



CMP Rs.53

Recommendation: BUY

Target Price Rs.75

Plant Visit Note

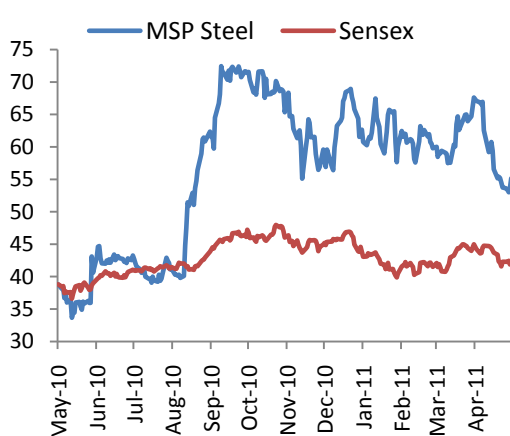
Sector: Metals & Mining

Key Details

Market Cap (Rs. cr)	320
Market Cap (US\$ mn)	71.4
O/S Share, cr	5.8
Face Value, Rs.	10
2 Week avg Vol, NSE Lakh	1.41
52 Week High	74.0
52 Week Low	33.4
Rs/US\$	44.83
Bloomberg	MSPS IN
Reuters	MSPO.BO
NSE	MSPL
BSE	532650

Share Holding, %	Q4 FY11	Q4 FY10
Promoters	71.8	71.8
FII	0.33	-
Inst Inv	0.77	-
Others	27.1	28.2

Source: BSE



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Expansion to drive the revenue growth

MSP Steel is on expansion spree. It is expanding its sponge iron plant capacity from 3,07,500 Tonnes Per Annum (TPA) to 4,23,000 TPA and captive power plant capacity from 42 mw to 76 mw. Both the projects are expected to come on stream by Q2 FY12. With increased sponge iron production the rolling mill will operate at higher capacity, leading to an increase in volume and revenue for the company. The surplus sponge iron production and captive power generation will be sold in the open market garnering more revenue.

Firm Steel price backed by strong demand

World Steel Association (WSA) estimates that India's steel use will grow by 14.3% in FY12. Gradual improvement in the global economy will also push up the steel demand. With strong domestic and improved global demand we believe that steel price will remain firm till FY13 and factored the same in our model.

Backward integration to enhance operating margins

In order to secure raw material supply for steel production the company has been expanding its pelletisation capacity. Rise in pelletisation capacity will lead to higher in-house sponge iron production reducing the company's exposure to the volatility in the market sponge iron price. It also procures cheaper low grade iron ore for pellet production which is converted to higher grade through beneficiation plant, thus reducing the pelletisation production cost. Lower cost involved in pellet production and resilience from the higher market sponge iron price will enhance operating margin.

Captive Power Generation

Currently MSP Steel operates a 42 MW thermal power plant, with coal and waste gas heat as fuel. The company plans to setup an additional 34 MW thermal power plant, which is expected to be operational by Q2 FY12. The upcoming power generation capacity will also be fed by the coal washery middlings, rejects and waste gas from sponge iron plant. This will further reduce the costs and improve in margin.

The total 76 MW generation capacity is expected to entirely fulfil the power requirement for company's future production (expansion) plans.

Ability to enhance profitability with flexible product mix

In Q3 FY11 the company shifted its product mix to sell more steel products than sponge iron and power to leverage from the higher steel prices. This indicates the company's ability to increase profitability in different pricing scenario by changing the product mix.

We expect the backward integration and in-house power production to lead to an increase in EBITDA margins from 20.5% in FY11 to around 24.2% in FY12 and further 26.2% in FY13.



QIP

MSP Steel plans to raise Rs. 100 cr via QIP to fund its ongoing capacity expansion. However, the QIP plans seem to be on hold due to highly volatile current market condition. We believe, at the CMP of Rs.53 levels the QIP will lead to high dilution of Promoters' equity from the current 71.8% to around 54.20%; the company will be more comfortable on the QIP placement at 65 to 75 levels, leading to lower dilution in Promoters' equity to around 57.63%.

Valuation

At current market price the stock is trading at an EV/EBITDA multiple of 5.4x and 3.75x its FY12E EBITDA of Rs.201 cr and FY13E EBITDA of Rs.261 cr respectively. We value the stock at EV/EBITDA multiple of 6x its FY12E EBITDA of Rs.201 cr and arrive at a target price of Rs.75. We recommend BUY for MSP Steel with upside potential of 36% and investment horizon of 12 months.



Company Background

Incorporated in 1968 as Adhunik Rollers Pvt. Ltd, company's name was changed to MSP steel and Power in March 2003. It is an integrated steel manufacturer with its products spanning from pellet and sponge iron to steel products such as angle, beam, channels and plates. It also has a 42 mw captive power plant. MSP Steel is currently focusing on backward integration to ensure steady raw material supply for steel production. Currently capacity expansion is ongoing for coal washery, pelletisation plant and captive power plant and is expected to commence operation by Q2 FY12.

Exhibit1: Current capacity

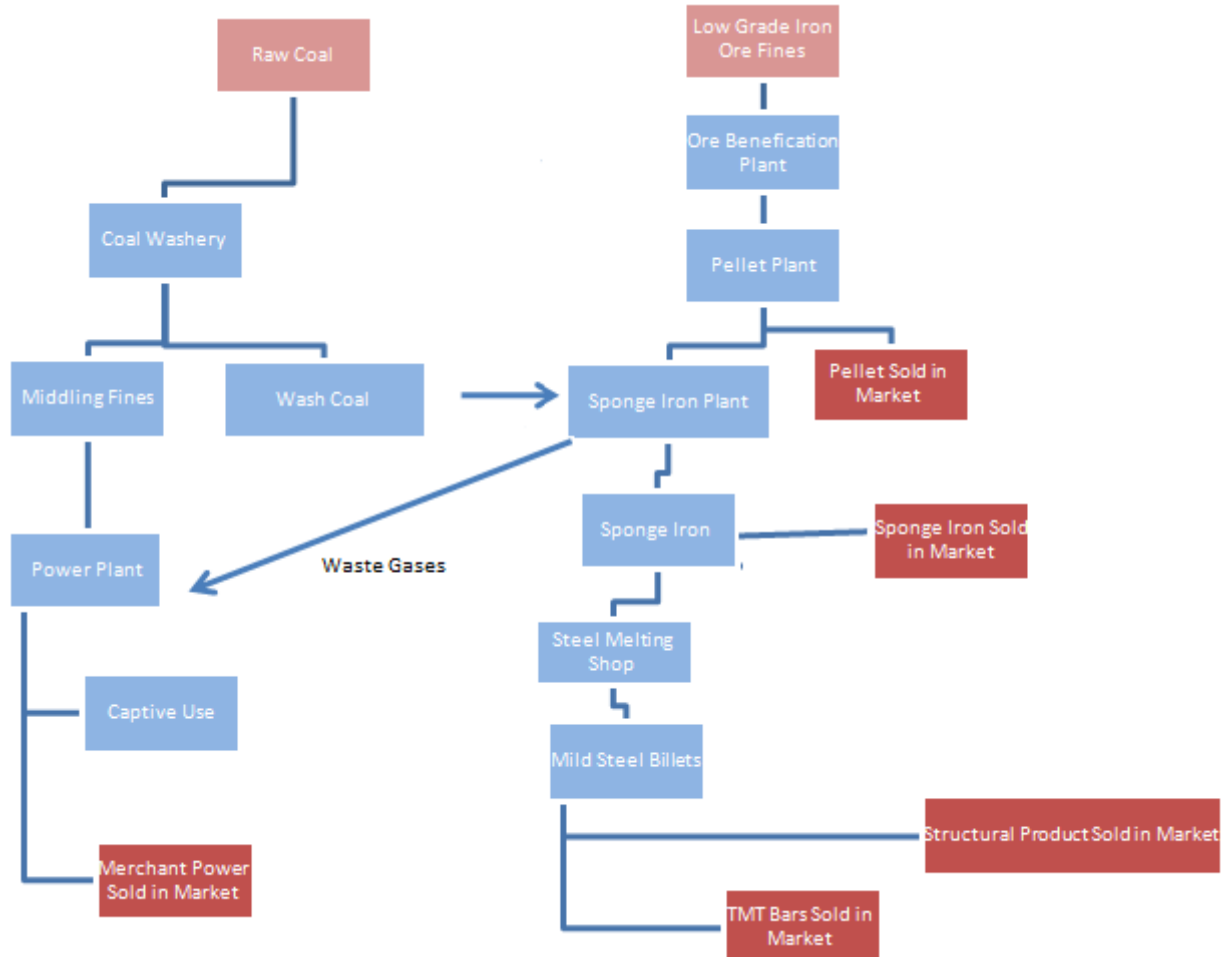
Particulars	Capacity
Pellet	3,00,000 TPA*
Sponge Iron	3,07,500 TPA
Coal Washery	3,45,600 TPA
Billet	1,44,109 TPA
Structural	1,28,000 TPA
TMT	8,000 TPA
Captive Power	42 MW#

Source: Company, SIHL Research

*Tonnes per annum

#MW=Mega Watt

Exhibit2: Product process flow



Source: Company, SIHL Research

Investment Rationale

Expansion to drive revenue growth

MSP Steel is expanding its capacity in a phased manner. It has increased sponge iron capacity from 1,92,000 TPA in FY10 to 3,07,500 TPA in FY11. Another 1,15,500 TPA capacity sponge iron plant is under construction, that will take the total sponge iron capacity to 4,23,000 TPA by Q2 FY12. The captive power capacity will be raised to 76 mw in FY12 from the current 42 mw. With increased sponge iron production the rolling mill (billet production) will operate at higher capacity. We have assumed the utilisation rate of rolling mill to gradually increase from 50% at present to 80% by FY13. The surplus sponge iron production and captive power generation will be sold in the open market garnering more revenue for the company.

Exhibit3: Expansion plan

Particulars	Current Capacity	Expansion	Total Capacity
Pellet	3,00,000 TPA	6,00,000 TPA	9,00,000 TPA
Sponge Iron	3,07,500 TPA	1,15,500 TPA	4,23,000 TPA
Coal Washery	3,45,600 TPA	3,83,625 TPA	7,29,225 TPA
Billet	1,44,109 TPA	-	1,44,109 TPA
Structural	1,28,000 TPA	-	1,28,000 TPA
TMT	80,000 TPA	-	80,000 TPA
Captive Power	42 MW	34 MW	76 MW

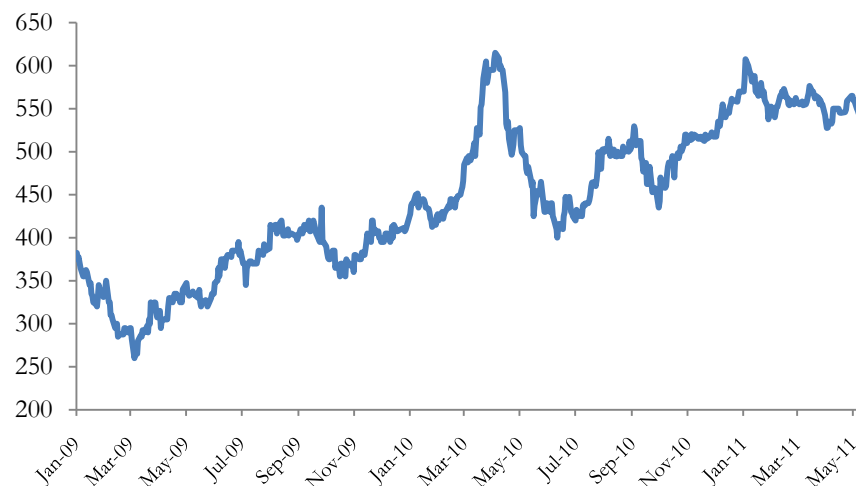
Source: Company, SIHL Research

Firm Steel price backed by strong demand

International Steel prices have been holding on at the \$500 to 550 per tonne levels for the past 6-8 months. We expect domestic Steel prices to remain stable with an upward bias on strong domestic demand and global economic recovery.

The short term outlook for steel released by WSA in April 2011 has projected steel demand in India to increase by 14.3% in 2012, up from 13.7% in 2011. We expect prices of steel billet, TMT bars and other structural products to remain firm for the next two years.

Exhibit4: Steel Billet Prices (US\$/Tonne)



Source: Bloomberg

Backward integration to enhance operating margins

MSP steel has planned a huge capex to boost its backward integration, leading to increased operating margins. The company is expanding its existing pelletisation plant from 3,00,000 TPA in FY11 to 9,00,000 TPA in FY12. As cost controls measure it buys iron ore fine for pellet production which is available at a cheaper price due to its lower quality. This low grade iron ore is then converted to higher grade in its beneficiation plant before sending to the pelletisation plant for pellet production. This enables the company to save Rs.2,000 on per tonne of iron ore. The increased captive power generation will also benefit the company in terms of bringing down the cost.

Exhibit5: Cost analysis of Iron Ore

Rs. Per Tonne	Fines	Sized	Total Saving
Landed Cost	2,000	6,500	
Processing Cost	2,500	-	2,000
Total	4,500	6,500	

Source: Company, SIHL Research

Post capacity expansion in FY11, increased sponge iron production required extra pellets, which the company procured from the market lead to higher manufacturing cost YoY. Increased pellet production in FY12 will enable the company to source raw material for sponge iron production from its internal operations, improving operating margin.

To secure a steady supply of key raw materials such as coal and iron ore, the company has managed to garner two mining blocks in Chhattisgarh from Government of India. Post commencement of mining, these blocks will act as raw material source for the company further improving its margin. The company won the coal block in a consortium and has an assigned share in the mining output.

Exhibit6: Mining blocks

Nature of Mines	Location	Mining Area	Reserve	MSP's Share
Coal Block	Chhattisgarh	714 Hectares	175 Mn Tonnes	26 Mn Tonnes
Iron Ore Block	Chhattisgarh	150 Hectares	35 Mn Tonnes	35 Mn Tonnes

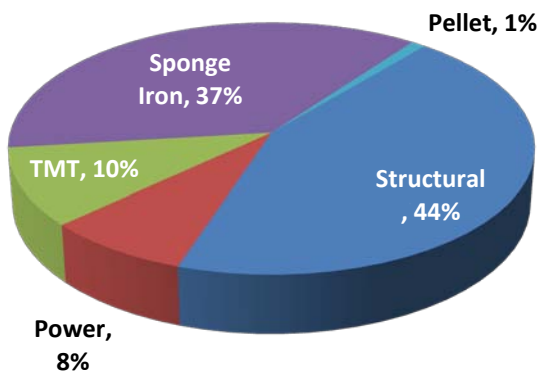
Source: Company, SIHL Research



Ability to enhance profitability with flexible product mix

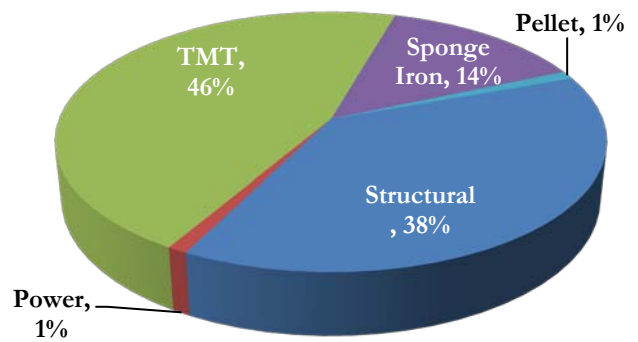
Due to higher steel prices in Q3 FY11 MSP Steel has changed its product mix and sold more structural products and TMT bars compared to sponge iron. Contribution of steel products in the revenue rose to 84% in Q3 FY11 compared to 54% in Q2 FY11. It sold more sponge iron and power in Q2 FY11 (contributing 43% of the revenue) when prices of both were high. The backward integration has brought more flexibility in its product mix enabling the company to increase profitability in different pricing scenarios.

Exhibit7: Segmental contribution to revenue Q2 FY11



Source: Company, SIHL Research

Exhibit8: Segmental contribution to revenue Q3 FY11



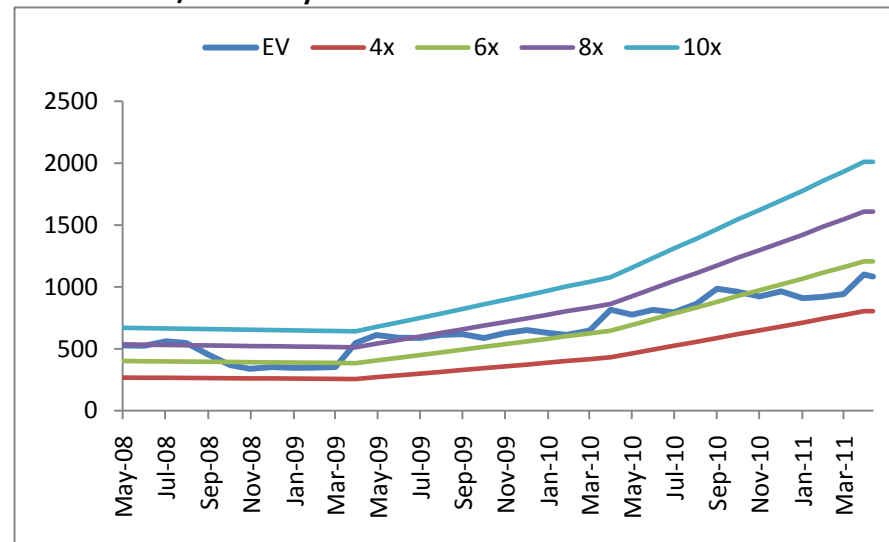
Source: Company, SIHL Research

Exhibit9: Peer comparison FY11 (Consolidated Results)

Particulars, Rs. Cr	Mcap	Sales	EBITDA	EBITDA Margin	TTM PE	EV/TTM EBITDA	RoE
Sail#	64,661	43,451	7,682	17.7%	13.1	6.3	13.3%
Tata Steel*	56,914	117,274	16,011	13.7%	7.8	6.2	19.0%
JSW Steel#	20,486	23,368	4,083	20%	13.5	3.3	9.0%
MSP Steel*	310	526	108	20.5%	5.8	6.9	21.0%
Monnet Ispat*	3,302	1,839	504	27.4%	11.8	10.0	15.7%

Source: Company, SIHL Research

Actual data for FY11, *Estimated data for FY11

Valuation**Exhibit10: EV/EBITDA 1yr forward band**

Source: Company, SIHL Research

At current market price the stock is trading at EV/EBITDA multiple of 5.4x and 3.8x its FY12E EBITDA of Rs.201 cr and FY13E EBITDA of Rs.261 cr respectively. We value the stock at EV/EBITDA multiple of 6x its FY12E EBITDA of Rs.201 cr and arrive at a target price of Rs.75. We recommend BUY for MSP Steel with upside potential of 36% and investment horizon of 12 months.

Financials

Exhibit11: Income Statement

Particulars, Rs. Cr	FY10	FY11E	FY12E	FY13E
Net Sales	388.7	526.0	831.7	995.6
Expenditures	324.7	418.2	630.7	734.4
EBITDA	64.1	107.8	201.0	261.2
Depreciation	12.6	16.0	39.7	42.7
EBIT	51.5	91.8	161.4	218.5
Interest	20.4	28.0	49.2	68.6
Other Income	7.1	2.3	3.0	3.5
EBT	38.2	66.0	115.2	153.4
Tax	6.2	12.0	21.9	29.1
PAT	32.0	54.0	93.3	124.2

Source: Company, SIHL research

Exhibit12: Balance Sheet

Particulars, Rs. Cr	FY10	FY11E	FY12E	FY13E
Sources of Funds				
Share Capital	58.1	58.1	72.4	72.4
Reserves & Surplus	143.2	194.3	369.7	490.4
Net worth	201.3	252.4	442.1	562.7
Preference Share Capital	22.2	79.5	89.5	89.5
Secured Loans	424.7	537.0	728.7	629.2
Unsecured Loans	36.3	56.8	77.0	66.5
Loan & Funds	461.1	593.7	805.7	695.7
Deferred Tax Liability	19.9	19.9	19.9	19.9
Total	704	945	1,357	1,368
Application Of Funds				
Gross Block	292.2	517.2	1,042.2	1,122.2
Less: Accumulated Depreciation	36.3	52.3	92.0	134.7
Net Block	255.9	464.9	950.2	987.5
Capital Work in Progress	245.4	260.4	100.4	40.4
Fixed Assets	501.3	725.3	1,050.6	1,027.9
Investment	45.0	45.0	45.0	45.0
Current Asset, Loan & Advances	227.2	269.4	414.6	490.8
Inventories	68.3	87.9	139.0	166.4
sundry Debtors	66.8	85.0	134.4	160.9
cash & Bank Balances	37.9	24.4	27.2	27.0
Other Current Asset	0.1	0.1	0.1	0.1
Loans & advances	54.1	72.1	113.9	136.4
Current Liabilities & Provisions				
Current Liabilities	64.2	89.3	148.1	190.9
Provisions	4.8	4.8	4.8	4.8
Net Current Assets	158.2	175.3	261.7	295.0
Total	704	946	1,357	1,368

Source: Company, SIHL research

Exhibit13: Cash flow Statement

Particulars, Rs. Cr	FY10	FY11E	FY12E	FY13E
Net Income+ Depreciation	44.6	70.0	133.0	167.0
(Inc)/Dec in Working Capital	7.2	-30.6	-83.6	-33.5
Cash Flow from Operation	51.81	39.47	49.34	133.47
Capital Expenditure	222.2	240.0	365.0	20.0
Change in Investment Dec/(inc)	38.2	-	-	-
Cash Flow from Investment	260.4	240.0	365.0	20.0
Issue of Equity	22.2	-	100.0	-
Issue/(Repay) Debt	248.1	132.7	212.0	-110.0
Issue of Preference Capital		57.3	10.0	-
Other Financing Cash Flows		-	-	-
Dividend		2.9	3.6	3.6
Cash Flow from Financing	270.30	187.06	318.43	-113.60
Cash Flow from the year	61.7	-13.5	2.8	-0.1

Source: Company, SIHL research

Exhibit14: Ratio analysis

Particulars	FY10	FY11E	FY12E	FY13E
Margin				
EBITDA	16.5%	20.5%	24.2%	26.2%
EBIT	13.2%	17.4%	19.4%	21.9%
PAT	8.2%	10.3%	11.2%	12.5%
Growth				
Sales Growth	-4.0%	35.3%	58.1%	19.7%
EBITDA Growth	-4.3%	68.2%	86.5%	29.9%
EBIT Growth	-13.5%	78.2%	75.8%	35.4%
PAT Growth	-19.7%	68.7%	72.6%	33.2%
Valuation				
Price/Book	1.5	1.2	0.9	0.7
EV/EBITDA	11.4	8.1	5.4	3.7
P/E	9.6	5.7	4.1	3.1
Fundamental Ratio				
EPS	5.5	9.3	12.9	17.1
Book Value per Share	34.7	44.0	62.0	79.2
Debt Equity	2.3	2.3	1.8	1.2
Interest Coverage	2.5	3.3	3.3	3.2
RoE	15.9%	21.4%	21.1%	22.1%
RoCE	7.8%	10.8%	12.9%	17.4%

Source: Company, SIHL research



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