Independent Equity Research

Enhancing investment decisions

In-depth analysis of the fundamentals and valuation

MSP Steel & Power Limited

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)

Fundamental Grade

CRISIL's Fundamental Grade represents an overall assessment of the fundamentals of the company graded in relation to other listed equity securities in India. The grade facilitates easy comparison of fundamentals between companies, irrespective of the size or the industry they operate in. The grading factors in the following:

Business Prospects: Business prospects factors in Industry prospects and company's future financial performance

Management Evaluation: Factors such as track record of the management, strategy are taken into consideration

Corporate Governance: Assessment of adequacy of corporate governance structure and disclosure norms

The grade is assigned on a five-point scale from grade 5 (indicating Excellent fundamentals) to grade 1 (Poor fundamentals)

CRISIL Fundamental Grade	Assessment
5/5	Excellent fundamentals
4/5	Superior fundamentals
3/5	Good fundamentals
2/5	Moderate fundamentals
1/5	Poor fundamentals

Valuation Grade

CRISIL's Valuation Grade represents an assessment of the potential value in the company stock for an equity investor over a 12 month period. The 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 Valuation Grade	Assessment
5/5	Strong upside (>25% from CMP)
4/5	Upside (10-25% from CMP)
3/5	Align (+-10% from CMP)
2/5	Downside (negative 10-25% from CMP)
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.

Disclaimer:

Independent Research Report – MSP Steel & Power Limited

Strengthening backend, but stress on the balance sheet

Industry: Metals & Mining | Steel
Date: July 29, 2010

CRISIL RESEARCH

MSP Steel & Power Ltd (MSP) is a medium-sized integrated steel manufacturer (with captive coal and limestone mines; iron ore mine will be operational post FY14) in Eastern India. The company produces sponge iron and long products. We assign MSP a fundamental grade of '2/5', indicating that its fundamentals are 'moderate' relative to other listed equity securities in India. We assign a valuation grade of '3/5', indicating that the current market price is 'aligned' with our fair value of Rs 44 per share.

Domestic steel demand rises, improvement in prices to provide respite

Domestic steel demand is expected to increase by 10-12% for next couple of years to 66 mn tonnes in FY12 after having bottomed in FY09. This also compares favourably with a likely 7-9% increase in global demand in CY10 and CY11. The increase in demand from the automobiles, infrastructure and construction sectors, which account for ~85% of the total domestic demand, has triggered the speedy recovery. The revival has increased the demand for steel and pushed up its prices.

MSP's large capacity expansion to fuel revenue growth

MSP is on a large expansion spree and plans to spend Rs 8.14 bn over FY10-12 to strengthen its backward integration by increasing production capacity for sponge iron, pellets and power. The capex will be funded through a mix of internal accruals and preference shares issued to promoters, and debt in the ratio of 1:2. The company has spent Rs 2.8 bn as of March 2010.

Presence across value chain, focus on merchant power to support margins

MSP's presence across the value chain of steel production helps it withstand pricing pressures effectively and benefit from the lower cost of production compared to non-integrated producers. MSP also plans to merchant additional units (installed capacity of 24MW against 19-20MW required) of power which will lend support to its margins.

Surmounting debt to worsen financial flexibility

We expect MSP's gross debt-equity ratio to worsen to 3.0x by March 2011 from 2.4x as of March 2010. During the same period, the interest coverage ratio will worsen to 2.3x from 2.8x. The deterioration will be because of huge borrowings to fund the ongoing expansion.

Margins remain vulnerable to fluctuation in iron ore prices in medium term

MSP remains exposed to fluctuations in iron ore prices as it procures iron ore (both fine and lumps) from the open market. Although MSP has acquired the rights to mine iron ore in Chhattisgarh, benefits from this are expected only after FY14.

Aligned valuations

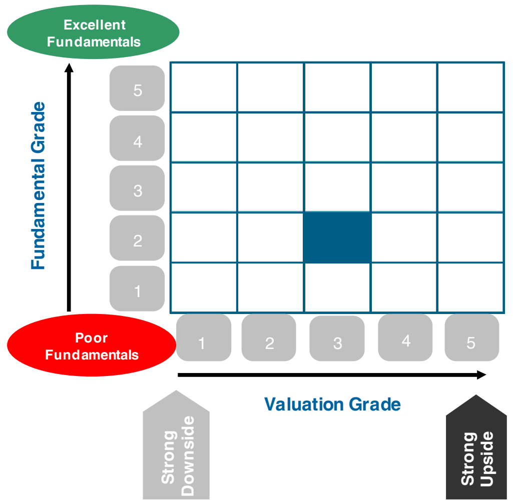
We have used the discounted cash flow (DCF) method to value MSP. Consequently, we initiate coverage on MSP with a valuation grade of **'3/5'**. This grade indicates that the current market price is **'aligned'** with our fair value of Rs 44.

Key forecast

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E	FY13E
Operating income	3,628	4,039	3,959	8,459	11,830	16,128
EBITDA	691	643	701	1,501	2,178	3,015
Adj Net income	343	268	314	484	857	952
EPS-Rs	5.9	4.6	5.4	8.3	14.7	16.3
EPS growth (%)	131.2	(18.6)	(15.6)	51.2	76.9	11.1
PE (x)	7.3	9.4	8.0	5.2	2.9	2.6
P/BV (x)	1.9	1.5	1.2	1.0	0.7	0.6
RoCE (%)	23.2	14.5	10.2	14.7	15.8	17.6
RoE (%)	32.4	18.0	16.9	21.5	29.3	24.9
EV/EBITDA (x)	6.0	7.6	8.7	6.4	5.7	4.0

Source: Company, CRISIL Equities' estimate

CFV matrix



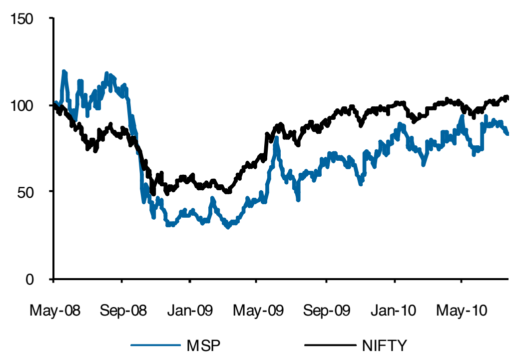
- Fundamental grade of '2/5' indicates moderate fundamentals
- Valuation grade of '3/5' indicates CMP is aligned to our fair value

Key stock statistics

BSE/NSE Ticker	MSPSTEEL/MSPL
Fair value (FV Rs 10)	44
Current market price	40
Shares outstanding (Mn)	58.10
Market cap (Rs Mn)	2,324
Enterprise value (Rs Mn)	9,603
52-week range (Rs) (H / L)	46.35/21.25
P/E on EPS estimate (FY11E)(x)	4.8
Beta	1.8
Free float (%)	28
Average daily volumes (3 months)	105,483

** as on report date*

Share price movement



** Indexed to 100*

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Business Environment

Parameter	Sponge iron	Billets	TMT/structural	Power
Revenue contribution (FY09)	13.7%	41.3%	44.8%	0.2%
Revenue contribution (FY13)	34.2%	14.7%	18.9%	8.3%
Geographic presence (revenue share)	Domestic 90% Exports 10%	Domestic 90% Exports 10%	Domestic 90% Exports 10%	Domestic 100%
Market position	Highly fragmented industry with a large number of unorganised players	Highly fragmented industry with a large number of unorganised players	Highly fragmented industry with a large number of unorganised players	Insignificant
Industry growth expectations	4-5%	8-9%	8-9%	12%
End market	Billets/ ingots manufacturers	Rolling mill	Infrastructure and construction sectors	State electricity boards (SEBs) and other industrial customers
Sales growth (FY07-FY09 – 2-yr CAGR)	-17.9%	101.5%	66.1%	-68.5%
Sales forecast (FY10-FY13 – 3-yr CAGR)	46.4%	16.2%	11.2%	86.6%
Demand drivers	Domestic and export consumption in steel production	Domestic consumption in steel structural production	Domestic and export demand for construction and infrastructure	Domestic demand for power
Key competitors	Adhunik Metaliks, Bihar Sponge Iron, Jai Balaji Sponge Ltd, Monnet Ispat, Jindal Steel & Power, TATA Sponge Iron Ltd	TATA Steel, SAIL, RINL, JSW, Ispat, Godavari	TATA Steel, SAIL, RINL, JSW, Ispat, Godavari	NTPC, TATA Power, CESC, Sterlite Energy
Margin drivers	Cost of raw material	Cost of raw material	Cost of raw material	Realisation rate per unit
Key risks	1) Availability and prices of iron ore lumps and fine 2) Overcapacity in the Indian sponge iron sector	NA	Depends on demand in the infrastructure and construction sectors	Realisation rate per unit

Source: Company, CRISIL Equities

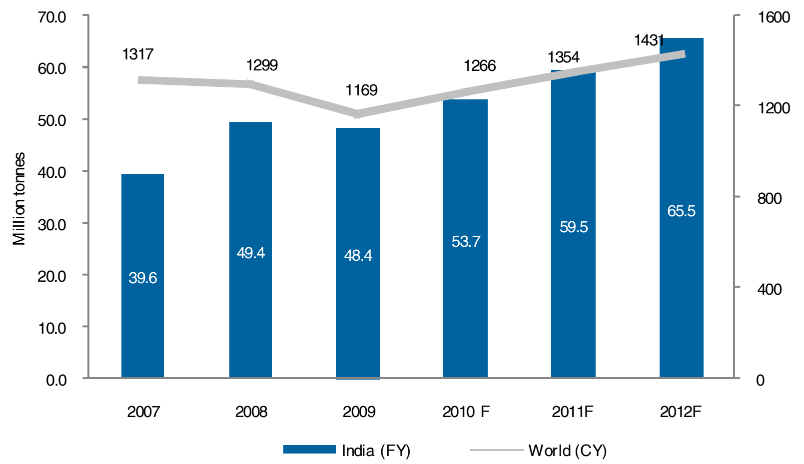
Grading Rationale

Crisil Research expects domestic demand for steel to log a CAGR of 10-12% during FY10-FY12

Domestic steel demand emerging out of the blues

Domestic steel demand is expected to increase by 10-12% for next couple of years to 66 mn tonnes in FY12 after having bottomed in FY09. This compares favourably with an expected 7-9% increase in global demand during the same time. The increase in demand from the automobiles, infrastructure and construction sectors, which account for ~85% of the total domestic demand, has triggered the speedy recovery. Also, the fiscal stimulus and monetary easing initiatives taken by the Indian government have lent support to the ascent.

Chart 1: Strong steel demand expected through FY10-12



Source: CRISIL Equities estimate

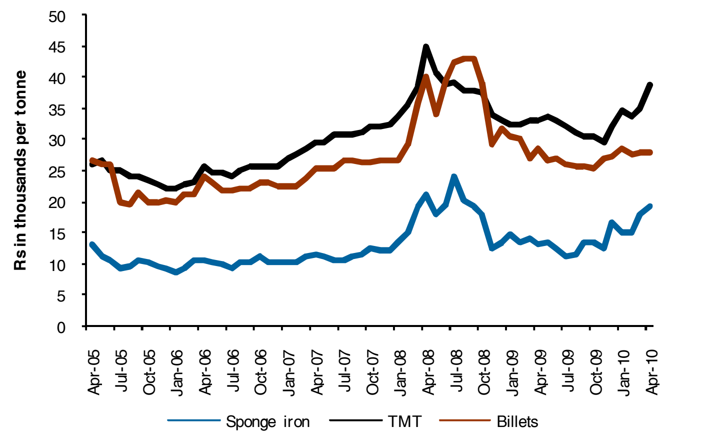
Improvement in steel prices to provide respite to players

We expect realisations to rise in the near term

The revival of the global economy has increased the demand for steel and pushed up steel prices. Crisil Research expects steel prices to increase from $455 per tonne in CY09 to $625-675 per tonne in CY10 and $675-725 per tonne in CY11.

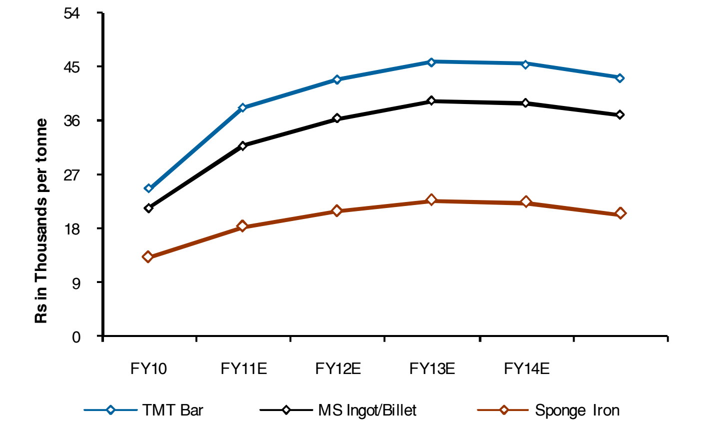
In line with global prices, domestic prices are expected to increase with the landed cost of imports. Domestic TMT prices increased to Rs 39,000 per tonne in April 2010 as against Rs 33,000 in April 2009. Similary, sponge iron and billets prices increased in tandem. Considering the strong domestic demand for steel on the back of robust auto and infrastructure spending, we believe steel players will be able to pass on the increase in raw material cost to consumers.

Chart 2: Historical trend in realisation



Source: Company, CRISIL Equities

Chart 3: Estimated trend in realisation



Source: Company, CRISIL Equities

Large capacity expansion by MSP to fuel its revenue growth

MSP is on a large expansion spree and plans to spend Rs 8.14 bn over FY10-12. The capital expenditure is expected to be through a mix of internal accruals and preference shares issued to promoters, and debt funds in the ratio of 1:2. The company has already spent Rs 2.8 bn as of March 2010, which includes debt to the tune of Rs 1.9 bn. MSP is currently focussing on strengthening its backward integration by increasing the production capacity for sponge iron, pellets and power. MSP is also increasing the coal washing capacity to support increased usage of coal.

Table 1: MSP's expansion plan

Phase	Divisions	Existing installed capacity	Proposed expansion	Capacity post expansion	Capital expenditure (Rs mn)	Company's estimate of completion	CRISIL's estimate of completion
I	Sponge iron (MT)	192,000	115,500	307,500			
	CPP/thermal power plant (MW)	24	18	42	2,333	Mar-11	Q4FY11
	Coal washery (MT)	345,600	383,525	729,125			
II	Sponge iron (MT)	307,500	115,500	423,000	1,800	Mar-11	Q4FY12
	Railway siding (KM)	2.4	2	4.4			
III	CPP/thermal power plant (MW)	42	34	76	1,752	Mar-11	Q4FY12
IV	Pellet (MT)	300,000	600,000	900,000	2,260	Mar-11	Q4FY12
	Total capital expenditure				**8,145**		

Source: CRISIL Equities estimate

Presence across value chain supports EBITDA margins…

MSP, a small integrated player, is present across the value chain of steel production. This helps it withstand pricing pressures effectively and benefit from the lower cost of production compared to non-integrated producers. Small integrated players earned EBITDA margins of 14-16% in FY09 compared to non-integrated players' 8-9%. We expect EBITDA margins of small integrated players to remain in the range of 16% to 18% over the next two-three years.

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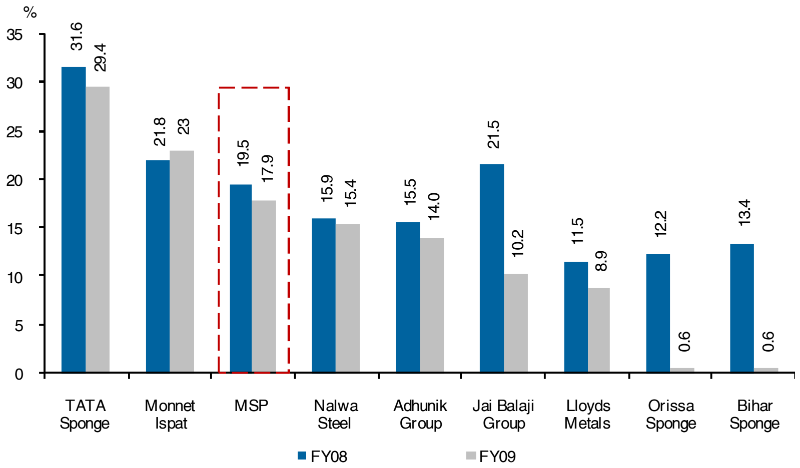
The operating cost of integrated players like MSP is lower by Rs 2,000-3,000 per tonne

Chart 4: MSP has consistently enjoyed better EBITDA margins (FY08-09)



Source: CRISIL Equities

*FY10 numbers not available for all the players

The operating cost of integrated players like MSP is lower by Rs 2,000-3,000 per tonne compared to that of non-integrated players, mainly due to captive production of raw material like sponge iron and power. A large integrated player, present across the value chain (with or without mines), enjoys an even lower cost of production.

Table 2 : Characteristics of steel players

Parameters	Primary players		Secondary players		
	With mine	Without mine	Integrated	Non-integrated	Re-rollers
Key players	Tata, SAIL	JSW, Ispat	MSP, Jai Balaji, Godawari	Marmagoa, Modern, Garg	Rathi bars, Kamdhenu
Product category	Full value chain, Flat dominated	Full value chain, Flat dominated	Mainly longs	Mainly TMT	Mainly TMT
Steel making process	Blast Furnace/ Basic Oxygen Furnace (BF/BOF)	Mainly BF/BOF	Electric Arc Furnace (EAF), Induction Furnace (IF)	Induction Furnace (IF)	N/A
Raw materials	Iron ore + coal	Iron ore + coal	Iron ore + coal	Sponge iron, scrap	Billet, ingot, scrap
Raw material sourcing					
Iron ore	Fully captive	Partially captive	Few partially captive	Sponge iron sourced locally	Semis sourced locally
Coking coal	Only Tata 60% captive	Import	Imported / locally sourced coke	Scrap is local or imported	Re-rollable scrap is local or imported
Product quality	High	High	Close to Primary	Varying quality	Varying quality
Typical realisation			Rs 34,000-35,000 per tonne	Rs 29,000-31,000 per tonne	
Typical op. margins	28-29%	20-21%	14-15%	8-9%	4-5%
Key markets	Large projects, infrastructure, auto			Regional market	
Branding	Established	Established	Few partially	Not a focus area	Minimal

Source: Company, CRISIL Equities

… so does focus on merchant power

We expect MSP to earn revenues of Rs 1,242 mn by FY13 from merchant power.

MSP has an installed power generation capacity of 24 MW as against the requirement of 19-20 MW for its captive purposes. With the ongoing capacity expansion, the installed capacity is expected to be 76 MW by FY12, of which 31-33 MW will be required to support the expanded manufacturing capacity. MSP plans to merchant the additional power units to support its EBITDA margins. We expect MSP to earn revenues of Rs 1,242 mn by FY13.

Through FY07-09, MSP has been incrementally selling power on a merchant basis to SEBs. In FY09, MSP generated revenues worth Rs 7 mn from the sale of 5 mn units (KWH) of power vs. 4.5 mn units sold in FY08.

Table 3: MSP's power expansion plan

Power (in MW)`	Existing	Additions		
	FY10	FY11	FY12	Total
Coal	8	10	24	42
Waste heat recovery	16	8	8	32
Total	24	18	32	74
Captive consumption	**20-21**	**3-4**	**7-8**	**30-33**
Merchant power	**3-4**	**14-15**	**24-25**	**43-45**

Source: CRISIL Equities estimate

As indicated in the previous table, around 43% of power is generated from waste heat recovery resulting in lower cost of generation. In FY09, MSP generated power at the rate of Rs 1.1 per unit and sold at Rs 1.40 on an average. The balance one-third power is generated using coal sourced from its coal linkages.

Table 4: MSP's power contribution to revenue

Rs mn	FY09	FY10F	FY11E	FY12E	FY13E
Power revenue	7	55	162	462	1,242
As % of total revenue	**0.2%**	**1.3%**	**2.8%**	**5.4%**	**10.1%**

Source: CRISIL Equities estimate

Proximity to key raw material is an advantage

MSP's geographical proximity to abundant, high quality coal reserves is an advantage. The steel unit at Raigarh, Chhattisgarh is strategically located at an economical distance from iron ore and other key raw material reserves. MSP's railway sliding of 2.4 km helps to lower the transportation costs. Also, MSP has been allotted a coal mine and an iron ore block in Chhattisgarh.

Table 5: MSP's captive allocation

Nature of mines	Location	Mining area	Reserves	MSP's share	Company estimate of completion	CRISIL's estimate of completion
Coal block	Chhattisgarh	714 hectares	175 mn tonnes	26 mn tonnes	Oct-10	Mar-11
Iron ore block	Chhattisgarh	150 hectares	35 mn tonnes	35 mn tonnes	Mar-14	Mar-14

Source: Company, CRISIL Equities estimate

Coal linkage helps control production costs

MSP has long-term contracts of coal linkages with Coal India Ltd (CIL). The linkages provide assured coal supply at a pre-determined price.

Table 6: Cost saving due to coal linkages

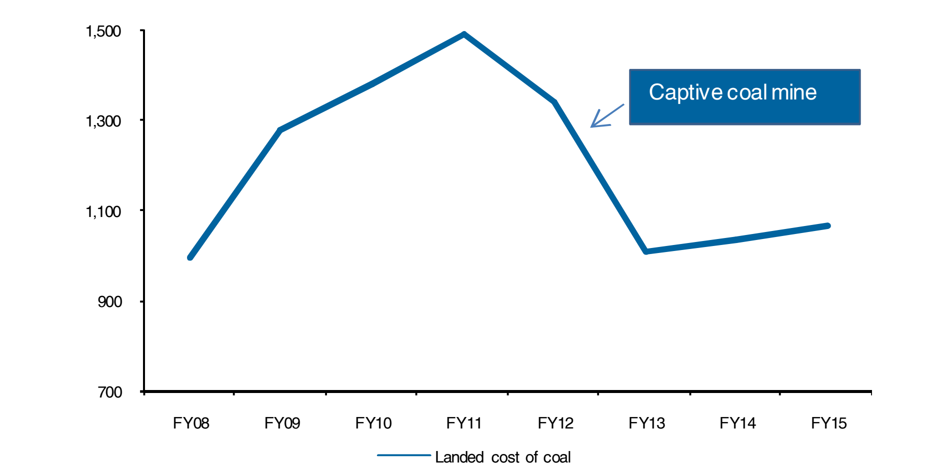
Particulars (Rs)	FY08	FY09
Average spot price during the year (Grade F)*	1,510	1,510
Average cost of coal to MSP*	993	1,275
Saving per tonne	517	235
Total coal consumed (MT)	490,970	514,119
Effective saving of MSP as a % of raw material	8-9%	3-4%
Effective saving of MSP as a % of revenues	6-7%	2-3%

*Including transportation cost.

Source: CRISIL Equities estimate

Further, MSP has been allocated coal mines in Chhattisgarh. Once fully operational in FY13, we believe it will significantly reduce costs.

Chart 5: MSP's landed cost of coal realisation trend (Rs per tonne)



Source: Company, CRISIL Equities estimate

Forward integration has to follow

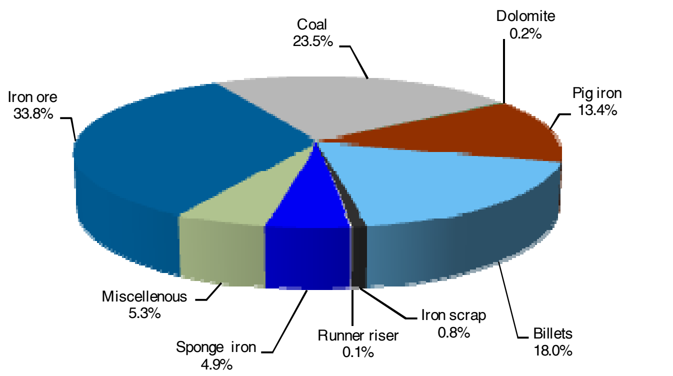
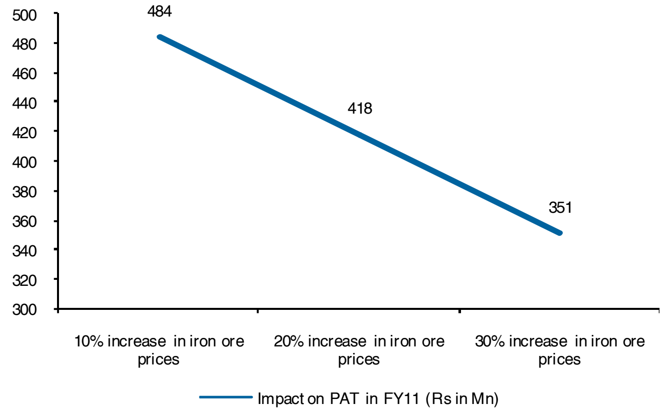
As indicated by the management, MSP is currently concentrating on strengthening its backward integration, i.e. sponge iron and captive power plant. Going forward, the company will increase its manufacturing capacity of billets and TMT bars to reap the benefit of across-the-value-chain presence.

If iron ore prices increase by 20% or 30% in FY11, PAT is expected to decline by 14% or 28%, respectively.

Margins remain vulnerable to fluctuation in iron ore prices

MSP remains exposed to fluctuations in iron ore prices as it procures iron ore (both lumps and fine) from the open market at the spot rate. If iron ore prices increase by 20% or 30% in FY11, PAT is expected to decline by 14% or 28%, respectively.

In order to achieve full integration, MSP has acquired the rights to mine iron ore in Kanker district of Chhattisgarh with its share of reserve of 35 mn tonnes. The state government has granted the prospecting licence but the benefits from the captive iron mines are expected to flow to the company only after FY14. Hence, MSP remains exposed to fluctuations in iron ore prices in the medium term.

Chart 6: Raw material composition (FY09)	Chart 7: Sensitivity to iron ore price movement
	
Source: Company, CRISIL Equities	**Source: Company, CRISIL Equities**

Pelletisation lowers cost of production

In FY10, MSP saved Rs 2,200 per tonne in raw material costs with the commissioning of the 300,000 tonne per annum (tpa) pelletisation plant in March 2009. We expect similar savings in raw material costs to accrue over the next three-four years.

The pelletisation process converts iron ore fines into the shape of a pellet with characteristics appropriate for use in a blast furnace for the production of sponge iron. In FY10, pellets contributed ~60% of the iron ore requirement for the production of sponge iron while iron ore lumps contributed the balance. Going forward, we expect a similar ratio of pellets and lumps.

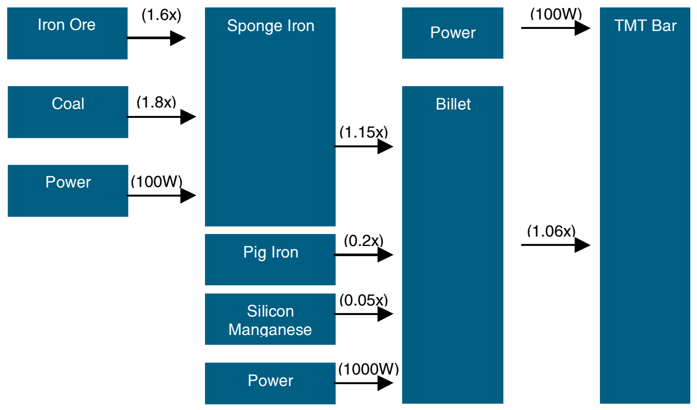
Table 7: Cost saving with pellet plant (FY10)

Rs per tone	Fine	Iron ore lumps	Total saving
Landed cost	2,000	5,800	
Processing cost	1,600	0	
Total	3,600	5,800	2,200

Source: CRISIL Equities estimate

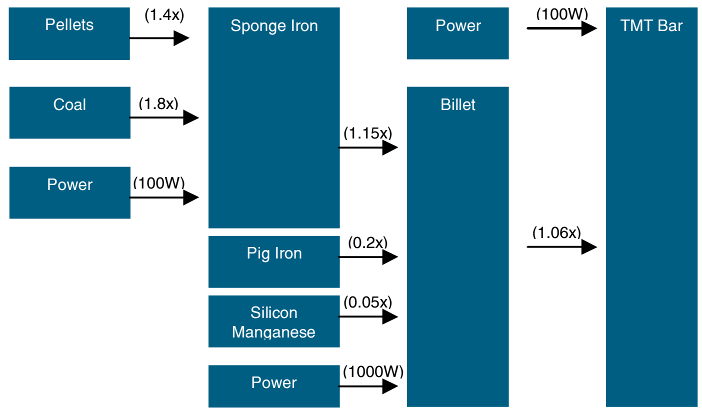
In tandem with the expansion in sponge iron capacities, MSP is increasing its pellet plant capacity to 900,000 tpa from 300,000 tpa. The incremental capacity is expected to be operational by FY13.

Chart 8: Production process with iron ore lumps



Source: Company, CRISIL Equities

Chart 9: Production process with pellets



Source: Company, CRISIL Equities

Surmounting debt to worsen financial flexibility

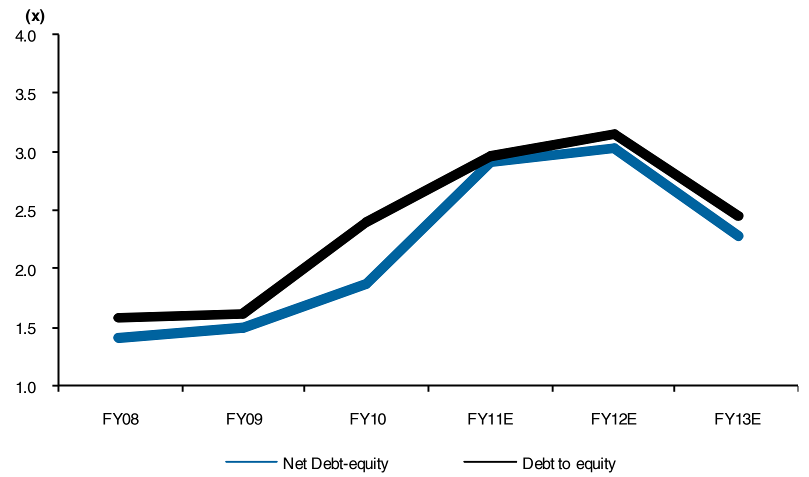
We expect MSP's gross debt-equity ratio to worsen to 3.0x by March 2011 from 2.4x as on March 2010. During the same period, the interest coverage ratio will worsen to 2.3x from 2.8x.

High gearing ratio to curb financial flexibility

The deterioration is because of huge borrowings raised to fund its ongoing Rs 8.1 bn expansion plan. The expansion is being funded through a mix of internal accruals, preference shares issued to promoter and debt in the ratio of 1:2. Promoters' contribution of Rs 1.2 bn, via non-cumulative 6% preference shares redeemable after 10 years, has been considered as a part of debt. The company has already spent Rs 2.8 bn as of March 2010, of which the term loan was Rs 1.87 bn. We expect the company to raise further debt to the tune of Rs 3.56 bn through FY11-13.

We remain concerned about MSP's current financial flexibility. Any further expansion drive (to strengthen its forward integration) will adversely hurt the company's debt-servicing capacity.

Chart 10: Debt-to-equity ratio to worsen in short term



Source: Company, CRISIL Equities estimate

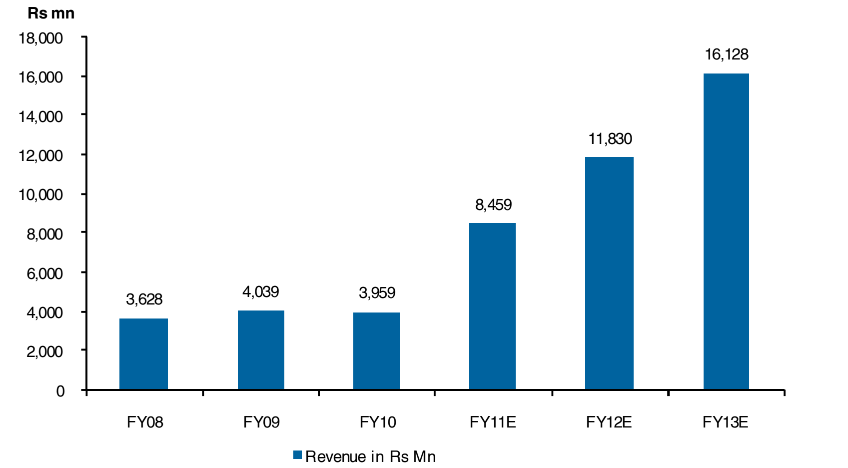
Financial outlook

Strong revenue growth on the back of high volumes, realisations

Revenues are expected to grow at a four-year CAGR of 42% to Rs 16.1 bn by FY13

We expect MSP's gross revenues to grow at a four-year CAGR of 42% to Rs 16.1 bn by FY13. The overall revenue growth will be supported by capacity expansion and higher realisations in the medium term.

Chart 11: Trend in revenues and top-line growth



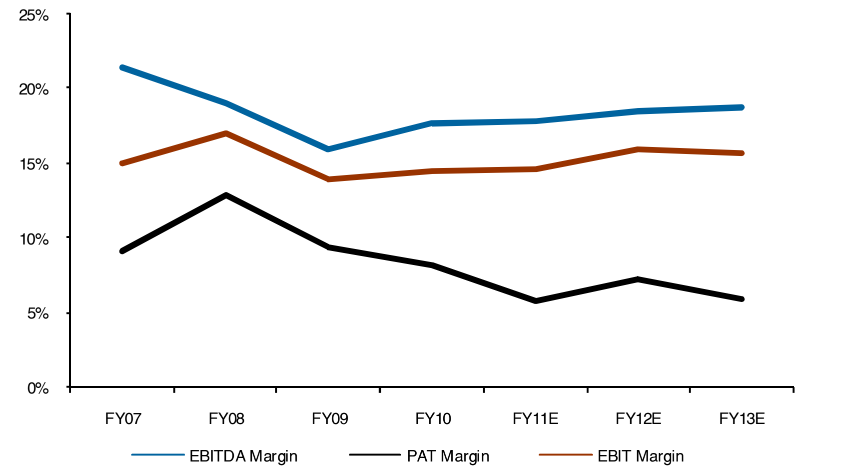
Source: Company, CRISIL Equities estimate

EBITDA margins to stabilise around 18%

We expect EBITDA margins to stabilise around 18%

We expect MSP's EBITDA margins to be 18% in FY11 and remain stable at 17-18% going forward. MSP's EBITDA margins will be supported by cost curtailment with the implementation of captive coal mine, beneficiation plant, pelletisation plant and captive power plant. Nevertheless, we expect PAT margin to remain subdued in the range of 6% to 7% through FY11-13, mainly due to higher interest and depreciation component.

Chart 12: EBITDA, EBIT and PAT margins



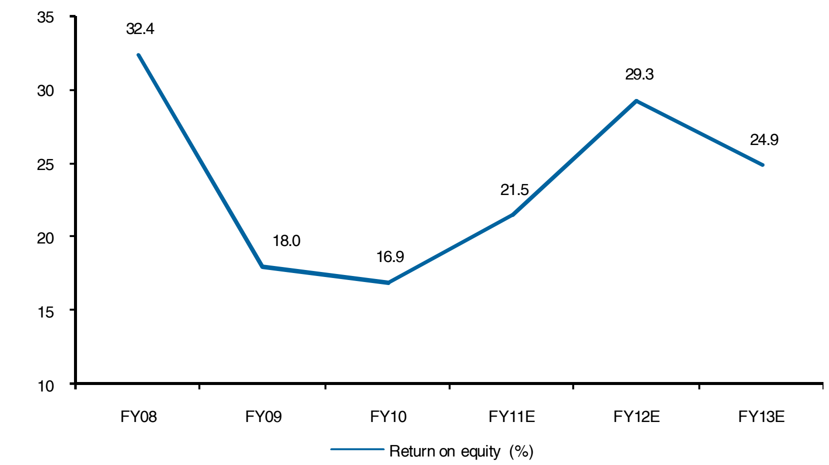
Source: Company, CRISIL Equities estimate

RoE to significantly improve post expansion

MSP earned a return on equity (RoE) of 18.0% in FY09, which fell to 16.9% in FY10 primarily because of weaker realisations and lesser volumes in the first three quarters of FY10. Improved realisations, captive coal mines and the commissioning of the pelletisation plant is expected to significantly improve RoE to 21.5% in FY11. Over the long term, we expect MSP to maintain RoE in the range of 14% to 20%.

MSP's RoE to improve post expansion

Chart 13: Movement in RoE



Source: Company, CRISIL Equities estimate

Key Risks

Financial flexibility to worsen with surmounting debt

MSP's debt-servicing capacity is expected to be adversely affected as its capital expansion is largely funded through debt. MSP's gearing is likely to worsen to 3.0x as of March 2011 from 2.4x as of March 2010. Interest coverage ratio is expected to worsen to 2.3x in March 2011 from 2.8x in March 2009.

MSP remains exposed to fluctuations in iron ore prices

MSP remains exposed to fluctuations in input costs. It sources iron ore (both lumps and fine) from the open market at spot rates. MSP has acquired captive iron mines in Kanker district of Chhattisgarh, but the benefits are expected only after FY14.

Margins dependent on sponge iron realisations

MSP is expanding its sponge iron capacity from 192,000 MT to 423,000 MT by FY12. This will expose MSP to volatility in sponge iron realisations as the present level of forward integration (production of TMT and billets) cannot absorb the entire production of sponge iron.

Corporate governance needs to be strengthened

MSP needs to strengthen its corporate governance practices and employ higher degree of transparency. CRISIL Equities assesses from its interactions with the company and independent directors that the corporate governance practices meet the stipulated requirement.

No non-compete agreement amongst its group companies

The MSP Group has several companies which are in similar lines of operations as that of MSP Steel. As indicated by the management, there is no non-compete agreement which exposes the company to potential conflict of interest.

Valuation Grading Grade: 3/5

The current market price is aligned with our fair value per share

We have used the discounted cash flow (DCF) method to value MSP. We initiate coverage on MSP with a valuation grade of **'3/5'**. This grade indicates that the current market price is **'aligned'** with our fair value per share of Rs 44.

Assumptions used in our valuation:

- We have used explicit cash flow forecasts for the FY11-15 period.
- Terminal growth rate of 2% beyond the explicit forecast time.
- Terminal debt-to-equity ratio of 1:1.
- We have factored in the cyclicality of the commodity prices in our forecasts.

Table 8: Peers - valuation indicators

	Market cap (Rs mn)	Net profit (Rs mn)			EBITDA (Rs)			EV/EBITDA (x)		
Companies	Current	FY07	FY08	FY09	FY07	FY08	FY09	FY07	FY08	FY09
SAIL	1,043,133	62,637	75,958	62,529	101,650	116,897	93,085	4.10	5.69	3.22
Tata Steel	560,764	41,773	123,500	49,509	77,343	188,724	187,617	4.78	5.58	3.83
JSW Steel	230,968	13,039	16,400	2,749	27,141	34,999	32,107	5.10	8.44	8.30
Monnet Ispat	7,601	1,347	1,662	2,126	1,744	2,521	3,736	8.92	12.35	5.05
Jai Balaji	15,212	271	1,217	18	524	2,843	1,821	4.14	9.89	12.05
Adhunik	14,678	771	820	461	1,203	1,733	2,465	6.46	13.46	7.97
MSP Steel	2,324	202	467	399	349	794	741	5.60	5.49	4.75
Modern steel	434	82	26	-47	235	215	124	3.43	4.93	5.97

	Price/earnings (x)			Price/ book (x)			ROE (%)			Debt to equity		
Companies	FY07	FY08	FY09	FY07	FY08	FY09	FY07	FY08	FY09	FY07	FY08	FY09
SAIL	7.5	10.1	6.4	2.7	3.3	1.4	41.49	37.25	24.24	0.21	0.17	0.31
Tata Steel	6.2	3.9	3.1	1.8	1.8	0.7	33.55	56.89	18.99	1.64	1.53	2.09
JSW Steel	6.1	9.0	17.7	1.5	2.0	0.6	n.a.	24.82	3.25	1.43	1.76	2.72
Monnet Ispat	6.1	11.4	3.5	1.4	2.2	0.6	27.47	20.03	17.90	1.77	1.02	1.06
Jai Balaji	5.7	11.4	201.6	2.4	3.1	0.8	51.40	n.a.	0.41	1.90	1.90	4.11
Adhunik	4.1	15.2	5.6	1.2	3.4	0.7	n.a.	26.06	12.48	1.78	3.05	3.59
MSP Steel	4.4	5.4	2.5	1.1	1.9	0.6	27.60	43.80	26.67	1.39	1.58	1.61
Modern steel	3.1	11.3	3.0	0.6	0.6	0.2	20.77	5.83	-10.98	1.56	1.73	1.65

*Market capitalisation as on July 28, 2010.

Source: CRISIL Equities

Management Evaluation

CRISIL Equities' fundamental grading methodology includes a broad assessment of management quality, apart from other key factors such as industry and business prospects, and financial performance. Overall, we believe the management is highly experienced and has a high risk appetite.

Management with adequate experience and domain expertise

Experienced promoters with domain expertise

The promoters, Mr Puran Mal Agrawal (Chairman) and his brother Mr Suresh Kumar Agrawal (Managing Director), are first-generation entrepreneurs and have more than two decades of experience in the steel sector. They have sound business knowledge in the field of steel manufacturing.

They are ably supported by Mr Saket Agrawal (Mr Suresh Kumar Agrawal's son) and Mr Manish Agrawal (Mr Puran Mal Agrawal's son). They too have been with the company for a long time.

Experienced second line of management

Based on our interactions and assesment, we believe the second line of management has vast and relevant work experience. The second line has experience of 12 to 26 years in their respective fields; they have been with the company for more than five-six years on an average. Based on our interactions, we believe they are equipped with adequate domain expertise.

Promoters have been proactive with regard to integration and expansion

Promoters have proactively focussed on integration (both backward and forward) to strengthen the value chain. They have undertaken pellet plant projects at Raigarh to reap the cost advantage and to hedge price volatility in iron ore prices. Further, the strengthening of backward integration with added sponge iron capacity, captive power plant, pelletisation plant and coal washery are viewed positively. Management has also indicated that the strengthening of forward integration (i.e. billets and TMT) is on their agenda.

Corporate Governance

CRISIL's fundamental grading methodology includes a broad assessment of corporate governance apart from other key factors such as industry and business prospects, and financial performance. Shareholding structure, board composition, typical board processes, disclosure standards and related party transactions are analysed by CRISIL Equities in this context. Any qualifications by regulators or auditors also serve as useful inputs while assessing the corporate governance of a company. CRISIL Equities is of the opinion that corporate governance practices adopted by MSP need to be strengthened.

Board composition

MSP's board comprises nine members, of whom five are independent directors, which is in accordance with the stipulated SEBI listing guidelines. The board includes the chairman, managing director, two non-executive directors and five independent directors. Most of the independent directors have been on the board for four-five years.

Corporate governance practices need to be strengthened

The only change in the board has been the resignation of Mr Akshaya Kumar Singh, an independent director in June 2007. He was replaced by Mr Debabrata Mukherjee, (ex-managing director of Durgapur steel plant) in FY09. However, on June 27, 2009, Mr Debabrata Mukherjee resigned from the board and was replaced by Mr P. K. Gupta. Given the background of directors, we believe the board is fairly diversified.

Board processes

The board processes appear to be adequately structured. CRISIL Equities assesses from its interactions with independent directors that the quality of agenda papers and the level of discussions at the board meetings meet the stipulated requirement. The company has appointed various committees - audit, remuneration, and the shareholders/investors grievance - to support corporate governance. The roles of chairman and MD have been segregated in the company.

Moderate levels of disclosures and transparency

Based on the disclosure levels in the annual reports, quarterly investor presentation and other publicly available information, CRISIL Equities is of the opinion that there is scope for improvement in disclosure and transparency in reporting.

Other governance aspects

We feel that the independent directors are aware of the company's business, but their engagement levels can be further improved. Further, MSP doesn't have an external-internal auditor.

The MSP Group has several companies which are in similar lines of operations as that of MSP Steel. As indicated by the management, there is no non-compete agreement that prevents any company to compete with another group company.

Company Overview

In 1968, Mr Puranmal Agrawal and Mr Suresh Kumar Agrawal jointly promoted Adhunik Rollers Pvt. Ltd. In 1993 it was renamed MSP Steel & Power Limited (MSP). MSP is the leading operating entity of the MSP Group. It accounted for 35% of the group's revenues of Rs 12 bn in FY10.

About MSP Group

The group has nine operational companies, which are into the production of steel intermediaries, steel products, ferro alloys, power, industrial and medical oxygen, and cement. There are no evident overlaps in the business concentration due to geographical distance and different customer market. Further, all group companies are driven by the same promoter group and there exists mutual understanding. However, they lack any formal agreement in that regard. None of the companies have any holding-subsidiary relationship amongst them and have insignificant cross holdings.

Table 9: MSP Group operating companies

Companies	Production facilities	Installed capacity	Location
MSP Steel & Power Ltd	Sponge iron, billets, TMT, power	-	Raigarh
MSP Metallics Ltd	Sponge Iron	*256,000*	Jharsuguda
	SMS	*263,000*	
	Pig Iron	*294,000*	
	Pellets	*600,000*	
	LAM Coke	*250,000*	
	Sinter Plant	*416,000*	
	Captive Power Plant	*27MW*	
	Railway Siding	*5Km*	
Chaman Metallics Private Ltd	Sponge iron	*94,000*	Chandrapur
Howrah Gases Ltd	Sponge Iron	*60,000*	Burdwan
	SMS	*50,000*	
MSP Sponge Iron Ltd	Sponge Iron	*78,000*	Keonjhar and Raigarh
	SMS	*50,000*	
	Re-rolling Mill	*48,000*	
	Ferro Alloys	*26,657*	
	Captive Power Plant	*12MW*	
MSP Rolling Mills Private Ltd	TMT	*48,000*	Howrah

Source: Company, CRISIL Equities

MSP Steel & Power Ltd

MSP is a small integrated steel manufacturer in Eastern India. The company produces sponge iron and long products. In the longs segment, it offers a wide range of products like billets, TMT, structural, angles, channel, plate and beam. It also has a captive power generation plant to support its captive requirements. Its manufacturing facilities are located at Jamgaon, Raigarh in Chhattisgarh.

Table 10: MSP's installed capacity and actual utilisation

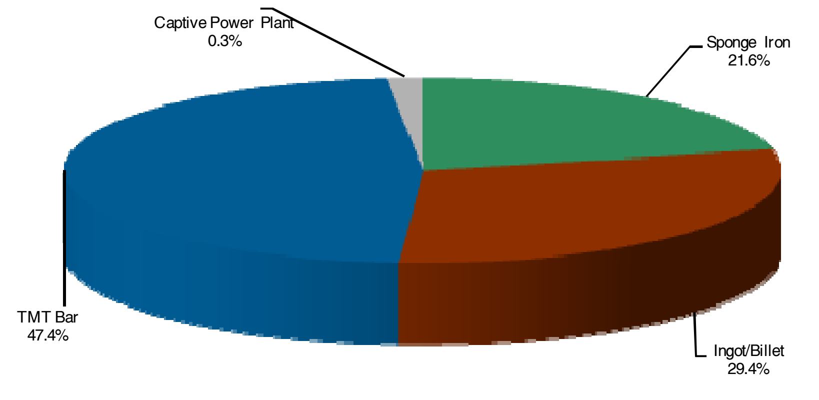
Divisions	Existing installed capacity	Production (Mar 09)	Capacity utilisation	Production (Mar 10)	Capacity utilisation
Sponge iron (MT)	192,000	124,896	65%	152,779	80%
Mild Steel billets (MT)	144,109	95,087	66%	98,886	69%
Construction bars (TMT)	80,000	56,506	71%	68,104	85%
CPP/thermal power plant (KWH)	190,080,000	137,088,268	72%	142,560,000	75%

Source: Company, CRISIL Equities

Focus on higher realisation products in the value chain

A significant part of MSP's revenues (~47%) was generated from TMT bars in FY10. Billets and sponge iron contributed 29% and 22%, respectively, in that year.

Chart 14: FY10 revenue break-up

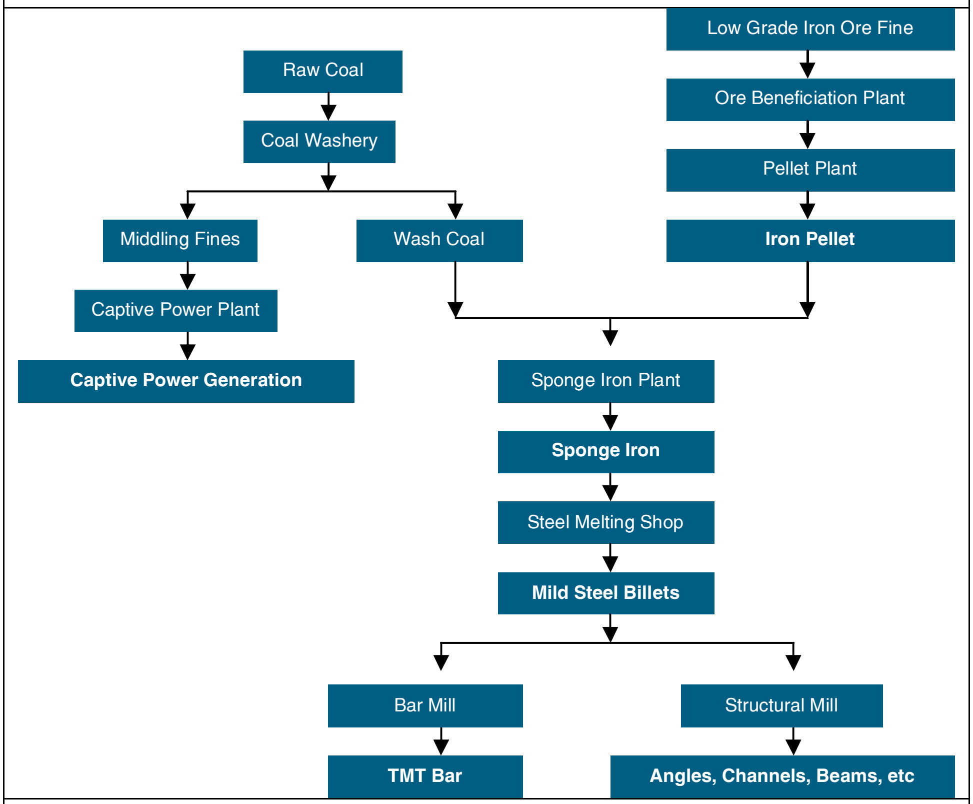


Source: CRISIL Equities

MSP's production flow chart

The following chart shows MSP's long value chain. MSP is present in right from pelletisation and coal washery to TMT bar and structural production.

Chart 15: Production flow chart



Source: Company, CRISIL Equities

Annexure: Financials

Income Statement

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E	FY13E
Net sales	3,607	3,917	3,757	8,376	11,713	15,968
Operating Income	**3,628**	**4,039**	**3,959**	**8,459**	**11,830**	**16,128**
EBITDA	**691**	**643**	**701**	**1,501**	**2,178**	**3,015**
Depreciation	73	79	127	266	292	479
Interest	141	215	205	526	627	1,142
Other Income	4	7	7	14	20	27
PBT	**480**	**355**	**375**	**723**	**1,279**	**1,421**
PAT	**343**	**268**	**314**	**484**	**857**	**952**
No. of shares	58	58	58	58	58	58
Earnings per share (EPS)	**5.9**	**4.6**	**5.4**	**8.3**	**14.7**	**16.3**

Balance Sheet

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E	FY13E
Equity capital (FV - Rs 10)	581	581	581	581	581	581
Reserves and surplus	712	1,111	1,432	1,916	2,773	3,725
Debt	2,053	2,727	4,833	7,413	10,569	10,569
Current Liabilities and Provisions	628	220	649	503	698	948
Deferred Tax Liability/(Asset)	93	158	199	158	158	158
Minority Interest	-	-	-	-	-	-
Capital Employed	**4,067**	**4,798**	**7,693**	**10,571**	**14,779**	**15,981**
Net Fixed Assets	1,347	2,273	2,559	4,696	4,913	8,176
Capital WIP	693	1,052	2,454	2,819	5,659	2,107
Intangible assets	-	-	-	-	-	-
Investments	61	67	450	450	450	450
Loans and advances	612	400	393	796	1,055	1,357
Inventory	463	393	380	801	1,104	1,483
Receivables	675	418	410	876	1,224	1,669
Cash & Bank Balance	215	194	1,048	134	375	740
Applications of Funds	**4,067**	**4,798**	**7,693**	**10,571**	**14,779**	**15,981**

Source: Company, CRISIL Estimates

Cash Flow

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E	FY13E
Pre-tax profit	480	355	375	723	1,279	1,421
Total tax paid	(73)	(21)	(21)	(279)	(422)	(469)
Depreciation	73	79	127	266	292	479
Change in working capital	(528)	131	458	(1,436)	(715)	(876)
Cash flow from operating activities	**(48)**	**544**	**939**	**(726)**	**434**	**555**
Capital expenditure	(831)	(1,364)	(1,815)	(2,768)	(3,349)	(190)
Investments and others	(7)	(6)	(382)	-	-	-
Cash flow from investing activities	**(838)**	**(1,370)**	**(2,198)**	**(2,768)**	**(3,349)**	**(190)**
Equity raised/(repaid)	-	(5)	-	-	-	-
Debt raised/(repaid)	898	674	2,106	2,580	3,156	-
Dividend (incl. tax)	-	-	-	-	-	-
Others (incl extraordinaries)	126	136	7	0	-	0
Cash flow from financing activities	**1,024**	**804**	**2,113**	**2,580**	**3,156**	**0**
Change in cash position	**139**	**(21)**	**854**	**(914)**	**240**	**365**
Opening Cash	76	215	194	1,048	134	375
Closing Cash	215	194	1,048	134	375	740

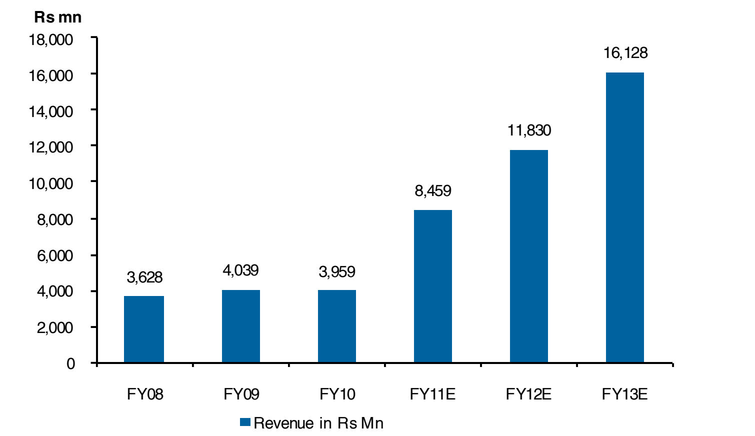
Ratios

	FY08	FY09	FY10	FY11E	FY12E	FY13E
Growth ratios						
Sales growth (%)	62.3	11.3	(2.0)	113.7	39.8	36.3
EBITDA growth (%)	44.5	(7.0)	9.0	114.3	45.1	38.5
EPS growth (%)	131.2	(18.6)	(15.6)	51.2	76.9	11.1
Profitability Ratios						
EBITDA Margin (%)	19.0	15.9	17.7	17.7	18.4	18.7
PAT Margin (%)	9.4	6.6	7.9	5.7	7.2	5.9
Return on Capital Employed (RoCE) (%)	23.2	14.5	10.2	14.7	15.8	17.6
Return on equity (RoE) (%)	32.4	18.0	16.9	21.5	29.3	24.9
Dividend and Earnings						
Dividend per share (Rs)	0.0	0.0	0.0	0.0	0.0	0.0
Dividend payout ratio (%)	0.0	0.0	0.0	0.0	0.0	0.0
Dividend yield (%)	-	-	-	-	-	-
Earnings Per Share (Rs)	5.9	4.6	5.4	8.3	14.7	16.3
Efficiency ratios						
Asset Turnover (Sales/GFA)	2.6x	2.0x	1.5x	2.1x	2.1x	2.1x
Asset Turnover (Sales/NFA)	3.0x	2.2x	1.6x	2.3x	2.5x	2.5x
Sales/Working Capital	4.2x	3.8x	5.2x	6.8x	5.1x	5.2x
Financial stability						
Debt to equity	1.6	1.6	2.4	3.0	3.2	2.5
Net Debt-equity	1.4	1.5	1.9	2.9	3.0	2.3
Interest Coverage	4.4	2.6	2.8	2.3	3.0	2.2
Current Ratio	3.1	6.4	3.4	5.2	5.4	5.5
Valuation Multiples						
Price-earnings	7.4x	3.7x	7.2x	4.8x	2.7x	2.4x
Price-book	1.9x	0.6x	1.1x	0.9x	0.7x	0.5x
EV/EBITDA	6.3x	5.5x	8.6x	6.4x	5.8x	4.0x

Source: Company, CRISIL Equities estimates

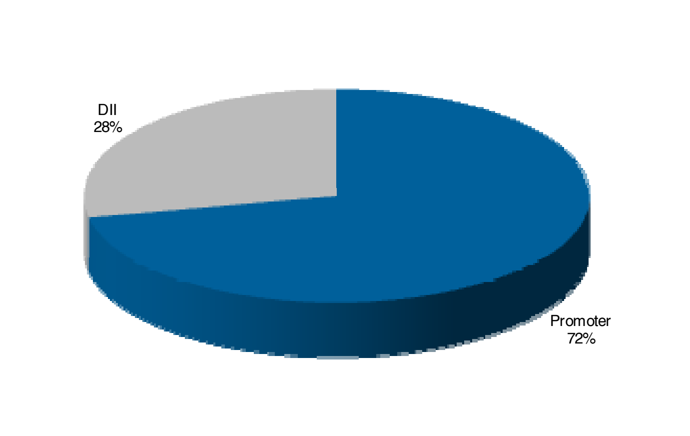
Focus Charts

Revenue growth trend



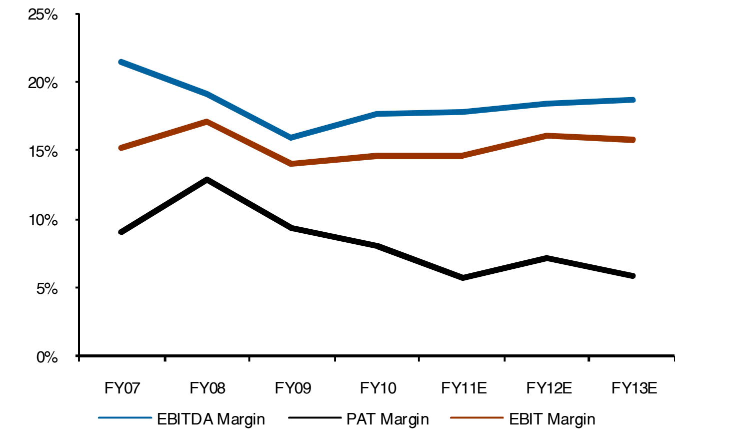
Source: CRISIL Equities estimate

Shareholding as of March 2010



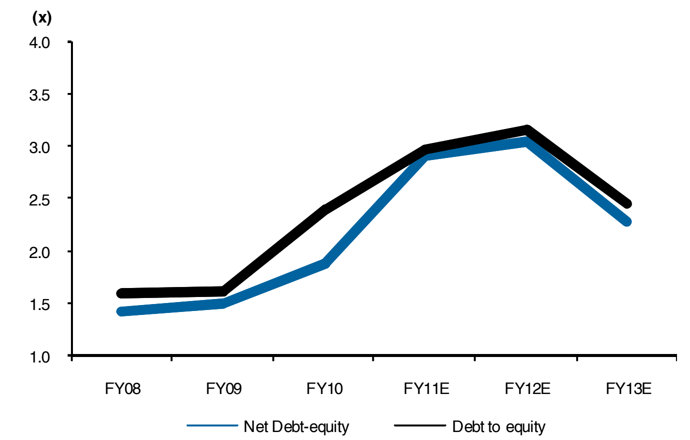
Source: Company

EBITDA and PAT margins



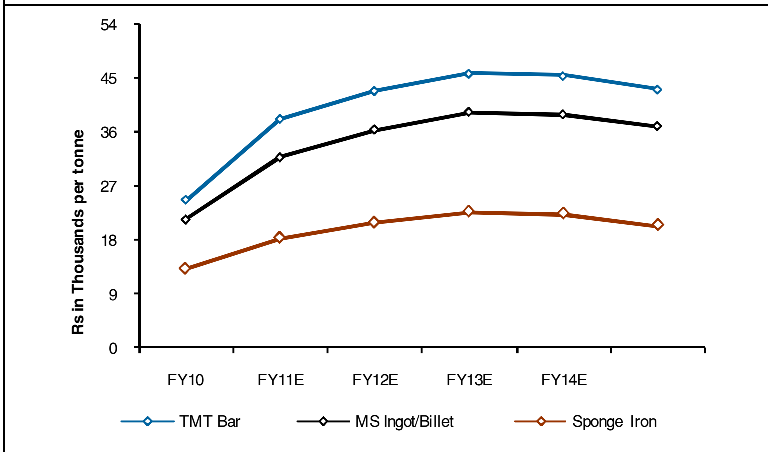
Source: Company data, CRISIL Equities estimate

Debt to equity



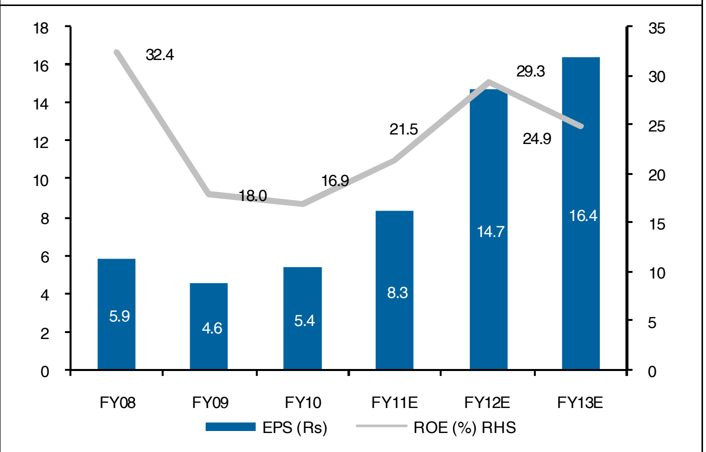
Source: Company data, CRISIL Equities estimate

Price realisations



Source: Company data, CRISIL Equities estimate

EPS and RoE



Source: Company data, CRISIL Equities estimate

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