BUY

Price ₹ : 60.15
Target ₹ : 102.0

FINSECURITIES PRIVATE LIMITED

17th January 2011 | Iron & Steel | MSP Steel & Power Limited

COMPANY REPORT

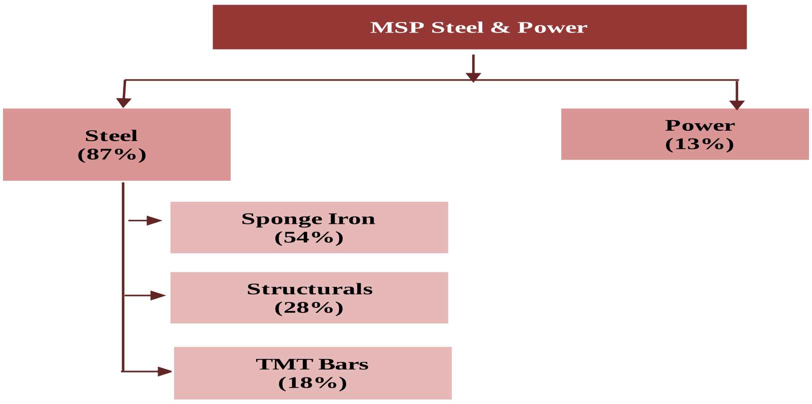
Company Background

MSP Steel and Power Limited (MSPL) is a integrated steel and merchant power player in Eastern India. The company is present across the entire value chain of steel production starting from mines to power to final output consisting of long products and structurals. It also sells intermediate steel products like pellet and sponge iron which are surplus over its captive consumption. Its production facilities are located at Raigarh in Chhattisgarh.

Business Verticals

MSPL's two business verticals are Steel & Power. As per management its year ending FY11 its product mix is expected to be as following:

Exhibit: Segment Revenue of MSPL



Source: MSPL Estatimates, MPA Finsecurities

What's the Theme?

We believe that the core theme behind MSPL is that it is one of those companies that has being completely overlooked by the market and is silently doing its basics right by expanding both forward and backward across the entire steel value chain and creating value for its self and its shareholders.

The key theme for investments are:

- ✓ Its large capacity expansion of which majority expected to be operational by FY12 giving a strong top line growth of over 150% from current levels of ₹ 388 cr. (FY10)
- ✓ MSPLs continuous focus on backward integration with expansion of its sponge iron, pellet, beneficiation and power capacity along with investment in mines and railway siding to give strong boost to its EBITDA margin by over 300-400 bps by FY13 from current levels of around 16%
- ✓ Surplus power after captive use which is produced 100% from the waste products of its iron plant will further boost its top line and margins

Risks

Slowdown in economic growth leading to a correction in steel prices and any delay in capacity expansion could hurt company's margins and its debt repayment capacity.

STOCK INFO

Sub- Sector	Iron & Steel
Listing	BSE/NSE
BSE Code	532650
Bloomberg Code	MSPS.IN
Face value (₹)	10.00
Sensex (January 17,2011)	18,893.14
Market cap (₹ Cr.)	351.00
Free float (%)	28.20
52 week H/L (₹)	80.00/31.00
Beta	1.46
Debt-Equity	1.91
No. Of Shares	58100000

KEY FINANCIAL RATIOS

EPS FY10 (₹)	5.52
EPS TTM (₹)	7.29
BV FY10 (₹)	34.74
Price/Earnings (TTM)	8.29
Price/BV (FY10)	1.74
Dividend Yield (%)	0.00

PRICE PERFORMANCE (%)

Time Frame	Stock	Sensex
1 Month	5.19	-4.74
3 Months	-15.09	-7.99
1 Year	42.44	7.25
3 Years	-12.59	-9.01

SHAREHOLDING PATTERN (%)

Promoters	71.8
FIIs	0.00
DIIs	0.59
Retail	7.44
Others	20.17

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Business Model:

MSPL has a completely integrated business model for steel production with the only leg currently missing being captive mines which would also be in place in near future.

The company has already being allotted in Chattisgarh:

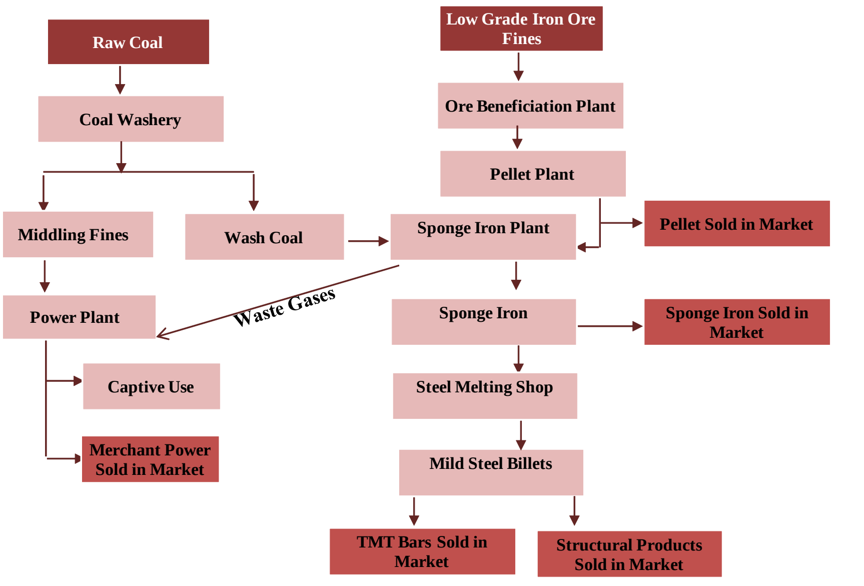
- A coal mine (26 mn tone reserve) and
- A iron ore mine (35 mn tone reserve)

As per the management the mines are expected to be operational by March FY13 (coal) and FY15 (Iron Ore) respectively and once operational will provide high reduction in the raw material prices and further robust its business model and strengthen margins.

Moreover the management has also stated that it will also strengthen its forward integration by increasing its capacity of Billets, TMT bars and structurals this will enable them to reap the benefits by the virtue of its presence across the entire value chain.

The biggest strength of its business model is its integration; all the necessary raw materials to produce steel via electric arc furnace are produced in house thus giving it a huge cost advantage over its peers.

Exhibit: Business Model of MSPL



Source: MSPL, MPA Finsecurities

Management Team:

Company's top management are first generation entrepreneurs with more than two decades of experience in steel and allied industry. Management in the past has shown high proactiveness with continuous focus on business integration and as per our discussion they are expected to continue doing so.

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Exhibit: Key Management

Name	Designation	Experience
Mr. Puranmal Agarwal	Chairman	25 Years
Mr. Suresh Agarwal	Managing Director	25 Years
Mr. Saket Agarwal	Director	7 Years
Mr. Manish Agarwal	Director	7 Years

Source: MSPL, MPA Finsecurities

Theme

Capacity Expansion Will Lead to Top Line Growth:

The company has undertaken big phase wise capacity expansion plan of which majority will be commissioned in FY12 and remaining by FY13 giving it a strong top line growth.

Huge capacity expansion along with increased utilizations and strong pricing trend in Eastern India will lead to a high top line growth for the company in FY12 and FY13

Exhibit: Capacity Expansion of MSPL

(Capacity in MT)

Divison	Installed Capacity	Proposed Expansion	Post Expansion	Estimated Year of Completion
Sponge Iron	307500	115500	423000	Q3 FY12
Pellet	300000	600000	900000	Q3FY12
Power	42 MW	34 MW	76 MW	Q3 FY12
Billets	114109	0	114109	N/A
TMT Rolling Mill	80000	0	80000	N/A
Structural Rolling Mill	128000	0	128000	N/A

Source: MSPL, MPA Finsecurities

As per our discussion with management the majority of its capacity expansion for its power and sponge iron division will be completed by third quarter ending FY12. This along with improve utilizations given the state of demand for steel in the Eastern India will enable the company to achieve a high top line growth.

Exhibit: Capacity Utilization of MSPL

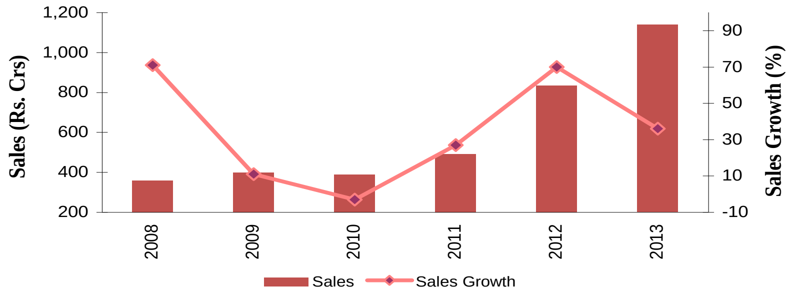
Divison	FY11	FY12	FY13
Sponge Iron	80%	90%	90%
Pellet	55%	70%	70%
Power	90%	90%	90%
TMT Rolling Mill	35%	60%	70%
Structural Rolling Mill	35%	65%	70%

Source: MSPL, MPA Finsecurities

This, we believe will lead to a top line growth of around 27% in FY11, 70% in FY12 and around 36% in FY13 taking the sales to over ₹ 1200 crs in FY13 from the current levels of ₹ 388 crs in FY10.

For FY11, FY12 and FY13 we believe company will post a top line of ₹ 491 crs, ₹ 834 crs and ₹ 1138 crs respectively giving an expected CAGR of over 43% from the current levels.

Exhibit: Sales and Sales Growth of MSPL



Source: MSPL & MPA Finsecurities

Backward Integration Will Expand Margins:

Its pellet plant will lead to a significant savings on raw material costs of over ₹ 2500/ton

Majority of MSPL's planned capacity expansion and its focus over the last few years has being on the area of backward integration to boost its bottom line. Post its capacity expansion it will become a completely integrated steel player right from mining its own ore and coal to manufacturing pellets to sponge iron to value added steel products.

Its various capacity expansion that in the are of backward integration which would be commissioned by FY13 are as follows:

Exhibit: Capacity Expansion of MSPL

(Capacity in MT)

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Structural Rolling Mill	128000	0	128000	N/A

Source: MSPL, MPA Finsecurities

All this proposed capacity expansion in the area of backward integration will lead to a significant expansion in margins. We believe its operating margins (EBIT margins) to expand from the current (FY10) levels of around 13% to 21% in FY12 and around 24% in FY13, giving strong boost to its bottom line.

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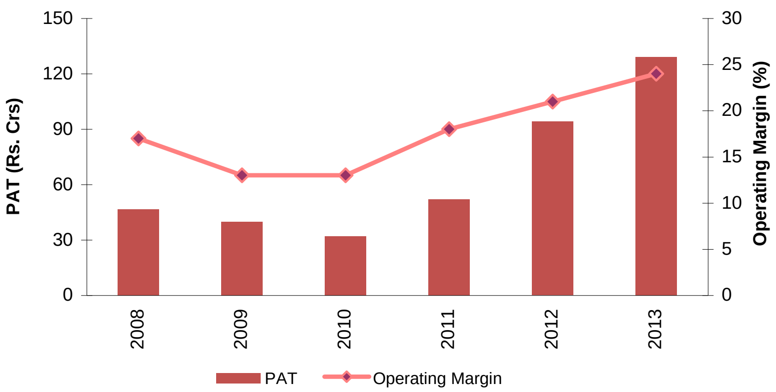
Exhibit: PAT and Operating Margin of MSPL



Source: MSPL & MPA Finsecurities

Surplus Power After Captive Use to Expand Top Line & Margins :

Company is currently producing significant amount of power over and above its captive requirement which it sells in open market as merchant power and this is expected to increase further by FY13. Post its expansion plans its total installed capacity will increase to 76 MW of which 34-36 MW will be required for its captive use and the rest would be sold in the open market

Almost 100% of the coal required or its power plant is available form the rejections of its coal washery which otherwise would be left wasted, giving the company a significant cost advantage

In order to produce power, almost 100% of the coal required is available form the rejections of its coal washery which otherwise would be left wasted, giving the company a high advantage and a significant boost in its margins.

This leads to a power production cost for MSPL of around ₹ 1.4-2/unit which is around 40-40% lower than the average of around ₹ 2.8/unit and with average merchant power tariff of around ₹ 3.5-4/unit in Eastern India adds a robust amount of growth to its bottom line by FY13.

By FY13 we believe power to contribute to over 13% of its total top line compared to only around 1% from its current levels.

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Exhibit: Merchant Power Sales of MSPL

(Million Units)

Divison	FY11	FY12	FY13
Installed Capacity	261.36	399.96	601.92
Capacity Utilization	90%	90%	90%
Annual Production	235.22	359.96	541.73
Captive Use	90.38	137.18	174.63
Sold as Merchant Power	144.85	222.79	367.10

Source: MSPL, MPA Finsecurities

Risks:

- Slowdown in economic growth and a fall in industrial activity could lead to a correction in steel prices and could hurt company's margins and its debt repayment capacity
- Moreover any delay in the scheduled capacity expansion could lead to both a slow down in the top line and a correction in its projected bottom-line growth because of increased raw material costs and higher interest costs

Peer Group Analysis:

Compared to most of its similar sized peers MSPL commands a higher ROE, PAT margins and coverage ratio, however comparatively is highly underpriced trading at a trailing twelve months (ttm) P/E of only around 8 and a lower EV/EBITDA

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Exhibit: Peer Group Analysis *Figures in Crores*

Particulars	MSP	Jai Balaji	Tata Sponge	Adhunik
Net Sales	411.56	1832.29	606.09	1340.57
EBIDTA	87.84	257.76	145.67	284.94
EBIDTA Margin (%)	21.34	14.07	24.03	21.26
Net Profit	42.42	44.12	89.99	65.72
Net Profit Margin (%)	10.31	2.41	14.85	4.90
Diluted EPS (Rs)	7.29	6.91	58.44	5.36
Paid-up Capital	58.10	63.77	15.40	123.50
Net Worth	223.51	903.01	420.97	615.50
CMP (14-01-2011)	60.45	231.55	351.35	100.70
Market Capitalization (14-01-2011)	364.00	1521.00	558.00	1263.00
Enterprise Vaue (14-01-2011)	787.13	3002.33	464.89	2381.46
P/E TTM (x)	8.29	33.51	6.01	18.79
P/B (x)	1.74	1.64	1.29	2.02
Interest Coverage Ratio (x)	4.09	2.06	N/A	2.24
Debt/Equity (x)	1.91	1.76	0.00	1.98
ROE (%)	16.32	5.06	21.96	11.88
EV/EBIDTA (x)	8.96	11.65	3.19	8.36
EV/Sales TTM (x)	1.91	1.64	0.77	1.78

Source: ACE-Equity, MPA Finsecurities

Note: Net Sales, EBIDTA, Net Profit, EPS & Interest Coverage Ratio are on Trailing Twelve Months

Valuations:

We believe have being completely over looked by the markets; however has being silently doing its basics right and is all set to reap benefits of the same

We strongly believe that given its high expected top line growth along with expanding margins and integrated business model and comparatively lower valuations against the peers MSPL is a definite re-rating candidate.

More importantly the company we believe have being completely over looked by the markets; however has being silently doing its basics right and is all set to reap benefits of the same.

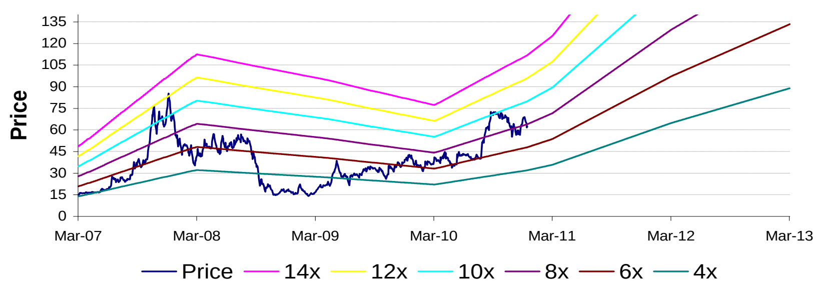
Price Earnings Based:

Over the last 4 years the company has traded at an average P/E multiple of around 6.5x and on an average one year forward band of only 4-6x given its 4 year earnings CAGR of around 17%. As per our estimates the company is expected to post an EPS of ₹ 8.95/share (YoY rise of 62%) for FY11, ₹ 16.19/share (YoY rise of 81%) for FY12 and ₹22.2/share (a year on year rise of 37%) for FY13.

Given strong expected earnings growth CAGR of over 59% for FY10-13 period, high revenue growth, expansion in margins, we believe market to re-rate the stock and assign a forward P/E multiple of around 8x. Thus, given FY12 expected EPS of around ₹ 16.19/share and forward multiple of 8x, we arrive at a 1 year P/E based price target of ₹ 129.5/share.

Given FY12 expected EPS of around ₹ 16.19/share and forward multiple of 8x, we arrive at a 1 year P/E based price target of ₹ 129.5/share reflecting an upside potential of 115% from the current levels

Exhibit: One Year Forward P/E Band

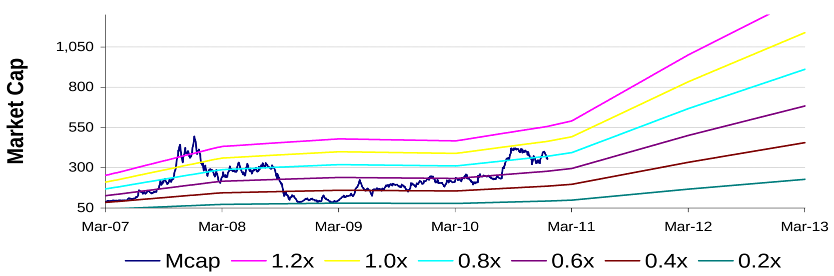


Source: Company Data & MPA Finsecurities

Market Capitalization to/Sales Based:

MSPL is currently trading at a Market Cap/Sales multiple of 0.42 x given its FY12 sales of ₹834.4 crs. Over the past it has traded at an average Market Cap/Sales multiple of around 0.6x and a forward band of 0.4x-0.6x. Thus given its strong expected sales growth CAGR of 43% over the next few years we assign a forward multiple of 0.8x for its FY12 sales of ₹834.4 crs and arrive a one year price target of ₹114.9/ share.

Exhibit: One Year Market Cap/Sales Band



Source: Company Data & MPA Finsecurities

Price Target:

We assign 40% weight to our P/E based price target of ₹129.5/ share and 60% weight to our market cap/sales based price target ₹114.9/ share and keeping a margin of safety of around 15% given it's a commodity and cyclical business we arrive at a one year price target of ₹102/share reflecting an upside potential of 67% from the current levels.

We assign 40% weight to our P/E based price target of ₹ 129.5/ share and 60% weight to our market cap/sales based price target ₹ 114.9/ share and keeping a margin of safety of around 15% given it's a commodity and cyclical business we arrive at a one year price target of ₹ 102/share reflecting an upside potential of 67% from the current levels

Financials:

Exhibit: Income Statement *Figures in Crores*

Particulars	2009	2010	2011E	2012E	2013E
Net Sales (Excluding Other Income)	398.86	388.74	491.95	834.45	1138.75
Sales Growth (%)	10.83	-2.54	26.55	69.62	36.47
Total Operating Expenditure	337.84	324.65	384.68	628.84	806.73
EBITDA	61.02	64.10	107.27	205.61	332.01
EBTIDA MARGIN (%)	15.30	16.49	21.81	24.64	29.16
Dpreciation	7.41	12.57	17.57	33.22	56.21
EBIT	53.61	51.52	89.70	172.39	275.80
Interest Cost	19.42	20.40	36.91	66.70	92.67
PBT (Including Other Income)	49.19	38.23	65.29	118.20	195.64
Tax	9.28	6.17	13.32	24.11	66.51
PAT	39.91	32.05	51.97	94.08	129.12
EPS	6.87	5.52	8.95	16.19	22.22

Source: ACE-Equity, MPA Finsecurities

Based on our estimations its EBITDA margins are expected to expand to levels of 24% in FY12 and 29% in FY13 from the current levels of around 17%

Its interest costs are also expected to increase 4 folds to ₹ 92 crs on account of debt taken for its planned capacity expansion

Exhibit: Balance Sheet *Figures in Crores*

Particulars	2009	2010	2011E	2012E	2013E
Source of Funds					
Paid-up Capital	58.10	58.10	58.10	58.10	58.10
Preference Share Capital	0.00	22.20	97.15	153.00	153.00
Reserves & Surplus	111.15	143.21	195.18	289.26	418.38
Networth	169.25	223.51	350.42	500.36	629.48
Deferred Tax Liability	15.83	19.86	19.86	19.86	19.86
Secured Loan	99.81	195.56	401.69	536.51	428.54
Unsecured Loan	50.22	112.23	135.03	135.03	135.03
Working Capital Loan (ST)	87.93	119.80	150.00	250.00	250.00
Total Debt (LT + ST)	237.96	427.59	686.72	921.53	813.56
Total Sources of Funds	**423.04**	**670.96**	**1057.00**	**1441.75**	**1462.91**
Application of Funds					
Gross Block	250.89	292.22	871.51	1170.38	1170.38
Depreciation	23.61	36.34	53.91	87.13	143.34
Net Block	227.28	255.89	817.60	1083.25	1027.05
Capital Work in Progress	105.21	245.41	0.00	0.00	0.00
Investments	9.10	13.69	42.40	89.44	132.95
Net Working Capital	81.46	155.98	197.01	269.06	302.91
Total Application of Funds	**423.04**	**670.96**	**1057.00**	**1441.75**	**1462.91**

Source: ACE-Equity, MPA Finsecurities

As per management they are also expected to bring in preferential share capital in order to fund the capacity expansion

Exhibit: Key Ratios

Figures in Crores

Particulars	2009	2010	2011E	2012E	2013E
Profitability Ratios					
EBITDA Margin (%)	15.30	16.49	21.81	24.64	29.16
EBIT Margin (%)	13.44	13.25	18.23	20.66	24.22
PAT Margin (%)	10.01	8.25	10.56	11.27	11.34
ROE (%)	26.68	16.32	18.11	22.12	22.86
ROCE (%)	18.03	11.94	8.02	10.88	14.31
Solvency & Liquidity Ratios					
Total Debt to Equity (x)	1.41	1.91	1.96	1.84	1.29
Long Term Debt to Equity (x)	0.89	1.38	1.53	1.34	0.90
Interest Coverage Ratio (x)	2.76	2.53	2.43	2.58	2.98
Current Ratio (x)	2.37	2.52	2.79	2.38	2.04

Source: ACE-Equity, MPA Finsecurities

Company's ROE and ROCE are expected to steadily increase to levels of 23% and 14% in FY13 from the current levels of 17% and 8% respectively

Despite higher debt in the books its long term debt to equity ratio remains fairly stable, giving the company further scope of expansion in the future

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