



INDEPENDENT EQUITY RESEARCH

MSP Steel and Power Ltd

Q3FY11 Result Update

Enhancing investment decisions

Explanation of CRISIL Fundamental and Valuation (CFV) matrix

The CFV Matrix (CRISIL Fundamental and Valuation Matrix) addresses the two important analysis of an investment making process – Analysis of Fundamentals (addressed through Fundamental Grade) and Analysis of Returns (Valuation Grade) The fundamental grade is assigned on a five-point scale from grade 5 (indicating Excellent fundamentals) to grade 1 (Poor fundamentals) The valuation grade is assigned on a five-point scale from grade 5 (indicating strong upside from the current market price (CMP)) to grade 1 (strong downside from the CMP).

CRISIL Fundamental Grade	Assessment	CRISIL Valuation Grade	Assessment
5/5	Excellent fundamentals	5/5	Strong upside (>25% from CMP)
4/5	Superior fundamentals	4/5	Upside (10-25% from CMP)
3/5	Good fundamentals	3/5	Align (+-10% from CMP)
2/5	Moderate fundamentals	2/5	Downside (- 10-25% from CMP)
1/5	Poor fundamentals	1/5	Strong downside (<-25% from CMP)

Analyst Disclosure

Each member of the team involved in the preparation of the grading report, hereby affirms that there exists no conflict of interest that can bias the grading recommendation of the company.

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MSP Steel and Power Ltd

Robust growth in margins

Fundamental Grade 2/5 (moderate fundamentals)

Valuation Grade 4/5 (CMP has upside)

Industry Metals & Mining

MSP Steel and Power Ltd's (MSP's) Q3FY11 revenues were below CRISIL Equities' expectations on account of lower production from the recently commissioned sponge and power plants but profit exceeded expectations as the company enjoyed better margins. It is difficult to predict MSP's top line since intermediate products (i.e. sponge iron and power) can be directly sold (current selling price ~Rs 21,000 per tonne and Rs 2.5 per unit, respectively) or can be processed for making higher-realisable products - billets (~Rs 29,000)/TMT bars (~Rs 31,000). The product mix variance depends on the delta between the finished goods prices and raw material prices, and can significantly impact the top line as well as EBITDA margins. MSP's expansion plans are on track and, therefore, we expect it to register significant growth going ahead. However, concerns relating to high leverage (net debt:equity 2.7x for FY11E) remain. Hence, we maintain our fundamental grade of '2/5'.

Q3FY11 result analysis

- Q3FY11 revenues increased by 46% q-o-q and 48% y-o-y to Rs 1,442 mn on account of higher realisation and one-month operation of the recently added capacity (115,000 MT of sponge iron and 18 MW power plant). Revenue mix was more skewed towards metal products (refer to page 3).
- EBITDA margin expanded by 98 bps q-o-q and 703 bps y-o-y to 25%. This was on account of better realisation of steel products. MSP's realisation of TMT bars and sponge iron increased by 31% and 15% y-o-y, respectively.
- PAT margin increased by 203 bps q-o-q and 485 bps y-o-y to 13% due to improved operating performance and lower depreciation and interest charge as the company capitalised depreciation and interest cost rather than expensing of the recently-added capacity in Q3FY11.

Margins to remain robust due to firm metal prices

Sponge iron prices increased by ~11% during Q3FY11, in line with the increase in raw material prices – iron ore. But MSP's backward integration (iron ore beneficiation and pellet plants) largely covered it from the increase in iron ore prices giving it better margins. MSP procures low-grade iron ore fines, which are in low demand leading to lower price increase, and improves the grade using its beneficiation plant. Sponge iron prices have further increased to ~Rs 21,000 in January compared to the average realisation of ~Rs 17,121 during Q3FY11 giving us further confidence in MSP's performance in the near future.

Valuations: Current market price has upside

We continue to value MSP based on the discounted cash flow method. Factoring in higher EBITDA margins, we have raised MSP's earnings estimates. Based on the revised estimates, we have increased our fair value to Rs 75 from Rs 57 and revised our valuation grade to '4/5'.

KEY FORECAST

(Rs mn)	FY08	FY09	FY10	FY11E	FY12E
Operating income	3,628	4,039	3,959	5,314	9,323
EBITDA	691	643	701	1,229	2,119
Adj PAT	343	268	314	599	998
Adj EPS-Rs	5.9	4.6	5.4	10.3	17.2
EPS growth (%)	70.28	(21.6)	16.8	91.07	66.6
Dividend yield	-	-	-	0.76	0.76
RoCE (%)	23.2	14.5	10.2	12.3	14.3
RoE (%)	32.4	18.0	16.0	24.9	32.6
P/E (x)	10.5	13.4	11.5	6.0	3.6
P/BV (x)	2.8	2.1	1.6	1.4	1.0
EV/EBITDA (x)	7.9	9.5	10.6	8.5	6.5

Source: Company, CRISIL Equities estimate

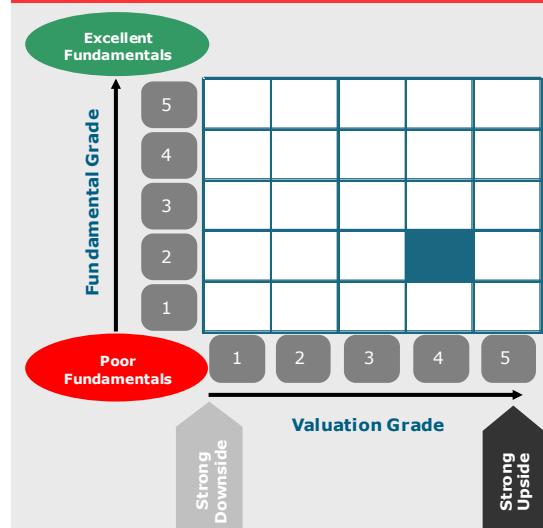
NM: Not meaningful; CMP: Current Market Price

February 03, 2011

Fair Value Rs 75

CMP Rs 62

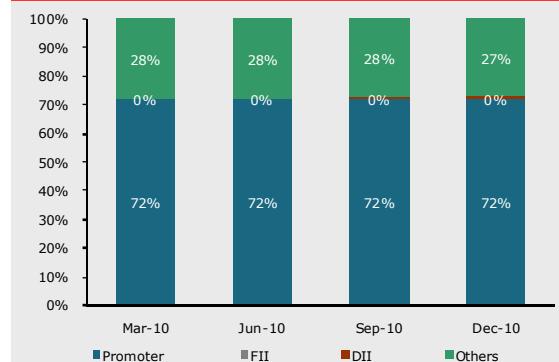
CFV MATRIX



KEY STOCK STATISTICS

NIFTY / SENSEX	5432/18091
NSE ticker	MSPL
Face value (Rs per share)	10
Shares outstanding (mn)	58.1
Market cap (Rs mn)/(US\$ mn)	3602/79
Enterprise value (Rs mn) / (US\$ mn)	7834/173
52-week range (Rs) (H/L)	80/31
Beta	1.3
Free float (%)	28%
Avg daily volumes (30-days)	150873
Avg daily value (30-days) (Rs mn)	10

SHAREHOLDING PATTERN



PERFORMANCE VIS-À-VIS MARKET

	Returns			
	1-m	3-m	6-m	12-m
MSPL	-9%	-9%	59%	69%
NIFTY	-11%	-11%	0%	12%

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Q3FY11 Result Summary

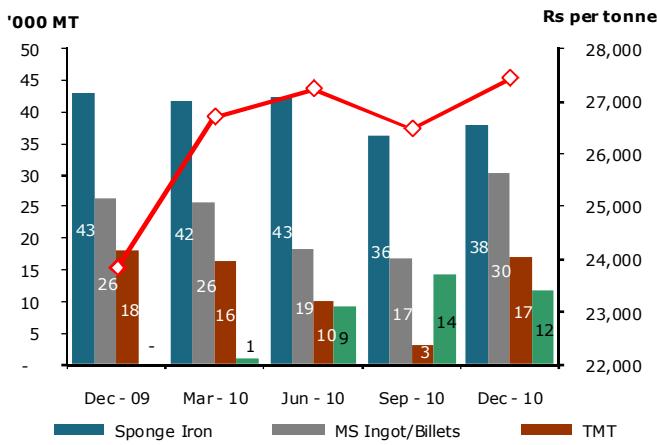
(Rs mn)	Q3FY11	Q2FY11	Q3FY10	q-o-q (%)	y-o-y (%)
Net sales	1,442	989	972	45.8	48.3
Raw materials cost	836	505	665	65.5	25.8
Raw materials cost (% of net sales)	58.0%	51.1%	68.4%	689bps	-1038bps
Purchase of traded goods	235	114	104	NM	NM
Employee cost	35	36	29	(0.3)	21.1
Other expenses	153	167	127	(8.3)	20.6
EBITDA	356	234	172	51.8	107.3
EBITDA margin	24.7%	23.7%	17.7%	98bps	703bps
Depreciation	41	43	31	(3.1)	35.3
EBIT	314	192	141	64.1	122.9
Interest and finance charges	63	58	53	8.7	19.4
Operating PBT	251	133	88	88.2	185.2
Other Income	2	8	8	n.m.	n.m.
PBT	251	142	95	76.8	162.7
Tax	60	31	14	92.4	320.8
PAT	190	110	81	72.4	134.6
Adj PAT	190	110	81	72.4	134.6
Adj PAT margin	13.2%	11.2%	8.3%	203bps	485bps
No of equity shares (Mn)	58.1	58.1	58.1	-	-
Adj EPS (Rs)	3.3	1.9	1.4	72.4	134.6

Revenues increased on account of higher realisation

PAT margin increased due to improved operating performance

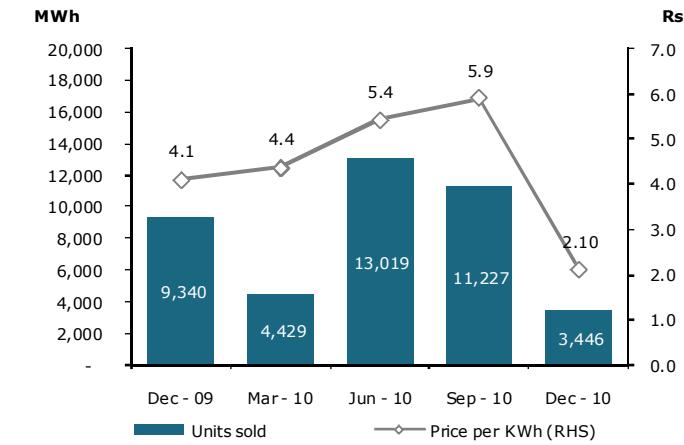
Source: Company, CRISIL Equities

Production of TMT up as prices increased...

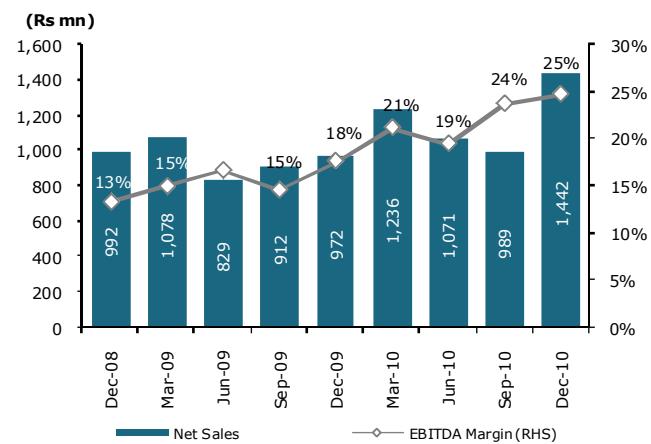


Source: Company, CRISIL Equities

... and merchant rate for power decreased

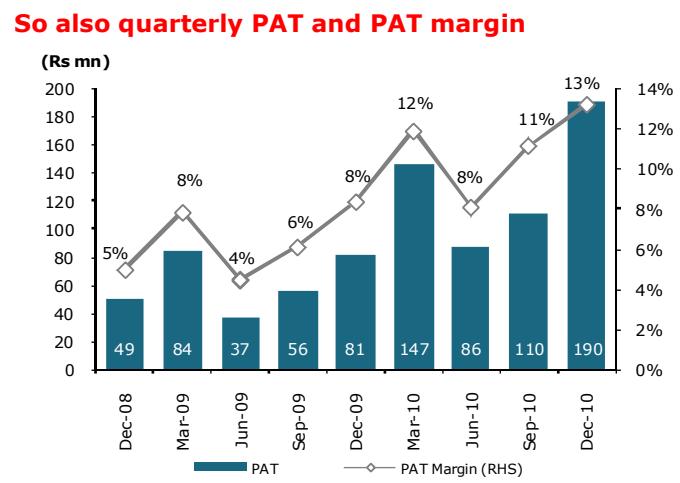


Quarterly sales and EBITDA margin on the rise



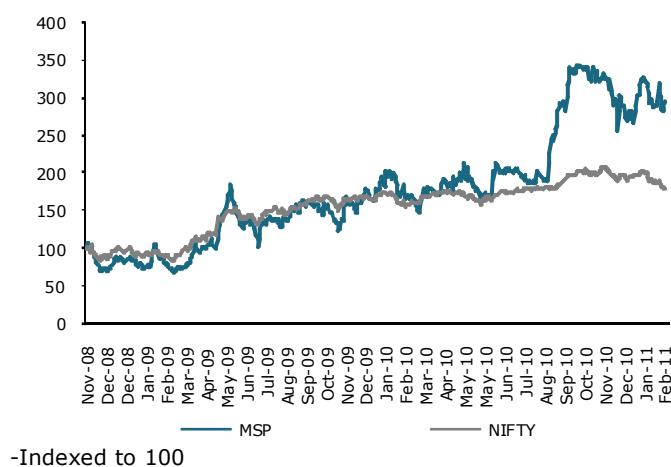
Source: Company, CRISIL Equities

So also quarterly PAT and PAT margin



Source: Company, CRISIL Equities

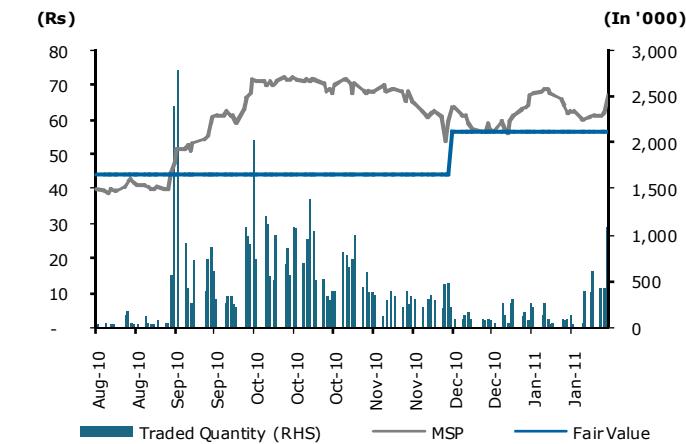
Share price movement



-Indexed to 100

Source: NSE, CRISIL Equities

Fair value movement since initiation



Source: NSE, CRISIL Equities

KEY DEVELOPMENTS

Increased profitability of sponge iron players

Sponge iron prices typically move in tandem with steel prices, which have increased due to higher coking coal prices (key raw material in manufacturing steel through the pig iron route). Rise in coking coal prices due to lower supply following the flooding of Australian coal mines has pushed the cost of manufacturing steel through the pig iron route leading to an increase in steel prices. This will add to the profitability of sponge iron players as their cost has not increased considering they use coal instead of coke, but realisations have increased. We believe coking coal prices will take a couple of quarters to come back to normal levels. At present, sponge iron prices have increased to Rs 21,000 compared to the average realisation of ~Rs 17,121 during Q3FY11 giving us further confidence in MSP's performance in the near future.

Harnessing benefits of vertical integration

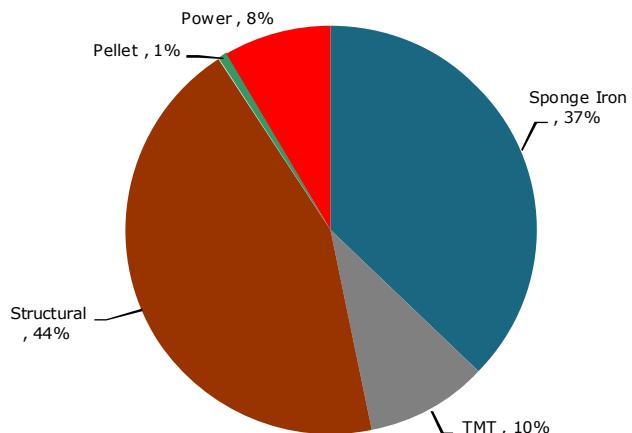
During the last quarter, MSP shifted its product mix to sell more metal products than sponge iron and power. Structural steel and TMT contributed close to 84% of sales in Q3FY11 compared to 54% in Q2FY11. MSP changed the product mix to capture higher metal prices (TMT prices increased to ~Rs 17,100 in Q3FY11 from ~Rs 15,500 in Q2FY11) and lower power prices (power realisation decreased to ~Rs 2.1 per unit from Rs 5.88 in Q2FY11).

This demonstrates the company's ability to capture high profitability in different price scenarios by virtue of vertical integration. When power tariff comes down or metal prices increase, the company captively consumes power to convert sponge iron into steel. When power prices are high or metal prices are low, the company sells power and sponge iron in the market. This helps the company sustain its profitability in different price scenarios.

Sponge iron prices on a rise while raw material costs are stable

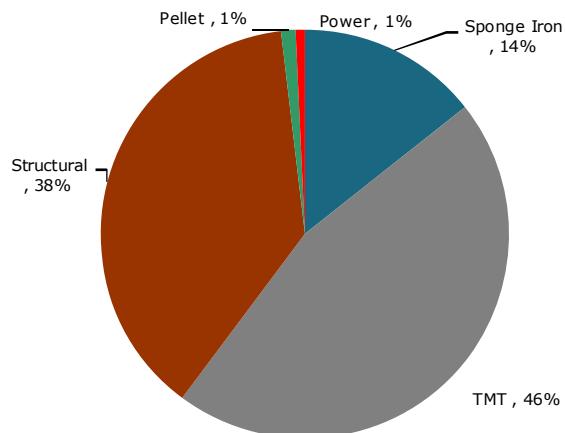
Structural steel and TMT contributed close to 84% of sales in Q3FY11 compared to 54% in Q2FY11

Q2FY11 – Sold power to capture higher tariff



Source: Company, CRISIL Equities

Q3FY11 – Sold steel to capture higher metal prices



Source: Company, CRISIL Equities

EARNINGS ESTIMATES REVISED UPWARDS

We have reduced our revenue estimates for FY11 as we had assumed six months of production from the recently added capacity (115,000 MT sponge iron plant and 18MW power plant) but the company started commercial production only in December. We have decreased revenue estimate for FY12 to capture the extended gap in installation and commercialisation of the plants coming online in FY12.

Due to increased realisation of steel products, we are raising our EBITDA margin estimates to 23.2% and 22.7% from 20.8% and 20.7% in FY11 and in FY12, respectively.

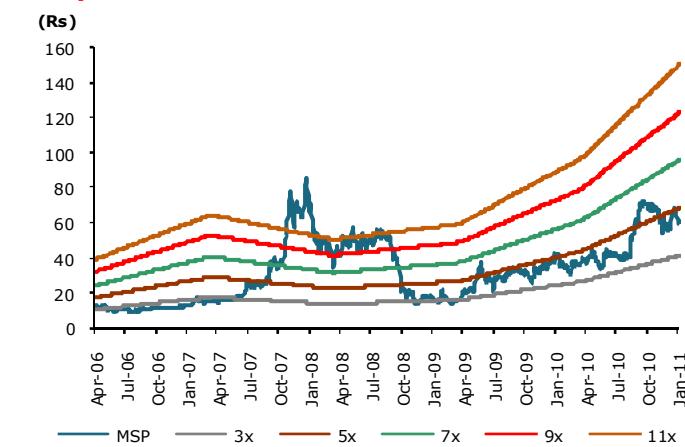
Particulars	Unit	FY11E			FY12E		
		Old	New	% change	Old	New	% change
Revenue	(Rs mn)	5,989	5,261	-12.15%	9,833	9,231	-6.12%
EBITDA	(Rs mn)	1,258	1,229	-2.27%	2,055	2,119	3.07%
EBITDA margin	%	20.8	23.1	2.34 pps	20.7	22.7	2.03 pps
PAT	(Rs mn)	509	599	17.80%	846	998	17.96%
PAT margin	%	8.4	11.3	2.87 pps	8.5	10.7	2.19 pps
EPS	Rs	8.8	10.3	17.80%	14.6	17.2	17.96%

VALUATION

We continue to value MSP based on the discounted cash flow method. We expect MSP to post strong results in the next couple of quarters due to firm sponge iron and TMT prices. Following a revision in our earnings estimates - lower sales but higher margins - we have increased our one-year fair value to Rs 75 from Rs 57. At this value, the implied P/E multiples are 7.3x FY11E EPS of Rs 10.3 and 4.4x FY12E EPS of Rs 17.2.

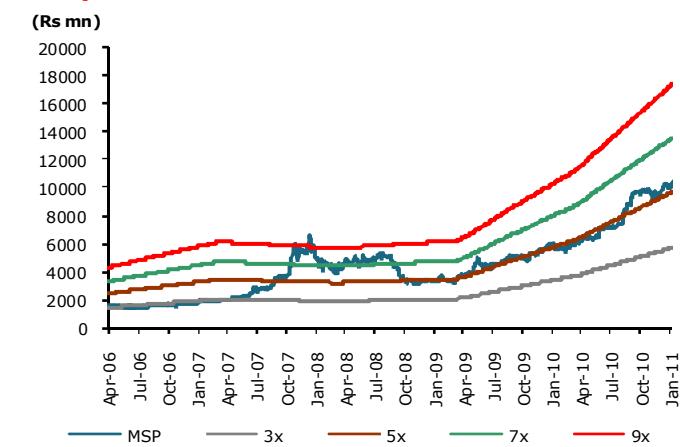
Fair value revised to Rs 75 per share

One-year forward P/E band



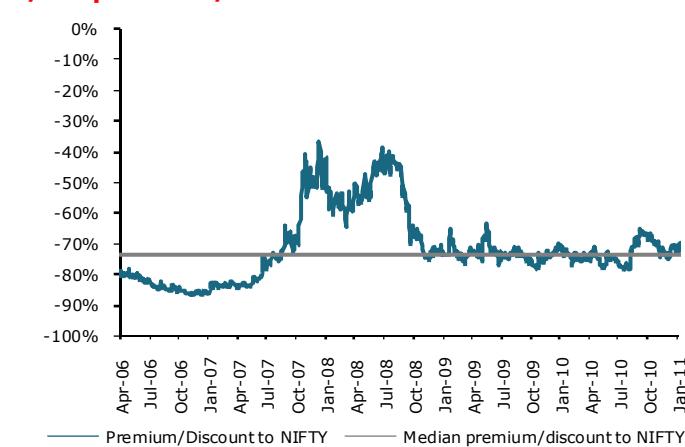
Source: NSE, CRISIL Equities

One-year forward EV/EBITDA band



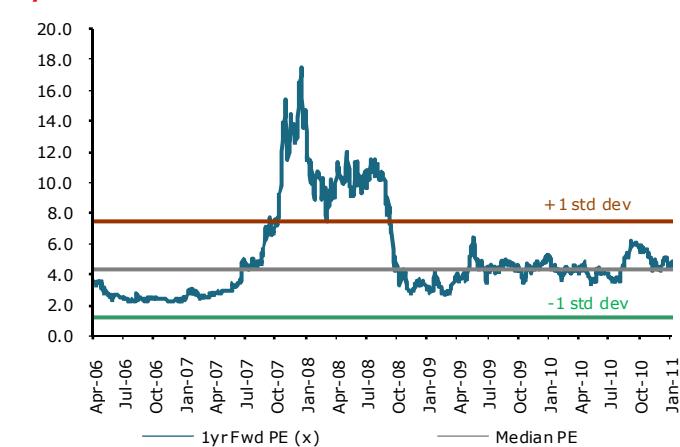
Source: NSE, CRISIL Equities

P/E – premium/discount to NIFTY



Source: NSE, CRISIL Equities

P/E movement



Source: NSE, CRISIL Equities

CRISIL IER reports released on MSP Steel and Power Ltd

Date	Nature of report	Fundamental grade	Fair value	Valuation grade	CMP (on the date of report)
29-Jul-10	Initiating coverage*	2/5	Rs 44	3/5	Rs 40
01-Dec-10	Q2FY11 result update	2/5	Rs 57	3/5	Rs 61
03-Feb-11	Q3FY11 result update	2/5	Rs 75	4/5	Rs 62

* For detailed initiating coverage report please visit: www.ier.co.in

CRISIL Independent Equity Research reports are also available on Bloomberg (CRI <go>) and Thomson Reuters.

FINANCIALS

Income statement

(Rs mn)	FY08	FY09	FY10E	FY11E	FY12E
Operating income	3,628	4,039	3,959	5,314	9,323
EBITDA	691	643	701	1,229	2,119
EBITDA margin	19.0%	15.9%	17.7%	23.1%	22.7%
Depreciation	73	79	127	190	378
EBIT	618	564	573	1,039	1,740
Interest	141	215	205	280	476
Operating PBT	476	348	368	759	1,264
Other income	4	7	7	9	16
Exceptional inc/(exp)	124	111	7	-	-
PBT	605	466	382	768	1,280
Tax provision	138	87	62	169	282
Minority interest	-	-	-	-	-
PAT (Reported)	467	380	321	599	998
Less: Exceptionals	124	111	7	-	-
Adjusted PAT	343	268	314	599	998

Ratios

	FY08	FY09	FY10E	FY11E	FY12E
Growth					
Operating income (%)	62.3	11.3	(2.0)	34.2	75.4
EBITDA (%)	44.5	(7.0)	9.0	75.5	72.3
Adj PAT (%)	70.3	(21.6)	16.8	91.1	66.6
Adj EPS (%)	70.3	(21.6)	16.8	91.1	66.6
Profitability					
EBITDA margin (%)	19.0	15.9	17.7	23.1	22.7
Adj PAT Margin (%)	9.4	6.6	7.9	11.3	10.7
RoE (%)	32.4	18.0	16.0	24.9	32.6
RoCE (%)	23.2	14.5	10.2	12.3	14.3
RoIC (%)	19.8	13.6	10.0	11.0	12.5
Valuations					
Price-earnings (x)	10.5	13.4	11.5	6.0	3.6
Price-book (x)	2.8	2.1	1.6	1.4	1.0
EV/EBITDA (x)	7.9	9.5	10.6	8.5	6.5
EV/Sales (x)	1.5	1.6	2.0	2.0	1.5
Dividend payout ratio (%)	-	-	-	4.8	2.9
Dividend yield (%)	-	-	-	0.8	0.8
B/S ratios					
Inventory days	59	44	77	80	80
Creditors days	72	23	72	21	21
Debtor days	73	37	61	45	45
Working capital days	86	96	101	108	105
Gross asset turnover (x)	2.6	2.0	1.5	1.3	1.3
Net asset turnover (x)	3.0	2.2	1.6	1.4	1.5
Sales/operating assets (x)	2.2	1.5	0.9	0.8	1.0
Current ratio (x)	3.1	6.4	4.0	11.6	10.3
Debt-equity (x)	1.6	1.6	2.1	2.9	3.0
Net debt/equity (x)	1.4	1.5	1.7	2.7	2.9
Interest coverage	4.4	2.6	2.8	3.7	3.7

Per share

	FY08	FY09	FY10E	FY11E	FY12E
Adj EPS (Rs)	5.9	4.6	5.4	10.3	17.2
CEPS	7.2	6.0	7.6	13.6	23.7
Book value	22.3	29.1	38.5	44.4	61.0
Dividend (Rs)	-	-	-	0.5	0.5
Actual o/s shares (mn)	58.1	58.1	58.1	58.1	58.1

Balance Sheet

(Rs mn)	FY08	FY09	FY10E	FY11E	FY12E
Liabilities					
Equity share capital	581	581	581	581	581
Reserves	712	1,111	1,654	1,997	2,961
Minorities	-	-	-	-	-
Net worth	1,293	1,692	2,235	2,578	3,542
Convertible debt	-	-	-	-	-
Other debt	2,053	2,727	4,611	7,493	10,793
Total debt	2,053	2,727	4,611	7,493	10,793
Deferred tax liability (net)	93	158	199	199	199
Total liabilities	3,439	4,578	7,044	10,270	14,534
Assets					
Net fixed assets	1,347	2,273	2,559	4,973	7,477
Capital WIP	693	1,052	2,454	2,654	2,994
Total fixed assets	2,040	3,325	5,013	7,627	10,471
Investments	61	67	70	70	70
Current assets					
Inventory	463	393	683	874	1,533
Sundry debtors	675	418	669	655	1,149
Loans and advances	612	400	500	671	1,177
Cash & bank balance	215	194	379	237	184
Marketable securities	-	-	380	380	380
Total current assets	1,966	1,406	2,611	2,817	4,422
Total current liabilities	628	220	649	243	429
Net current assets	1,338	1,185	1,962	2,573	3,993
Total assets	3,439	4,578	7,044	10,270	14,534
Cash flow					
(Rs mn)	FY08	FY09	FY10E	FY11E	FY12E
Pre-tax profit	480	355	375	768	1,280
Total tax paid	(73)	(21)	(21)	(169)	(282)
Depreciation	73	79	127	190	378
Working capital changes	(528)	131	(212)	(753)	(1,474)
Net cash from operations	(48)	544	270	36	(97)
Cash from investments					
Capital expenditure	(831)	(1,364)	(1,816)	(2,804)	(3,223)
Investments and others	(7)	(6)	(382)	-	-
Net cash from investments	(838)	(1,370)	(2,198)	(2,804)	(3,223)
Cash from financing					
Equity raised/(repaid)	-	(5)	-	-	-
Debt raised/(repaid)	898	674	1,884	2,882	3,300
Dividend (incl. tax)	-	-	-	(34)	(34)
Others (incl. extraordinaries)	126	136	229	(222)	-
Net cash from financing	1,024	804	2,113	2,626	3,266
Change in cash position	139	(21)	185	(141)	(54)
Closing cash	215	194	379	237	184

Quarterly financials

(Rs Mn)	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Net Sales	972	1,236	1,071	989	1,442
Change (q-o-q)	NM	27%	-13%	-8%	46%
EBITDA	171	262	209	234	356
Change (q-o-q)	NM	53%	-20%	12%	52%
EBITDA margin	17.6%	21.2%	19.5%	23.7%	24.7%
PAT	81	147	86	110	190
Adj PAT	81	147	86	110	190
Change (q-o-q)	NM	81%	-41%	28%	72%
Adj PAT margin	8.3%	11.9%	8.1%	11.2%	13.2%
Adj EPS	1.4	2.5	1.5	1.9	3.3

Note: All ratios are computed on adj. PAT

Source: Company, CRISIL Equities estimate

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- Customised Research on Market sizing, Demand modelling and Entry strategies
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