

JSW Steel

Event update

Mkt Cap: Rs255bn; US\$5.7bn

Event

Media reports suggest that JSW Steel has emerged the top contender to acquire management control of Bellary Steel & Alloys Ltd (BSAL); with a bid value of Rs2.1bn.

About Bellary Steel:

BSAL is a sick company under the administration of BIFR. It has a steel production capacity of 0.1mtpa and an annual sponge iron production capacity of 60,000 tonnes. The sponge iron and steel units operated at 34% and 0.2% utilization respectively in FY09. BSAL had a gross block of Rs25.5bn; mostly relating to 0.5mtpa integrated steel plant (ISP) expansion project.

Bellary Steel and Alloys Ltd (BSAL) -- Operating capacities

Operating capacities	in tonnes
Sponge iron	100,000
Finished steel	60,000

Source: Company

ISP expansion project highlights

Facilities	in tonnes
Sinter plant	827,500
Blast furnace	500,500
Steel Melt shop	500,500
Continuous billet caster	480,500
Rolling Mill	500,000

Source: Company

Apparent issues faced by BSAL

BSAL's operations appear highly inefficient with a production cost of ~US\$500/ tonne in FY09; since steel production was negligible we assume that these numbers reflect the cost of sponge iron production. BSAL purchased almost half of its power requirement from the merchant market at ~Rs6.8/ unit in 2009. About 10% of power came from DG sets at an astronomical cost of Rs22/ unit. The remaining appears to have been supplied by captive power plant with a thermal coal input of US\$100/ tonne. Operations seem to have been also affected by non-availability of working capital. The company had total debt of Rs32.7bn as of Q2FY11, excluding Rs2.3bn of redeemable preference shares and acceptances (~Rs1bn as on March 2009). A large part of the debt appears to have been taken for an expansion-cum-modernization project, which seems to have been stalled due to the financial crunch. The existing business, meanwhile, seems to be suffering from a lack of working capital

Integrated Steel plant (ISP) project details

BSAL is setting up a 0.5mtpa steel plant (with a provision to expand it up to 2mtpa) in Bellary for manufacturing long products, using blast furnace and basic oxygen furnace, with a total capex of Rs8.9bn. It is also setting up a 1*30MW captive thermal power plant which will meet the complete power needs of the ISP. The power plant will utilize the blast furnace gas as fuel for its multi-fuel boilers. Most of the equipment is in place and there has been substantial progress in construction. BSAL has modernization plans besides the expansion project; it is setting up a 12MW captive power

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Metals

Price chart



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plant at the sponge iron plant site, which will use as fuel waste heat from the kiln gases as well as burn coal and agricultural wastes. Part of the project has been completed and commissioned as a 2.5MW plant. The 12MW turbo generators have also been erected. The company also expects to be allocated captive iron ore mines by the Karnataka government

□ Valuations and view

We expect the bid amount to be pumped into BSAL by preferential allotment (not for buying out the existing promoters). Prima facie it appears that JSW's bid has a three-fold rationale: a) completion of BSAL's modernization project, which, coupled with improvement in utilization levels and easing of working capital, could sharply reduce cost of operations; b) ensuring financial closure is done for the ISP project; capital work-in-progress relating to the ISP project currently accounts for over 70% of the balance sheet and is not generating any returns. c) Proposed allocation of an iron ore mine and land for the expansion project. However, whether the deal makes financial sense would depend entirely on the amount of haircut banks and financial institutions would be willing to take on outstanding loans. While further details of the proposed bid are awaited, we are incrementally concerned about the impact of JSW's acquisition strategies on its balance sheet, especially as the bid comes close on the heels of the Ispat Industries buyout. JSW Steel's consolidated gearing ratio would cross 1.1x after Ispat preferential allotment. However, we maintain our Outperformer rating on the stock with a price target of Rs1,365/share.

Bellary Steel & Alloys (BSAL)--Summary Financials

Rs m	FY06	FY07	FY08	FY09	FY10
Net Sales	311	312	436	351	189
Other Income	81	1	1	3	-
Stock Adjustments	(6)	(1)	11	1	-
Total Income	386	311	448	355	189
Raw Materials	231	235	305	284	133
Power & Fuel Cost	33	23	25	22	n.a
Employee Cost	31	29	31	33	30
Other Manufacturing Expenses	19	16	14	21	78
Selling and Administration Expenses	26	34	51	58	n.a
Miscellaneous Expenses	3	8	4	33	n.a
Operating expenses	343	346	429	450	241
EBITDA	43	(35)	19	(95)	(52)
Interest	782	967	1,103	1,269	1,510
Depreciation	71	71	71	71	72
PBT	(811)	(1,072)	(1,155)	(1,435)	(1,632)
Tax	1	0	1	1	-
Reported PAT	(811)	(1,072)	(1,156)	(1,436)	(1,632)

Bellary Steel & Alloys (BSAL)---Key Balance sheet highlights (figures in Rs m)

Rs m	FY06	FY07	FY08	FY09
Share capital	2,315.7	2,315.7	2,315.7	2,315.7
Reserves	(4,237.3)	(5,309.7)	(6,465.4)	(7,901.6)
Others		80.9	80.9	80.9
Total shareholders funds	(1,921.6)	(2,913.1)	(4,068.8)	(5,505.0)
Secured loans	18,346	20,761	23,057	26,720
Unsecured loans	28.1	33	271	328
Total debt	18,374	20,795	23,328	27,048
Net block	710	622	555	508
Capital WIP	15,843	17,368	18,828	21,289
Cash	6	5	12	10

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2. Neutral: Within 0-5% to Index (upside or downside)
3. Underperformer: Less than 5% to Index

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