

**Inflection Point**

**PLANT VISIT NOTE**

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MSP Steel & Power Ltd (MSP), a part of MSP Group, is a medium size integrated steel company based in East India. It is engaged in manufacturing of pellet, sponge iron, long products and captive power generation. In longs segment, it offers a wide range of products like billets, TMT, structural, angles, channel, plates and beam. The company has its making facilities in Jamgaon, Raigarh in Chhattisgarh. We expect the company to report a significant increase in the topline through volume growth and in bottomline through cost savings & backward integration. Currently, the stock is trading at 6.5X and 3.8X on FY11E & FY12E EPS of ₹ 10.3 & ₹ 17.6 respectively. We recommend BUY at current levels with FY12 price target of ₹ 87, an upside of 28%.

**Investment Rationale**

Capacity Expansion to Drive Volumes:

MSP is well poised to take advantage of the growing steel demand in the country. The company has undertaken a massive phase wise expansion plan focus being on strengthening backward integration by increasing the production capacity for sponge iron, pellets and power. Going forward, this expansion would drive volumes.

	Existing Capacity	Phase I	Phase II	Total
Pellet (mt)	300000	-	600000	900000
Sponge Iron (mt)	192000	115500	115,500	423,000
Coal Washery (mt)	345000	-	383,525	729,125
Billets (mt)	144109	-	-	144,109
Power Plant (mw)	24	18	34	76
TMT Bars (mt)	80000	-	-	80,000
Structurals (mt)	128000	-	-	128000
Railway Siding (km)	2.4	-	4	6.4
Expected to be commissioned by	-	Oct 2010 (Commissioned)	July-Oct 2011	-

The quantum of the above mentioned capex is ₹ 814 crore of which ₹ 350 crore has already been spent. The capex is being funded through a mix of debt and internal accruals and preference shares (issued to promoters) in the ratio of 2:1 (the equity portion being internal accruals and preference shares).

Rating	BUY
Target Price	₹87
CMP	₹68
Upside	28%
Sensex	20005

Key Data	
Bloomberg Code	MSPS IN
Reuters Code	MSPO.BO
NSE Code	MSPL
Current Share o/s (mn)	58.1
Diluted Share o/s (mn)	58.1
Mkt Cap (₹bn/\$mn)	4/89.9
52 WK H/L (₹)	80/25.05
Daily Vol.(3M NSE Avg)	569404
Face Value (₹)	10
Beta	1.29
1USD/₹	44.5

Shareholding Pattern	(%)
Promoters	71.8
FII	0.0
Others	28.2

Price Performance (%)	1M	6M	1yr
<b>MSPL</b>	-2.6	77.2	142.4
<b>NIFTY</b>	0.2	11.9	25.1

Source: Bloomberg; \*As on 27<sup>th</sup> Oct., 2010

### Integrated Value Chain:

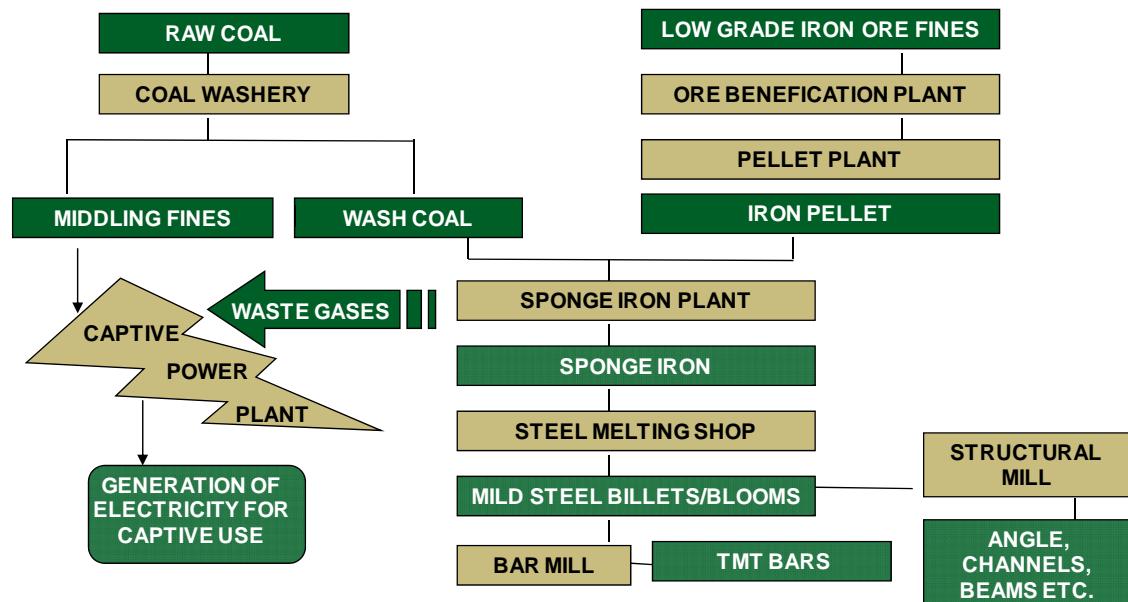
MSP is an emerging integrated business model right from mining its own coal and iron ore and captive power generation to manufacture of value added steel products.

MSP has been allotted a coal mine (175 mn tons reserve) and an iron ore mine (35 mn tons reserve) in Chhattisgarh which is expected to be operational by March FY11 and FY16 respectively. These captive mines will reduce its raw material cost in future. Moreover procuring 90% of its raw materials through its railway siding of 2.4 km further reduce the transportation cost by ₹ 500 / mt.

Nature of mines	Coal Block	Iron Ore Block
Location	Chhattisgarh	Chhattisgarh
Mining area	714 hectares	150 hectares
Reserves	175 mn tons	35 mn tons
MSP's share	26 mn tons	35 mn tons
Proximity from plant	150 km	125 km
Expected to be operational by	FY11	FY16

Of its raw materials, currently MSP procures its coal through coal linkages of 257000 mtpa with Coal India while Iron Ore Resources are procured from Essel Mining (Aditya Birla Group Company) whose mines are located at a distance of 200 km from its Raigarh plant.

### Process Flow Chart



Source: Company, Network

MSP being an integrated player, enjoys a cost saving of ₹ 2000-3000 / ton compared to the non-integrated players due to the captive production of intermediary input materials viz. pellet, sponge iron and power.

### **Pelletisation to Lower Cost of Production:**

The Pelletisation along with Beneficiation process converts low grade iron ore fines of 58 Fe content into the shape of a pellet with characteristics appropriate for use in DRI Kiln for the production of sponge iron. MSP procures its Iron ore at ₹ 2500/ ton and the process of Pelletisation and beneficiation costs around ₹ 2500 i.e. total cost of ₹ 4000/ ton. Whereas, typically most of the steel makers use ~63 Fe content Iron ore which costs ₹ 6500. So MSP has a cost saving of ₹ 2500 / ton. Besides with reduced Iron Ore demand from China and the likely ban on Iron ore exports, there is abundant availability of the same and at cheaper prices.

### **Power to Add Revenues**

MSP has an installed capacity of 24 mw power plant and it recently commissioned its Phase-I 18 mw (12 mw coal based & 6 mw waste heat gas based) power plant. Post capex the total capacity will be 76 mw. Currently the company requires around 18-20 mw of power and going forward considering its capacity expansion plan, it will need 34-36 mw. The rest of the power generated will be deployed in profitable merchant sales. Power contributed to 2% to the top line in FY10 and going forward its contribution is likely to increase.

<b>Power (mw)</b>	<b>Existing</b>	<b>Additions</b>	<b>Total</b>
AFBC (Fuel Based)	18	26	44
WHRB (Waste Heat Recovery Based)	24	8	32
Total	42	34	76
Captive Consumption	27	9	36
Merchant Power	15	25	40

### **Coal Beneficiation**

MSP has the flexibility to procure low-quality coal (D, E and F grades) and benefitiate them in its coal washery which leads to a better efficiency of coal resulting in better PLF of the sponge iron plant and also reducing the overall manufacturing cost.

### **Going Green**

MSP uses ESP (electrostatic precipitator) which acts like an air cleaner that removes particles before emitting gasses in the air and which are very efficient in energy consumption. In a coal washery, ESP extracts coal rejects which have some carbon content and further uses it in power plants. In a sponge iron plant, ESPs extract fly ash which is used to make bricks which are utilised for the construction of side walls in and around the manufacturing unit. This process not only saves the cost of waste management but is also a very eco-friendly initiative.

Apart from zero wastage, MSP has also taken necessary steps for conservation of energy. The company has installed waste heat recovery boilers to use the waste heat from sponge iron kiln to produce power. Also the company has installed AFBC (atmospheric fluidized bed combustion) which utilize coal rejects from the coal washery apart from normal coal.

Besides, the company has also installed electrical energy efficient motors for prevention of wastage of energy, energy savers for lighting and capacitors.

**Clientele:**

Prakash Industries, Monnet Ispat & Energy Ltd., Parsvanath Developers Ltd., Sterling Construction Ltd., Knowledge Infrastructure Systems Pvt Ltd., Chhattisgarh State Electricity Board, Ramky Infrastructures Ltd. are some of its major clients.

**Threats:**

If MSP does not get the necessary environmental clearances for its captive mines, it will adversely affect its raw material procurement costs and thus its competitiveness.

Moreover if the company is not able to execute its projects on time then it will affect its cash flows adversely. However the company has a good track record, in fact it is ahead of its schedule.

Income Statement	FY07	FY08	FY09	FY10	FY11e	FY12e
Revenue	84.34	362.3	413.73	394.98	625	850
Other Income	1.1	14.77	0.14	0.88	0	0
Total Income	85.44	377.07	413.87	395.86	625	850
Expenditure	75.02	295.11	337.86	324.65	490.0	632.0
PBDIT	10.42	81.96	76.01	71.21	135.0	218.0
PBDIT %	12.35	22.62	18.37	18.03	21.61	25.6
Interest	3.47	14.15	19.42	20.4	42	65
PBDT	7.0	67.8	56.6	50.8	93.0	153.0
OPM %	12.35	22.62	18.37	18.03	14.9	18.0
Depreciation	-4.34	-7.34	-7.41	-12.57	32.7	50.1
PBT	2.61	60.47	49.18	38.24	60.3	102.9
Tax	-1.5	-13.79	-9.28	-6.17	15	25.5
Net Profit	1.11	46.68	39.9	32.07	45.3	77.4
NPM %	1.32	12.88	9.64	8.12	7.25	9.11

Balance Sheet	FY07	FY08	FY09	FY10	FY11e	(₹ in Cr) FY12e
<b>SOURCES OF FUNDS :</b>						
Share Capital	58.1	58.1	58.1	58.1	58.1	58.1
Reserves Total	4.92	71.76	111.13	143.19	188.5	265.9
Preference Capital	0	0	0	22.2	120	120
	83.2	129.86	169.23	223.49	366.6	444.0
Secured Loans	94.04	180.1	249.44	424.74	480	752
Unsecured Loans	21.47	25.21	23.25	36.33	45	60
Total Debt	115.51	205.31	272.69	461.07	525	812
<b>Total Liabilities</b>	<b>198.7</b>	<b>335.2</b>	<b>441.9</b>	<b>684.6</b>	<b>1011.6</b>	<b>1376.0</b>
<b>APPLICATION OF FUNDS :</b>						
Gross Block	130.68	150.39	250.89	292.22	545	835
Less : Accumulated Depreciation	20.66	15.72	23.61	36.34	69.04	119.14
Net Block	110.02	134.67	227.28	255.88	475.96	715.86
Capital Work in Progress	18.26	83.63	105.2	245.42	264.4	280.4
Investments	5.41	6.1	6.73	44.95	47	49
<b>Current Assets, Loans &amp; Advances</b>						
Inventories	33.8	46.3	39.3	68.3	75.9	101.3
Sundry Debtors	20.8	66.6	41.8	66.8	99.3	135.1
Cash and Bank	7.63	21.52	19.4	37.87	78	115.8
Loans and Advances	19.94	47.12	42.62	54.2	75	114.1
Total Current Assets	82.1	181.5	143.2	227.3	328.2	466.3
<b>Less : Current Liabilities and Provisions</b>						
Current Liabilities	11.06	57.22	21.57	64.23	78	107
Provisions	3.96	4.83	3.05	4.85	5.46	7.49
Total Current Liabilities	15.02	62.05	24.62	69.08	83.46	114.49
<b>Net Current Assets</b>	<b>67.1</b>	<b>119.5</b>	<b>118.5</b>	<b>158.2</b>	<b>244.7</b>	<b>351.8</b>
Miscellaneous Expenses not written off	0.76	0.54	0	0	0	0
Net Deferred Tax	-2.81	-9.25	-15.83	-19.86	-20.4	-21
<b>Total Assets</b>	<b>198.7</b>	<b>335.2</b>	<b>441.9</b>	<b>684.6</b>	<b>1011.7</b>	<b>1376.0</b>

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