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Pitti Laminations (PITLAM)

Research Analyst

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Pitti Laminations (Pitti) is a leading manufacturer of electrical steel laminations, motor cores, sub-assemblies, die-cast rotors and press tools. These products find application in basic capital goods products viz. motors and alternators, which are the quintessential products used in process engineering. With the domestic capex cycle at the cusp of a cyclical recovery and good exports visibility, we expect Pitti's sales and PAT to grow at a CAGR of 21% and 62%, respectively, in FY14-17E.

Price

₹ 120

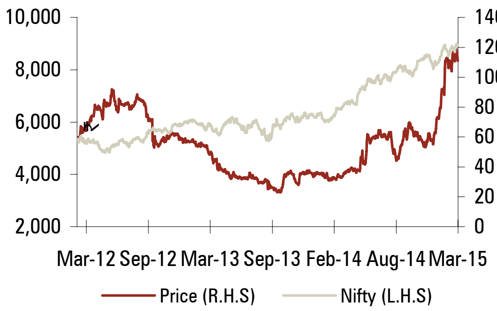
Recommendation

Buy

Fair value

₹ 160-175

Price performance



Highlights

- **Exports, domestic business to pick up simultaneously:** Pitti manufactures electrical laminations/stampings, which constitutes a healthy ~83% of its gross sales (FY14) and has a strong clientele for this product both globally as well as domestically. With GE group companies awarding Pitti a three year contract (CY15-17) worth ₹ 600 crore, we expect export sales at Pitti to grow at a CAGR of 34.4% in FY14-17E to ₹ 250 crore in FY17E (₹ 103 crore in FY14). Domestically, with a new government at the helm, renewed emphasis on capacity creation and bottoming up of GDP growth, we expect sales to match up to its customer's (Siemens, ABB, Cummins India, Crompton Greaves among others) growth rate. Also, we expect domestic sales to grow at a CAGR of 8.8% in FY14-17E to ₹ 181 crore in FY17E (₹ 140 crore in FY14)
- **Re-organising capacity; will lead to enhanced business dynamics**: Pitti has shifted ~38% (12000 tonne) of its total installed capacity (32000 tonne) to a new facility in Pune, Maharashtra. The shift in capacity was undertaken as majority (~65%) of its domestic customers are based out of the industrial belt near Pune while two of its main raw material suppliers (Posco & ThyssenKrupp) are also based out of the same region. This will lead to better business dynamics at Pitti, thereby helping them to reduce the lead time and savings in terms of transportation & logistics costs
- **Strong financial performance to warrant re-rating**: With the recovery of domestic capex cycle & good export orders visibility, we expect sales and PAT to grow at a CAGR of 20.7% and 62.4%, respectively, in FY14-17E. The increase in PAT will also be aided by an improvement in EBITDA margins (80 bps over FY14-17E) on account of increasing share of value added products. However, increase in working capital needs may keep debt-equity at ~1.1x (FY14-17E). Hence, on the conservative side, we have valued Pitti at ₹ 160-175, i.e. 12.0x-13.0x P/E on FY17E EPS of ₹ 13.5/share

Key risks-

Business specific

Delay in revival of capex cycle/industrial activity: Pitti's product profile is highly sensitive to core industrial activity involving capital goods, which, in turn forms an integral part of any process engineering. Hence, any delay in the revival of the capex cycle can dampen the business environment for Pitti. In the past two years, the company has witnessed a sharp reduction in sales, thereby denting its profitability and return ratios. Therefore, any prolonged contraction of industrial activity and a delay in revival of the capex cycle will hamper the growth prospects of Pitti with the associated perils of negative operating leverage kicking in. These remain key risks to our estimates.

Company specific

High client concentration & elongated working capital cycle: Pitti has a high client concentration, which can lead to lumpiness in growth, going forward. In the exports market, the company realises majority of its revenues (~80% of exports) from GE group companies and, hence, is susceptible to business risk if some ramp down happens at GE or the company's product do not meet the desired quality specifications. Also, by virtue of importing raw material (electrical steel) for orders from GE group companies and shipping the final product to GE entities through sea, the company has elongated working capital needs with net working capital days at 146 days as of FY14 and 167 days as of FY13. The company is shifting some of its manufacturing capacity from Hyderabad to Pune (to cater to its domestic customers), which should help in cutting down the lead time starting from procurement of raw material to final delivery. However, any further stretching of the working capital cycle will result in increased leveraging of balance sheet and a consequent drop in PAT margins for Pitti.

Description

Pitti Laminations (Pitti) is a leading manufacturer of electrical steel lamination, motor cores, sub-assemblies, die-cast rotors and press tools domestically. These products find application in basic capital goods products, viz. motors and alternators, which are themselves quintessentially used in any process engineering. Pitti clocked a topline of ₹ 247.8 crore in FY14 with corresponding EBITDA at ₹ 32.7 crore (EBITDA margins at 13.2%) and PAT at ₹ 4.2 crore. Electrical laminations/stampings constitute a healthy ~83% of its total gross sales followed by scrap (~12%), job work (~3%) and tools (~2%). Pitti reported an EPS of ₹ 3.1 in FY14

History and track record

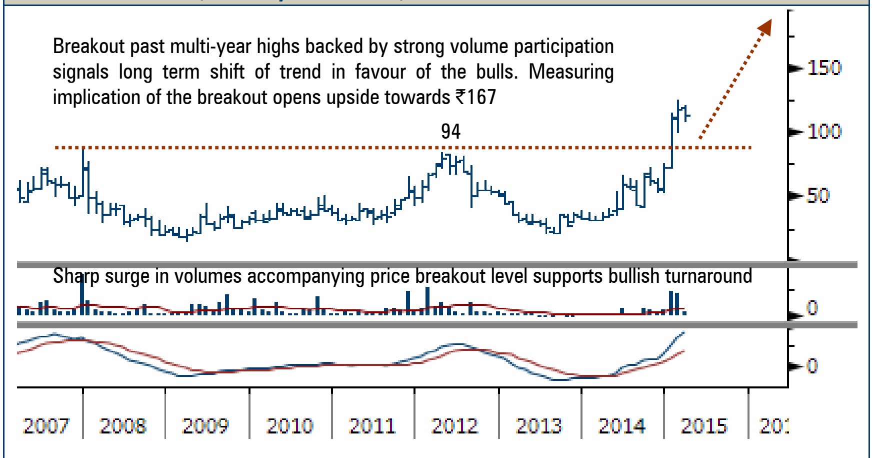
- The company was founded in 1983 by Sharad B Pitti
- Pitti has an installed capacity of 32000 tonne/annum (TPA) of electrical stampings/laminations and 3000 motor housing/stator frames. Laminations are sold both domestically as well as globally while motor housings are meant only for exports
- Pitti is undergoing de-bottlenecking, which will increase its electrical laminations capacity to 36000 TPA in the near term. It aims to augment its capacity to 50000 TPA in the long term
- Pitti is India's first commercial manufacturer of laminations, which is certified by BVQI of UK for ISO 9002 and manufactures laminations from 50 mm to 1,250 mm outer diameter
- It is India's only end-to-end product and service provider in the electrical lamination segment and a market leader in the special purpose motors segment. Pitti is one of the few suppliers with tooling, laminations, casting and machining all under one roof
- The company is a pioneer of the manufacture of traction motor sub-assemblies in India and possesses an indigenously developed tool room with a portfolio of over 3,400 tools
- Pitti also holds a 47% stake in its group company Pitti Castings Pvt Ltd, which manufactures castings domestically

Earning estimates

₹ crore	FY13	FY14	FY15E	FY16E	FY17E
Total Operating Income	310.4	247.8	333.2	401.6	436.0
EBITDA	40.8	32.7	41.0	54.2	61.0
EBITDA margin (%)	13.2	13.2	12.3	13.5	14.0
PAT	9.8	4.2	7.5	14.4	18.2
EPS	7.3	3.1	5.6	10.6	13.5

Source: Company, ICICIdirect.com Research

Technical Chart (Weekly Bar chart)



Source: Bloomberg, ICICIdirect.com Research

Stock data

Market Capitalization (₹ crore)	162.0
52 Week High / Low (₹)	125 / 31
Promoter Holding (%)	60.0
FII Holding (%)	0.0
DII Holding (%)	0.8
Dividend Yield (%)	0.9
12M / 6M stock return (%)	245 / 123
Debt (₹ crore)	120.6
Cash and Cash Equivalent (₹ crore)	9.5
Enterprise Value (₹ crore)	273.1
5 Year Revenue CAGR (%) (FY09-14)	-1.2
5 Year EBITDA CAGR (%) (FY09-14)	-5.0
5 Year PAT CAGR (%) (FY09-14)	-7.2

Valuation

	FY14	FY15E	FY16E	FY17E
P/E	38.2	21.5	11.3	8.9
Target P/E	53.5	30.2	15.8	12.5
EV / EBITDA	8.3	7.1	5.6	4.9
P/BV	1.5	1.4	1.3	1.1
RoNW	3.8	6.4	11.2	12.8
RoCE	10.3	10.0	14.0	15.1
ROIC	10.7	9.9	13.8	15.5

Source: ICICIdirect.com Research

Quarterly performance

(₹ crore)	Q4FY14	Q1FY15	Q2FY15	Q3FY15
Sales	66.4	72.0	71.8	93.4
EBITDA	6.1	6.9	9.3	12.4
EBITDA Margin (%)	9.2	9.6	12.9	13.3
Depreciation	2.2	3.9	3.9	4.0
Interest	1.1	2.3	4.2	4.1
Other Income	0.4	0.6	0.3	0.3
PAT	2.0	0.8	1.0	2.9
EPS (₹)	1.5	0.6	0.7	2.2

Source: ICICIdirect.com Research

Shareholding trend (%)

Key Shareholders	Q4FY14	Q1FY15	Q2FY15	Q3FY15
Promoter group	60.0	60.0	60.0	60.0
FII	0.0	0.0	0.0	0.0
DII	0.7	0.7	0.2	0.8
Non-institutional	39.3	39.3	39.8	39.2

Source: ICICIdirect.com Research

Technical View

The share price of Pitti Laminations has registered a multi year breakout in January 2015 as it surged past its historical highs of 2007 (₹ 98) and 2012 (₹ 94) signalling a major turnaround on the larger degree price charts. Thus, it provides a fresh entry opportunity to ride the next up move

In September 2013, the stock bounced back after taking support near the 2009 low of ₹ 20. Since then, it has embarked upon a sustained uptrend. The positive price structure is further supported by the behaviour of volumes, which surged almost four times the 12 months average volume of (3.5 lakh shares/month) during the recent breakout highlighting strong participation in the direction of the trend

We expect the stock to remain on course towards the target of ₹ 167. The measuring implication of the multi-year range breakout, i.e. the magnitude of 2012-13 decline (₹ 94 to ₹ 21) projected from the breakout point of ₹ 94 opens up upsides towards ₹ 167 levels on a larger time frame

What's the story?

Government's thrust on revival of domestic capex cycle, Pitti's product the basic necessity!!!

Industrial activity has been subdued in the recent past with capex oriented manufacturing operations across the country taking a hit. The same was reflected in the IIP index, which fell from 8.2% in FY11 to -0.1% in FY14. However, with a new government at the helm and the recent initiatives undertaken by them viz. coal blocks auctioning, launch of e-biz portal, online application of environmental clearances, correcting the inverted duty structure for the domestic electronics industry (Union Budget 2015-16) and emphasis on making India a manufacturing hub through "Make In India" campaign bode well for the domestic capital goods industry. The new government has also significantly focused on the budgeted plan capital expenditure, which has been increased 34% YoY to ₹ 1,35,257 crore for FY16E. In Union Budget (2015-16), the government also reduced the rate of income tax on royalty and fees for technical services from 25% to 10% to facilitate technology inflow. All these measures are likely to lead to a resurrection of the domestic electrical laminations industry that forms the core component of any motor and alternator, which are, in turn, quintessential products in any manufacturing/process engineering. The penultimate end usage of Pitti products includes industries like power generation, transportation, mining, industrial motors, locomotives, aerospace, automobile, oil & gas, earth moving & mining.

Leading lamination player domestically; only one in listed space!!!

Domestically, there are six major players in electrical laminations/stampings industry with leadership in quality being maintained by Pitti. The main players in the domestic industry include Precision Stampings (Faridabad, capacity~36000 tonne per annum), Pitti (Hyderabad & Pune, capacity ~32000 tonne per annum), Kapson Industries (Jalandhar & Pune), Tempel India (Chennai, capacity ~24000 tonne per annum) and Pearl Engineering (Delhi, capacity ~24000 tonne per annum). All these players supply laminations to domestic capital goods manufacturers, manufacturing motors and alternators. However, majority of them have exposure to laminations, which are small in size and used in consumer durables segment, which is more of a commodity play rather than a specialised play. Pitti, on the contrary, is present in the industrial segment and manufactures specialised custom made products that are capex linked and, hence, would be the key beneficiary of capex cycle revival domestically amongst its peer set.

Quality product; strong clientele both domestically and globally!!!

Pitti by virtue of supplying specialised custom made quality product has a very strong clientele with most clients sticking with Pitti for a fairly long time. Domestically, in the laminations segment, Pitti's clients include ABB, Alstom, Bhel, Crompton Greaves, Cummins, L&T, ReGen Powertech, Siemens and Voith among others. On the global front, GE group entities mainly GE Transportation Systems (GETS) and GE Consumer and Industrial (GECI) constitute the major chunk of its exports. Here we would like to mention that getting approved by such large engineering players like Siemens, GE and Cummins, among others, is a Herculean task involving very strict quality checks and supplying capabilities. Therefore, Pitti being approved by these behemoths and being able to maintain long standing relationships with them [Crompton Greaves (20 years), Siemens (15 years), GE (10 years)] speaks for the quality control and its supplying capabilities. Hence, the company is poised to grow along with its customers, going forward.

Volume led growth; exports to lead the way!!

In FY14, Pitti sold 15055 tonne of electrical laminations of which 71% was constituted by domestic sales (10747 tonne) while export comprised the rest i.e. 29% (4308 tonne). In the past five years, the average domestic to export sales mix (by volume) has been in the range of 66:34. Going forward, however, on the back of firm orders from GE group companies amounting to ₹ 600 crore over CY15-17 (~₹ 200 crore annually), we expect export sales to lead the way for Pitti. In exports, we expect a volume CAGR of 38.1% in FY14-17E to 11340 tonne in FY17E while domestically, on the back of a recovery of the domestic capex cycle; we expect a volume CAGR of 13.4% in FY14-17E to 15660 tonne in FY17E. Overall, for Pitti, we expect a volume CAGR of 21.5% in FY14-17E with domestic to export sales mix (by volume) at 61:39.

Sales, PAT expected to grow at CAGR of 20.7%, 62.4% in FY14-17E; poised for gains!!!

The topline has grown at 14.4% CAGR in FY10-14 while its PAT has grown at 93.4% CAGR in FY10-14 largely due to forex fluctuations. Post a subdued FY14, the performance has improved in FY15 and is gaining traction with 9MFY15 sales at ₹ 237 crore, up 31% YoY (₹ 181 crore in 9MFY14) and 9MFY15 profit at ₹ 5 crore (₹ 2 crore in 9MFY14). Going forward, on the back of the domestic capex cycle being on the cusp of a cyclical recovery and good export orders visibility, we expect sales to grow at 20.7% CAGR in FY14-17E to ₹ 436.0 crore in FY17E (₹ 247.8 crore in FY14) while PAT is expected to grow at 62.4% CAGR in FY14-17E to ₹ 18.2 crore in FY17E (₹ 4.2 crore in FY14) on the back of an 80 bps improvement in EBITDA margins to 14.0% by FY17E (13.2% in FY14). We have valued Pitti at ₹ 160-175, i.e. 12.0x-13.0x P/E on FY17E EPS of ₹ 13.5/share.

Financial summary

Profit and loss statement				₹ Crore
(Year-end March)	FY14	FY15E	FY16E	FY17E
Net Sales	243.4	328.6	396.7	431.0
Other Operating Income	4.4	4.6	4.9	5.1
Total Operating Income	247.8	333.2	401.6	436.0
Growth (%)	-20.2	34.4	20.5	8.6
Raw Material Expenses	152.7	216.6	261.0	283.4
Employee Expenses	25.7	30.7	36.1	39.2
Other Operating Expense	36.7	45.0	50.2	52.3
Total Operating Expenditure	215.1	292.2	347.4	375.0
EBITDA	32.7	41.0	54.2	61.0
Growth (%)	-19.8	25.2	32.3	12.6
Depreciation	8.8	15.7	15.8	16.8
Interest	19.2	15.0	17.6	18.5
Other Income	2.0	1.5	0.9	1.8
PBT	6.8	11.8	21.7	27.5
Exceptional Item	0.0	0.0	0.0	0.0
Total Tax	2.6	4.3	7.4	9.4
PAT	4.2	7.5	14.4	18.2
Growth (%)	-56.9	77.5	90.7	26.5
EPS (₹)	3.1	5.6	10.6	13.5

Source: Company, ICICIdirect.com Research

Cash flow statement				₹ Crore
(Year-end March)	FY14	FY15E	FY16E	FY17E
Profit after Tax	4.2	7.5	14.4	18.2
Add: Depreciation	8.8	15.7	15.8	16.8
(Inc)/dec in Current Assets	24.2	-66.4	-49.2	-25.2
Inc/(dec) in CL and Provisions	12.4	29.8	20.5	10.3
Others	19.2	15.0	17.6	18.5
CF from operating activities	68.7	1.7	19.1	38.6
(Inc)/dec in Investments	0.0	0.0	0.0	0.0
(Inc)/dec in Fixed Assets	-16.8	-4.2	-10.0	-10.0
Others	1.5	0.0	0.0	0.0
CF from investing activities	-15.3	-4.2	-10.0	-10.0
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	-29.4	15.0	10.0	5.0
Dividend paid & dividend tax	-1.6	-1.6	-3.2	-4.7
Inc/(dec) in Share Cap	0.0	0.0	0.0	0.0
Interest Paid	-19.2	-15.0	-17.6	-18.5
CF from financing activities	-50.1	-1.6	-10.7	-18.2
Net Cash flow	3.3	-4.1	-1.6	10.3
Opening Cash	6.2	9.5	5.4	3.8
Closing Cash	9.5	5.4	3.8	14.1

Source: Company, ICICIdirect.com Research

Balance sheet				₹ Crore
(Year-end March)	FY14	FY15E	FY16E	FY17E
Liabilities				
Equity Capital	13.5	13.5	13.5	13.5
Reserve and Surplus	98.1	104.0	115.2	128.6
Total Shareholders funds	111.6	117.5	128.7	142.1
Total Debt	120.6	135.6	145.6	150.6
Deferred Tax Liability	7.2	7.2	7.2	7.2
Minority Interest / Others	0.0	0.0	0.0	0.0
Total Liabilities	239.3	260.3	281.5	299.9
Assets				
Gross Block	143.2	153.2	163.2	173.2
Less: Acc Depreciation	55.9	71.6	87.4	104.3
Net Block	87.3	81.6	75.7	68.9
Capital WIP	5.8	0.0	0.0	0.0
Total Fixed Assets	93.1	81.6	75.7	68.9
Investments	4.1	4.1	4.1	4.1
Inventory	96.8	126.0	157.6	171.2
Debtors	64.2	94.5	114.1	124.0
Loans and Advances	39.4	47.6	45.6	47.4
Other Current Assets	1.4	0.0	0.0	0.0
Cash	9.5	5.4	3.8	14.1
Total Current Assets	211.3	273.6	321.2	356.7
Current Liabilities	63.9	90.0	108.7	118.1
Provisions	5.3	9.0	10.9	11.8
Current Liabilities & Prov	69.2	99.0	119.6	129.9
Net Current Assets	142.1	174.6	201.6	226.8
Others Assets	0.0	0.0	0.0	0.0
Application of Funds	239.3	260.3	281.5	299.9

Source: Company, ICICIdirect.com Research

Key ratios				
(Year-end March)	FY14	FY15E	FY16E	FY17E
Per share data (₹)				
EPS	3.1	5.6	10.6	13.5
Cash EPS	9.6	17.2	22.4	25.9
BV	82.6	87.0	95.3	105.3
DPS	1.0	1.0	2.0	3.0
Cash Per Share (Incl Invst)	10.1	7.1	5.9	13.5
Operating Ratios (%)				
EBITDA Margin	13.2	12.3	13.5	14.0
PAT Margin	1.7	2.3	3.6	4.2
Inventory days	145.1	140.0	145.0	145.0
Debtor days	96.3	105.0	105.0	105.0
Creditor days	95.8	100.0	100.0	100.0
Return Ratios (%)				
RoE	3.8	6.4	11.2	12.8
RoCE	10.3	10.0	14.0	15.1
RoIC	10.7	9.9	13.8	15.5
Valuation Ratios (x)				
P/E	38.2	21.5	11.3	8.9
EV / EBITDA	8.3	7.1	5.6	4.9
EV / Net Sales	1.1	0.9	0.8	0.7
Market Cap / Sales	0.7	0.5	0.4	0.4
Price to Book Value	1.5	1.4	1.3	1.1
Solvency Ratios				
Debt/EBITDA	3.7	3.3	2.7	2.5
Debt / Equity	1.1	1.2	1.1	1.1
Current Ratio	3.1	2.8	2.7	2.7
Quick Ratio	1.7	1.5	1.4	1.4

Source: Company, ICICIdirect.com Research

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