FundsIndia

Equity Research Desk

ALPHA

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RHI Magnesita India – Magnifying Performance

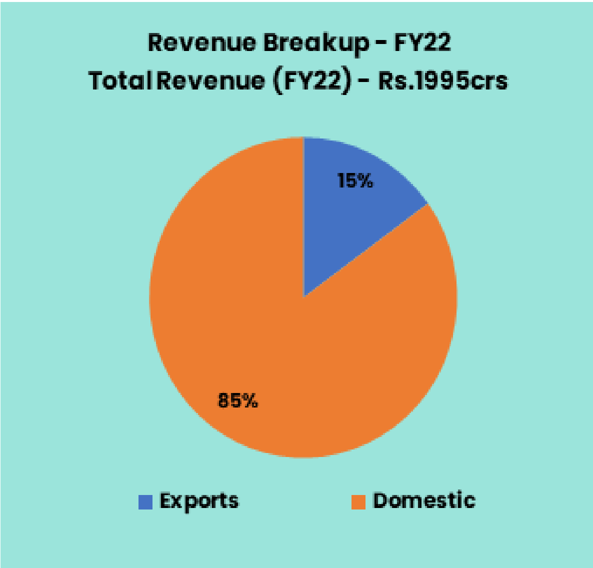
Market Data	
CMP	Rs. 636
Date	07-Sep-22
Target Price	Rs. 740
Upside Potential	16.00%
52 Week High/Low	674/323
Market Cap	Small Cap
Sector	Refractories
Rating	Buy

RHI Magnestia India ltd earlier known as Orient Refractories Limited (ORL) is in the business of manufacturing and marketing special, basic and non-basic refractory products, systems and services to the steel industry in India and Globally. The Company is market leader for refractories in India and has many global customers for its international quality products. The Company produces nearly 1,40,000 tons of refractory per annum including customized products. The refractory products are mainly used in high temperature manufacturing processes in iron and steel industry, metal smelters, cement, glass industry and for other industrial products. RHI recently merged its Indian entities - RHI India Pvt. Ltd., RHI Clasil Ltd with Orient Refractories to create India's largest refractory manufacturing and trading company called RHI Magnesita India (RHIM). It has currently has three manufacturing units at Bhiwadi (Rajasthan), Vizag (Andhra Pradesh) and Cuttack (Odisha).

Products & Services: The company produces products such as Isostatic pressed continuous casting refractories, slide gates, plates, nozzles, etc. which are used in the end industries like Steel, Cement, Glass, Energy, etc.

SHP	Jun - 22 (%)	Mar - 22 (%)	Change
Promoters	70.19	70.19	0.00
FPI	2.20	0.64	1.56
DII	8.29	9.18	-0.89
Public & Others	19.32	19.99	-0.67
Pledged	0.00	0.00	0.00

Subsidiaries: The Company has only one subsidiary named Intermetal Engineers (India) Private Limited as on 31st March 2022.



Margins - FY22	
Gross	40%
EBITDA	19%
PAT	13%

Key Rationale

- **Transforming the business -** The industry is moving towards full line contracts under Total Refractory Management (TRM) services or complete business solution model. Steel companies prefer this model. Here, the company provide a broad range of tailored services at customer sites such as refractory installation, recycling, digital and supply chain services. These drive process efficiencies, reduce costs and generate sustainable benefits, thereby creating value for customers as well as for the companies. Total Refractory Services (TRM) can contribute significantly to revenues and margins as the company is moving towards this service. This will also help the company to cater to large players. Some of the key customers of the merged entity includes Jindal Stainless Ltd., JSW Steel, Gerdau, Tata Steel, Lafarge Holcim, Sunflag Steel, Birla Shakti Cement, SAIL, etc.
- **Merger Benefits –** One of the reasons for lower RM cost for merged entity is the captive mines operated by its parent in Turkey, Brazil and Europe, which makes for 40% of total raw material requirement of the Indian entity. Only 20-25% of RM is sourced from China as compared to more than 40% sourcing by other refractory manufacturers in India and the rest is locally sourced. Sourcing can now happen centrally for all the manufacturing facilities in turn efficiently managing working capital.
- **Q1FY23 –** RHI reported a strong sales growth of 40% YoY at Rs.602 crs in Q1FY23. EBITDA increased by 57% YoY to Rs.116 crs and EBITDA margin increased 190 bps YoY to 19.2%. Net profit grew by 64% YoY to Rs.82 crs. The company has set a strategic business goal of doubling the production capacity to 300,000 TPA and revenue by FY 2025-26 as compared to 2020-21. This will be achieved through organic and inorganic means. For this, a phased capex investment of Rs.400 crores (upto 2025-26) for expanding capacities and automation has been earmarked. During the current year, the company started a number of projects at Bhiwadi and Vizag to make certain high-grade import substitute products like purge plugs, coke oven blocks, tap hole clay mass, etc.
- **Financial Performance –** The company reported a 5-year Sales and Profit CAGR of 31% for the period of FY18-22 on a standalone basis. On a consolidated basis, the company reported a 3-year Sales and Profit CAGR of 39% and 45% for the period of FY20-22. The company's 5-year average RoE & RoCE stands at 25% and 35% for the period of FY18-22 on a standalone basis. The company is almost debt free with a consistent free cashflow generation ability except for FY22.

Ratios - FY22	
ROE	26%
ROCE	33%
Div. Yield	0.41%
PE Ratio	38.00
Face Value	1.00
EPS	Rs. 16.71

Industry Analysis

India was the world's second-largest producer of crude steel. In FY22, the production of crude steel and finished steel stood at 133.596 MT and 120.01 MT, respectively. In April 2022, India's finished steel consumption stood at 9.072 MT. India's finished steel consumption is anticipated to increase to 230 MT by 2030-31 from 133.596 MT in FY22. In FY22, exports and imports of finished steel stood at 13.49 MT and 4.67 MT, respectively. In FY22, India's export rose by 25.1% YoY, compared with 2021. Refractory material has high heat resistance properties and is critical for high - temperature processes exceeding 1,200°C in a wide range of industries, including steel, cement, non - ferrous metals and glass. Further, 70% of the domestic demand for refractories is driven by steel manufacturers and the rest by other industries like glass, cement and non-ferrous metals.

Growth Drivers

The National Infrastructure Pipeline will be the biggest driver of steel demand for the next 5 years due to the enormous spending of Rs.102tn over several sectors like Energy, urban & rural infrastructure, irrigation, railways, roads, etc., which are also the most vital areas for infrastructure development in any country.

With a huge focus over drinking water penetration to rural and semi-urban areas, the Government of India has launched and executed an enormous campaign called Jal Jeevan Mission – Rural and Urban which is expected to spend massive Rs.6.5trn over the next 5 years.

On July 2021, the Union Cabinet chaired by Prime Minister Narendra Modi approved a Rs.6,322-crore PLI scheme to boost the production of speciality steel in India.

Peer Analysis

Competitors: IFGL Refractories, Vesuvius India, etc.

Refractory business is more comparable to consumable manufacturers and is far more superior than commodity businesses. Clearly, RHIM is the winner across the parameters like Return ratios, Market Share, EBITDA Margin and Sales growth. Its industry leading EBITDA margins resulted from the favourable sourcing of RM and higher dependence on the domestic markets. This in turn generated strong return ratios historically.

Company	CMP	Mcap.	ROE	ROCE	P/E	EPS
RHI Magnesita	636	10247	26.00%	33.00%	38	16.71
Vesuvius India	1453	2935	7.00%	10.00%	43	33.53
IFGL Refractories	265	954	8.00%	10.00%	12	21.50

Company	Market Share (2021)	EBITDA Margin (FY22)	5 Yr Sales CAGR
RHI Magnesita	15.90%	19.00%	31.00%
Vesuvius India	8.10%	10.00%	5.00%
IFGL Refractories	6.60%	11.00%	10.00%

Outlook

The company's recent merger is expected to be highly value accretive due to synergies from a diverse product portfolio and wide customer reach across mini mills, PSUs and private steel plants. Focus on full line contracts, import substitution at Cuttack plant and making Indian entities the manufacturing and R&D hub for Asia and African markets should accelerate its revenue growth. Apart from the above, Better Margins are arriving from good product mix, Vertical integration and a great supply chain network. The company also leads the capacity utilisation level at ~85% than the industry level of 50-60%. Net cash balance sheet status will ensure expansion and acquisitions through internal accruals. RHIM will continue trading at a quite premium valuation in the industry it caters, due to comprehensive product portfolio, strong growth prospects, superior financials and MNC parentage.

Valuation

We expect better than peer volume growth in FY23 on the back of product (aggressive capex plan of Rs.4bn) & customer additions and rising steel demand. This, combined with healthy balance sheet i.e., being net cash makes the stock very attractive. We recommend a BUY rating in the stock with the target price (TP) of Rs.740, 30x FY24E EPS.

Risks

- **Raw Material risk –** The current surge in RM cost due to high sea freight and also shortage of raw material in China may last longer. Though the company is decreasing its dependency on China, it is still a part and will affect the RM cost.

- **Strategical Risk –** Failure of TRM strategy i.e., failure in acquiring full line contracts with new customers due to intense competition or issues over acceptability of products can lead to a decline in growth prospects.

- **Demand Related Risk –** Refractories are mostly dependent on steel industry and a deep decline in the end user industry will impact the revenues. But the normal cyclicality of the steel industry wont usually affect the refractory products.

Source – Tickertape, Company's Website, BSE Website.

Thanks & Regards

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