

August 23, 2018

RE-INITIATING REPORT

VOL-4, NO-9

Indian Hume Pipe Co. Limited

BUY

CMP: Rs.289

TARGET PRICE: Rs.500

TIME : 12 months

REINITIATION REPORT

We had initiated coverage on Indian Hume Pipes Co Limited (IHP) on July 13, 2015 (Vol-1 No-2) at the price of Rs341 and target of Rs475 then. Post our coverage, the stock has breached our initial target price, forcing us to revise the target price more than four times. Not to forget, the investors were also treated with bonus shares in the ratio of 1:1 in December 2016. With the recent developments and consistently strong order created by the company, the conviction in the recommendation still stands stronger. We thereby re-initiate a BUY call on the stock at CMP of Rs288 and target of Rs500 over a horizon of 12 months.

About the Company:

Established in 1926, Indian Hume Pipe Company Limited (IHP), is a major player in the business of manufacturing, laying and jointing of pipelines of various pipe materials such as RCC pipes, steel pipes, prestressed concrete pipes, penstock pipes, bar wrapped steel cylinder pipes (BWSC), prestressed concrete cylinder pipes (PCCP) etc. All this work is involved in providing infrastructure facility and development for drinking water supply projects, irrigation projects, hydro electric projects, sanitation and sewerage systems. IHP is considered a pioneer in the field of water supply industry and has been in this line for more than 9 decades. The company is chaired by Mr. Rajas R. Doshi who is a graduate in Civil Engineering and has an experience of more than four decades in this industry.

For more than three decades now, IHP has been instrumental in the process of nation building via infrastructure development programmes by executing combined water supply projects on turnkey basis. The company's services include right from designing of custom made pipes to total engineering packages for pipeline projects. These projects include undertaking the complete job of water supply from source to distribution centres which engages manufacturing, laying and jointing of pipelines included construction of intake wells, water sumps, water treatment plants, water pumping stations, installation of pumping machineries, electro-mechanical works, branch mains, ground level reservoirs, elevated reservoirs, leading to executions of complete systems for water supply to various towns and villages of India. Thus, IHP is a total engineering solution provider executing most projects on turnkey basis.

INVESTMENT RATIONALE

(A) Concrete Foundations:

Water is one of the most crucial elements, mentioned in our national developmental planning for the 21st century. Proper management of the limited water resources has become essential, wherein the role of IHP also becomes critical. IHP has been in the business of manufacturing, laying and jointing of pipelines of various pipe materials such as RCC pipes, Steel pipes, Prestressed Concrete pipes, Penstock pipes, Bar Wrapped Steel Cylinder pipes (BWSC), Prestressed Concrete Cylinder pipes (PCCP) etc. The company's presence is there in almost all water supply related activities, viz. urban & rural water supply, penstock for hydro power generation, tunnel lining, large diameter irrigation pipelines, head works including pumping machinery, treatment plants, overhead tanks and other allied civil construction. With growing population and higher standard of living, shortage of drinking water is prone to happen. This gives impetus to the vast scope of improvement in infrastructural developmental activities in water supply, drainage and sewerage schemes which give visibility to the company's manufacturing and contracting activities. The company also supplies concrete railway sleepers to Indian Railways.

As of now, domestic and industrial water needs were largely restricted in or around major cities, but recently the demand in rural areas is expected to increase sharply. This is led by the development programmes of state governments to improve the economic conditions of the rural masses; demand from hydro and thermal power generation and for other industrial uses is also increasing substantially. Growth of population and the expansion of economic activities inevitably lead to increasing demands for water for diverse purposes i.e. domestic, industrial, agricultural, hydro-power, thermal power, navigation, recreation etc.

Please Turn Over

SNAPSHOT				
52 week H / L		Mcap (INR mn)		
591 / 238		13,989		
Face value: 2				
BSE Code		NSE CODE		
504741		INDIANHUME		
Annual Performance				
(Rs mn)	FY16	FY17	FY18	FY19E
Sales (Net)	9,389	18,126	15,514	16,349
EBITDA	970	2,064	1,515	1,995
EBITDA (%)	10.33	11.39	9.77	12.20
Other Income	30	29	26	24
Interest	453	457	429	488
Depreciation	98	105	108	110
PBT	449	1,531	1,004	1,421
PAT	291	998	661	938
Equity	48	97	97	97
EPS (INR)	12.0	20.6	13.6	19.4
Quarterly Performance				
Parameters (Rs mn)	Sept-17	Dec-17	Mar-18	Jun-18
Sales (Net)	2,142	3,561	4,112	3,356
EBITDA	250	366	467	386
EBITDA (%)	11.7	10.3	11.4	11.5
Other Income	7	5	7	6
Interest	113	117	90	104
Depreciation	26	28	29	25
PAT	83	147	232	170
Equity (Rs mn)	97	97	97	97
Ratio Analysis				
Parameters (Rs mn)	FY16	FY17	FY18	FY19E
EV/EBITDA (x)	17.6	7.9	11.4	8.8
EV/Net Sales (x)	1.8	0.9	1.1	1.1
M Cap/Sales (x)	1.5	0.8	0.9	0.9
M Cap/EBITDA (x)	14.4	6.8	9.2	7.0
Debt/Equity (x)	1.0	0.7	0.8	0.7
ROCE (%)	26.5	51.0	30.6	35.0
Price/Book Value (x)	2.3	3.5	3.1	2.6
P/E (x)	24.1	14.0	21.2	14.9
Share Holding Pattern as on 30th June 2018				
Parameters	No of Shares	%		
Promoters	33,874,770	69.9		
Institutions	2,771,867	5.7		
Public	11,800,533	24.4		
TOTAL	48,447,170	100.0		

Source: Annual Report

Note: All the data is calculated as per Market Price on 21st Aug 2018.

INVESTMENT RATIONALE (contd.)

(A) Concrete Foundations:

For the year ending FY18, the company has successfully completed some prominent water supply projects and drainage schemes which amounted for more than Rs250mn. While at the same time, projects worth Rs250mn are nearing completion. The order book of the company as on 15th May 2018 stood at Rs32bn. The same was Rs26.5bn as at 15th May 2017. The execution time for these orders ranges from 18-30 months. Hence, there is a good scope for many water supply projects coming up in near future which augurs well for IHP.

(B) Recent Order bagged:

There are immense growth opportunities in India itself and IHP has been constantly securing orders. Some of the most recently secured orders are mentioned below.

- In April 2018, the company was successful in securing a work order of Rs1081.9mn from Narmada Water Resources, Water Supply & Kalpsar Dept, Gujarat for lift irrigation project for transmission 100 cusecs of water from Kherva to Visnagar.
- In August 2018, the company has received Letter of Award for work order of Rs4685.8mn from Karnataka Power Corporation Ltd, Bengaluru for manufacture and supplying to site, laying, jointing, testing and commissioning of 1600/1700mm dia PCCP pipeline and construction of appurtenant works for the water supply pipeline from Kushtagi to Bellary thermal power plant approximate length 103 km. Timeline for completion of this project is within 24 months.
- On 8th August, 2018 the Board of IHP approved the proposed revenue sharing transaction with the developer Kalpataru Gardens Pvt. Ltd. in respect of development and sale of the developed areas on the company's land at Vadgaon, Pune. The land is admeasuring about 59,784.29 sq. mtrs. which is equivalent to 6,43,518.09 sq. ft. which is a project for residential group housing apartments, complex, commercial / retail areas. Company's share of Revenue is 34% while that of the Developer's is 66%. FSI / DR / TDR is to be provided by IHP. The Company will also bear the conversion charges from industrial to residential use. While the developer will bear and pay all construction, development, marketing and selling costs and other project related costs.
- In August 2018, IHP received a work order of Rs2561.9mn from Tamil Nadu water supply & drainage board, Coimbatore for providing combined water supply scheme to Alampalayam town panchayat, Padaveedu town panchayat including 669 rural habitations in Pallipalayam and Tiruchengode Unions in Namakkal District and Sankari Town Panchayat in Salem district with river Cauvery as the source. The project is to be completed within 2 years which includes a trial run and maintenance period of 5 years.

(C) Land Development:

Besides the strong business in the water infrastructure space, the other add-on to the prospects of the company is the huge land bank which the company is sitting on. The focus of the company has been on properties at Hadapsar, Badarpur and Wadala. As per the understanding, IHP will have to spend on FSI and other requisite approvals as and when these will be developed.

(i) Hadapsar, Pune:

- IHP has tied up with a developer for this land parcel. Approximate area of this land parcel is around 4 acres.
- Post GST, the company faced issues with the new laws and once again the project had to be reworked.
- This would be the fourth time that the project would be submitted to Pune authorities.
- Potential development area (saleable) is around 13 Lakhs sq. ft. where the share of IHP's revenue would be 40% while the rest will go to the developer.
- Of course, the project will be done in phases and will take nearly 5-7 years for completion.

(ii) Badarpur, Delhi:

- At Badarpur (near Delhi) IHP has signed a MoU with Shobha developers.
- Potential development area is around 10 Lakhs sq. ft.
- For further proceedings, this land parcel will have to be converted from industrial to residential which will invite expenditures for IHP.
- Sobha Developers has indicated that it will take another 1 year to get the approvals.
- As the extension of Delhi Metro Rail passes through this property, higher FSI would be possible.

(iii) Wadala, Mumbai:

- This is a SRA project. Potential area for development here after considering SRA's share is around 40,000 sq. ft. only.
- IHP has entered into MoU with Dosti Developers for this land parcel.

Financials:

The Net profit for FY18 stood at Rs660mn as compared to Rs996mn in FY17. There was a drop witnessed as the company incurred a one-time payment of sales tax liability (due to works contract levied by Rajasthan Government) to a tune of Rs303mn. The company had gone through a tough time during the implementation of GST which the Management kept on mentioning in the quarterly results as well. As per the Management commentary, the company was earlier paying a VAT of 5% on the water-related projects; however, during the transition post the GST regime, the new tax was imposed was 18% which was then reduced to 12%. As a result of which some legacy contracts got trapped in this bargain, and Management has been finding it difficult to pass on the GST to its customers. Post the negotiations with the customers, the company has been successful in passing through nearly 70% of the changes while they are still in negotiations with rest of the customers.

Moreover, during the year under review (in FY18), the company faced increased in prices of raw materials and other requirements like HR Coils (by 24%), MS Wires (by 17%) and PC Wires (by 35%). Moreover, the prices of bought out pipes also increased for DI pipes (by 9%), HDPE Pipes (by 16%), PVC Pipes (by 8%) and cement prices (by 6%) which also affected the margins. However, the Management appears to be comfortable with the margins they are earning.

The promoters look content with the current shareholding of 69.92% which will also serve the purpose of maintaining enough float in the market. Nearly 5.7% is owned by MF and institutions while 24.4% is owned by the general public.

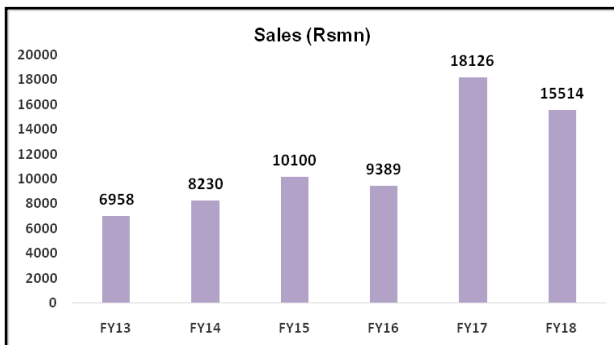
In terms of the idea of becoming a debt free company; the management is happy till return on equity is greater than the cost of capital; so, we will not see the company becoming debt free anytime soon. Over the years, the Management has been generous in rewarding the shareholders with incremental dividends.

Exhibit: Corporate Events (Dividend & Bonus)

Ex- Date	Amount (In Rs)	Face Value (In Rs)
19 July 2007	6.00	10.00
21 July 2008	7.00	10.00
13 July 2009	8.50	10.00
16 July 2010	10.00	10.00
13 July 2011	2.00	2.00
11 July 2012	2.00	2.00
10 July 2013	2.20	2.00
09 July 2014	2.40	2.00
22 July 2015	3.00	2.00
17 Mar 2016	3.00	2.00
17 Mar 2016	0.20	2.00
Bonus Issued 1:1 (09 December 2016)		
15 Feb 2017	1.00	2.00
28 June 2017	2.40	2.00
06 July 2018	3.40	2.00

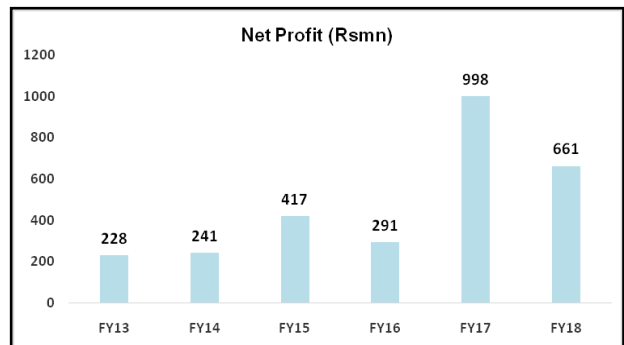
Source: Bseindia

Exhibit: Sales



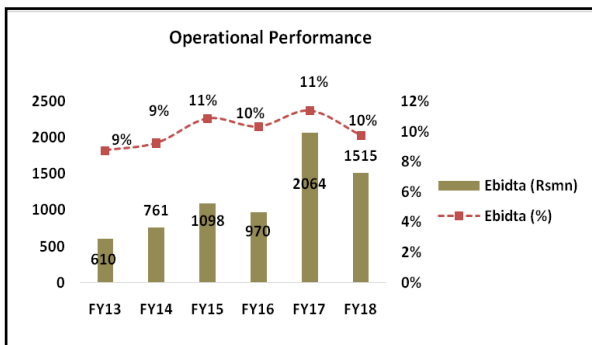
Source: Ace Equity

Exhibit: Net Profit



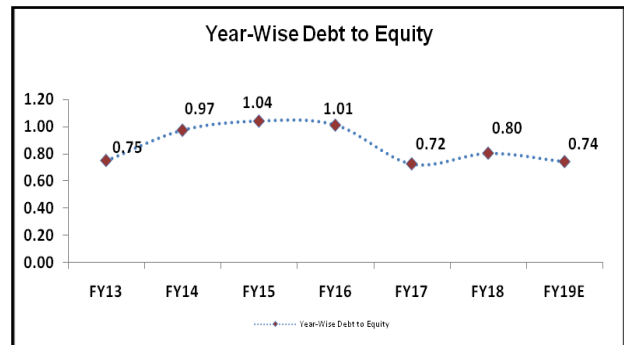
Source: Ace Equity

Exhibit: Operational Performance



Source: Ace Equity

Exhibit: Debt to Equity



Source: Ace Equity

Risks and concerns:

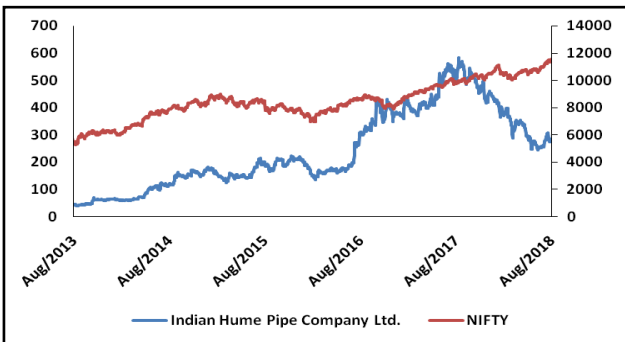
The company is involved in businesses with various state and central governments which makes IHP dependent on their policy for approval of finance, allocation of funds, ability to raise funds etc for various water supply projects. Any delay or lack of funds results in higher costs for the business prospects of the industry as well as the company. The company faces severe competition from the manufacturers of alternative pipes like ductile iron pipes, PVC pipes, HDPE pipes, spirally welded steel pipes etc. The cost of various raw materials like steel, HR Coils, MS Wires PC Wires as also the prices of bought out pipes like DI pipes, HDPE, PVC Pipes and cement prices affect the margins of the company.

Outlook and valuations:

The urban limits are spreading wider and wider; however, the basic amenities like water supply, drainage, etc. are not keeping pace with the requirement of this massive urbanization in progress; thus, the outlook for the company still looks brighter. The game changer would be once the property development starts hitting the profits and the land banks are monetized. In the current scenario, real estate as a sector is not doing that well, however, once triggered, land development will be an important plus point to the earnings and will thus re-rate the stock. The development of the entire land bank available with the company can take nearly 5-7 years; which makes the idea long term in nature. The current year (FY18) has been a year of consolidation for the company as well as the shareholders. Things should start picking up for the company from Q3FY19 and Q4FY19. We continue to advocate a BUY on the stock for long term gains and maintain our target of Rs500 over the next 12 months.

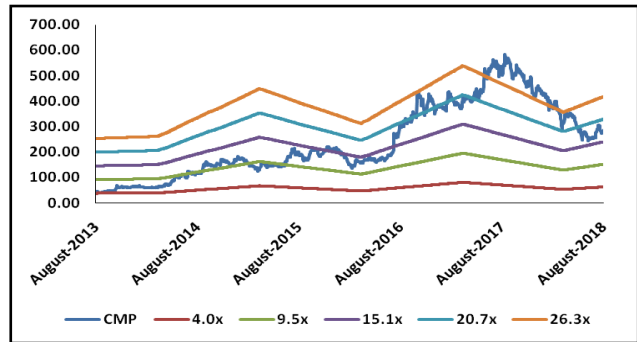
Price Performance:

Exhibit: IHP vs. Nifty



Source: Ace Equity

Exhibit: One Year Forward P/E



Source: Ace Equity

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