

Stock Update Premier Explosives Ltd.

Small Cap (High Risk)

October 24, 2022





Premier Explosives Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Explosives	Rs.466.4	Buy between Rs.462-475 & add more on dips of Rs.415	Rs.522	Rs.560	2-3 quarters

HDFC Scrip Code	PREEXPEQNR
BSE Code	526247
NSE Code	PREMEXPLN
Bloomberg	PRE:IN
CMP Oct 21, 2022	466.4
Equity Capital (Rs Cr)	10.8
Face Value (Rs)	10
Equity Share O/S (Cr)	1.1
Market Cap (Rs Cr)	501.5
Book Value (Rs)	182
Avg. 52 Wk Volumes	32602
52 Week High	532
52 Week Low	220

Share holding Pattern % (Sep, 2022)	
Promoters	41.3
Institutions	3.7
Non Institutions	55.0
Total	100.0



HDFCsec Retail research
stock rating meter
for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

Premier Explosives Ltd (PEL) is engaged in the manufacture of high energy materials and allied products for the defence, space, mining and infrastructure industries. It has three business divisions: explosives (catering to mining and infra), defence and service (undertakes operations and maintenance services for government owned solid propellant plants). PEL has now been into the business for more than four decades and has longstanding relations with many Government institutions/departments as well as private players.

The company was facing problem in the explosive business during Covid times and then in H2FY22 as the prices of raw material was rising and demand was also dull. Recently, due to geopolitical issues, the demand of the coal has risen and that in turn has increased demand for explosives. We believe that Government's focus on infrastructure development will keep the demand of explosives at high levels. The raw material prices have also started to come down. Government has undertaken multiple steps for the development of defence segment, PEL being the pioneer in manufacturing and supply solid propellants to India's prestigious missile programs is well positioned. The company is also looking to expand the exports business in this segment.

In our Initiating Coverage report ([Link](#)) on Premier Explosives Ltd. dated April 20, 2022, we had recommended to buy in the band of Rs.370-380 and add more on dips in Rs.333 for base case target of Rs.418 and bull case target of Rs.452 over next two quarters. The Bull case target was achieved in the given time frame.

Valuation & Recommendation:

The performance of the company has improved in last two quarters, the order book now stands at an all-time high level. Recently, the company has commenced manufacturing at its new plant at Katepally and gradually this will start contributing meaningfully in terms of revenue. Management has given strong guidance for both order book and revenue growth. The margins could also improve with the change in business mix and cooling down in raw material prices. PEL is one of the key beneficiaries of defence indigenisation. We expect the company to deliver 27% CAGR in revenue and 99% in net profit (lower base) over FY22-24E. Being a turnaround case, the valuation may optically look expensive.

We feel that investors can BUY Premier Explosives Ltd between Rs.462-475 band (24.2x FY24E EPS) and add further on dips to Rs.415 band (21.5x FY24E EPS) for the Base case target of Rs.522 (27x FY24E EPS) and Bull Case target of Rs.560 (29x FY24E EPS) over period of 2-3 Quarters.



Financial Summary (Rs.Cr)

	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY21	FY22	FY23E	FY24E
Total Income	51.8	32.7	58.3	60.5	-14.4	153.6	199.1	255.7	318.9
EBITDA	5.8	6.0	-3.2	4.9	18.4	6.3	20.9	36.7	48.4
APAT	1.3	1.3	-0.8	1.2	6.8	-10.9	5.2	13.1	20.8
EPS	1.2	1.2	-0.8	1.1	6.4	-10.2	4.9	12.2	19.3
RoE						-5.7	2.8	6.7	9.8
P/E						-46.1	95.0	38.3	24.3
P/BV						2.7	2.7	2.5	2.3

(Source: Company, HDFC sec)

Change in Estimates (Rs.Cr)

	FY23E			FY24E		
	Old	New	% Change	Old	New	% Change
Sales	241.0	255.7	6.1	290.0	318.9	10.0
Operating profit	36.0	36.7	1.8	43.0	48.4	12.5
PAT	13.7	13.1	-4.1	18.3	20.8	13.4
EPS (Rs.)	12.8	12.2	-4.5	17.0	19.3	13.6

Q1FY23 Result Update

The company has delivered revenues of Rs.51.8 Cr during the quarter, up 58% YoY supported by healthy growth from the explosive business. However, it was down 14.4% sequentially. Operating margin stood at 11.2% compared to 8.2% in Q4FY22 and 18.3% in Q1FY22. It reported almost similar level of net profit YoY at Rs.12.6 Cr, while it was up 18% QoQ. The company has generated a healthy cash profit of Rs.4.1 Cr and the run rate is expected to improve in the coming quarters given. Changing business mix with the increase in contribution of defence segment could improve the margin going ahead. Further, the management expects turnover ballpark number of Rs.280 Cr to Rs.300 Cr in FY23, while order book is expected to reach Rs.1000 Cr mark by FY24.



Sales Mix (%):

	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
Explosives	74.7	24.8	35.8	36.8	45.3	27.2	38.3	39.0	57.3
Defence	6.4	64.8	53.8	48.9	38.2	66.8	54.1	53.9	33.6
Services	18.9	10.3	10.4	14.4	16.5	6.0	7.6	7.1	8.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Robust order book

As of Q1FY23, the order book stands at a healthy level of Rs.646.4 Cr, which translates into 3.25x revenue of FY22. This order book represents a strong growth over the previous period and this is the highest ever. 56% of the order book is from defence side, while explosive and service segments are 22% each. During the quarter, the company has received order from Singareni Collieries Company Limited worth Rs. 105 Cr for supplying of different types of explosives and other accessories. It has also signed a deal with Ministry of Defence for Army for delivering of NSM for a total worth of Rs. 45 Cr and for manufacturing of 50mm MTV flares worth Rs.58 Cr. In the defence segment, LRSAM, MRSAM, Astra, NGARM, and QRSAM are under development by DRDO and PEL is the qualified vendor for the propellant casting of all these listed missiles. The company is expecting good order inflows from the defence segment in the coming quarters. It is targeting that around order book could reach Rs.1000 Cr mark by FY24.

Price of raw materials are stabilizing

Ammonium nitrate and fuel oil form major part of raw materials in manufacture of explosives and those raw material prices are influenced by international demand supply dynamics. The company uses a mix of domestic and imported ammonium nitrate taking into account the landed cost of the materials. The raw material prices had skyrocketed up to almost 200% in the last one year. This had affected the performance of Bulk explosives segment negatively despite of price escalation clauses in some supply contracts. However, the prices have been cooling off lately as the matter was taken up with the government by the manufacturers association. The sudden demand surge in the coal has also helped. Management is hoping that the Government influence on the price of raw materials will continue as it is important that explosive industry survives for the better outlay or output from the coal industry. The Company has also received licenses for bulk storage of Ammonium Nitrate (Solid) and Ammonium Nitrate (Melt) at Musthyala Village, Godavarikhani, Telangana. Apart from this prices of other raw materials that the company uses such as steel, Aluminium and magnesium are also coming down.

This will help the company improve margin. Further, the share of high margin business - defence is increasing. So the margin should proportionately go up in coming quarters. Management has guided that the company is aiming to achieve ~20% margin this financial year.

Explosives offers strong growth prospects



The Russia-Ukraine conflict has suddenly changed the dynamics of the global energy business. Almost every country was talking about gradually shifting to renewable energy earlier. But now as the European Union (EU) is facing curtailment in gas supply (Low-carbon natural gas is a competitor for coal) from Russia, it is considering coal-based power as an alternative. China has also decided to increase its reliance on low-cost coal to help boost its economy. These developments have increased the demand for the coal and consequentially led to rise in demand for explosives. Coal mining constitutes the major customer for explosives. The change was also visible in India as the import of coal increased considerably in last couple of months. We believe that the trend is expected to sustain at least for the medium term.

Further, talking about the long term timeframe, growing population, rapid urbanisation and continuing industrialisation require the construction of houses, commercial buildings, roads, and factories. The government has been encouraging the creation of infrastructure through various schemes like Sagar Mala, Housing for All and PM GatiShakti National Master Plan which will result in demand for cement and metals which require explosives for extracting minerals and metals. The company drives more than 35% of its revenue from the explosive business.

Defence Opportunity

We have explained in detail in our Initiating Coverage report regarding the defence opportunities in India such as import embargo on Defence items under 'Atmanirbhar Bharat Programme', promotion for export business, Strategic Partnerships, generous budget outlay and many more. We feel that PEL is well positioned to enhance participation as it is pioneer in manufacturing and supply solid propellants to India's prestigious missile programs and has been member of Missile Technologies Control Group (MTCR) (to provide access Advanced Technologies). Further, the company possesses various industrial licenses for production and has manufacturing facilities capable of handling higher volume & new product requirements. Recently it has done greenfield expansion at Katepally (near Hyderabad) in about 150 acres. Another 100 acres of land available for further expansion. It is also in advanced stage of negotiations with various OEMs for partnerships to manufacture in India. Defence sales which were 26% of sales in FY20 have risen to 56% in FY22 and could rise to 65-70% in the years going forward. Margins on these orders are expected to be healthy at around 15%+.

Exports Business

Indian Defence exports have grown almost six times in past five years. Looking at the opportunities, the company is also focusing on increasing exports by developing new customers and higher volumes with existing customers. It is adding more products in existing markets as well as foraying into new markets. Special focus on overseas market has started yielding the results and the company is getting high value export orders from various countries. The products designed and developed for the exports market includes Rocket Motors from 60mm dia to 179 Mm, Warheads for missiles & rockets and Micro dets and Booster Pellets.

Risks & Concerns:



Cyclical mining/ infrastructure industries

Both mining and infrastructure industries are notorious for the cyclicity. The company generates substantial amount of revenue from these deeply cyclical businesses. Any slowdown in the economy or prolonged monsoon led subdued mining / infra activities could also impact the business of PEL. Further, long gestation period for order execution and completion of major orders are the risks in defence segment. PEL competes with Solar Industries which is a very large player.

Client concentration risk

The company's client concentration is quite high; top five clients contributes majority of the revenue. In the past also this has hurt the company i.e. PEL has lost its major customer, Northern Coal Fields, which contributed to ~25% of its revenues during FY19. In the commercial explosives segment, the competition is high largely because of commoditised nature of the products.

Stock in T2T segment

The stock being under T2T segment is under the price circuit limit of 5%. This could put off some segments of investors.

Working capital intensive business

As per management, the receivables in the commercial explosives segment are paid within 2-3 months while those in defence segment are paid anywhere between 6-9 months. Defence segment contributes almost one third in the total revenue. The inventory days of the company has also remained high in past two years. All these has resulted in high working capital cycle.

Service contracts taken by PEL pull down the overall margins as they are of 10 years and even with escalation clauses, the margins on these contracts are low.

Company Background:

Incorporated in 1980, Premier Explosives Ltd (PEL) is engaged in the manufacture of high energy materials and allied products for the defence, space, mining and infrastructure industries. The company has been developing and manufacturing solid propellants for rockets like Pinaka, tactical missiles like Astra, Akash, LRSAM / MRSAM / QRSAM, Brahmos, etc., strategic missiles like Agni, Veda and also strap-on-motors for satellite launch vehicles. The extended capabilities of the company include products such as chaff, IR flares, explosive bolts, pyro devices, smoke markers, cable cutters, tear gas grenades and many other products including pyrogen igniters for defence and space applications. The company is a pioneer in indigenising the technology for manufacture of explosives and accessories. PEL has seven manufacturing facilities in Telangana, Madhya Pradesh, Maharashtra & TamilNadu.



PEL has two subsidiaries - Premier Wire Products Limited (80% stake) and PELNEXT Defence Systems (100% stake). While Premier Wire Products Limited manufactures Galvanised Iron (GI) wires used in detonators, PELNEXT Defence Systems is established for manufacturing ammunition for Indian defence. PEL also incorporated a 50:50 joint venture with the Kalyani Group in April 2015, under the name BF Premier Energy Systems Private Limited for manufacturing defence products; however, it is yet to commence operations.

The company is managed by a team of qualified and experienced professionals. T V Chowdary, MD, is a Chemical Engineer with over 35 years of experience in production of Chemicals, Explosives and Solid Propellants. Dr. A. N. Gupta, Non-Executive Chairman, is a recipient of 'Udyog Rattan Award' & 'Pickering and ISM Medal'. He is a member of Society of Explosives Engineers, U.S.A, Ex-Chairman of Explosive Development Council and Fellow of High Energy Materials Society of India (HEMSI). Y. Durga Prasad Rao, Director Operations, is a mechanical engineer having 34 years' experience in manufacture of explosives, propellants, refractories and factory management. The company has 825 skilled workforce and about 100 Engineers / Scientists.

Increasing participation in India's Space Program

Operations & Maintenance Under GOCO:

- Operating and Maintaining Solid Propellant plant of ISRO at SHAR under GOCO Contract for 10 years in Jan' 2019
- Operating and maintaining the solid propellant plant of Advance Systems Laboratory (ASL) at Solid Fuel Complex, Jagdalpur
- Provides exposure to advanced processes in manufacture of solid propellants

PSOM-XL for ISRO:

- Trial order successfully tested in January 2018
- Successfully completed delivered an order received from Vikram Sarabhai Space Centre (VSSC) for production of PSOM-XL (solid propellant) for the Satellite Launch Vehicle (SLV)
- The order was executed at Katapalley Plant

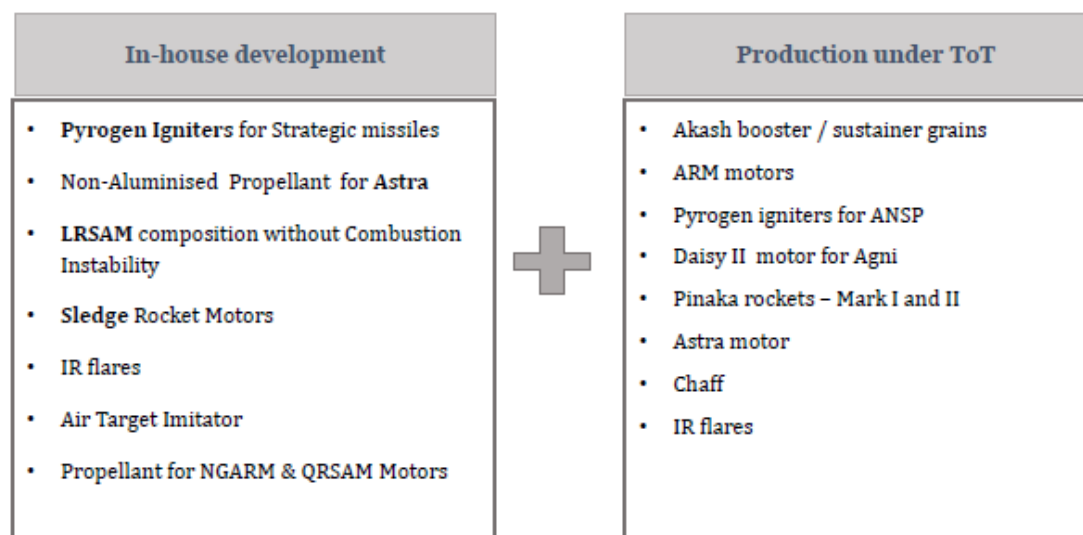
Volume data:

	FY20	FY21	FY22
Detonators (in Cr Pieces)	2.03	1.91	2.44
Bulk explosives (tonnes)	23989.0	10047.0	6221.0



Focus on enhancing Technological Capabilities

Unmatched Technological know-how and Research Capabilities....



.... and Industrial Licences from DIPP

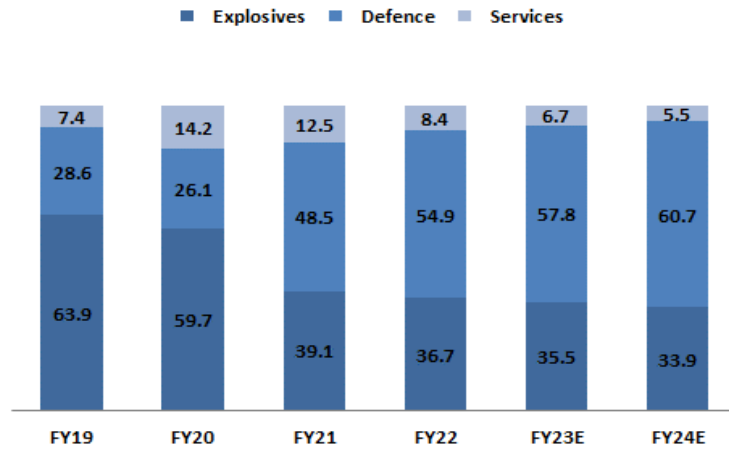
Defence Industrial Licenses
<ul style="list-style-type: none"> In Defence, received Industrial Licenses from DIPP for the following Few of the key licenses are: <ol style="list-style-type: none"> 1. Rockets and Missiles 2. Bombs & Mines for Defence 3. Ammunition.

Contributing to India's Prestigious Missile Programs:

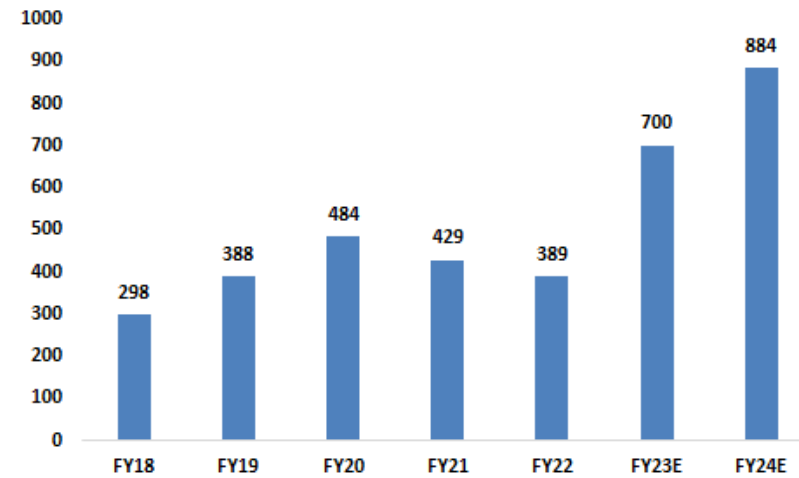
Missile	Type	Stage	Client	End user	PEL's contribution
Akash	Tactical, Surface to Air	Production	Bharat Dynamics Limited (BDL)	Indian Air Force and Indian Army	Supplied 2000+ booster grains and 450+ sustainer grains
MRSAM	Tactical, Surface to Air	Production from 2019	DRDO / BDL	Indian Army	100% requirements of solid propellants
Agni	Ballistic	Production	Advanced Systems Laboratory	Strategic Forces Command	Pyrogen igniter
Brahmos	Cruise, Air launched Anti-ship, Land attack	Production	HEMRL	Indian Air Force, Indian Navy and Indian Army	Transfer of technology is under induction
LRSAM	Tactical, Surface to Air	Production	DRDO	Indian Navy	100% requirements of solid propellants
Astra	Tactical, Air to Air	Production	DRDO	Indian Air Force	100% requirements of solid propellants



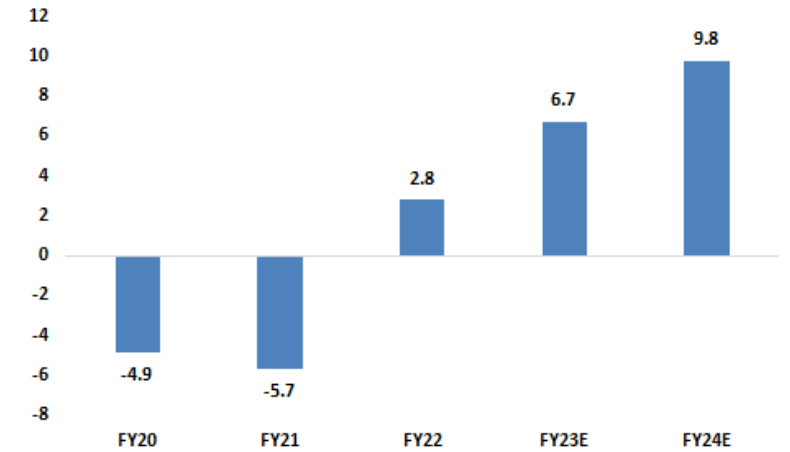
Revenue Mix (%)



Order book Trend (Rs. Cr)



RoAE (%)





Premier Explosives Ltd.

Financials

Income Statement

(Rs Cr)	FY20	FY21	FY22	FY23E	FY24E
Revenue	164.5	153.6	199.1	255.7	318.9
Growth (%)	-35.0	-6.6	29.6	28.4	24.7
Operating Expenses	170.0	147.3	178.2	219.0	270.5
EBITDA	-5.4	6.3	20.9	36.7	48.4
Growth (%)	-	-	230.1	75.2	31.9
EBITDA Margin (%)	-	4.1	10.5	14.3	15.2
Depreciation	5.3	6.3	9.5	11.7	12.3
EBIT	-10.7	0.1	11.4	25.0	36.1
Interest	5.8	7.1	7.3	11.1	12.2
Exceptional Items	0.0	-9.1	0.0	0.0	0.0
Other Income	1.5	0.9	2.8	3.6	3.8
PBT	-15.0	-6.1	7.0	17.4	27.7
Tax	-5.0	-4.2	1.8	4.3	6.9
RPAT	-10.0	-1.9	5.2	13.1	20.8
EPS	-9.2	-10.2	4.9	12.2	19.3

Balance Sheet

(Rs Cr)	FY20	FY21	FY22	FY23E	FY24E
Share Capital	10.8	10.8	10.8	10.8	10.8
Reserves	185.7	174.0	178.7	191.9	212.1
Shareholders' Funds	196.4	184.8	189.5	202.6	222.8
Minority Interest	1.3	1.3	1.2	1.2	1.2
Long-Term Borrowings	3.9	10.2	5.1	5.5	6.0
Other non-Current Liab & Provisions	13.5	10.4	12.4	8.3	8.0
Total Source of Funds	215.1	206.7	208.2	217.6	238.0
APPLICATION OF FUNDS					
Net Block	115.0	183.3	179.6	174.9	173.7
Capital Work-in-Progress	61.7	1.8	3.7	4.0	4.4
Intangible assets under development	0.0	0.0	0.0	0.0	0.0
Deferred Tax Assets (net)	0.0	0.0	0.0	0.0	0.0
Long Term Loans & Advances	10.3	7.5	10.4	10.7	11.0
Total Non Current Assets	187.1	192.5	193.7	189.6	189.0
Short-Term Loans and Advances	8.0	8.7	7.7	8.5	9.3
Inventory	42.0	36.7	37.7	45.6	55.2
Trade Receivables	47.8	43.1	71.6	77.7	100.5
Cash & Equivalents	15.9	6.2	4.8	31.0	37.5
Other Current Assets	5.6	6.2	5.5	6.0	6.5
Total Current Assets	119.2	101.0	127.2	168.8	209.0
Short-Term Borrowings	51.2	47.9	72.8	89.0	92.0
Trade Payables	18.9	16.9	21.2	27.7	37.5
Other Current Liab & Provisions	21.9	22.8	19.6	24.1	30.6
Total Current Liabilities	92.0	87.6	113.6	140.8	160.0
Net Current Assets	27.2	13.3	13.6	27.9	49.0
Total Application of Funds	215.1	206.7	208.2	217.6	238.0



Premier Explosives Ltd.

Cash Flow

(Rs Cr)	FY20	FY21	FY22	FY23E	FY24E
Reported PBT	-15.0	-15.2	7.0	17.4	27.7
Non-operating & EO items	6.6	3.4	2.5	-12.1	5.3
Interest Expenses	4.5	6.6	6.8	11.1	12.2
Depreciation	5.3	6.3	9.5	11.7	12.3
Working Capital Change	-5.6	9.2	-26.3	0.5	-27.2
Tax Paid	-2.0	-0.5	-0.7	-4.3	-6.9
OPERATING CASH FLOW (a)	-6.3	9.9	-1.3	24.4	23.3
Capex	-29.3	-12.9	-14.4	-7.0	-11.0
Free Cash Flow	-35.7	-3.0	-16.6	17.4	12.3
Investments	0.0	0.0	1.9	-0.2	-0.3
Non-operating income	15.0	9.0	1.7	3.6	3.8
INVESTING CASH FLOW (b)	-14.3	-4.0	-10.8	-3.6	-7.5
Debt Issuance / (Repaid)	30.2	0.3	19.9	16.6	3.5
Interest Expenses	-6.4	-7.4	-7.4	-11.1	-12.2
FCFE	-11.9	-10.1	-4.0	22.8	3.6
Share Capital Issuance	0.0	0.0	-0.1	0.0	0.0
Dividend & Other	-3.5	0.0	0.0	0.0	-0.5
FINANCING CASH FLOW (c)	20.3	-7.1	12.5	5.4	-9.3
NET CASH FLOW (a+b+c)	-0.3	-1.1	0.4	26.2	6.5

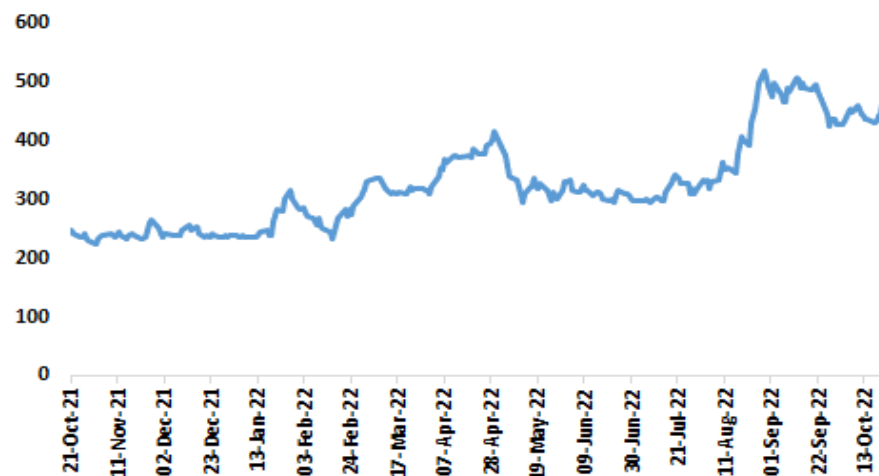
Key Ratios

	FY20	FY21	FY22	FY23E	FY24E
Profitability (%)					
EBITDA Margin	-3.3	4.1	10.5	14.3	15.2
EBIT Margin	-6.5	0.0	5.7	9.8	11.3
APAT Margin	-6.1	-7.1	2.6	5.1	6.5
RoE	-4.9	-5.7	2.8	6.7	9.8
RoCE	-5.0	0.0	5.5	11.5	15.2
Solvency Ratio					
D/E	0.3	0.3	0.4	0.5	0.4
Net D/E	0.2	0.3	0.4	0.3	0.3
PER SHARE DATA					
EPS	-9.2	-10.2	4.9	12.2	19.3
BV	183	172	176	188	207
DPS	0.0	0.0	0.0	0.0	0.5
Turnover Ratios (days)					
Debtor days	106.0	102.4	131.1	111.0	115.0
Inventory days	93.2	87.3	69.1	65.1	63.2
Creditors days	81.1	83.8	79.5	78.8	82.1
Working capital days	118.1	105.9	120.8	97.3	96.1
VALUATION					
P/E	-50.7	-46.1	95.0	38.3	24.3
Dividend Yield	0.0	0.0	0.0	0.0	0.1
P/BV	2.6	2.7	2.7	2.5	2.3
EV/EBITDA	-107.3	92.3	27.9	16.0	12.1

(Source: Company, HDFC sec)



One Year Price Chart



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. These 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 cyclicity 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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