MSP Steel & Power

Capex Growth

MSP Steel & Power is expanding its operations to capitalise on the rising steel demand in India. Though the results of the expansion will take some time to show up, the company has a bright future ahead, says Shashikant

MSP Steel & Power (MSPSPL), formerly Adhunik Rollers, came out with its FY11 results a few days ago. It witnessed a sharp jump of 57 per cent in profit on a yearly basis, against a 29 per cent jump in sales during the same period. The company is on an expansion spree – it has completed its first phase of expansion and is in the middle of the second phase. To know more about the company, its expansion plans and how this will impact its future financials, our analyst visited the manufacturing site of MSPSPL and got first hand information on the same.

> "Going forward we expect the sales mix in FY12 to remain same, with slight increase in contribution from pellet."
>
> KK Jain, *CFO*, MSPSPL

Expansion Plans

MSPSPL is a Kolkata-based company which has its manufacturing unit at Raigarh, Chhattisgarh. It is engaged in manufacturing of pellets, sponge iron, long products and also has captive power generation capabilities. In the longs segment, it offers products like billets, TMT, structural, angles, channel, plates and beams. Currently, the total installed capacity is 300000 tonnes per annum (TPA) for pellets, 307500 tonnes for sponge iron, 144109 tonnes for billets and 80000 tonnes for TMT Bars. Its Structural Rolling Mill has a capacity of 128000 tonnes. In addition to this, the company has a captive power plant with a capacity of 42 MW. These capacities are after the completion of its first round of expansion, in which the company increased its capacity of sponge iron by 115500 tonnes and that of the power plant by 18 MW. Currently, the company is in its second phase of capacity expansion, wherein its pellet capacity will be expanded by two times to 900000 tonnes, sponge iron to 423000 TPA and that of its power plant from 42 MW to 76 MW. The reason that MSPSPL has taken this huge capacity expansion is to capture the rising demand for steel in India. At its current capacity, its ability to service the demand is falling short. As per the company's management, at the end of June 2011, its various plants (TMT, structurals, pellets) are operating at anywhere between 68-90 per cent of their capacity.

The total cost of expansion will come to around ₹815 crore, and the financial closure for this has already been achieved. Of this, banks will fund ₹545 crore, internal accruals will be to the tune of ₹135 crore and the rest will be funded by the promoters in form of six per cent redeemable non-cumulative preference shares of ₹10, at a premium of ₹90 per share. The company has already used ₹335 crore from the bank. The average interest rate that the company is paying on its debt is around 12.5 per cent.

Understanding the vagaries in the

Points To Note

- The past financial performance of the company has witnessed CAGR of 39 per cent in revenues and 115 per cent in profit for the five years ending FY11.
- The company is investing in growth and expansion; it has completed its first phase of expansion and is in the middle of the second phase.
- The installation of a power plant of 34 MW capacity is also expected to boost its topline and bottomline.

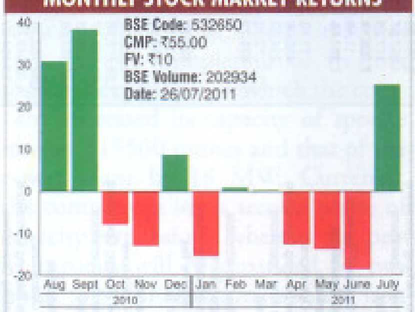
prices of key raw materials, iron ore and coal, MSPSPL has chalked out a long-term programme to protect itself from such price volatility. Integrating backwards, MSPSPL has even got coal mines allocated in Madanpur (Chhattisgarh), which have an area of 714 hectares and reserves of 175 MT, in which MSP's share is 26 MT. This is likely to serve the expanded capacity of MSPSPL for 26 years. It has been allotted an iron ore block of 150 hectares with reserves of 35 MT, at Kankan (Chhattishgarh). However, the immediate benefit of these mines will not be available to the company as "it will take 15 months for the iron ore and three years for the coal to start producing ore and coal from captive mines respectively", explained KK Jain, CFO of MSPSPL. This means that the financial impact of this backward integration will not be reflected in the current financial year, and will have a partial impact only in FY13.

Financial Information FY11 (₹/Cr)	
Gross Turnover	553.87
EBITDA	110.05
Profit Before Tax	67.10
Profit After Tax	50.21
EBITDA Margin	22%
EPS (₹)	8.62

Financials

The past financial performance of the company has witnessed a compounded annual growth rate (CAGR) of 39 per cent in revenues for the five years ending FY11. The impressive part was the growth in profit, that increased from ₹1.1 crore in FY06 to ₹50.21 crore in FY11, growing at a CAGR of 115 per cent. We believe that for the next year too, its topline will continue to grow at historical rates. Almost 10 per cent of the growth will come from the price hikes and the rest will come from volume increase. According to us, the second phase of expansion will start contributing to the company's growth from the last quarter of FY12. In FY11, it was structurals that contributed the highest of 34 per cent of sales, followed by TMT bars and sponge iron that contributed 33 per cent and 26 per cent respectively. When asked if there will be change in the sales mix in FY12, Jain said, "Going forward we expect the sales mix in FY12 to remain the same, with a slight increase in contribution from pellets". Subject to the contribution of the pellet segment in the entire revenue, margins are likely to improve, as pellets have an EBITDA margin of more than 40 per cent compared to others that hover between 18-25 per cent.

MONTHLY STOCK MARKET RETURNS



When we argued that increasing raw material prices may eat away some of the margin, Jain explained, "We are setting up a six lakh ton of benefaction and pelletisation plant. Going forward, we will be purchasing iron ore from the market that will have Fe (Iron) content of 56-58 per cent that is not exported and not used by any other company in India. None of the major eastern and central Indian companies has a benefaction plant. This will help us in mitigating the volatility in our iron ore prices. We are also setting up a coal washery of 3.8 lakh tonnes. We have linkages of 2.5 lakh tones of coal from Coal India at prices lesser than the open market". The price difference between iron ore sized with better Fe content and iron ore fine with lesser Fe content (including processing cost) is around ₹3000 per ton.

CAPEX PLAN				
Product	Existing Capacity	Phase I	Phase II	Total
Pellet (Tonnes)	300000	-	600000	900000
Sponge Iron (Tonnes)	192000	115500	115500	423000
Coal Washery (Tonnes)	345000	-	383525	729125
Billets (Tonnes)	144109	-	-	144109
Power Plant (MW)	24	18	34	76
TMT Bars (Tonnes)	80000	-	-	80000
Structural (Tonnes)	128000	-	-	128000

Another factor that will boost both the topline and the bottomline of the company is, the installation of a power plant of 34 MW capacity, which will take its total power capacity to 76 MW. The company will use only 38 MW as captive, and will sell the extra 38 MW at ₹4 per unit. This will boost the bottomline of the company, because it will have a cost advantage by producing 42 per cent of the total power through the waste heat gas route, which is much cheaper than the conventional coal route. The total cost of power generation in the last fiscal was ₹1.85 per unit, which will increase by 35-40 paise this year to around ₹2.2-2.25 per unit. Sale of power contributed to four cent of revenue in FY11; according to management estimates, it will be between 7-10 per cent in FY12.

When we look at the valuation of the company, the current share price discounts its FY11 net earnings by 6.2 times and the EV/EBITDA stands at nine times (assuming peak debt of ₹660 crore). This is comparable to some of other listed companies in the same field. However looking at the company, the prospects look attractive, considering the future expansion plan that will fuel the growth rate. Therefore, we advise our readers to take an exposure in the counter, with expected price appreciation of 20-25 per cent in the next eighteen months, when the full effect of the ongoing expansion plans will be reflected in the financials of the company.

(Wish to comment on this article? Send your feedback to shashikant@dsij.in)