



MSP STEEL & POWER



SUMMARY

Stock Data

NSE Symbol: MSPL
 BSE Code: 532650
 Bloomberg code: MSPS IN
 No. of shares: 5.81 cr shares
 Face Value: ₹10

Price Data

Nifty: 5253.55
 Sensex: 17592.77
 Market price: ₹60.75
 52 wk high/low: ₹80/ ₹31
 Market Cap: ₹352.96 crs
 Avg. Daily Vol: 122000

Shareholding Pattern

Promoter Group: 71.77%
 Institutional Investors: 1.19%
 Public: 27.04%

BUSINESS:

MSP Steel & Power is an integrated steel manufacturer based in Eastern India. Its product mix comprises sponge iron, MS ingots/billets, TMT bars, structurals and power. It is among the fastest growing steel companies in the country.

SECTOR OUTLOOK:

India is the fifth largest producer of steel in the world. Going forward, demand for steel is set to grow at a brisk pace, supported by sectors like infrastructure, construction, automobiles and housing.

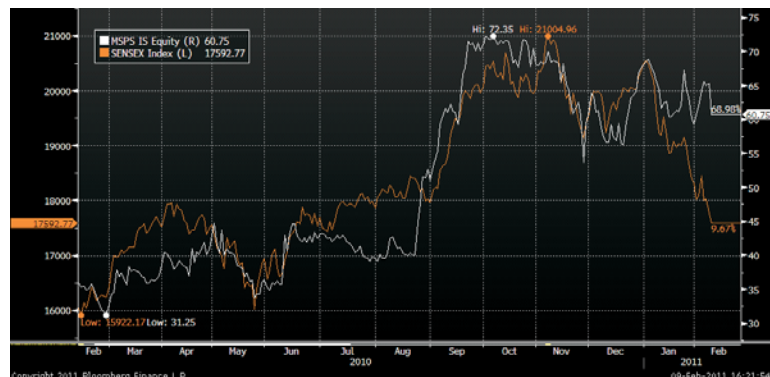
INVESTMENT VIEW:

MSP Steel & Power's integrated business model and attractive valuations make it a strong candidate for exponential growth in the next three years.

COMPANY BACKGROUND

MSP Steel & Power is among the fastest growing steel companies in India. The company is an integrated manufacturer and distributor of steel products. It manufactures a wide range of steel products, including TMT bars, billets and structurals. The company is present across the value chain of steel production and is building capacities in the power segment. Its plant is located in Raigarh, Chhattisgarh. MSP's key customers include Monnet Ispat, Prakash Industries, Parsvnath Developers and Chhattisgarh State Electricity Board.

The company is part of the Kolkata-based MSP Group, promoted by Mr. Puran Mal Agarwal and Mr. Suresh Kumar Agarwal. The promoters are first generation entrepreneurs and have more than twenty years experience in the steel sector.



MSP Steel & Power vs. Sensex February 10, 2010 to February 09, 2011



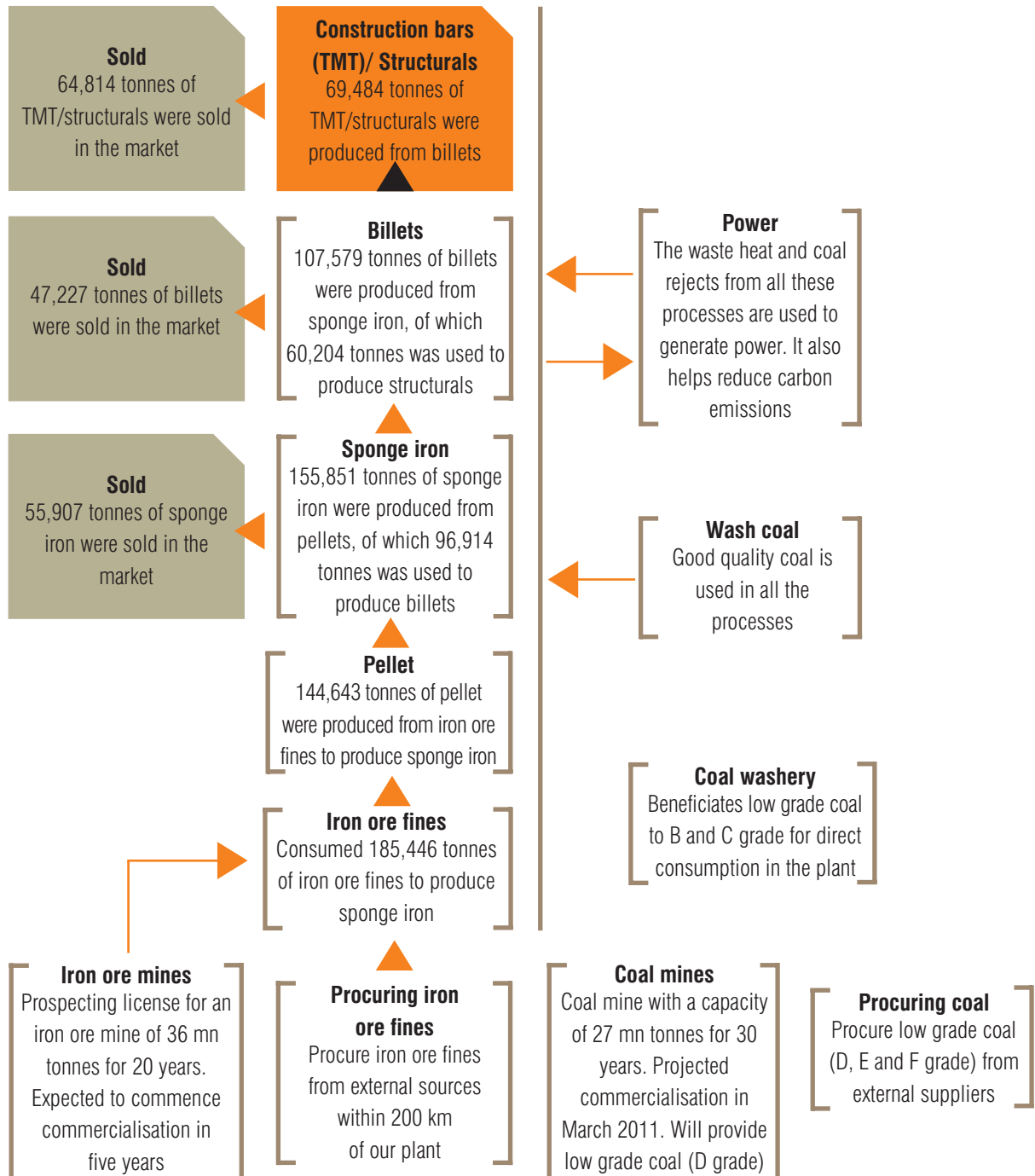
BUSINESS VERTICALS

The company's business verticals comprise of Steel and Power. Most of the revenues are from the Steel segment. Over the years, the company has transformed from a standalone sponge iron manufacturer to a fully integrated steel company. The product mix comprises of sponge iron, pellets, billets, ingots, TMT bars, structurals, angles, channel, plates and beam. MSP has also forayed into merchant power and has major expansion plans for this segment going forward. MSP is headquartered in Kolkata and has a pan-India marketing network. The company's business has been planned in a way that most raw materials are internally procured. Iron ore fines are purchased from the market at competitive rates. MSP has long-term contracts of coal linkages with Coal India Ltd, strong relationship with Essel Mining (A.V.Birla Group) for securing iron ore resources. Further, the company has been allotted a coal mine and an iron ore block in Chhattisgarh. The plant is located close to the mines, improving logistics and saving transportation costs. MSP has its own railway siding of 2.4 km, further streamlining the movement of goods. The power plant has been set up in the factory itself and uses waste heat, coal rejects for power generation. The surplus power is sold in the open market. As per the management, the company owns more than 200 acres of land that can be used for the purpose of expansion.

MSP's business model is now an interplay of value-added steel products and merchant power sales, significantly enhancing profitability and stability:



BUSINESS MODEL



Source: Company data, GPSK Research
Note: Figures as per FY10



KEY INVESTMENT ARGUMENTS

1) **Bright future ahead for the Indian steel industry:**

Steel is among the fastest growing industries in India, with growth projected at 12-13% versus the global average of 10%. The country is positioned to emerge as a leading steel manufacturer and consumer driven by rising aspirations, vast hydrocarbon reserves, mineral resources, strong workforce and favorable government policy. As per the Ministry of Steel, India is already the fifth largest producer of steel in the world. Going forward, demand for steel is expected to grow driven by sectors like infrastructure, housing, construction, automobiles and engineering.

2) **Competitive Advantage over peers:**

The management has shown tremendous foresight in positioning the company. At a time when other steel companies were consuming calibrated iron ore, an expensive option, as key raw material, MSP chose to commission a 3 lac TPA pellet plant, at a fraction of the cost of mine acquisition. This enabled the company to consume iron ore fines, traditionally unsuitable for direct blast furnace consumption. The company's expansion was done in phases, instead of large capex opted for by others. The idea was to initiate cash flows that could be reinvested subsequently. Ultimately, it helped the company reduce interest costs while mobilizing funds. MSP also expanded its product mix to include value-added products and integrated power in the business model. These strategic masterstrokes gave the company a significant edge over its peers.

3) **Integrated business model:**

The company's business model is fully integrated, from iron ore fines at one end to value-added steel products at the other end. The company saved a lot of money by using iron ore fines, treated as waste by competitors owing to their inconvenience in usage. At every stage of production, the company has used latest technology in the manufacturing process and planned production in such a way that part of the production is marketed independently. For example, 62.18% of the sponge iron produced is consumed in-house while the rest is sold in the market. The real boost to margins has come from the addition of value added products such as TMT construction rods and structurals. The TMT bars are branded and sold as 'MSP Gold Thermex TMT bars'.

MSP's plant is in Raigarh, Chhattisgarh, strategically located for proximity to iron ore and coal reserves. The company has its own 2.4 km railway siding, improving logistics and reducing transportation costs. It uses waste heat generated during the manufacturing process and coal rejects for power generation. Currently the installed power generation capacity is 42 MW, expected to increase to 76 MW by FY12. The company sells surplus power as merchant power. In FY10, power contributed 2% of the revenues, expected to increase to 13% by FY11. It has been allotted a coal mine and iron ore block in Chhattisgarh.

4) **Capacity expansion to fuel revenue growth:**

The company has planned capex of Rs.814 crore over FY10-12, mainly to increase capacities in pellets, sponge iron and power:



	Existing Facilities	Phase – I	Phase – II	Total Post Expansion Capacity
Pellet	300,000	-	600,000	900,000
Sponge Iron	192,000	115,500	115,500	423,000
Coal Washery	345,600	-	383,525	729,125
Billets	144,109	-	-	144,109
Power Plant (Mw.)	24	18	34	76
TMT	80,000	-	-	80,000
Structural	128,000	-	-	128,000
Railway Siding	2.4 Km.	-	4 Km.	6.4 Km.
Completion Date		Started trial production in October' 10	July – Oct.'11	

Source: Company data, GPSK Research

The promoters will be funding ₹269.5 crore of the capex, the rest will be through debt financing. The debt financing has already been arranged through banks and financial institutions. Once the expansion is complete as planned, it will propel the company to far greater heights by FY13.

5) Surplus power after captive use to boost bottom-line:

The expansion program includes increasing capacity of power produced from the current 42 MW to 76 MW over the next two years. Post expansion about 36 MW will be required for internal use; the rest of the units will be sold in the market as merchant power. The merchant power sales will boost profits significantly. Further, the company will gain in terms of an uninterrupted supply of power for captive use. In FY11, as per discussions with the management, power should account for about 13% of the revenues.



FINANCIAL ANALYSIS

The company has performed well in recent years, in spite of the impact of the global meltdown in 2008-09. Going ahead, we expect the company to grow rapidly, with merchant power sales giving a boost to margins:

PROFIT AND LOSS STATEMENT

(Figures in ₹ crores)

	FY08A	FY09A	FY10A	FY11E	FY12E
Sales	360.72	404.75	388.74	447.06	648.23
Other Operating Revenue	12.28	4.40	6.23	38.24	58.81
Total Revenue	373.00	409.16	394.98	485.30	707.05
Selling, General & Admin Expense	300.98	342.51	336.91	375.53	547.76
Operating profit (loss)	72.02	66.65	58.06	109.77	159.29
Operating Profit Margin	19.97	16.47	14.94	24.55	24.57
Interest Expense	13.86	18.78	20.40	34.69	58.97
Foreign Exchange Losses (Gains)	-2.04	0.68	0.00	0.00	0.00
Net Non-Operating Losses (Gains)	-0.25	-1.98	-0.57	-1.00	-1.50
Pretax Income	60.46	49.17	38.23	76.08	101.82
Tax Provision	13.79	9.28	6.17	17.50	21.38
Tax Rate	0.23	0.19	0.16	0.23	0.21
Net profit (loss)	46.66	39.89	32.05	58.58	80.44
Basic EPS after XO items	8.03	6.87	5.52	10.08	13.85
Basic Weighted Avg Shares	5.81	5.81	5.81	5.81	5.81
Diluted EPS	8.03	6.87	5.52	10.08	13.85
Diluted Weighted Avg Shares	5.81	5.81	5.81	5.81	5.81
PE Ratio	7.56	8.85	11.01	6.03	4.39
Reference Items					
EBITDA	79.36	74.06	70.64	127.37	187.46
EBITDA Margin	22.00%	18.30%	18.17%	28.49%	28.92%
Operating Margin(EBIT Margins)	19.97	16.47	14.94	24.55	24.57
Profit Margin	12.94%	9.86%	8.25%	13.10%	12.41%
Sales Growth	71.35%	12.21%	-3.96%	15.00%	45.00%
Basic EPS Before XO Growth	8.03	6.87	5.52	10.08	13.85
Depreciation Expense	7.34	7.41	12.57	17.60	28.16

Source: Company data, GPSK Research

**BALANCE SHEET**

(Figures in ₹ crores)

	FY08A	FY09A	FY10A	FY11E	FY12E
Assets					
Cash & Near Cash Items	16.26	3.82	37.04	63.74	73.76
Short-Term Investments	5.25	15.58	38.83	48.83	58.83
Cash & Cash Equivalents	21.51	19.40	75.87	112.57	132.59
Accounts & Notes Receivable	66.56	41.80	66.84	80.72	117.60
Inventories	46.33	39.34	68.34	45.71	66.59
Other Current Assets	47.12	42.62	73.62	50.03	66.03
Total Current Assets	181.53	143.16	284.67	289.03	382.82
LT Investments & LT Receivables	6.10	6.73	5.23	5.76	6.33
Gross Fixed Assets	230.05	350.56	514.40	797.32	949.60
Accumulated Depreciation	15.72	23.61	36.34	53.94	82.10
Net Fixed Assets	214.32	326.95	478.06	743.38	867.50
Other Long-Term Assets	4.51	5.53	5.53	5.81	6.39
Total Long-Term Assets	224.94	339.21	488.83	754.95	880.22
Total Assets	406.47	482.37	773.50	1043.97	1263.04
Liabilities & Shareholders' Equity					
Accounts Payable	55.51	19.72	62.13	71.45	103.60
Short-Term Borrowings	69.23	94.73	140.03	140.03	140.03
Other Short-Term Liabilities	6.54	4.89	6.95	7.99	9.59
Total Current Liabilities	131.28	119.34	209.11	219.47	253.22
Long-Term Borrowings	136.08	177.96	321.04	444.64	489.11
Other Long-Term Liabilities	9.25	15.83	19.86	22.84	27.40
Total Long-Term Liabilities	145.33	193.79	340.90	467.48	516.51
Total Liabilities	276.61	313.14	550.01	686.95	769.73
Share Capital & APIC	59.17	58.66	58.66	58.66	58.66
Preference Share Capital	0.00	0.00	22.20	97.15	153.00
Retained Earnings & Other Equity	70.69	110.58	142.63	201.21	281.65
Total Shareholders' Equity	129.86	169.23	223.49	357.02	493.31
Total Liabilities & Equity	406.47	482.37	773.50	1043.97	1263.04
Reference Items					
Shares Outstanding	5.81	5.81	5.81	5.81	5.81
Book Value per Share	22.35	29.13	38.47	61.45	84.91

Source: Company data, GPSK Research



Compared to peers, the company looks attractive based on different valuation parameters:

(Figures in ₹ crores)

	Price	P/E			EPS			Market Cap/Sales			Price/Book Value		
		FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E
Sail	160.40	9.97	10.84	9.21	16.00	14.28	17.07	1.62	1.47	1.47	1.98	1.73	1.51
Tata Sponge	332.40	7.07	5.72	5.19	47.05	58.06	63.96	1.04	0.81	0.81	1.26	1.06	0.90
Jai Balaji	199.25	18.97	12.69	7.33	10.50	15.69	27.17	0.67	0.56	0.56	1.38	1.29	1.12
Monnet Ispat	561.15	10.40	11.57	8.85	53.96	50.41	63.39	2.09	1.71	1.71	1.91	1.76	1.47
MSP	65.00	11.01	6.03	4.39	5.52	10.08	13.85	0.96	0.78	0.78	1.69	1.06	0.77
Target Price		54.62	90.75	105.91				78.13	80.10	116.71	63.21	84.72	98.02
Industry Average		11.00	10.00	8.50				1.28	1.07	1.07	1.64	1.38	1.15

Source: Company data, GPSK Research

We value the company at 8x FY12E earnings, implying a target price of ₹111. However, since this is an emerging business, we give the target price a discount of 10%, implying ₹100.



RISKS & CONCERNS

1) High leverage to fund the ongoing expansion:

The Company is executing a mega-expansion plan; total capex for the same is ₹814 crore. Banks and institutions will lend ₹544.5 crore, the rest will be financed by promoters. The debt undertaken is huge considering the size of the company. If things don't go as planned, it can severely affect the company's future prospects.

2) Economic slowdown:

There may be a slowdown in economic growth due to high inflation, interest rates, and global factors. This will lower steel prices, hurting the company's margins. Interest costs will further eat into margins.

3) Legal hassles in operating mines:

The mines allotted to the company for coal and iron ore in Chhattisgarh have raised objections from environmentalists. Subsequently, a court order was issued asking the company to stall work on developing the mines. This can threaten the company's plans to operate the mines by FY13-14. However, going by the recent clearance given to POSCO to go ahead with its project in Orissa, we are hopeful that the matter will be resolved soon.

4) Fluctuations in input costs:

MSP sources iron ore (lumps and fine) from the spot market and is hence exposed to risk of a sharp increase in iron ore prices. Though the company has acquired captive iron ore mines in Chhattisgarh, benefits are expected only after FY14.

5) No non-compete agreement among group companies:

The MSP group has entities whose line of business is similar to that of MSP Steel & Power. There is no noncompete agreement in place, exposing the company to possible conflict of interest.

Summary & Investment Recommendation

MSP Steel & Power is well placed to capitalize on the emerging opportunities in the steel sector. The management's foresight and key strategic decisions should hold the company in good stead going forward. The contrarian approach taken by the management has resulted in profits growing by 96.28% CAGR over FY05-10. We are confident that MSP will deliver in the coming years and recommend buying the stock at current levels with a target of ₹100, implying a 10% discount on 8x FY12E earnings.

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