Adhunik Metaliks Limited

Assets underpriced

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ANTIQUE

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Introduction

Adhunik Metaliks Limited (AML) is only integrated steel company in India which offers merchant mining and merchant power. The unique portfolio of integrated steel operations along with merchant mining and merchant power offers significant value in terms of high operating margin diversification across business verticals. The key attraction of AML lies in its natural resources reserves and which include iron ore, coal and manganese ore. AML is geared to rise up in the value chain by integrating and consolidating its three business verticals resulting in expansion of value proposition for stakeholders.

Scaling up merchant mining

AML operates its merchant mining business through its 100% subsidiary Orissa Manganese and Minerals Limited (OMML). OMML has a reserve of 90mt iron ore and 50mt manganese ore. Currently the company is producing ~120kt of iron ore and 25kt of manganese ore per month. Accordingly it targets to produce ~1.5mt of iron ore and 0.3mt of manganese ore in the current fiscal. OMML plans to scale up its iron ore and manganese ore production capacity to 5mt and 0.7mt respectively over the next couple of years. OMML has envisaged setting up a 1.2mt pellet plant and a ferro alloy plant for value addition with a capex of INR7.5bn however the timelines on the same is yet to be decided.

Rising visibility in merchant power

AML is setting up a 540 MW (270MWx2) merchant power unit in its subsidiary Adhunik Power & Natural Resources Limited (APNRL). The project is financed through a debt equity mix of 75:25. While 80% of the debt is already closed, the balance 20% closure is expected by the end of this month. BTG order for 540MW has been placed with BHEL and all necessary regulatory approvals are in place. It has a captive coal block allocation in alliance with Tata Steel (APNRL's share 69mt) and the same is expected to commence production in 2-3 years time.

Backward integration in steel operations to expand margins

AML has a 0.45mt integrated steel facility located in the mineral rich state of Orissa. It is one of the leading players in alloy and special steel catering largely to automotive, construction and engineering industry. Its steel facilities are integrated backward with captive iron ore and coal mines. While captive iron ore is expected to commence in 2QFY10, captive coal mine will take 2-3 years before it see the light of the day. Contribution from captive iron ore mines coupled with captive power plant will help expand margin from current 19% to 25% in FY11.

Valuation

Stable steel pricing environment, strong control over key raw material (coal and iron ore) and predictability of revenues from its proposed merchant mining business places Adhunik in an enviable position. Moreover, scaling up in operations and captive linkages for iron ore (FY10 onwards) would result in substantial topline and net profits growth. Thus at the CMP, there is a huge scope for re-rating due to asset mis-pricing, as well as growth prospects. **Hence, we recommend a BUY on this stock with a 24-month price target of INR 180 (based on SOTP valuation), representing an upside of 90% from current levels.**

Integrated Steel facility

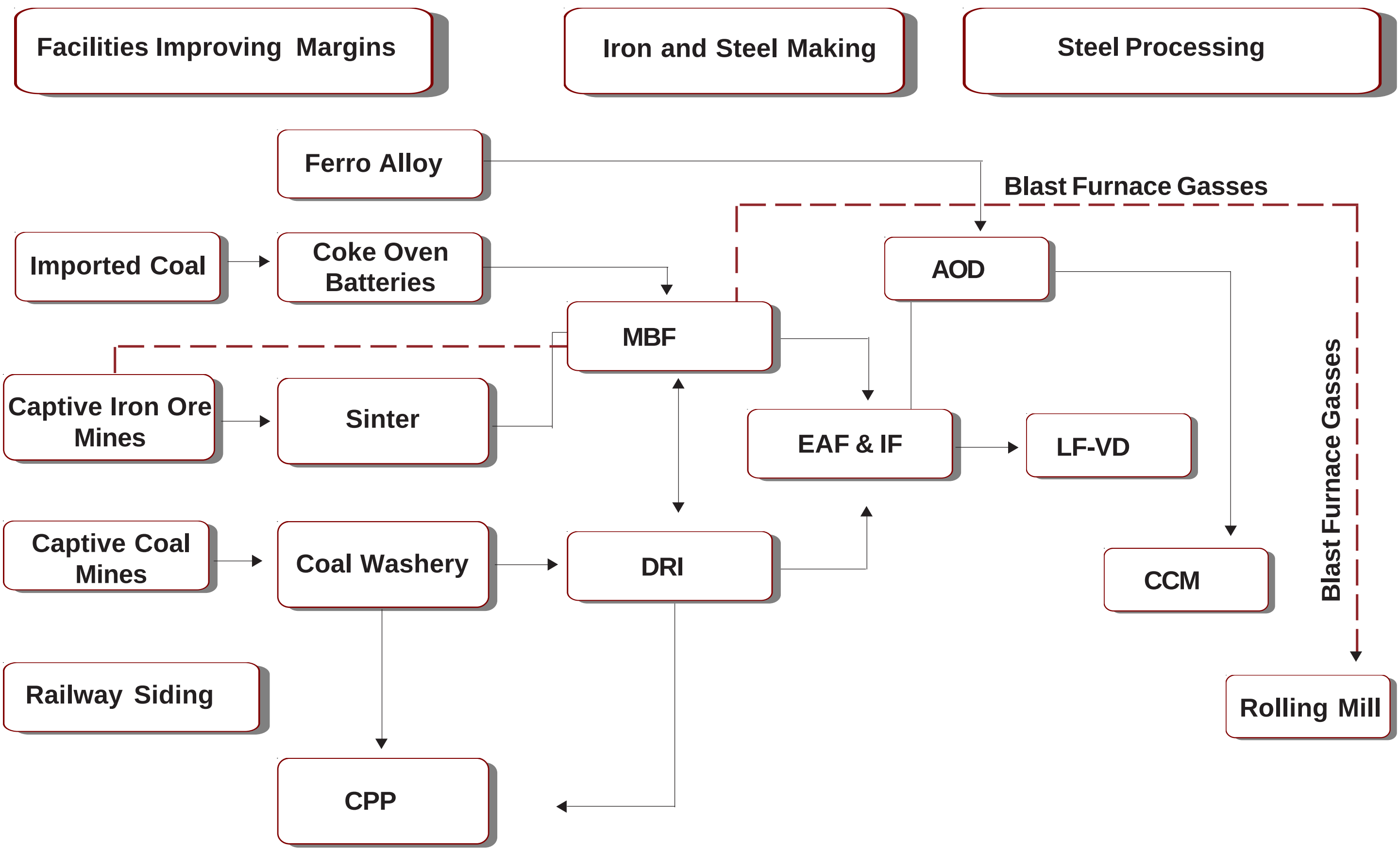
AML operates a cost effective production route (DRI-BF-EAF) with strong integration across the value chain. Its production model is supported by allied facilities like coal washery, captive power, sintering plant, ferro alloy unit, coke oven batteries and railway sidings. Currently AML is in the last leg of completing its additional 17MW captive power plant and 350TPD DRI. The company sells steel products in the form of billets and rolled products.

Production facilities

Primary facilities	Unit	Capacity
DRI	KTPA	270
MBF	KTPA	210
Steel Melting	KTPA	450
Rolling	KTPA	220
CPP	MW	34
Ferro Alloy	KTPA	50
Allied facilities		
Coke oven	KTPA	120
Coal washery	KTPA	700
Sinter plant	KTPA	300
Oxygen plant	Mn SM3	10

Source: Company , Antique

Flow chart - Steel making process



Source: Company , Antique

Merchant Mining

OMML is one of very few mining companies in India with iron ore and manganese ore for merchant sales. The mines are located in close proximity to steel manufacturing units with proper infrastructure in place. The company plans to sell most of the ore in the domestic market as sales are generally in form of lumps for which there is a strong demand in the local market. The fines generated in the mining process are stored for value addition in future.

Merchant miners - Iron ore	Unit	Reserves
NMDC	MT	1500
Kudermukh Iron ore	MT	1000
OMC	MT	600
Sesa Goa	MT	210
Rungta Mines	MT	200
Essel Mining	MT	125
OMML	MT	90
Sundur Manganese & Iron	MT	5
Merchant miners - Manganese ore		
MOIL	MT	62
OMML	MT	50
OMC	MT	30
Sundur Manganese & Iron	MT	18

Source: Company , Antique

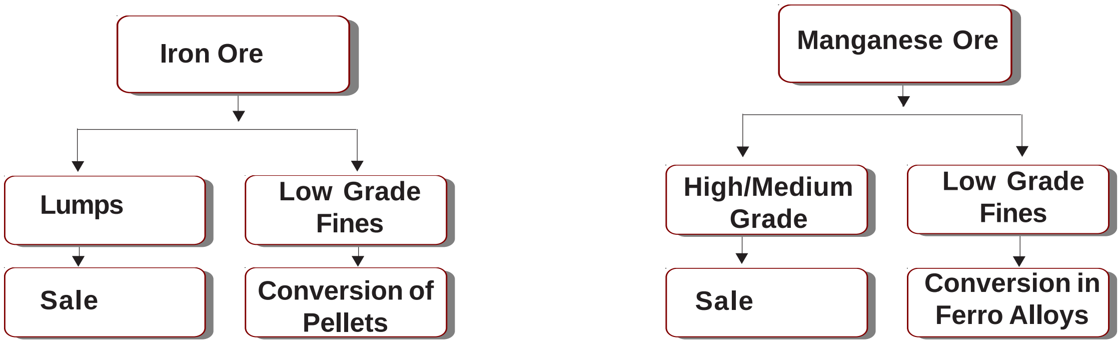
The company has adopted contract mining through local contractors with strong credentials. Mining contracts are in the range of INR250-270 per tonne. Including overheads and inland freight, the cost ex mines comes to INR800per tonne. It is presently realizing INR1,500-1,800 per tonne for sale of iron ore and hence making an EBITDA per tonne of INR1,000. Iron ore is fetching low realisation due to low grade which is expected to improve going forward.

Manganese ore mines are operational for sometime however the mining cost is higher compared to iron ore mining cost. Currently the proportion of low grade ore is more and than high grade ore. Low grade ore is fetching ~INR1,200-1,500/t while high is fetching INR5,000-6,000 per tonne. At the current prices the blended realisation is at INR3,000 per tonne generating an EBITDA per tonne of INR1,000.

Expansion

OMML is planning to set up a 1.2mt pelletisation plant (cost INR4.3bn) and 50kt ferro alloy plant including CPP and allied infrastructure (cost INR3.2bn) over the next three to five years. The idea is to value add iron ore into fines and manganese ore into ferro alloy and fetch higher margins. This will also enable the company to go ahead and pitch for additional mines as government favors/ prefer miners producing value added products over mines just selling the ore.

Value addition proposition



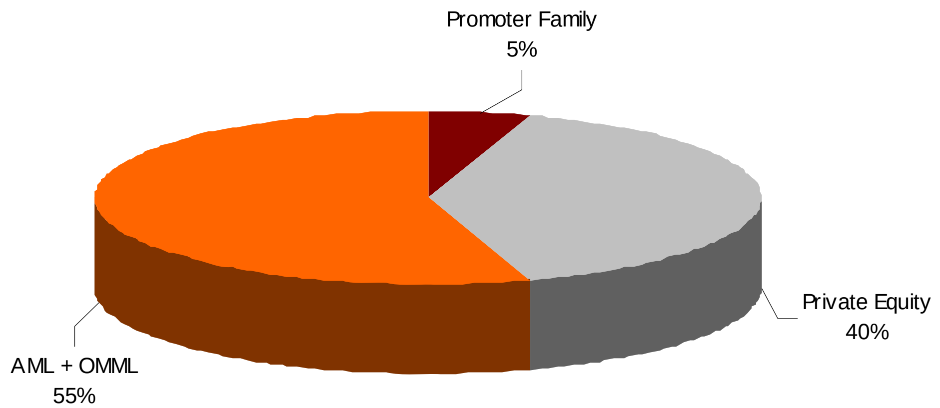
Merchant power

AML is all set to capitalize the lucrative business opportunity offered by the merchant power business in India. It is foraying into merchant power through its subsidiary APNRL which has signed a MoU with the Government of Jharkhand, Chattisgarh and Bihar for setting up a 1,000MW merchant thermal power plant.

Phase I financial closure completed

APNRL is in advanced stages of setting up 540MW power plant in two phases at Jamshedpur, Jharkhand. The total project cost is estimated at INR26bn and the same will be funded through debt equity ratio of 3:1. Estimated equity infusion is INR6.5bn out of which INR2.0bn will be infused by AML and OMML, INR4bn will be through private equity and balance will be funded by the promoter family. Total estimated debt would be INR20bn out of which INR16bn has been tied up. The balance tie up is expected by end of 2QFY10.

Proposed capital structure of APNRL



Source: Company , Antique

BTG order placed

The company has already placed BTG orders with BHEL for 540MW. Phase I 270MW is expected to commence by December 2011 and phase II is expected to commence within 3-4 month of the completion of phased I.

PPA agreement with Tata Power

The company has signed a PPA with Tata Power Trading Company Limited (TPTCL) for sale of 100MW at minimum INR2.75. TPTCL will sell the power through short term and medium term contracts to tap the benefits of high merchant tariff in the spot market. The agreement is such that any price realized by TPTCL over and above INR2.75 will be shared between APNRL and TPTCL in the ratio of 85:15. APNRL is also participating in tariff based competitive bidding jointly with PTC.

Fuel source

Coal required for the power plant will be sourced from the captive coal mine allotted to the APNRL in 50:50 JV with Tata Steel. The estimated reserves of mine is 138mt (AML's share is 69mt). It has also received coal linkage from Ministry of Coal for 275MW capacity (Phase I) and the same will ensure fuel supply till captive mines gets operational. APNRL has signed water supply agreement with the state government of Jharkhand for 1,000MW power plant. The company has completed the possession of necessary land required for the project and civil and construction work has already been started

Natural resources portfolio

Mineral	Company	Reserves (MT)	Location	Purpose	Status
Captive Mines					
Iron ore	AML	25	Keonjhar, Orissa	Captive Steel	Its an open cast mine with average Fe content of 62-64%. The mine is 140km from AML's steel plant. Extraction to start in September 09
Coal	AML	42	Talcher, Orissa	Captive Steel	Its an open cast mine with D, E and F grade coal. The mine is 160km from AML's steel plant. Extraction to start in April 11
Coal	APNRL	69	Ganeshpur, Jharkhand	Merchant power	This mine is allocated in JV with Tata Steel. Tata Steel to lead the mining operation. Coal to be used for generation of merchant power
Merchant Mines					
Manganese ore	OMML	50	Patmunda, Orissa	Merchant sales	Total 6 leases with 975 hectare or area under mining. These are open cast mines with average manganese grade of 34%+. These mines are operational since January 2008
Iron ore	OMML	90	Ghatkuri, Orissa	Merchant sales	It's an open cast mine with average Fe content of 62-64%. The ratio of lumps to fines is 60:40 with a low stripping ratio of 1.3. The mine commenced operations in January 08

Source: Company , Antique

Financial Snapshot - Consolidated

Year ended Mar 31 (INRm)	FY07	FY08	FY09	FY10e	FY11e	FY12e
Net Sales	7,358	10,046	12,702	12,049	15,657	19,436
Expenses	6,208	8,444	10,649	8,093	10,302	11,706
EBITDA	1,233	1,713	2,053	3,955	5,355	7,730
Depreciation	113	232	402	472	461	569
EBIT	1,120	1,481	1,929	3,483	4,894	7,161
Interest	262	568	1,200	1,095	992	878
PBT	858	913	729	2,388	3,902	6,283
PAT	775	805	467	1,791	2,731	4,398
EPS (INR)	8	9	4	17	26	42

Source: Company , Antique

Valuation

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SOTP	Unit	Amount
AML		
FY11 EBITDA	INRm	2,340
EV/EBITDA	INRm	6
Implied EV	X	14,040
Net Debt	INRm	10,500
Market Cap	INRm	3,540
Value per share	INR	34
OMML		
FY11 EBITDA	INRm	3,015
EV/EBITDA	INRm	4.5
Implied EV	X	13,567
Net Debt	INRm	500
Market Cap	INRm	13,067
Value per share	INR	126
APNRL		
Investment	INRm	700
Book Value	X	3
Implied Value	INRm	2,100
Value per share	INR	20
SOTP		**180**

Source: Antique

Important Disclaimer:

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