Stock Note

Vesuvius India Ltd.

November 21, 2022

RETAILRESEARCH

Vesuvius India Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Refractories	Rs. 1649	Buy in Rs 1640-1670 band and add more on dips in Rs 1424-1445 band	Rs.1824	Rs. 1932	2 quarters

HDFC Scrip Code	VESUVIEQNR
BSE Code	520113
NSE Code	VESUVIUS
Bloomberg	VI:IN
CMP – Nov 18, 2022	1649
Equity Capital (Rs Cr)	20.3
Face Value (Rs)	10
Equity Share O/S (Cr)	2
Market Cap (Rs Cr)	3348
Book Value (Rs)	445
Avg. 52 Wk Volumes	19803
52 Week High	1738
52 Week Low	900

Share holding Pattern % (September, 2022)	
Promoters	55.57
Institutions	24.93
Non Institutions	19.50
Total	100.0

* Refer at the end for explanation on Risk Ratings

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Our Take:

Vesuvius India Limited (VIL) is part of UK based Cookson group. The Cookson group, a leading global materials science company in the ceramics, electronics and precious metals markets, acquired the Vesuvius group in 1987. The Cookson group holds 55.6% stake in VIL India.

It is the manufacturer and trader of refractories and is managed organizationally as a single unit. The company is engaged in designing, engineering, manufacture and delivery of refractory products, systems and services for high-technology industrial applications. Its products include Industrial Ceramics for Continuous Casting & Pouring of Molten Metals, Slide Gate Plates & Nozzles. Vesuvius Flow-Control and Linings divisions provide customers with a full range of products, including Process automation, Lining materials, Tundish furniture and Slide gate systems and refractories.

Growth in steel industry in the longer term is inevitable given the disparity in steel consumption in India and across the globe. With various government initiatives to protect/promote domestic steel industry and various steel demand inducing steps of higher infra spend and increased housing requirements, the demand for refractories is set to rise structurally. VIL being one of the leading refractory manufacturer is best placed to tap the opportunity that is present in both segments i.e. shaped as well as unshaped. VIL is expected to capitalize on growth from lining work of blast furnace and ladle at the time of plant installation with products from the unshaped segment, while it is expected to benefit from running of operations with specialised flow control products from its shaped segment. Additionally, increasing focus on services segment is margin accretive.

Valuation & Recommendation:

VIL's strong track record unequivocally establishes its ability to largely transcend the cyclicality of its customer industry – steel. We are impressed by the company's strong track record in a technology driven sector that is getting increasingly concentrated, balanced product portfolio delivering superlative growth, technology support from global parent, and debt-free balance sheet with consistent free cash flow. **We think the base case fair value of the stock is Rs 1824 (25.5x CY23E EPS) and the bull case fair value is Rs 1932 (27x CY23E EPS). Investors can buy the in stock Rs 1640-1670 band (23x CY23E EPS) and add more on dips in Rs 1424-144 (19.5x CY23E EPS).**

Financial Summary

Particulars (Rs Cr)	Q3CY22	Q3CY21	YoY-%	Q2CY22	QoQ-%	CY20	CY21P	CY22E	CY23E
Operating Income	353	268	32%	330	7%	792	1,047	1,337	1,595
EBITDA	50	28	80%	41	22%	77	99	164	198
APAT	36	19	86%	29	23%	53	68	120	145
Diluted EPS (Rs)	17.8	9.6	86%	14.5	23%	26.1	33.5	59.1	71.6
RoE-%						6.4	7.8	12.7	13.7
P/E (x)						63.1	49.2	27.9	23.0
EV/EBITDA						36.3	28.1	16.9	13.8

Vesuvius reported a strong all-round operating performance in Q3CY22 (it follows Calendar year). Revenues came in at Rs 353 Cr, up 32%/7% YoY/QOQ, EBITDA in Q3CY22 came in at Rs 50 Cr, up 80%/22% YoY/QoQ with margins at 14.16% (+381 bps/+173 bps YoY/QOQ). Consequently, PAT grew 86%/23% YoY/QoQ to Rs 36 Cr.

Key Triggers

Refractories as a business

1. What are refractories?

Refractories are ceramic materials designed to withstand the very high temperatures (in excess of 1,000°F [538°C]) encountered in modern manufacturing. More heat-resistant than metals, they are used to line the hot surfaces found inside many industrial processes. In addition to being resistant to thermal stress and other physical phenomena induced by heat, refractories can withstand physical wear and corrosion caused by chemical agents. Thus, they are essential to the manufacture of petrochemical products and the refining of gasoline.

2. What are refractories made of?

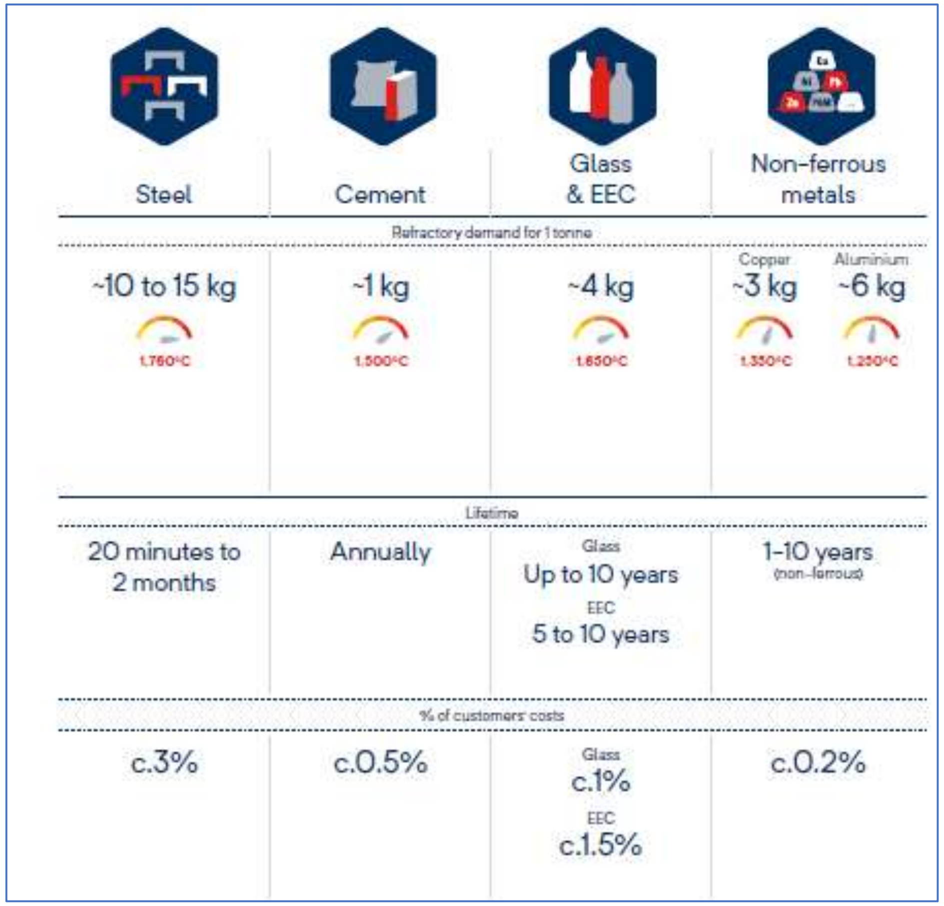
Refractories are produced from natural and synthetic materials, usually nonmetallic, or combinations of compounds and minerals such as alumina, fireclays, bauxite, chromite, dolomite, magnesite, silicon carbide, and zirconia.

3. What are refractories used for?

From the simple (e.g., fireplace brick linings) to the sophisticated (e.g., re-entry heat shields for the space shuttle), refractories are used to contain heat and protect processing equipment from intense temperatures. In industry, they are used to line boilers and furnaces of all types (reactors, ladles, stills, kilns, etc.).

4. Who uses refractories?

Demand for refractories is driven in the first instance by demand from industries requiring advanced heat-resistant materials for their production processes, being predominantly the steel, cement/lime, non-ferrous metals, glass, energy and chemicals industries. Over the long term, demand for refractories is linked to production volumes in these industries, which in turn are determined by the end markets for those materials. The most important end markets for the refractory industry are construction, automotive and transport, machinery and equipment, electronics and consumer goods and energy, oil and gas and petrochemicals.



Steel industry is the biggest demand driver of refractories

Refractory application and consumption favour replacement dynamics for 70% of the business, leading to non-cyclical growth. Steel making requires maximum amount of refractories (10-15kg/tonne) with replacement requirement ranging from 20 minutes to 2 months. Steel industry demands complete refractory management and services driven solutions from refractory makers. While cement industry is the next big user with annual replacement requirement, non-ferrous and glass industries have longer replacement cycles.

Limited export opportunities

Vesuvius Plc, the parent of VIL, has multiple arms across the globe. Hence, VIL doesn't initiate overseas sales, but follows leads from other sister companies/parent company across the globe. Around 5.8% of VIL's sales in CY21 were to export markets mainly by way of sales to other arms of Vesuvius Plc, at an arm's length price. This is only a need-based requirement from the other units, whenever they are unable to supply on their own. The company also sells to a designated local agency in India, which, in turn, sources refractories for exports. This is classified as deemed exports in the books and the company gets export benefits on the same.

With strong parental profile and experienced management, VIL is focused on product development

Vesuvius, plc, a leading refractory product manufacturer with a ~8-9% global market share, is a leader in the steel flow-control process. Vesuvius India is a leader in its home market, with a ~35% market share. The Vesuvius Group strategy is articulated around the following five pillars designed to ensure long-term revenue growth, improved profitability and sustained cash generation:

- Reinforce technology leadership;
- Increase penetration of value-creating solutions;
- Capture growth in developing markets;
- Improve cost leadership and margins; and
- Build a Technical Services business

Vesuvius Group's strategy to continue to focus on research and development and to invest in solutions that will enable further automation of customer's production processes, another world class Research and Development Centre has been set up at Visakhapatnam, India. Company has been extremely supportive of their Indian operations and continues to provide constant support in terms of technology, systems, manufacturing etc. Global R&D support from Vesuvius, plc, provides strong support in innovation and solutions to Vesuvius India, which has complete access to the latest technology from its parent. In turn, it pays royalty of ~1.6% of sales for the technology transfers.

Business Overview:

It primarily caters to the steel and foundry industry in the process of continuous casting of steel and transfer of molten materials. The company also supplies refractory products for application in industries such as aluminum, cement, lime, mineral processing, hydrocarbon processing, and power generation. It has factories at Kolkata, Mehsana, and Visakhapatnam, and a manufacturing arrangement at Salem.

Factory	Activities	
Kolkata Factory	» Monoblock Stoppers	» Slide Gate plates
	» Ladle Shrouds	» Collector Nozzles
	» Sub-entry Nozzles	» Purge Plugs
	» Sub-entry Shrouds	» Slide Gate machines and machine parts
	» Tundish Nozzles	
Visakhapatnam Factories		
First Factory	» Gunning & Shortcrete refractory	» Insulating Castables
	» Conventional castables	» Self-flow castables
	» Ultra low cement & low cement castables	» Mortars
	» No cement castables	» Tundish Nozzles
Second Factory	» Precast shapes	
	» Taphole clay	
Mehsana Factory	» Crucibles	
	» Stoppers & nozzles	

Newer capacities and products to drive the growth

VIL has initiated several investments to enhance manufacturing capabilities and capacities in its plant at Kolkata as well as Vizag. In addition to this, the company, in September 2022, has laid the foundation stone of a new manufacturing facility at Perwada, Visakhapatnam. This facility will be the latest addition to the existing manufacturing facilities at Kolkata, Visakhapatnam, and Mehsana. VIL will invest approx. Rs 57 Cr in 1st phase. This is in addition to roughly Rs 100 Cr investments in progress in building capabilities and capacities in different plants in Kolkata (isostatic capacity up 50%) and Vizag. This facility once commissioned will produce latest generation Mould flux product. It will further strengthen VIL product & service portfolio; and enhancing solution for customer. At the end of Q2CY22, CWIP was at Rs. 80.46 crore. Commissioning of the same will lead to strong revenue uptick over the next few years.

In addition, the R&D facility at Vizag has helped establish the compatibility of alternate raw materials, utilisation of recycled material as well as improved performance in applications. According to the management, innovation and customised solutions offered to customers has helped the company to increase sales by 32.3% whereas the real growth in steel manufacturing has been only 18% during CY21.

Superior financial strength

VIL is best placed to capitalise on explosive production growth likely in the domestic steel market. The company is present in both the segments i.e. specialised shaped and unshaped (monolithic). We like to highlight that these segments have different demand drivers, like the unshaped segment's products are primarily used for lining work in blast furnace and ladle, while the specialised shaped segment's products are used more in flow control, which is linked to steel capacity utilization. Besides, the ongoing expansion will lead to strong revenue uptick over the next two to three years. Being close to the Vizag port, VIL will be in a better position and can target higher share of the exports markets.

The management's increased focus on margin accretive services segment has seen its contribution increasing from 3.5% in CY17 to 26.3% in CY21. Likewise, the contribution of lower margin traded goods has decreased 31.5% in CY17 to 20% in CY21.

We expect VIL's revenues and PAT to grow at 23% and 46% CAGR over CY21-24E. As of June 30, 2022, the company had cash and equivalents worth across ~Rs 450 Cr on its books, and increasing profits and reducing working capital should ensure robust cash generation. The higher cash balance, however, has led to suppressed RoE. The company can announce higher dividend payouts which should lead to improvement in return ratios.

Key risks

Adverse government policies and economic slowdown:

The growth of steel sector, which is major demand driver for refractories is highly dependent on government's policies and investment. While no reversal in the planned investment is envisaged, prices and demand are definitely subject to changes in policies on tendering and indenting. Also changes in the import/export duties or regulations could impact the steel industry in India and indirectly demand for VIL's products. Any slow down or macro uncertainty in India as well as outside India could hit VIL's business because of weak development related activities.

Rate hike in Royalty could impact its profitability

Royalty, trademark and service fees paid to the parent, as a percentage of overall sales, stood in the range of 1.4-1.8% of net sales during CY11-21. Any increase in the same could pose a risk.

Competitive intensity

Industry suffers from low capacity utilization of ~60% with excess installed capacities and as a result pricing power is low for refractory makers who are squeezed between raw material suppliers and steel makers. In the past, cheap refractory imports from China have kept prices in check.

Rise in RM prices

Increase in raw material cost which is sourced from China due to either shortage created by China's domestic issues or due to global shortage of raw material may lead to downward revision of our estimates. However, company with the help of the parent Vesuvius Group has developed a diversified supplier base and multiple options for key raw materials. This allows it to follow a fairly aggressive purchasing strategy by pooling volumes across geographies and exerting reasonable purchasing power.

About the company:

Vesuvius India Ltd (VIL, earlier known as Vesuvius Refractories Ltd) was incorporated in September 1991 and started commercial production in its first factory at Kolkata from July 1, 1994. The company is promoted by the Vesuvius group, UK, which accounts for over half of the world's continuous cast refractory market. The Vesuvius group is part of the Cookson group of companies, which is into ceramics, electronics, and precious metals. Vesuvius Plc., the ultimate holding company, is listed on the London Stock Exchange and is a global leader in metal flow engineering, principally serving the steel and foundry industries.

Vesuvius India Ltd.

VIL is primarily engaged in the manufacturing and trading of refractory goods and the company also provides services in relation to refractory goods. It has operations in India and caters to both domestic and international markets. VIL's factories are located at Kolkata and Visakhapatnam and have been certified ISO 9001:2015 for Quality Management Systems Standards.

For CY21, VIL's manufactured sales accounts for 53.8% of sales and traded goods contributes 20% to overall sales. The services segments accounted for 26.3% of sales.

Revenue Mix

(in Rs Cr)	CY11	CY12	CY13	CY14	CY15	CY16	CY17	CY18	CY19	CY20	CY21
Manufactured goods											
Refractories (Shaped)	239	271	266	247	252	321	367	331	254	223	281
Refractories (Unshaped)	189	191	206	236	265	293	261	215	149	174	279
Total	**427**	**462**	**472**	**483**	**517**	**614**	**628**	**546**	**403**	**397**	**560**
YoY Growth		*8.1%*	*2.2%*	*2.3%*	*7.1%*	*18.7%*	*2.4%*	*-13.1%*	*-26.2%*	*-1.5%*	*41.3%*
% of sales	*79.1%*	*82.1%*	*78.5%*	*74.1%*	*74.0%*	*74.9%*	*69.1%*	*59.4%*	*45.6%*	*50.4%*	*53.8%*
Traded Goods											
Refractories (Shaped)	55	41	69	94	114	125	151	110	114	66	81
Refractories (Unshaped)	70	82	91	105	107	126	136	177	139	117	127
Total	**125**	**123**	**160**	**199**	**221**	**251**	**287**	**288**	**253**	**183**	**208**
YoY Growth		*-1.6%*	*29.4%*	*24.5%*	*11.1%*	*13.7%*	*14.3%*	*0.2%*	*-12.1%*	*-27.6%*	*13.8%*
% of sales	*23.2%*	*21.9%*	*26.6%*	*30.5%*	*31.6%*	*30.6%*	*31.5%*	*31.3%*	*28.6%*	*23.2%*	*20.0%*
Total Sale of products											
	553	**585**	**632**	**681**	**738**	**865**	**915**	**833**	**655**	**580**	**769**
YoY Growth		*5.9%*	*7.9%*	*7.9%*	*8.3%*	*17.2%*	*5.9%*	*-8.9%*	*-21.4%*	*-11.6%*	*32.6%*
Sale of Services											
	28	**27**	**26**	**30**	**27**	**28**	**32**	**85**	**228**	**208**	**274**
YoY Growth		*-3.9%*	*-2.0%*	*14.2%*	*-9.0%*	*2.9%*	*14.6%*	*164.7%*	*167.9%*	*-9.1%*	*31.8%*
% of sales	*5.2%*	*4.8%*	*4.4%*	*4.6%*	*3.9%*	*3.4%*	*3.5%*	*9.3%*	*25.8%*	*26.4%*	*26.3%*

Financials

Income Statement

Particulars (in Rs Cr)	CY19	CY20	CY21	CY22E	CY23E
Net Revenues	**887**	**792**	**1047**	**1337**	**1595**
Growth (%)	***-4.1***	***-10.8***	***32.3***	***27.7***	***19.3***
Operating Expenses	766	715	948	1173	1397
EBITDA	**121**	**77**	**99**	**164**	**198**
Growth (%)	***-18.1***	***-36.4***	***29.2***	***65.7***	***20.3***
EBITDA Margin (%)	***13.6***	***9.7***	***9.5***	***12.3***	***12.4***
Depreciation	27	26	27	27	32
Other Income	29	21	20	24	30
EBIT	**123**	**72**	**92**	**161**	**196**
Interest expenses	0	0	0	0	0
PBT	**123**	**72**	**92**	**161**	**196**
Tax	38	19	24	41	50
PAT	**86**	**53**	**68**	**120**	**145**
Share of Asso./Minority Int.	0	0	0	0	0
Adj. PAT	**86**	**53**	**68**	**120**	**145**
Growth (%)	***-7.5***	***-38.0***	***28.3***	***76.2***	***21.3***
EPS	42.1	26.1	33.5	59.1	71.6

Balance Sheet

Particulars (in Rs Cr) - As at March	CY19	CY20	CY21	CY22E	CY23E
SOURCE OF FUNDS					
Share Capital	20	20	20	20	20
Reserves	784	822	876	979	1103
Shareholders' Funds	**804**	**842**	**896**	**999**	**1123**
Minority Interest	0	0	0	0	0
Total Debt	0	0	0	0	0
Net Deferred Taxes	0	0	0	0	0
Total Sources of Funds	**805**	**843**	**897**	**1000**	**1124**
APPLICATION OF FUNDS					
Net Block & Goodwill	125	121	117	155	192
CWIP	28	21	27	27	27
Investments	0	0	0	0	0
Other Non-Curr. Assets	48	52	67	71	88
Total Non-Current Assets	**201**	**195**	**211**	**252**	**307**
Inventories	108	117	213	238	267
Debtors	188	163	164	238	284
Cash & Equivalents	468	559	554	573	615
Other Current Assets	17	25	47	43	58
Total Current Assets	**781**	**864**	**978**	**1093**	**1223**
Creditors	124	157	223	256	297
Other Current Liab & Provisions	52	59	69	89	110
Total Current Liabilities	**177**	**216**	**292**	**345**	**407**
Net Current Assets	604	648	686	747	816
Total Application of Funds	**805**	**843**	**897**	**1000**	**1124**

Vesuvius India Ltd.

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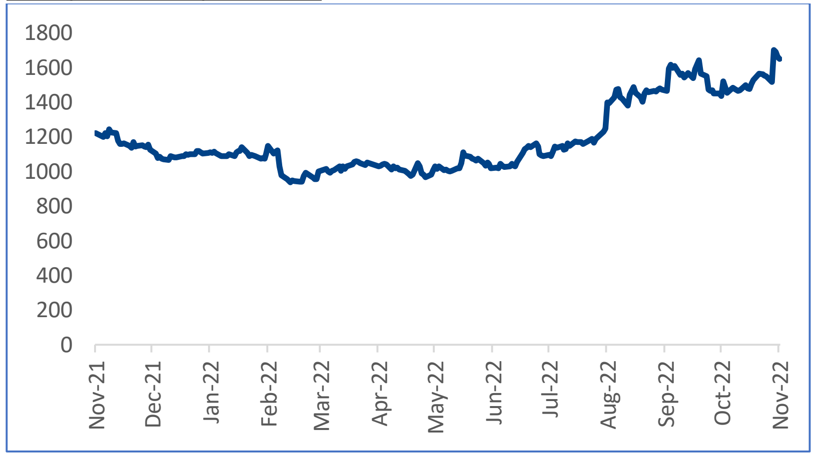
Cash Flow Statement

Particulars (in Rs Cr)	CY19	CY20	CY21	CY22E	CY23E
Reported PBT	123	72	92	161	196
Non-operating & EO items	6	-1	0	-4	-17
Interest Expenses	-23	-18	-16	0	0
Depreciation	27	26	27	27	32
Working Capital Change	-19	44	-49	-41	-27
Tax Paid	-39	-20	-27	-41	-50
OPERATING CASH FLOW (a)	**74**	**102**	**27**	**102**	**133**
Capex	-31	-15	-32	-65	-70
Free Cash Flow	43	87	-5	37	63
Investments	0	0	0	0	0
Non-operating income	328	-488	-7	0	0
INVESTING CASH FLOW (b)	**297**	**-503**	**-39**	**-65**	**-70**
Debt Issuance / (Repaid)	0	0	0	0	0
Interest Expenses	0	0	0	0	0
FCFE	371	-401	-12	37	63
Share Capital Issuance	0	0	0	0	0
Dividend	-14	-14	-14	-17	-21
FINANCING CASH FLOW (c)	**-14**	**-14**	**-14**	**-17**	**-21**
NET CASH FLOW (a+b+c)	**357**	**-415**	**-26**	**20**	**42**

Key Ratios

Particulars	CY19	CY20	CY21	CY22E	CY23E
Profitability Ratios (%)					
EBITDA Margin	13.6	9.7	9.5	12.3	12.4
EBIT Margin	13.9	9.0	8.7	12.1	12.3
APAT Margin	9.6	6.7	6.5	9.0	9.1
RoE	11.1	6.4	7.8	12.7	13.7
RoCE	16.0	8.7	10.5	17.0	18.4
Solvency Ratio (x)					
Net Debt/EBITDA	-3.9	-7.3	-5.6	-3.5	-3.1
Net D/E	-0.6	-0.7	-0.6	-0.6	-0.5
PER SHARE DATA (Rs)					
EPS	42.1	26.1	33.5	59.1	71.6
CEPS	55.2	39.1	47.0	72.4	87.6
BV	396.3	414.7	441.5	492.1	553.2
Dividend	7.0	7.0	7.0	8.5	10.5
Turnover Ratios (days)					
Debtor days	76	81	57	55	60
Inventory days	47	52	58	62	58
Creditors days	55	65	66	65	63
VALUATION					
P/E	39.1	63.1	49.2	27.9	23.0
P/BV	4.2	4.0	3.7	3.4	3.0
EV/EBITDA	23.8	36.3	28.1	16.9	13.8
EV / Revenues	3.2	3.5	2.7	2.1	1.7
Dividend Yield (%)	0.4	0.4	0.4	0.5	0.6

One-year share price data



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. This 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 cyclicality 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.

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