

Tough times ahead; a washed out quarter followed by pandemic penetrating into new regions

CMP: Rs 61

Rating: Unrated

Stock Info

BSE	534392
NSE	VSSL
Bloomberg	VSSL IN
Reuters	VARM.NS
Sector	Steel
Face Value (Rs)	10
Equity Capital (Rs Cr)	40.39
Mkt Cap (Rs Cr)	257
52w H/L (Rs)	89 / 35

Shareholding Pattern %

(As on June, 2020)

Promoters	59.2
FII	0.0
DII	9.2
Public & Others	31.6

Stock Performance (%)

	3m	6m	12m
VSSL	45.1	-11.8	-25.8
Nifty 50	21.4	-6.8	3.3

VSSL Sales	Jun-19	Mar-20	Jun-20
Sales Volume (tonnes)	36,658	35,715	12,487

Vardhman Special Steels Limited was formed way back in 1973 and is in the business of making specialty steels to be used majorly by auto & ancillary makers both in domestic and overseas markets. The company is among the leading producers of special and alloy steels, catering to diverse requirements of hot rolled bars for engineering, automotive, tractor, bearing and allied industries. It started with an initial capacity of 50,000 metric tonnes of special & alloy steels. As of FY20, the company had a steel melting shop of 2 lakh tonnes annual capacity, rolling mill of 2 lakh tonnes annual capacity and bright bars of 36,000 tonnes annual capacity. Recently, the company has partnered with Aichi Steel Corporation of Japan, a leading specialty steel alloys manufacturer which has invested Rs 50 Cr for 11.46% of stake in the company and is working alongside Vardhman's management to produce enhanced quality products with their technological expertise in the industry.

Business Update for Q1 FY21:

VSSL reported a disappointing but expected set of earnings in Q1FY21. The sales stood at Rs 67.9 Cr (down 67% QoQ), EBITDA fell to Rs -8.8 Cr (down from Rs 18.1 Cr previous quarter) and Net Loss at Rs 12.8 Cr (Profit of Rs 3.6 Cr in Q4FY20 / Profit of Rs 1.1 Cr in Q1FY20).

Gradual recovery in auto sector: The slowdown in auto sector that begun with BS-VI norms along with macro slowdown followed by the pandemic now projecting green shoots of revival, with demand picking up for 2-wheelers and tractors.

Capital position sufficient enough to steer through: VSSL informed of the company's capital position with sizeable reserves and Rs 43 Cr deposit with a PSU Bank.

Massive impact of Covid-19: VSSL has been hit hard by the corona pandemic, with its sales volumes dropping to a third of its quarterly average. The company has re-started its operations and is witnessing pick-up in demand on a month-on-month basis. However, the management refrained from providing any guidance as the pandemic spreads across the nation triggering regional lockdowns in new hot-spot of its spread.

New Products and other developments: VSSL has been engaged with Aichi Steel, Japan, and working on several new high-end products like, gear components and its parts to target the Japanese OEMs in future. These facilities will be operational by next 1-2 year.

Valuation & View

Vardhman Special Steels Limited has a sizeable amount of reserve (Rs +373 Cr as of March 2020) which will steer the company through these dark times as the company has to bear fixed costs per quarter, no matter of the sales. VSSL is also engaging with several banks to negotiate for better interest rates on its borrowings. As the economy opens up again, we expect the demand to increase gradually but remain way below previous year's quarterly earnings. However, with mandated nation-wide lockdowns not happening again, we expect the demand to pick-up as the pent up demand starts building pressure on consumption cycle. Therefore, considering the uncertainty with the pandemic and intermittent lockdowns to continue for the rest of the year, we remain bearish on the company's near term business outlook.

Concall Highlights

- VSSL management brushed aside any concern with working capital requirements, informing of its relation with five large banks extending its Working Capital facilities.
- The company has a deposit of Rs 43 Cr with a PSU Bank.
- On the operations front, VSSL is witnessing increasing month-on-month demand, e.g. July sales were better than June despite surge in corona cases across the nation.
- VSSL is working with Aichi Steel, Japan, on the development of new high-end gear components to target Japanese OEMs and is developing products which will commercialize in 1-2 years time.
- Aichi Steel is also helping VSSL to reduce its costs in the longer run to cut on its costs of production during normal times.
- Management warned of the high fixed-costs of the company which are dragging down its profitability.
- The Rs 50 Cr of capital injection by Aichi Steel last year was considering the price levels and business outlook of yesteryear, and hence, Aichi Steel may be injecting more capital in order to strengthen VSSL's balance sheet with renewed focus on current & post pandemic prices.
- The management refrained from providing any guidance for current year capex, rather deferred it for next quarter earnings.
- Management focus is towards getting as close to last year sales as possible.
- VSSL expects to have a better 2nd half for FY21, with one quarter where the sales volume will be comparable to last year quarterly sales.

Quarterly (Standalone) (Rs Cr)

Quarterly (in Cr)	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Sales -	202.1	207.1	218.4	231.4	269.5	295.5	312.5	243.3	240.8	211.8	187.9	205.7	67.9
YOY Sales Growth %	25.0%	22.4%	26.9%	33.7%	33.3%	42.7%	43.1%	5.1%	-10.7%	-28.3%	-39.9%	-15.5%	-71.8%
QoQ Sales Growth %	16.8%	2.4%	5.5%	5.9%	16.5%	9.6%	5.8%	-22.2%	-1.0%	-12.0%	-11.3%	9.4%	-67.0%
Expenses -	190.8	192.5	199.5	214.2	251.7	280.2	290.5	232.6	225.4	209.2	182.0	189.0	78.4
Raw Material	114.7	113.4	114.4	127.2	156.2	182.1	192.8	140.6	147.6	156.7	110.0	123.7	43.6
Material Cost %	56.7%	54.8%	52.4%	55.0%	58.0%	61.6%	61.7%	57.8%	61.3%	74.0%	58.5%	65.5%	55.6%
Employee Cost	10.9	11.8	11.8	12.2	12.7	13.4	12.6	12.5	12.1	11.1	12.5	12.5	10.7
Employee Cost %	5.4%	5.7%	5.4%	5.3%	4.7%	4.6%	4.0%	5.1%	5.0%	5.2%	6.7%	6.7%	15.8%
Operating Profit	11.3	14.5	18.9	17.2	17.8	15.3	22.0	10.6	15.4	2.6	5.9	16.7	-10.6
OPM %	5.6%	7.0%	8.7%	7.4%	6.6%	5.2%	7.0%	4.4%	6.4%	1.2%	3.2%	3.2%	-15.6%
Other Income	1.5	1.3	1.0	2.3	1.8	1.2	0.4	0.5	0.7	5.4	1.9	1.5	1.8
Interest	5.7	5.2	4.6	5.9	4.9	5.6	6.5	6.6	8.1	6.5	6.0	5.1	5.1
Depreciation	4.6	4.9	5.7	6.3	5.7	6.0	6.2	6.1	6.1	6.3	6.7	6.6	6.7
EBITDA	12.8	15.9	19.9	19.5	19.6	16.6	22.4	11.2	16.0	8.0	7.9	18.1	-8.8
EBITDA Margin (%)	6.3%	7.7%	9.1%	8.4%	7.3%	5.6%	7.2%	4.6%	6.7%	3.8%	4.2%	8.8%	-13.0%
Profit before tax	2.5	5.8	9.5	7.3	9.1	4.9	9.6	-1.5	1.8	-4.9	-4.9	5.6	-19.5
Tax %	0.0%	0.0%	0.0%	0.8%	0.0%	-43.4%	35.6%	90.1%	37.0%	35.3%	137.3%	36.7%	34.5%
Net Profit	2.5	5.8	9.5	7.2	9.1	7.1	6.2	-0.2	1.1	-3.2	1.8	3.6	-12.8
Net Profit Margin(%)	1.2%	2.8%	4.4%	3.1%	3.4%	2.4%	2.0%	-0.1%	0.5%	-1.5%	1.0%	1.7%	-18.8%
EPS in Rs	1.0	1.8	3.0	2.2	2.5	2.0	1.7	0.0	0.3	-0.9	0.5	0.9	-3.2

Source: Arianth Research, Company Filings, Ace Equity, Bloomberg

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Key Financials

Standalone Profit & Loss Account (Rs Cr)	FY15	FY16	FY17	FY18	FY19	FY20
Revenue From Operations	733.1	724.0	751.8	873.4	1120.8	846.2
<i>Less: Excise/Sevice Tax/Other Levies</i>	72.6	72.8	79.3	18.9	0.0	0.0
Revenue From Operations [Net]	660.5	651.2	672.4	854.5	1078.1	846.2
Other Operating Revenues	1.1	1.5	1.4	4.5	0.0	0.0
Total Operating Revenues	661.6	652.7	673.8	859.0	1078.1	846.2
Other Income	7.4	2.7	5.6	6.1	1.9	9.4
Total Revenue	669.0	655.4	679.5	865.1	1122.6	855.6
Cost Of Materials Consumed	408.9	325.1	364.2	488.9	799.3	389.3
Purchase Of Stock-In Trade	0.0	0.0	0.0	0.0	34.9	4.3
Changes In Inventories	3.7	29.9	-11.7	-19.2	-162.4	144.4
Employee Benefit Expenses	28.4	33.7	39.8	46.7	51.3	48.1
Finance Costs	20.2	23.0	28.3	21.4	23.7	25.7
Depreciation And Amortisation Expenses	13.9	17.0	18.1	21.5	23.9	25.7
Other Expenses	209.1	222.5	221.6	280.6	329.9	220.4
Total Expenses	684.1	651.2	660.3	840.0	1100.5	857.9
Profit/Loss Before Tax	-15.1	4.2	19.1	25.1	22.1	-2.3
Total Tax Expenses	0.0	0.0	0.0	0.1	-0.1	-5.7
Profit/Loss For The Period	-15.1	4.2	19.1	25.0	22.2	3.3
<i>Profit Margin (%)</i>	-2.3%	0.6%	2.8%	2.9%	2.1%	0.4%
Basic EPS (Rs.)	-8.15	2.27	10.31	7.91	6.22	0.89
Diluted EPS (Rs.)	-8.15	2.27	10.31	7.88	6.19	0.89

Source: Arianth Research, Company Filings, Ace Equity, Bloomberg

Standalone Balance Sheet	FY15	FY16	FY17	FY18	FY19	FY20
Equities And Liabilities						
Equity Share Capital	18.6	18.6	18.6	35.7	35.8	40.4
Reserves and Surplus	151.2	160.6	179.5	303.6	326.2	373.2
Total Shareholders Funds	169.7	179.2	198.1	339.3	362.0	413.6
Non-Current Liabilities						
Long Term Borrowings	104.4	129.0	115.5	101.5	135.1	107.8
Other Long Term Liabilities	0.2	0.1	0.2	0.0	0.4	1.9
Long Term Provisions	0.5	0.6	0.8	0.9	1.0	1.2
Total Non-Current Liabilities	105.1	129.8	116.5	102.3	136.5	111.0
Current Liabilities						
Short Term Borrowings	239.1	166.8	138.7	118.5	186.8	148.6
Trade Payables	51.6	41.0	34.9	60.6	163.5	61.7
Other Current Liabilities	48.4	96.4	124.3	55.3	40.0	34.4
Short Term Provisions	0.6	0.6	0.3	0.6	0.5	0.9
Total Current Liabilities	339.8	304.9	298.1	235.0	390.8	245.7
Total Capital And Liabilities	614.6	613.8	612.7	676.7	889.3	770.2
Assets						
Non-Current Assets						
Tangible Assets	230.0	250.3	264.2	249.3	279.5	308.3
Intangible Assets	0.0	0.4	0.4	0.3	0.3	0.3
Capital Work-In-Progress	20.8	2.1	1.1	7.0	32.6	12.3
Fixed Assets	250.8	252.7	265.7	256.6	312.4	322.4
Non-Current Investments	14.1	1.4	0.7	0.0	0.0	51.4
Deferred Tax Assets [Net]	0.0	0.0	0.0	9.7	16.4	22.9
Long Term Loans And Advances	9.9	0.3	0.5	1.4	0.7	0.8
Other Non-Current Assets	0.0	12.2	10.8	20.9	14.1	11.8
Total Non-Current Assets	274.7	266.6	277.6	288.6	343.5	409.4
Current Assets						
Current Investments	0.0	13.1	0.3	8.2	0.0	5.0
Inventories	132.9	106.9	117.8	158.6	313.2	151.8
Trade Receivables	179.0	194.2	189.0	194.6	187.3	179.9
Cash And Cash Equivalents	8.7	3.8	6.0	7.5	0.3	2.3
Short Term Loans And Advances	19.4	0.5	0.7	1.0	1.0	12.7
Other Current Assets	0.0	28.8	21.3	18.3	44.0	9.2
Total Current Assets	339.9	347.2	335.1	388.1	545.8	360.9
Total Assets	614.6	613.8	612.7	676.7	889.3	770.2

Source: Arian Research, Company Filings, Ace Equity, Bloomberg

Cash-Flow Statement

Standalone Cash Flow Statement	FY15	FY16	FY17	FY18	FY19	FY20
Net Profit Before Tax	-15.1	4.2	19.1	25.1	22.1	-2.3
Net Cash From Operating Activities	-32.8	46.4	68.0	11.2	-18.9	135.4
Net Cash (used in)/from Investing Activities	-3.7	-15.8	-15.7	-16.3	-70.1	-88.2
Net Cash (used in)/from Financing Activities	31.2	-35.5	-50.2	6.6	81.8	-45.2
Net (decrease)/increase In Cash & Equivalents	-5.3	-4.9	2.2	1.5	-7.2	2.0
Opening Cash & Cash Equivalents	13.9	8.7	3.8	6.0	7.5	0.3
Closing Cash & Cash Equivalents	8.7	3.8	6.0	7.5	0.3	2.3

Source: Arian Research, Company Filings, Ace Equity, Bloomberg

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Stock Rating Scale	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

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