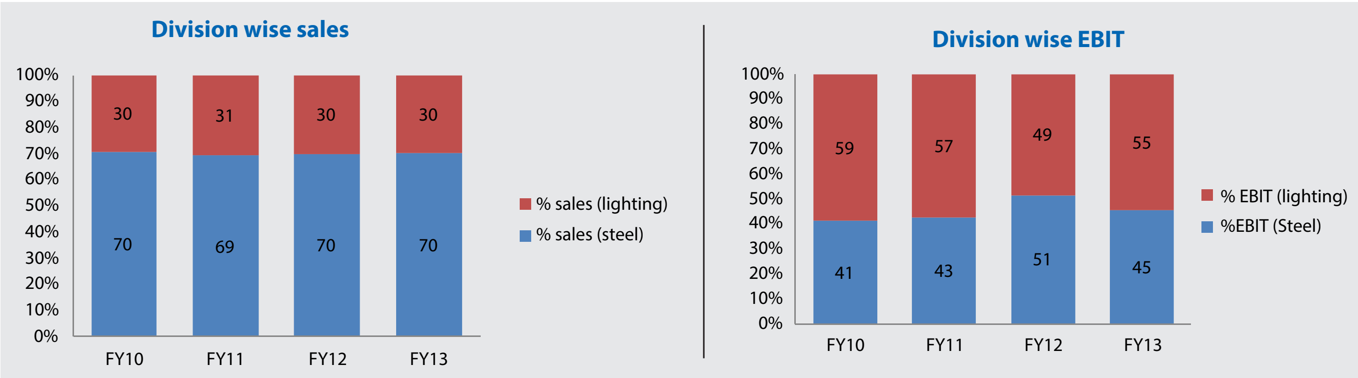
SRL (Standalone): Division wise sales & profitability



Source: Company and CARE Equity Research

Despite witnessing healthy margins in the lighting division, the margins for the company remain low due to low margin in the steel division which contributes more than 50% to the total sales. The division wise contribution of steel and lighting division for FY10-13 is as below:

SRL (Standalone): Division wise share of sales and EBIT



Source: Company and CARE Equity Research

As visible from the table above, the lighting division contributes about 30% of the sales for the company at the standalone level, however, its contribution in the EBIT is relatively high and contributed around 55% of the EBIT in FY13. On a consolidated level, the proportion of sales and EBIT for lighting is marginally less due to the operations of SGL which commenced from FY11 and has contributed to company's sales in the steel division. Further, the long term demand from the steel division is expected to remain healthy both on the global as well as domestic fronts, on the back of increasing demand arising from oil and gas, infrastructure, water supply and sanitation projects. This shall bode well for SRL and shall support the growth in the steel division.

Commodity nature of business with high competitive intensity

The steel industry is sensitive to the shifting business cycles, including changes in the general economy, interest rates and seasonal changes in the demand and supply conditions in the market. Apart from the demand side fluctuations, the highly capital intensive nature of steel projects along-with the inordinate delays in the completion hinders the responsiveness of supply side to demand movements. This results in several steel projects bunching-up and coming on stream simultaneously leading to demand supply mismatch. Furthermore, the value addition in the steel products like pipes and sheets is also low, resulting into low product differentiation in the market. The steel producers are essentially price-takers in the market, which directly expose their cash flows and profitability to volatility in the steel prices. The company procures its major raw material viz HR coil from various reputed players in India such as Steel Authority of India Ltd (SAIL), Essar Steel, JSW Steel, etc. However, the company does not enter any long term price contract for the raw material which exposes the company to the risk of raw material price variations. Further in the lighting industry, the company is facing competitive pressures from various organized and unorganized players and also from cheap imports from China. With CFL constituting the majority of the sales in the lighting division for SRL, presence of players like Philips, Osram, Havells and cheap imports from China is expected to provide stiff competition to SRL.

Experienced promoters with long track record of profitable operations and strong marketing network

The company started its steel business in 1973 and later diversified into the lighting business in 1985. The company has shown consistent growth in income and profitability over the years with income and EBIDTA growing at a CAGR of 18.2% and 22.6% respectively during FY10-13. The promoter of the company, Mr. J P Agarwal has rich experience of about four decades in the industry and is supported by a management team consisting of experienced professionals in the steel and lighting segments.

The company also has a widespread marketing network with separate teams focusing on the steel and lighting divisions. Further, within the steel and lighting divisions also, the company has subdivisions catering to various segments i.e. general trade, industrial, Government and export thus having clear focus on each category of consumers. The company has a strong market reach to more than 2,00,000 retailers across the country through its branch network of 30 offices.

In compliance with listing agreement 49

As on June 30, 2013, the Board of Directors (BoD) for SRL consisted of nine directors of which one is Promoter Executive Director, two are Executive and Non- Independent director and six are Non-Executive and Independent Directors, i.e. more than half of the board comprises of Non-Executive and Independent Directors. The board is chaired by Mr. J. P. Agarwal, Promoter and Executive Director. SRL has formed three board level committees- Audit Committee, Shareholders'/Investors' Grievance Committee and Remuneration Committee. All the three committees are chaired by Independent directors as required by the listing agreements.

SRL: Board of Directors

Mr. J. P. Agarwal	Chairman and Promoter Director
Mr. Raju Bista	Managing Director
Mr. Utkarsh Dwivedi	Deputy Managing Director
Mr. K.K. Narula	Non-Executive, Independent Director
Mr. Dev Dutt Das	Non-Executive, Independent Director
Mr. T.S. Bhattacharya	Non-Executive, Independent Director
Mr. R.K. Narang	Non-Executive, Independent Director
Mr. U.K. Mukhopadhyay	Non-Executive, Independent Director
Mr. Mukesh Tripathi	Non-Executive, Independent Director

Source: Company

VALUATION GRADE **Moderate Upside Potential** **4/5**

CARE Equity Research values SRL equity shares at Rs.95 per share; assigns a valuation grade of 4/5

We have valued the equity shares of SRL at Rs.95 per share. The valuation has been arrived at using the discounted cash flow valuation methodology based on five year consolidated financial estimates. SRL has presence in primarily two businesses 1) manufacturing of steel pipes & 2) manufacturing of lighting products. SRL has a single subsidiary Surya Global Steel Tubes Ltd. (SGL) which is also into manufacturing of steel pipes. Since, both SRL and its subsidiary are into manufacturing and of similar products we have used consolidated financials and discounted cash flow methodology to arrive at the valuation for the equity shares of the company. The following are the key inputs for arriving at the valuation.

SRL: Valuation Assumptions

Cost of debt	12.8%
Cost of equity	16.4%
Effective tax rate	14.0%
Debt/ Equity	1.5
WACC	13.2%
Terminal growth rate	3.0%

Source: Company and CARE Equity Research

SRL: Valuation based on DCF methodology

(Rs. Crore except per share data)

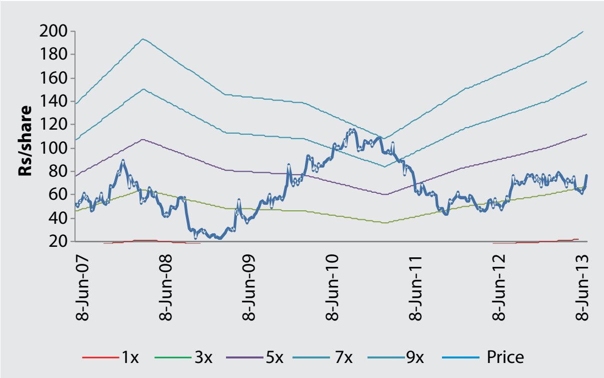
	FY14E	FY15E	FY16E	FY17E	FY18E
PAT (After Minority Interest)	88	109	134	159	180
Depreciation	98	102	103	104	105
Interest (1-Tax Rate)	122	118	116	112	92
Capital Expenditure	(90)	(90)	(95)	(90)	(120)
Increase in Working Capital	(167)	(92)	(129)	(154)	(195)
Free Cash Flow (FCF)	**51**	**147**	**128**	**131**	**62**
Discount Factor	0.94	0.83	0.73	0.65	0.57
PV of FCF	**48**	**122**	**94**	**85**	**35**
PV of Terminal Value					**714**

Total Discounted Value of Firm	1,098
Less: Net Debt (FY13)	627
Less: Minority Interest (FY13)	54
Present Value of equity	416
No of Equity Shares (Crore)	4.38
CIV	**95**

At the current market price of Rs.76.8per share the equity shares of SRL are trading a one year forward rolling P/E multiple of 3.4 times and one year forward rolling EV/EBITDA multiple of 4.2 times. Historically, SRL's equity shares have traded at one year forward rolling average P/E multiple of 3.4 times and one year forward rolling average EV/EBITDA multiple of 4.3 times.

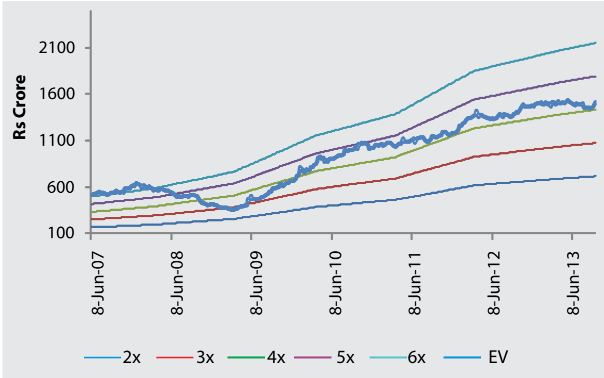
The CIV of Rs. 95 per share as arrived by using the DCF methodology results in one year forward P/E multiple of 4.2 times and one year forward EV/EBITDA multiple of 3.1 times. We feel the resultant multiples are in the range of where the company's equity shares have traded in the past and the CIV arrived by DCF methodology is justified. The slightly higher resultant P/E multiple (than historical levels), factors in the expected improvement in SRL's net margins going ahead.

SRL: One year forward rolling P/E



Source: BSE and CARE Equity Research

SRL: One year forward rolling EV/EBITDA



Source: BSE and CARE Equity Research

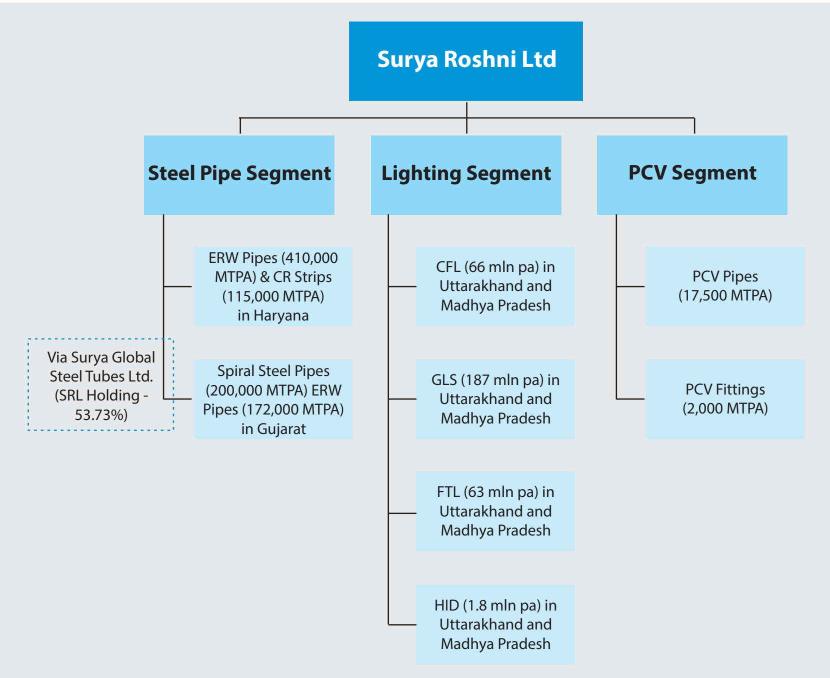
The CIV of Rs. 95 per share is around 23.8% above the current market price (CMP) of Rs.76.8 per share; hence we assign a valuation grade of 4/5 to the equity shares of SRL, indicating that equity shares of SRL have 'Moderate Upside Potential'.

COMPANY BACKGROUND

Incorporated in October 1973 as Prakash Tubes Private Limited by Mr. B. D. Aggarwal and his son Mr. J. P. Aggarwal, SRL commenced operations as a steel pipe manufacturing unit in Bahadurgarh (Haryana). In 1984-85, the company diversified into manufacture of lighting products and established its manufacturing facility at Malanpur (Madhya Pradesh). Currently, SRL operates in two business segments i.e. steel and lighting. Going ahead, company plans to diversify further into PVC pipes; the share of PVC pipes in the total revenue currently is miniscule.

SRL also has a subsidiary Surya Global Steel Tubes Ltd. (SGL) (53.73% share holding) which is also into manufacturing of ERW and Spiral Steel pipes.

SRL: Business segments and production capacities



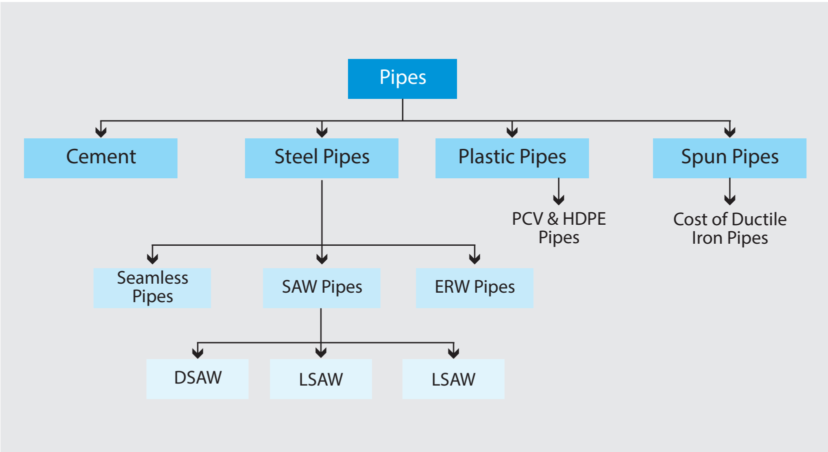
Source: Company

SNAPSHOT OF THE INDUSTRY

Pipe Industry

Pipes can be broadly classified into steel pipes, cement pipes (RCC) and plastic pipes. Steel pipes are widely used and find application in oil & gas distribution, water supply, heavy industries, cold storage, sanitation, housing etc. Cement pipes are used in irrigation systems, sewerage, water supply etc. Plastic pipes are used in irrigation, water supply and agriculture

Structure of Indian Pipe Industry



Source: CARE Research

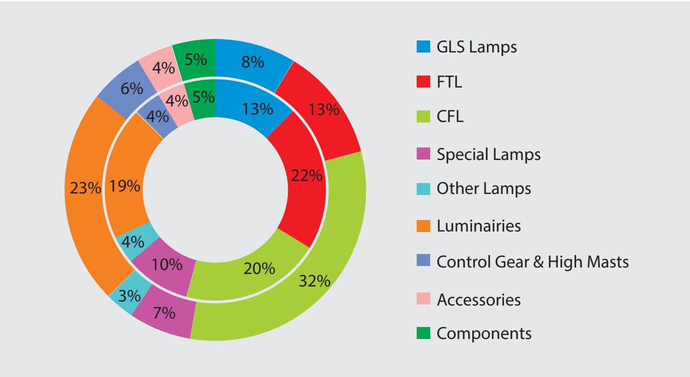
CARE Research estimates global and domestic steel pipes demand for the Indian manufacturers (excluding replacement demand) at 16.2 mn tonnes (USD 19.45 bn) over the next five years from the oil and gas sector alone. Demand from the replacement market is likely to be 10.4 million tonnes for next five years, which remains a significant driving force since most of pipes laid during the 1960s and 1970s primarily in the US & developed nations will need replacement.

ERW pipes are widely used in the City Gas Distribution (CGD) projects. CGD accounted for 6.7% of the total gas consumption at ~13 million metric standard cubic meters per day (mmscmd) as on FY2012 but it is expected to grow to 46 mmscmd by FY2017. While, the Petroleum and Natural Gas Regulatory Board (PNGRB) has plans to cover as many as about 300 towns and cities under CGD, with the current shortfall in gas availability, CGD projects will slow down for next couple of years leading to lower demand for ERW pipes. However, ERW pipes would find application in other areas such as infrastructure projects, water pipelines, etc.

Lighting Industry

The Indian lighting market has been segmented into General Lighting Services (GLS), Florescent Tube Lamps (FTL), Compact Florescent Lamps (CFL), special lamps, other lamps, luminaries, control gear and high mast, accessories and components. The contribution of CFL to the overall lighting market has been increasing over the years given the longer life energy efficiency. In 2011, the Indian Lighting market size was around USD 2 bn. The Indian lighting market has witnessed a CAGR of 12.8% over 2005-2011 periods. The growth of the Indian Lighting market was mainly influenced by demand for CFL. The CFL market has grown at a higher CAGR of 27.2% annually from 2005-2011. Going forward the Indian lighting market is expected to grow at a CAGR 7.6% annually from 2012 till 2016 mainly led by 1) rising population 2) higher personal disposable income 3) changes in government regulation and 4) increase in electrification of households in India.

CFL's account for the major share in the Indian lighting market



Source: Industry
*Note: Inner ring denote market share during CY2007
and Outer ring denotes CY2011

FINANCIAL STATISTICS

Income Statement

(Rs. Crore)	FY10	FY11	FY12	FY13	FY14 E	FY15 E
Operating Income	**1,795**	**2,317**	**3,057**	**3,569**	**3,959**	**4,380**
EBITDA	129	192	231	310	344	374
Depreciation and amortisation	27	55	60	85	98	102
EBIT	102	138	171	225	246	272
Interest	49	68	116	145	142	137
PBT	54	71	56	82	106	137
Ordinary PAT (Before minority interest)	45	67	53	77	95	119
PAT (After minority interest)	**45**	**67**	**52**	**73**	**88**	**109**
Fully Diluted Earnings Per Share* (Rs.)	**10.3**	**15.3**	**11.9**	**16.8**	**20.1**	**24.9**
Dividend, including tax	**6.5**	**7.6**	**0.0**	**20.4**	**5.0**	**5.0**

* Calculated based on ordinary PAT on Current Face Value of Rs. 10/- per share

Balance Sheet

(Rs. Crore)	FY10	FY11	FY12	FY13	FY14 E	FY15 E
Tangible Net worth (including Minority Interest)	256	490	542	598	688	803
Debt (incl. Preference Shares)	296	923	1,120	1,137	1,206	1,181
Deferred Liabilities	56	54	53	45	45	45
Capital Employed	**608**	**1,468**	**1,715**	**1,781**	**1,939**	**2,028**
Net Fixed Assets, incl. Capital WIP, net of reval reserve	507	877	1,012	1,036	1,028	1,017
Investments	56	13	6	6	6	6
Inventory	274	431	553	496	626	687
Receivables	179	299	343	450	517	562
Cash and Cash Equivalents	10	23	27	20	19	28
Current Assets, Loans and Advances	29	44	73	104	87	76
Less: Current Liabilities and Provisions	448	220	298	332	345	348
Total Assets	**608**	**1,468**	**1,715**	**1,781**	**1,939**	**2,028**

Ratios based on Financials

	FY11	FY12	FY13	FY14 E	FY15 E
Growth in Operating Income	29.1%	31.9%	16.8%	10.9%	10.6%
Growth in EBITDA	49.4%	20.1%	34.2%	11.1%	8.7%
Growth in PAT	48.6%	-22.1%	40.5%	19.7%	24.1%
Growth in EPS	48.6%	-22.1%	40.5%	19.7%	24.1%
EBITDA Margin	8.3%	7.5%	8.7%	8.7%	8.5%
PAT Margin	2.9%	1.7%	2.1%	2.2%	2.5%
RoCE	13.2%	10.7%	12.9%	13.2%	13.7%
RoE	18.0%	10.1%	12.9%	13.7%	14.6%
Gross Debt-Equity (times)	2.1	2.2	2.0	1.9	1.6
Net Debt-Equity (times)	2.0	2.2	2.0	1.8	1.5
Interest Coverage (times)	2.0	1.5	1.6	1.7	2.0
Current Ratio (times)	3.6	3.3	3.2	3.6	3.9
Inventory Days	56	59	54	52	55
Receivable Days	38	38	41	45	45
Price / Earnings (P/E) Ratio	5.0	6.4	4.6	3.8	3.1
Price / Book Value(P/BV) Ratio	0.8	0.7	0.6	0.5	0.4
Enterprise Value (EV)/EBITDA	6.4	6.2	4.7	4.4	4.0

Source: Company, CARE Equity Research

EXPLANATION OF GRADES

CARE Equigrade Grid (CEG)

Through CEG, CARE Equity Research addresses two critical factors considered by an investor while investing in a particular company's equity shares:

1. **Fundamentals:** Whether the company is fundamentally sound with respect to its business, its financial position, its management and its prospects.
2. **Valuation:** What is the Current Intrinsic Value (CIV) of the stock and how it compares vis-a-vis its Current Market Price (CMP)

These factors are answered assigning quantitative grades to both these parameters. CEG is the snapshot of 'Fundamental Grade' and 'Valuation Grade' assigned by CARE Equity Research.

Fundamental Grade

This grade represents how sound the company is fundamentally, vis-à-vis other listed companies in India. This grade captures:

1. Business Fundamentals and Prospects

2. Financial Soundness

3. Management Quality

4. Corporate Governance Practices

The grade is assigned on a five-point scale as under:

CARE Fundamental Grade	Evaluation
5/5	Strong Fundamentals
4/5	Very Good Fundamentals
3/5	Good Fundamentals
2/5	Modest Fundamentals
1/5	Weak Fundamentals

Valuation Grade

This grade represents the potential value in the company's equity share for the investor over a 1-year period. The Current Intrinsic Value (CIV) or the price arrived by CARE Equity Research on fundamental basis is compared with the Current Market Price (CMP) of the stock and the grade is assigned based on the gap between CIV and CMP of the stock.

The grade is assigned on a five-point scale as under:

CARE Valuation Grade	Evaluation
5/5	Considerable Upside Potential (>25% upside from CMP)
4/5	Moderate Upside Potential (10-25% upside from CMP)
3/5	Fairly Priced (+/- 10% from CMP)
2/5	Moderate Downside Potential (10-25% downside from CMP)
1/5	Considerable Downside Potential (>25% downside from CMP)

Grading determination is a matter of experienced and holistic judgment, based on relevant quantitative and qualitative factors of the company in relation to other listed companies.

Disclosures

- Each member of the team involved in the preparation of this grading report, hereby affirms that there exists no conflict of interest that can bias the grading recommendation of the company.
- This report has been sponsored by the company.

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