Usha Martin (Q4 FY07) - Investment Update

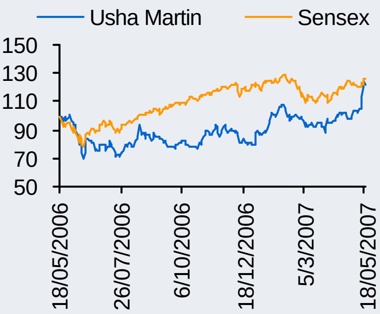
Recommendation	BUY
CMP	Rs242
Market Cap.	Rs11.6bn
52 Week H/L	Rs253/135
Face Value	Rs5
Average volumes (6m)	39,452
BSE Code	517146
NSE Code	USHAMART
Reuters Code	USBL.BO

Usha Martin consolidated Q4 FY07 results were on our expected lines with earnings remaining flat qoq at Rs393mn and revenues growing 3.8% qoq to Rs4.99bn. On stand-alone basis, revenue growth was strong at 14.4% qoq while earnings growth was marginal at 2.1% qoq. During the quarter OPM slipped sequentially by 222 bps on stand-alone basis and 100 bps on consolidated basis. Margin was mainly impacted by sharp Rupee appreciation, higher coke prices and higher contribution from Agra rolling mill. Full year consolidated numbers were also in line with our expectations. We remain positive on Usha Martin but have marginally tweaked our FY08 EPS estimate downward to Rs33.9 from Rs34.1.

Share Holding Pattern

Mar '07	(%)
Promoters	43.0
Non Promoter Corp Holding	5.0
Institutions	20.0
Foreign	21.0
Public & Others	8.0

Share Price Chart



Financial highlights - Stand-alone

Period	03/07	12/06	Growth (%)	03/06	Growth (%)	03/07	03/06	Growth (%)
Rs mn	(3)	(3)	qoq	(3)	yoy	(12)	(12)	yoy
Sales	4,019	3,514	14.4	3,566	12.7	14,086	12,318	14.4
Expenditure	(3,244)	(2,759)	17.6	(2,947)	10.1	(11,370)	(9,914)	14.7
Operating profit	775	755	2.5	619	25.2	2,717	2,404	13.0
Other income	19	12	54.1	67	(72.1)	143	95	51.2
Interest	(177)	(186)	(4.8)	(170)	4.3	(713)	(731)	(2.4)
Depreciation	(191)	(191)	-	(198)	(3.6)	(763)	(761)	0.2
PBT	426	391	8.9	319	33.6	1,384	1,007	37.4
Tax	(136)	(107)	26.8	(115)	18.0	(369)	(358)	3.2
PAT	290	284	2.1	204	42.4	1,015	650	56.2
OPM (%)	19.3	21.5	-	17.4	-	19.3	19.5	-
Equity	240.0	236.4	-	221.9	-	240.0	221.9	-
EPS (Rs) Ann.	24.2	24.0	-	18.4	-	21.1	13.5	-
P/E (x)	10.1	-	-	-	-	11.6	-	-

Financial highlights – Consolidated

Period	03/07	12/06	Growth (%)	03/07	03/06	Growth (%)
Rs mn	(3)	(3)	qoq	(12)	(12)	yoy
Sales	4,987	4,804	3.8	19,647	17,985	9.2
Expenditure	(4,026)	(3,831)	5.1	(16,137)	(14,947)	8.0
Operating profit	961	973	(1.3)	3,510	3,039	15.5
Other income	50	15	241.1	169	107	57.9
Interest	(232)	(235)	(1.2)	(915)	(910)	0.6
Depreciation	(238)	(231)	2.7	(935)	(972)	(3.8)
PBT	541	522	3.8	1,829	1,265	44.6
Tax	(144)	(121)	18.8	(441)	(411)	7.5
PAT	398	401	(0.8)	1,388	854	62.5
OPM (%)	19.3	20.3	-	17.9	16.9	-
Equity	240.0	236.4	-	240.0	221.9	-
EPS (Rs) Ann.	32.8	33.8	-	28.6	19.0	-
P/E (x)	7.5	-	-	8.6	-	-

Analyst
Rajiv Mehta
rajivm@indiainfoline.com
91-22-6777 0893

Head of Research
Sachin Neema
91-22-6749 1750

Institutional Sales
Sandeepa Arora
91-22-6749 1776

IndiaInfoline

Production/Sales volumes & Realizations (Stand-alone)

Period	Q1FY06	Q2FY06	Q3FY06	Q4FY06	Q1FY07	Q2FY07	Q3FY07	Q4FY07	FY06	FY07
Production (MT)										
Wire Rods & Bars (Rolled Steel)	72,841	70,969	76,804	82,013	79,943	85,250	85,144	79,048	302,627	329,385
% qoq growth	-	(2.6)	8.2	6.8	(2.5)	*6.6*	*(0.1)*	(7.2)	-	-
% yoy growth	-	-	-	-	9.8	*20.1*	*10.9*	(3.6)	-	8.8
Wires, Strands & Wire Ropes (VAP)	28,660	33,452	36,732	35,783	36,200	38,909	40,555	41,141	134,627	156,805
% qoq growth	-	16.7	9.8	(2.6)	1.2	*7.5*	*4.2*	*1.4*	-	-
% yoy growth	-	-	-	-	26.3	*16.3*	*10.4*	*15.0*	-	16.5
Sales (MT)										
Wire Rods & Bars (Rolled Steel)	36,124	38,252	41,994	55,306	45,280	45,514	40,910	41,791	171,676	173,495
% qoq growth	-	5.9	9.8	31.7	(18.1)	*0.5*	*(10.1)*	*2.2*	-	-
% yoy growth	-	-	-	-	25.3	*19.0*	*(2.6)*	*(24.4)*	-	1.1
Wires, Strands & Wire Ropes (VAP)	23,652	31,507	33,698	37,666	31,258	37,998	37,204	41,037	126,523	147,497
% qoq growth	-	33.2	7.0	11.8	(17.0)	*21.6*	*(2.1)*	*10.3*	-	-
% yoy growth	-	-	-	-	32.2	*20.6*	*10.4*	*8.9*	-	16.6
Avg Realizations (Rs/MT)										
Wire Rods & Bars (Rolled Steel)	37,500	36,600	35,150	31,700	34,145	35,600	36,300	36,600	34856	35626
% qoq growth	-	(2.4)	(4.0)	(9.8)	7.7	*4.3*	*2.0*	*0.8*	-	-
% yoy growth	-	-	-	-	(8.9)	*(2.7)*	*3.3*	*15.5*	-	2.2
Wires, Strands & Wire Ropes (VAP)	58,900	54,800	52,970	52,250	54,013	55,700	57,330	58,200	54320	56449
% qoq growth	-	(7.0)	(3.3)	(1.4)	3.4	*3.1*	*2.9*	*1.5*	-	-
% yoy growth	-	-	-	-	(8.3)	*1.6*	*8.2*	*11.4*	-	3.9
% VAP volume/Total sale volume	39.6	45.2	44.5	40.5	40.8	45.5	47.6	49.5	42.4	46.0
% of steel used downstream*	50.4	46.1	45.3	32.6	43.4	46.6	52.0	47.1	43.3	47.3

Source: Company, India Infoline Research

Performance Highlights

- ✓ On stand-alone basis, revenue grew by 14.4% on qoq basis and 12.7% on yoy basis. The robust sequential growth in the quarter was driven by higher sales volumes (2.2% for rolled products & 10.3% for value added products), better realizations (0.8% for rolled products & 1.5% for value added products) and higher contribution from Agra rolling mills (Rs400mn, included for 3 months against 1 month in the previous quarter). Sequentially, the production of rolled products was impacted by lesser no of working days in February and 2 days normal shutdown. The yoy growth was mix of lower overall sales volumes (24.4% lower for rolled products & 8.9% higher for value added products) and higher realizations (15.5% for rolled products & 11.4% for value added products) and addition of Agra mill wef December 2006.

- ✓ On consolidated basis, sequential revenue growth was relatively subdued due to flattish growth in the cable business and sharper Rupee appreciation impact on foreign manufacturing subsidiaries.

- ✓ For the full year, stand-alone revenues were higher by 14.4% driven by higher sales volumes (1.1% for rolled products & 16.6% for value added products) and higher realizations (2.2% for rolled products & 3.9% for value added products). Consolidated revenues for FY08 grew by 9.2% yoy.

- ✓ The stand-alone operating margin declined sharply by 220 bps qoq to 19.3% after two successive quarters of material improvement in it. The margin slipped despite higher iron ore integration sequentially (at 91% against 75%) and better realizations. The key factors that impacted margin were full inclusion of Agra rolling mill (converts billets into TMT bars, OPM of just ~4%, contributed ~8-9% of consolidated revenues), higher coke prices, unprecedented significant Rupee appreciation and lower production of rolled products. In line with stand-alone movement, the consolidated operating margin also dipped by 100 bps to 19.3%.

- ✓ Company repaid debt worth Rs240-250mn in the quarter and Rs930mn in the year. The annual capex was ~Rs1.57bn, incurred in majority in H1 FY07. On annual basis, interest and depreciation were near flat yoy.

- ✓ Due to margin contraction, sequential net profit growth was just 2.1% on stand-alone basis while on consolidated basis there was a marginal de-growth in profits of 1.6% qoq. Full year consolidated earnings stood at Rs1.38bn, representing robust growth of 63% yoy.

Company's outlook for the year FY08

- ✓ Rolled steel (Wire Rods & Bars) production/sales to be higher by 5-8% yoy

- ✓ Value added products (Wires, Strands & Wire Ropes) production/sales to be higher by 18-20% yoy

- ✓ Prices/Realization likely to remain stable

- ✓ Cost reduction from 100% iron ore integration for entire year and thereby yoy margin expansion

- ✓ Coal mine to start by end of the year

- ✓ Start of commercial production of 30,000tpa Wire Rope plant in USA by June 2007

- ✓ Start of commercial production of 6,000tpa OT wires joint venture project with Joh Pengg of Austria in Ranchi, India

IndiaInfoline

Capex plans

Particulars	Capacity	Expansion I	Capacity	Time-frame	Expansion II	Capacity	Time-frame
Iron making capacity (MT)	**(Current)**		**(post Exp I)**			**(post Exp II)**	
Hot metal/Pig iron	200,000	350,000	550,000	Sep-08	50,000	600,000	Mar-10
DRI/Sponge iron	120,000	100,000	220,000	Sep-08	155,000	375,000	Mar-10
Steel making capacity (MT)							
Billets	360,000	540,000	900,000	Sep-08	-	900,000	Mar-10
Blooms	-	250,000	250,000	Sep-08	-	250,000	Mar-10
Combination Mill	-	-	-	Sep-08	175,000	175,000	Mar-10
Finished	340,000	230,000	570,000	Sep-08	-	570,000	Mar-10
Wire rods	275,000	100,000	375,000	Sep-08	-	375,000	Mar-10
Straight bars	48,000	2,000	50,000	Sep-08	-	50,000	Mar-10
Value-added products capacity (MT)							
Wires, Strands & Wire ropes	197,000	58,000	255,000	Sep-08	23,000	278,000	Mar-10
Specialty wires & cords	12,000	-	12,000	Sep-08	-	12,000	Mar-10
Bright bars	12,000	36,000	48,000	Sep-08	-	48,000	Mar-10
OT wires	-	6,000	6,000	Sep-08	-	6,000	Mar-10
Spring Flat	-	-	-	-	30,000	30,000	Mar-10
Captive power (MW)							
Power generation	43.3	30	73.3	Sep-08	30	103.3	Mar-10

Source: Company

Steel capacity expansion projects are progressing on schedule. Major equipment orders for achieving steel capacity expansion of 0.6mn tones by Q2 FY09 have been placed. Apart from the above expansion plans, company intends to increase value added products capacity by 150,000 tones through overseas acquisitions. The capex would be financed by a mix of debt, equity and internal accruals as below.

Capex funding

Capex Funding	Rs bn	Status
Equity	2	Already raised. Fully diluted equity capital to be at Rs250mn post warrants conversion in April 2007
GDR	1.1	
Warrants	0.9	
Debt	5.75	10 successive quarterly installments of Rs550mn starting from Q4 FY07. Already started.
Tranche I	3.50	
Tranche II	2.25	
Internal Accruals	5.75	Over next 42 months
Total	**13.5**	

Source: company

IndiaInfoline

Revised FY08 consolidated estimates of the company

- ✓ Revenues to grow by 13.6% yoy driven by cumulative sales volume growth of 9.5% (3% for rolled products & 15.4% for value added products), better sales product mix and full year contribution of Agra rolling mill. We have assumed average realizations to be flat yoy.

- ✓ We expect consolidated OPM to improve by 150bps yoy to 19.4% (near Q4 FY07 consolidated level) driven by 100% iron ore integration leading to absolute ~Rs600-650mn savings and superior sales mix (higher share of value added products fetching far better realizations and margins than rolled products). We are not factoring savings from captive coal supply due to regulatory and procedural delay risks involved before the start of actual mining and as we also understand that quality mining (usable quality) takes time after the start of actual mining. Also factored margin pressures from higher coke prices and higher Agra mill contribution.

- ✓ Net profit of the company is anticipated to grow by 23.3% and EPS expected to grow by 18.4% to Rs33.9 due to dilution in Equity from Rs240mn to Rs250mn on conversion of warrants by promoters. The conversion has already happened in April 2007.

Since our last recommendation at Rs210 in our Q3 FY07 Investment Update in February 2007, the stock has run-up by 16.7%. Despite this, we remain positive on the company for its re-rating potential. At CMP Rs242, company trades at 7.2x FY08E EPS and 5.1x FY08E EV/EBITDA. We believe these valuations do not reflect sufficient premium to commodity steel makers with company's character of an alloy/special steel manufacturer producing high value added products like Wires and Wire Ropes in majority. Also as seen, company's products are subjected to far less cyclical price fluctuations than that of commodity steel players. With operating margin on improvement path from backward integration (iron ore – started & coal - to start) and stress on value added products, we expect material upgrades to valuations.

IndiaInfoline

Financials

Projected Income Statement

Period (Rs mn)	FY04 (12)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
Net Sales	10,625	15,503	18,019	19,394	21,333
Operating expenses	(8,766)	(13,137)	(14,993)	(15,850)	(17,002)
Operating profit	1,860	2,366	3,026	3,543	4,331
Other income	75	26	107	134	125
PBIDT	1,935	2,392	3,134	3,678	4,456
Interest	(872)	(860)	(910)	(918)	(1,035)
Depreciation & Amortized	(818)	(873)	(960)	(929)	(1,090)
Profit before tax (PBT)	245	659	1,264	1,830	2,331
Tax	(92)	(203)	(410)	(461)	(618)
Profit after tax (PAT)	154	456	854	1,370	1,713
Extraordinary/prior period items	10	47	-	-	-
Share of earnings/(loss) in associates	(0)	3	-	-	-
Minority Interest	-	(5)	(11)	(10)	(10)
Adjusted profit after tax (APAT)	164	500	844	1,360	1,703

Projected Balance Sheet

Period (Rs mn)	FY04 (12)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
Sources					
Share Capital	186	186	222	250	250
Reserves	3,739	4,026	5,880	7,040	8,515
Net Worth	3,925	4,212	6,102	7,290	8,765
Loan Funds	11,349	10,472	8,651	9,500	10,800
Minority Interest	-	78	107	127	147
Def Tax liability	1,052	1,106	1,367	1,500	1,600
Total	**16,326**	**15,868**	**16,227**	**18,417**	**21,312**
Uses					
Gross Block	15,672	16,914	18,588	21,588	25,088
Accd Depreciation	(5,450)	(6,290)	(7,371)	(8,299)	(9,389)
Net Block	10,221	10,625	11,217	13,288	15,698
Capital WIP	951	445	731	500	500
Total Fixed Assets	11,172	11,070	11,948	13,788	16,198
Investments	443	445	4	4	4
Total Current Assets	8,065	9,753	9,573	10,587	11,666
Total Current Liabilities	(3,443)	(5,460)	(5,339)	(5,990)	(6,575)
Net Working Capital	4,622	4,292	4,234	4,597	5,091
Miscellaneous expenditure	88	60	42	28	19
Total	**16,326**	**15,868**	**16,227**	**18,417**	**21,312**

IndiaInfoline

Projected Cash Flow

Period (Rs mn)	FY04	FY05	FY06	FY07P	FY08P
Net profit before tax and extraordinary items	245	659	1,264	1,829	2,304
Depreciation	818	873	960	935	1,110
Interest expense	872	860	910	915	1,035
Interest income	0	0	0	0	0
Dividend income	0	0	0	0	0
Operating profit before working capital changes	1,935	2,392	3,134	3,680	4,449
Add: changes in working capital					
(Inc)/Dec in					
(Inc)/dec in sundry debtors	(2,027)	(348)	(260)	(315)	(400)
(Inc)/dec in inventories	(3,743)	(1,084)	384	(407)	(650)
(inc)/dec in other current assets	(205)	(7)	(43)	(145)	(100)
Inc/(dec) in sundry creditors	2,026	19	275	220	235
Inc/(dec) in other current liabilities	1,417	1,999	(396)	181	200
Net change in working capital	(2,532)	578	(39)	(467)	(715)
Cash from operating activities	(597)	2,970	3,095	3,213	3,734
Less: Income tax	(92)	(203)	(410)	(441)	(599)
Inc/Dec in Def Tax Asset/liability	1,052	54	261	33	0
Misc expenditure w/off	(88)	28	18	13	9
Net cash from operating activities	275	2,849	2,964	2,818	3,144
Extraordinary inc/(exp)	10	47	0	0	0
Share in earnings/(loss) in assoc	(0)	3	0	0	0
Minority Interest	0	(5)	(11)	(13)	(10)
Cash Profit	**285**	**2,892**	**2,953**	**2,804**	**3,134**
Cash flows from investing activities					
(Inc)/Dec in fixed assets	(11,990)	(771)	(1,837)	(1,342)	(3,000)
(Inc)/Dec in intangible asset	0	0	0	0	0
(Inc)/Dec in Investments	(443)	(2)	441	0	0
(Inc)/Dec in Minority Interest	0	78	29	20	20
Interest received	0	0	0	0	0
Dividends received	0	0	0	0	0
Net cash from investing activities	**(12,433)**	**(695)**	**(1,366)**	**(1,322)**	**(2,980)**
Cash flows from financing activities					
Inc/(Dec) in debt	11,349	(876)	(1,821)	949	1,300
Inc/(Dec) in equity/premium	186	0	36	18	10
Direct add/(red) to reserves	3,607	(150)	1,149	0	(0)
Interest expense	(872)	(860)	(910)	(915)	(1,035)
Dividends	(31)	(63)	(139)	(205)	(214)
(inc)/dec in loans & advances	(1,702)	(144)	281	(1,505)	(216)
Net cash used in financing activities	**12,537**	**(2,093)**	**(1,404)**	**(1,659)**	**(155)**
Net increase/(decrease) in cash & cash equivalents	**388**	**105**	**183**	**(176)**	**(1)**
Cash at start of the year	0	388	493	677	500
Cash at end of the year	388	493	676	501	499

IndiaInfoline

Key Ratios

Period	FY04 (12)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)
Per share ratios (Rs)					
EPS	4.4	13.5	19.0	28.6	33.9
Div per share	0.7	1.5	2.7	3.8	3.8
Book value per share	105.6	113.3	137.5	151.9	175.6
Valuation ratios (x)					
P/E	47.6	15.6	11.0	8.6	7.2
P/BV	2.0	1.9	1.5	1.6	1.4
EV/sales	1.8	1.1	1.0	1.1	1.0
EV/ PBIT	16.8	11.7	8.0	7.6	6.8
EV/PBIDT	9.7	7.4	5.5	5.7	5.1
Profitability ratios (%)					
OPM	17.5	15.3	16.8	17.9	19.4
PAT	1.5	3.2	4.7	7.0	7.6
ROCE	7.3	10.3	14.7	16.3	17.0
RONW	4.2	11.9	13.8	18.9	19.3
Liquidity ratios					
Current ratio	2.3	1.8	1.8	2.1	2.1
Debtors days	69.6	55.9	53.4	54.8	54.8
Inventory days	128.6	113.6	90.0	90.1	90.0
Creditors days	69.6	48.1	47.0	47.2	45.4
Leverage ratios (x)					
Debt / Total equity	2.9	2.5	1.4	1.3	1.2
Payout ratios (%)					
Dividend Payout Ratio	19.1	12.7	16.4	14.9	12.6
Tax payout	37.3	30.8	32.4	24.1	26.0

Our Recent Publications

Allsec (Q4 FY07) - "Lowering estimates for FY08, but...- May 16, 2007

State Bank of India (Q4 FY07) - May 14, 2007

RPG Transmission Ltd (Q4 FY07) - May 07, 2007

Voltamp Transformers Ltd (Q4 FY07) - May 04, 2007

Andhra Bank (Q4 FY07): Stable growth ahead - May 03, 2007

India Infoline Ltd, 15th Floor, P.J.Tower, Dalal Street, Mumbai -01. Tel 91-22-67491700.

India Infoline Research can be also accessed on Bloomberg (Code IILL), Thomson First Call and ISI Emerging markets.

IT'S ALL ABOUT MONEY, HONEY!