Company Overview

MSP Steel and Power Ltd (MSP) is one of the fastest growing Steel manufacturing companies in India. It has a diversified portfolio, ranging from pellet to sponge iron to billet to power generation to rolling mills to structure mill etc. The company is Fully Integrated across the value chain and has manufacturing facilities in Raigarh, Chhattisgarh.

Product Profile

Below table shows the products manufactured and marketed by MSP. :

Products	
Pellets	Construction (TMT)
Sponge Iron	Structurals
Billet / Bloom	Power

Source : Company, A C Choksi Research

Investment Rationale

Growth from expansions and Backward Integration – Cost Benefits

MSP is focusing on backward integration and intends to become a well-integrated player. The company had lined up an aggressive capital expenditure for increasing capacities of sponge iron, pellets and power. From the current expansion, the company is substantially integrating backward and it is also believed that company will have attractive savings from this.

The total project cost for the entire expansion is around Rs 815 crore and of this, company has achieved a financial closure of Rs. 545 crore from banks and financial institutions. For the balance funding, the company is looking at raising funds through QIP and promoters themselves are also partly infusing the funds in the company. The company is expecting to close the QIP this month. Further for capex, Rs.450 crore have been already invested into the company and all the expansion plans are scheduled to be operational phase wise before October 2011. A part of the project - 18 MW power plant and 1 lakh tonne of DRI had commenced operations in the March 2011 quarter.

Capital Expenditure - Costs & Schedule

CAPITAL EXPANSION PROJECT					
Division	Existing Capacity	Proposed Expansion	Post Expansion	CAPEX (Rs.- crores)	Completion Date
PHASE I					
Sponge Iron (MT)	192,000	115,500	307,500		Commissioned Oct 2010
Coal Washery	345,600	383,525	729,125		April 2011
CPP/Thermal Power Plant (MW)	24	18	42	233.33	Commissioned Oct 2010
PHASE II					
Sponge Iron (MT)	307,500	115,500	423,000		October 2011
Railway Siding (KM)	2.4	2.00	4.40	180.00	March 2012
PHASE III					
CPP/Thermal Power Plant (MW)	42	34	76	175.19	September 2011
PHASE IV					
Pellet (MT)	300,000	600,000	900,000	226.00	October 2011
Total Capex				**814.51**	

Source : Company, A C Choksi Research

The details of company`s expansion plans are as under:

Sponge Iron : Co. is increasing its current sponge iron capacity from 307500 MT to 423000 MT.

Pellets: The company has a pellet plant with a 300000 MT tonnes capacity and is increasing its capacity three-fold to 900000 MT at a cost of Rs. 226 crores. This is expected to significantly reduce the cost of production by over ~ Rs. 2,300 per tonne as pellets can be directly used to produce sponge iron.

Power : MSP is increasing its power generation capacity from 24 MW to 76 MW.

Coal washery : To support the increased usage of coal, MSP is increasing its coal washing capacity from 345600 MTPA to 729125 MTPA.

Railway siding : MSP is also in the process of modernising and extending its railway siding facility by 2 KM from 2.4 KM to 4.4 KM.

Thus from above, we believe that company will have substantial savings from backward integration and upon completion of expansion and backward integration; the company will have much high revenues, its margins will increase and its profits also will increase substantially.

Cost and other advantages

MSP has various cost and other advantages as under:

(1) It has the advantage of geographical proximity to abundant, high quality coal and iron ore reserves.

(2) Further, due to a combination of captive production of raw material, pelletisation, coal benefication and captive power generation, the operating cost of the company is lower by Rs.2000 – Rs.3000 / MT as compared to other non integrated players.

Financials

Income Statement

(Rs Crs)	FY07	FY08	FY09	FY10
Net Sales	**210.52**	**359.90**	**405.42**	**386.76**
Net Sales Growth (%)		*70.96%*	*12.65%*	*-4.60%*
Total Expenditure	181.93	305.35	337.76	329.82
EBITDA	**28.59**	**54.55**	**67.66**	**56.94**
EBITDA Margin (%)	*13.58%*	*15.16%*	*16.69%*	*14.72%*
Depreciation	14.16	7.34	7.41	12.57
Interest	10.82	14.15	19.43	20.40
Other Income	13.39	14.90	9.49	8.29
PBT	**23.23**	**60.46**	**49.17**	**38.22**
Taxes	3.05	13.80	9.28	6.17
Net Profit	**20.18**	**46.66**	**39.89**	**32.05**
Net Profit Growth (%)		*131.22%*	*-14.51%*	*-19.65%*
Net Profit Margin (%)	*9.59%*	*12.96%*	*9.84%*	*8.29%*
Adj. Net Profit	**20.18**	**46.66**	**39.85**	**32.06**
Adj. Net Profit Growth (%)		*131.22%*	*-14.59%*	*-19.55%*

Source: Capitaline, A C Choksi Research

Balance Sheet

(Rs Crs)	FY07	FY08	FY09	FY10
Share Capital (Face Value : Rs.10)	58.10	58.10	58.10	58.10
Shareholder's Funds	83.20	129.86	169.23	223.49
Total Debt	115.51	205.31	272.69	461.07
Current Liabilities and Provisions	15.02	62.05	24.62	69.08
Deffered Tax Liability/Asset	2.81	9.25	15.83	19.86
Total Liabilities	**216.54**	**406.47**	**482.37**	**773.50**
Net Fixed Assets	110.02	134.67	227.28	255.88
Capital WIP	18.26	83.63	105.20	245.42
Intangibles	0.00	0.00	0.00	0.00
Investments	5.41	6.10	6.73	44.95
Loans and Advances	19.94	47.12	42.62	54.20
Inventory	33.75	46.33	39.34	68.34
Cash & Bank balance	7.63	21.52	19.40	37.87
Receivables	20.77	66.56	41.80	66.84
Misc exp. Not w/off	0.76	0.54	0.00	0.00
Total Assets	**216.54**	**406.47**	**482.37**	**773.50**

Source: Capitaline, A C Choksi Research

(3) Its Railway siding reduces the transportation cost by more than Rs. 500 per MT.

Thus, as seen MSP enjoys various advantages.

Cost benefit from Coal and Iron ore mines

MSP has been allotted a coal mine with reserves of 26 mn MT in Chhatisgarh which will significantly reduce its raw material costs upon starting of the operations which are expected by end of 2012. Further, MSP has been also allotted an iron ore mine with reserves of 35 mn MT in Chhatisgarh which is likely to be operational by 2015.

Thus from above we believe that upon the operationalisation of its mines, the MSP `s raw material cost will reduce further.

Contribution from Merchant Power and Fungible model advantage

As seen, MSP is increasing its power generation capacity from 24 MW to 76 MW. In this also the company will have a cost advantage as it will be producing 42% of the total power through the waste heat gas route, which is comparatively much cheaper than the conventional coal route. Further, as only 34 -36 MW of total power output will be required for supporting the expanded manufacturing capacity, the company will get the opportunity for increasing its revenues and profits from merchant power sales of the balance surplus power available.

Also, MSP is expecting that its revenues from power will increase upto 10% from existing 2% of total revenues in FY 2012.

Thus, as seen MSP will have increased revenues and profits from merchant power sales also in the coming periods.

Further, the MSP also has the advantage of a fungible model wherein it can swap billet production by selling merchant power in the open market. As Billet production is a very power intensive, on finding that it is not feasible in producing the billets in cases where the power costs are high and exceed certain limit then in such situations it stops the production of billets and sells power.

Impressive Interim Financial results

The highlights of the results for the period April 2010 – December 2010 are as under:

The Net Sales of the company for Apr – Dec 10 has increased by 19% to Rs. 317.11 crores as compared to net sales of Rs.267.27 crores done in corresponding period of the last year.

Operating Profit (OP) for Apr-Dec 10 has also simultaneously increased by 64 % to Rs.125.18 crores as compared to last year`s corresponding period Operating Profit of Rs.76.21 crores.

The company`s Profit after tax for Apr-Dec 10 has also increased by 144% to Rs.38.66 crores as compared to its last year corresponding period profit after tax of Rs. 15.86 crores.

Overall there has been also good increase in the margins of the company for Apr –Dec 10 as compared to last year corresponding period`s margins. Its PBIDTM % has increased to 25% from last year `s 17 % and its last year`s PATM% of 6 % has increased to 12% this year.

Thus as seen MSP has reported impressive financials for nine months ending December 2010.

Financials

Cash Flow				
(Rs Crs)	**FY07**	**FY08**	**FY09**	**FY10**
Pre-tax Profit	23.23	60.46	49.17	38.23
Depreciation	14.16	7.34	7.41	12.57
Chg in Working Capital	(29.60)	(42.33)	3.78	(19.55)
Total Tax Paid	(1.67)	(3.97)	(8.64)	(5.26)
Other Operating activities	11.05	1.39	19.00	19.98
CF form Operations (I)	**17.17**	**22.89**	**70.72**	**45.97**
Capital Expenditure	(21.59)	(85.08)	(110.40)	(164.13)
Chg in Investments	(4.69)	(0.28)	0.00	(37.55)
Other Investing activities	0.00	0.00	0.00	0.00
CF form Investing (II)	**(26.28)**	**(85.36)**	**(110.40)**	**(201.68)**
Equity Raised/(repaid)	0.00	0.00	0.00	0.00
Debt Raised/(repaid)	10.09	75.94	37.41	173.93
Dividend	0.00	0.00	0.00	0.00
Other financing activities	0.00	0.00	0.00	0.00
CF form Financing (III)	**10.09**	**75.94**	**37.41**	**173.93**
Net Change in cash (I+II+III)	0.98	13.47	(2.27)	18.22
Beginning Cash	6.64	7.62	21.09	18.82
Ending Cash	**7.62**	**21.09**	**18.82**	**37.04**

Source: Capitaline, A C Choksi Research

Ratios				
	FY07	**FY08**	**FY09**	**FY10**
Growth Ratios				
Sales Growth (%)		70.96%	12.65%	-4.60%
EBITDA Growth (%)		90.80%	24.03%	-15.84%
Adjusted EPS Growth (%)		131.22%	-14.59%	-19.55%
Profitability Ratios				
EBITDA Margin (%)	13.58%	15.16%	16.69%	14.72%
PAT Margin (%)	9.59%	12.96%	9.84%	8.29%
RONW (%)	24.25%	35.93%	23.57%	14.34%
ROCE (%)	19.61%	28.32%	20.74%	11.29%
Per Share Ratios				
Adjusted Earnings Per Share (Rs.)	3.47	8.03	6.86	5.52
Cash Per Share	5.91	9.29	8.14	7.68
Book Value Per Share	14.32	22.35	29.13	38.47
Valuation Multiples				
P/E (x)	15.43	6.67	7.81	9.71
P/BV (x)	3.74	2.40	1.84	1.39
EV/EBITDA	14.67	9.08	8.35	12.90

Source: Capitaline, A C Choksi Research

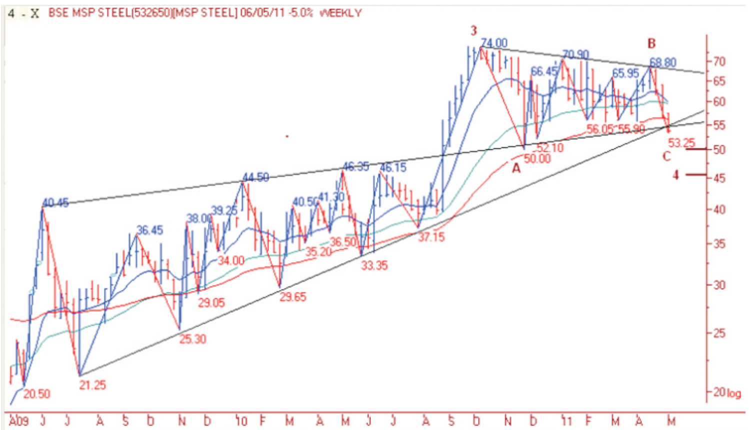
Concern

(i)In case there is a delay in expansion, then the company`s revenues may not increase as higher as estimated by it. (ii) High debt (Consolidated total debt of Rs.461.08 crores as of March, 2010) is an area of concern. (iii) In case, if MSP`s input costs increase and if it is unable to pass on to the end users then it may affect its profitability.

Management Guidance

In FY 2012, MSP is looking at increasing its revenues by ~ 60% as expansion will contribute in operations for six months. In FY 2013 also , MSP believes that its revenues will increase further by 30% - 40% as it will get contribution from the expansions throughout the year. Further, MSP also believes that its margins will improve as pellet and benefication plant have much higher EBITDA margins than its existing operations. Company also believes that post expansion, merchant power sales will also lead to considerable improvement in its EBITDA margins.

Technical View



The scrip is in the consolidation pattern since October 2010 after making top at Rs.74 and the correction is likely to get over around Rs.50 as shown on chart as wave C and rock bottom for the scrip is placed at Rs.46 as marked on the chart. Major resistance is seen around Rs.68 in the chart, which is shown as downside sloping line on the chart. Breakout above Rs.68 will see the scrip testing all time high of Rs.89 it made in January 2008 in medium to long term. Short term and long term investors can buy the scrip around Rs.50 for the target of Rs.68.

TARGET : Rs.68 SUPPORT : Rs.50 ROCK BOTTOM : Rs.46

Equity Research Team

Disclosure of Interest	
Analyst ownership of the stock	NO
Broking Relationship with the company covered	NO
Investment Banking relationship with the company covered	NO
Discretionary Portfolio Management Services	NO