BUY (Maintained)

CMP: **INR 2,558** Target Price: **INR 3,265 (INR 1,750)** ▲ 28%

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16 September 2024

India | Equity Research | Company Update

Gravita India

Metals

The stars shine down

Despite surging 2x in the last three months, we see further steam in Gravita India (GRAV) stock on the back of: 1) Regulatory tailwinds aiding availability of scrap in domestic market; 2) planned expansion in Europe; and 3) increased use of recycled material across products and geographies. In our view, the positive impact of regulatory tailwinds and benefits from planned capacity expansion as per 2028 plan is likely to be visible in earnings in medium term. Hence, we shift our valuation methodology to DCF (earlier P/E) in order to adequately capture the growth path. Our revised TP works out to INR 3,265 (earlier INR 1,750 on 30x P/E), implying 28% upside on CMP. We retain **BUY** rating on GRAV stock.

Regulatory tailwinds to aid procurement

The Central Pollution Control Board (CPCB) has notified the Environmental Compensation (EC) guidelines for lead acid and lithium-ion (Li-ion) batteries within the framework of Battery Waste Management Rules (BWR) 2022. As per the notification, recyclers will be able to trade the metal-wise Extended Producer Responsibility (EPR) credits in the range of 30-100% of EC costs with an objective to increase investments in collection networks, reducing the burden on recyclers and helping legitimate recyclers compete against the unorganised/informal sector. It is noteworthy that while li-ion batteries are still in infancy stage, the objective of the government seems to address the high-processing costs by supporting significant investments in R&D and health & safety measures. Additionally, it may ensure 100% battery coverage by making collection and logistics economically viable. Refer **Annex-1** for details.

Secondly, in GST council meeting held on Sep 9, '24, the reverse charge mechanism (RCM) was introduced on supply of metal scrap by unregistered person to registered person, provided the recipient pays tax even if the supplier is under threshold. Furthermore, a TDS of 2% shall be applicable on supply of metal scrap by registered player in B2B transactions, enabling the proper tracking. Taken together, these steps are likely to create a level-playing field for organised players in procuring domestic scrap as well as accelerate the shift from unorganised to organised, leading to better compliance and accountability. In particular, players such as GRAV with multi-location recycling plants and efficient procurement network are likely to benefit more.

Financial Summary

Y/E March (INR mn)	FY23A	FY24A	FY25E	FY26E
Net Revenue	28,006	31,608	39,407	48,186
EBITDA	1,976	2,836	4,529	6,202
EBITDA Margin (%)	7.1	9.0	11.5	12.9
Net Profit	2,041	2,423	3,356	4,680
EPS (INR)	30.0	35.6	49.4	68.8
EPS % Chg YoY	37.5	18.7	38.5	39.4
P/E (x)	85.2	71.8	51.8	37.2
EV/EBITDA (x)	1.5	1.5	0.7	0.4
RoCE (%)	20.9	20.8	27.3	28.3
RoE (%)	47.8	39.2	38.2	38.0

Amit Dixit
amit.dixit@icicisecurities.com
+91 22 6807 7289
Mohit Lohia
mohit.lohia@icicisecurities.com
Pritish Urumkar
Pritish.urumkar@icicisecurities.com

Market Data

Market Cap (INR)	177bn
Market Cap (USD)	2,105mn
Bloomberg Code	GRAV IN
Reuters Code	GRAI.BO
52-week Range (INR)	2,632 /707
Free Float (%)	35.0
ADTV-3M (mn) (USD)	14.9

Price Performance (%)	3m	6m	12m
Absolute	99.8	245.3	237.3
Relative to Sensex	91.9	231.4	214.5

Earnings Revisions (%)	FY25E	FY26E
Revenue	0.0	(0.0)
EBITDA	10.8	14.4
EPS	12.2	17.7

Previous Reports

23-07-2024: Q1FY25 results review
09-05-2024: Initiating Coverage

Acquisition in Romania- a first in Europe for GRAV

GRAV's step down subsidiary, Gravita Netherlands BV (GNBV) has executed an MoU to acquire Access Auto Trading SRL (AAT), a waste tyre recycling plant in Romania of 17ktpa capacity. GRAV will not acquire any shares of AAT, but will acquire its fixed assets including land, building and plant & machinery by forming a separate SPV in Romania. GRAV will ultimately own 80% economic interest in the plant at an investment of INR 320mn, subject to detailed due diligence. AAT is engaged in trading and recycling of waste tyres in Romania since CY10 and delivered a turnover of INR 420mn, INR 670mn and INR 800mn in CY23, CY22 and CY21, respectively.

We note this is the first time the company is marking its presence in Europe which would enable it to build the customer base in this market. Besides enhanced diversification, this further enhances GRAV's presence in recycled rubber market. Over medium term, we expect GRAV to increase its total recycling capacity to over 700ktpa (currently 303ktpa) spread over lead, aluminium, rubber, plastics, steel and paper by FY28E.

Street talk: Recycling is gathering momentum

Our channel checks suggest India is fast becoming the favoured destination for companies looking for recycled lead in their products. Our recent interactions with a few corporates reveal that they have to incorporate a specific proportion of recycled lead in their products. Lead, being a homogenous material, can be sourced from anywhere and various Indian players are adding capacities.

A new study documenting the scourge of plastic waste around the world has found that more than half of branded plastic pollution can be traced back to just 56 companies (Link). More than 20% of all branded pollution is linked to four brands: The Coca-Cola Company (11%), PepsiCo (5%), Nestlé (3%) and Danone (2%). In a statement, Coca-Cola said its goal is to make 100% of its packaging recyclable globally by 2025 and to use at least 50% recycled material in its packaging by 2030. The company also said it aims "to collect and recycle a bottle or can for each one we sell" by 2030. In our view, this can have favourable rub-on effect on companies such as GRAV.

In India, new EC guidelines to strengthen waste tyre management have been approved by the Ministry of Environment, Forest and Climate Change (MoEFCC). Manufacturers unable to meet EPR targets will have to pay penalties of up to INR 8.40/kg of waste tyres. Besides, there are separate penalties for not complying.

We believe these are positive steps and are likely to benefit players like GRAV disproportionately as it is sourcing network and multi-plant locations, ensuring better margins than peers.

Outlook and valuation: Capabilities getting regulatory support

Despite an impressive run-up in the past three months, we see further upside in GRAV stock due to regulatory push post notification of EC guidelines for lead, rubber and plastics. Besides, the RCM comes as a shot in the arm by possibly accelerating the shift from unorganised to organised sector. In our view, both these developments will facilitate the domestic scrap availability to organised sector and improve compliance. This will likely benefit GRAV the most as its multi-plant location and extensive sourcing network may be a key enabler. On valuation, we believe relative valuation methodology might not suffice for GRAV as the company is continuously expanding capacity and enhancing its presence in new segments. Hence, we prefer to take a medium-term view and shift to DCF-based methodology (earlier P/E). Our TP as per DCF-based methodology works out to INR 3,265 (earlier INR 1,750 on 30x P/E). We maintain **BUY** rating on GRAV stock.

Exhibit 1: Earnings revision table

(INR mn)	FY25E			FY26E		
	New	Old	% Chg	New	Old	% Chg
Sales	39,407	39,407	0.0	48,186	48,186	(0.0)
EBITDA	4,529	4,087	10.8	6,202	5,422	14.4
PAT	3,356	2,991	12.2	4,680	3,975	17.7

Source: I-Sec research

Key risks

- Delay in commissioning of new capacities
- Spread compression due to competition in scrap market
- Inadequate shift from unorganized to organized.

Exhibit 2: DCF valuation

(INR mn)	FY24	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E	FY32E	FY33E	FY34E
EBITDA	2,836	4,529	6,202	7,155	12,180	14,202	16,579	19,236	24,106	27,752	34,090
Tax	(319)	(463)	(676)	(810)	(1,473)	(1,814)	(2,181)	(2,689)	(3,511)	(4,119)	(5,349)
WC Change	(2,449)	(189)	(1,536)	(1,118)	(4,627)	(3,331)	(3,855)	(3,982)	(4,705)	(5,254)	(6,954)
Capex	(982)	(2,285)	(3,120)	(2,190)	(2,590)	(2,861)	(2,882)	(3,003)	(2,944)	(3,555)	(3,526)
FCF	(914)	1,592	869	3,037	3,491	6,196	7,661	9,562	12,946	14,824	18,261
Time factor			-	1	2	3	4	5	6	7	8
PV		1,518	869	2,761	2,885	4,655	5,233	5,937	7,308	7,607	8,519
WACC	10%										
Terminal Growth	5%										
EV	2,25,254										
Net Debt	3.232										
Market Cap	2,22,022										
No of Shares (mn)	68										
Net Equity value (INR)	**3,265**										

Source: I-Sec research

Annexure-1

Guidelines for calculation of Environmental Compensation (EC)

Environmental Compensation to be levied on producers/recyclers/refurbishers is divided into two regimes:

- EC Regime 1 – In this regime, EC will be levied to the producers for non-fulfilment of metal-wise EPR targets.
- EC Regime 2 – In this regime, EC will be levied to any entity for non-compliances of BWM Rules, 2022.

EC Regime 1

In this regime, EC is calculated separately for following two types of batteries:

- For lead acid batteries
- For lithium-ion and other batteries

For both types of batteries calculation of EC includes cost of handling, collection & transportation and cost of processing of waste battery. Detailed calculation of EC is as follows:

For lead acid battery

The cost components for EC calculation per tonne of waste lead acid battery are as follows:

- Cost of handling, collection and transportation of waste battery
- Processing cost to recover lead metal

The details of the above cost incurred by the recycler of lead-acid battery is given below:

Exhibit 3: Cost incurred by lead-acid battery recycler

Cost components	INR/te
Handling, Collection and Transportation	3,000
Processing	15,000
EC Charges/te	18,000

Source: I-Sec research, Company data

Since, 'lead (Pb)' is the only key battery metal selected for lead acid battery, the EC cost per kg for 'lead (Pb)' is equal to INR 18. This amount will be treated as maximum cost of EPR credit for lead metal. EPR credit cost for lead metal will be in the range of INR 5.4-18/kg.

Cost components for EC calculation per tonne of waste lithium-ion and other batteries are as follows:

- Cost of handling, collection and transportation of waste battery is computed as INR 70,000/te.
- Processing cost to recover key battery metals – summarised in Exhibit 4 below:

Exhibit 4: Average processing cost for li-ion battery recycler

Metals	Average Processing cost (INR/kg)
Lithium	2,330
Cobalt	485
Nickel	485
Manganese	485
Copper	200
Aluminium	50
Iron	50

Source: I-Sec research, Company data

Assuming that the battery contains equal quantity of all the 7 metals, the cost of handling, collection and transportation for each metal (per kg metal) will be INR 70. Hence, the total cost of recovery of each metal is calculated by adding the cost of handling, collection and transportation for each metal and processing of cost of each metal and this cost will serve as EC cost for each metal.

Exhibit 5: EPR computation

Metals	Total EC cost (INR/kg)	EPR cost (INR/kg)
Lithium	2,400	720-2400
Cobalt	555	166-555
Nickel	555	166-555
Manganese	555	166-555
Copper	270	81-270
Aluminium	120	36-120
Iron	120	36-120

Source: I-Sec research, Company data

EC Regime 2

For non-compliances other than shortfall in EPR targets, EC is calculated as follows:

- For first default – EC equivalent to application fees as per SoP (middle slab) for registration of producers/recyclers/refurbishers under Battery Waste Management Rules, 2022, i.e., INR 20,000 = INR 20,000/-.
- For second default – two times of first default i.e. INR 20,000 x 2 = INR 40,000/-.
- For third default – two times of second default i.e. INR 40,000 x 2 = INR 80,000/-.

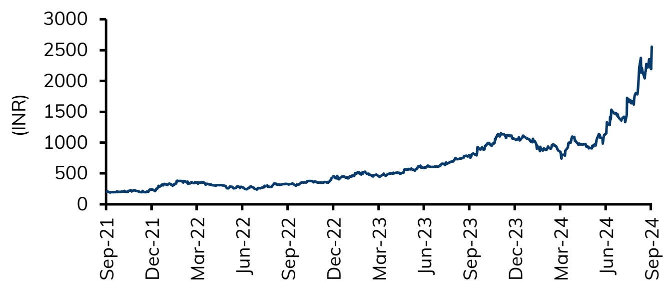
The EC cost in this regime will increase by 10% every year.

Exhibit 6: Shareholding pattern

%	Dec'23	Mar'24	Jun'24
Promoters	66.5	66.5	63.7
Institutional investors	11.1	11.5	14.4
MFs and others	0.1	0.1	0.9
FIs/Banks	0.0	0.0	0.0
Insurance	0.0	0.0	0.1
FIIs	11.0	11.4	13.4
Others	22.4	22.0	21.9

Source: Bloomberg

Exhibit 7: Price chart



Source: Bloomberg

Financial Summary

Exhibit 8: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Net Sales	**28,006**	**31,608**	**39,407**	**48,186**
Operating Expenses	3,210	3,160	3,940	4,845
EBITDA	**1,976**	**2,836**	**4,529**	**6,202**
EBITDA Margin (%)	7.1	9.0	11.5	12.9
Depreciation & Amortization	240	380	349	511
EBIT	1,737	2,456	4,181	5,691
Interest expenditure	391	492	485	512
Other Non-operating Income	931	778	123	177
Recurring PBT	**2,276**	**2,742**	**3,819**	**5,357**
Profit / (Loss) from Associates	-	-	-	-
Less: Taxes	235	319	463	676
PAT	2,041	2,423	3,356	4,680
Less: Minority Interest	-	-	-	-
Extraordinaries (Net)	-	-	-	-
Net Income (Reported)	**2,041**	**2,423**	**3,356**	**4,680**
Net Income (Adjusted)	**2,041**	**2,423**	**3,356**	**4,680**

Source Company data, I-Sec research

Exhibit 9: Balance sheet

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Total Current Assets	8,624	11,597	13,015	15,568
of which cash & cash eqv.	381	988	1,862	2,599
Total Current Liabilities & Provisions	2,249	1,894	2,237	2,502
Net Current Assets	**6,375**	**9,703**	**10,778**	**13,066**
Investments	11	165	165	165
Net Fixed Assets	2,664	3,421	5,358	7,967
ROU Assets	68	63	63	63
Capital Work-in-Progress	455	428	428	428
Total Intangible Assets	1	1	1	1
Other assets	229	349	349	349
Deferred Tax Assets	-	-	-	-
Total Assets	**9,803**	**14,129**	**17,141**	**22,039**
Liabilities				
Borrowings	**3,445**	**5,451**	**5,094**	**5,297**
Deferred Tax Liability	**133**	**54**	**66**	**81**
provisions	65	100	100	100
other Liabilities	143	19	19	19
Equity Share Capital	138	138	138	138
Reserves & Surplus	5,751	8,236	11,592	16,272
Total Net Worth	**5,889**	**8,374**	**11,730**	**16,411**
Minority Interest	128	132	132	132
Total Liabilities	**9,803**	**14,129**	**17,141**	**22,039**

Source Company data, I-Sec research

Exhibit 10: Quarterly trend

(INR mn, year ending March)

	Sep-23	Dec-23	Mar-24	Jun-24
Net Sales	8,362	7,578	8,634	9,079
% growth (YOY)	6.4	(6.4)	(22.3)	8.9
EBITDA	726	804	722	877
Margin %	8.7	10.6	8.4	9.7
Other Income	234	141	154	-
Extraordinaries	-	-	-	-
Adjusted Net Profit	525	588	615	2,423

Source Company data, I-Sec research

Exhibit 11: Cashflow statement

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Operating Cashflow	**2,032**	**386**	**4,001**	**4,167**
Working Capital Changes	(786)	(2,487)	(189)	(1,536)
Capital Commitments	(1,061)	(1,687)	(2,285)	(3,120)
Free Cashflow	**971**	**(1,300)**	**1,716**	**1,047**
Other investing cashflow	**7**	**108**	**-**	**-**
Cashflow from Investing Activities	(1,054)	(1,578)	(2,285)	(3,120)
Issue of Share Capital	-	-	-	-
Interest Cost	(389)	(482)	(485)	(512)
Inc (Dec) in Borrowings	(433)	1,997	(357)	203
Dividend paid	(43)	(295)	-	-
Others	-	-	-	-
Cash flow from Financing Activities	(874)	1,209	(842)	(309)
Chg. in Cash & Bank balance	**105**	**17**	**874**	**738**
Closing cash & balance	339	320	1,232	1,970

Source Company data, I-Sec research

Exhibit 12: Key ratios

(Year ending March)

	FY23A	FY24A	FY25E	FY26E
Per Share Data (INR)				
Reported EPS	30.0	35.6	49.4	68.8
Adjusted EPS (Diluted)	30.0	35.6	49.4	68.8
Cash EPS	33.5	41.2	54.5	76.3
Dividend per share (DPS)	-	-	-	-
Book Value per share (BV)	86.6	123.1	172.5	241.3
Dividend Payout (%)	-	-	-	-
Growth (%)				
Net Sales	26.4	12.9	24.7	22.3
EBITDA	(6.3)	43.5	59.7	36.9
EPS (INR)	37.5	18.7	38.5	39.4
Valuation Ratios (x)				
P/E	85.2	71.8	51.8	37.2
P/CEPS	76.3	62.1	47.0	33.5
P/BV	29.5	20.8	14.8	10.6
EV / EBITDA	1.5	1.5	0.7	0.4
Dividend Yield (%)	-	-	-	-
Operating Ratios				
Gross Profit Margins (%)	18.5	19.0	21.5	22.9
EBITDA Margins (%)	7.1	9.0	11.5	12.9
Effective Tax Rate (%)	10.3	11.6	12.1	12.6
Net Profit Margins (%)	7.3	7.7	8.5	9.7
Net Debt / Equity (x)	0.5	0.5	0.3	0.2
Net Debt / EBITDA (x)	1.5	1.5	0.7	0.4
Fixed Asset Turnover (x)	10.3	8.9	7.8	6.7
Inventory Turnover Days	102	90	85	80
Receivables Days	23	35	22	22
Payables Days	15	9	11	11
Profitability Ratios				
RoCE (%)	20.9	20.8	27.3	28.3
RoE (%)	47.8	39.2	38.2	38.0
RoIC (%)	22.3	22.1	29.9	31.9

Source Company data, I-Sec research

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Name of the Compliance officer (Research Analyst): Mr. Atul Agrawal, Contact number: 022-40701000, **E-mail Address** : complianceofficer@icicisecurities.com

For any queries or grievances: Mr. Bhavesh Soni Email address: headservicequality@icicidirect.com Contact Number: 18601231122