



## Sarda Energy & Minerals

		Rs231	Neutral											
BSE SENSEX	S&P CNX													
18,091	5,432													
Bloomberg	SEMLIN													
Equity Shares (m)	34.0													
52-Week Range (Rs)	382/172	3/10A	5,228	268	7.9	-83.3	29.4	1.5	5.0	3.6	2.3	15.9		
1,6,12 Rel. Perf. (%)	-20/-10/-1	3/11E	8,466	417	11.6	48.0	19.8	1.3	6.3	5.0	1.5	11.1		
M.Cap. (Rs b)	7.9	3/12E	9,231	906	25.3	117.3	9.1	1.1	12.3	7.7	1.5	9.1		
M.Cap. (US\$m)	176.7	3/13E	9,838	1,144	31.9	26.3	7.2	1.0	13.6	8.3	1.4	8.4		

- Sarda Energy and Mineral's standalone adjusted PAT for 3QFY11 was Rs55m (down 67% YoY) v/s a loss of Rs4m in 2QFY11.
- Net sales increased 7% QoQ to Rs2.1b. Steel division revenue grew 10% QoQ to Rs1.1b due to higher steel volumes. The company produced more steel and sold less sponge iron during the quarter. Saleable steel product volumes grew 49% QoQ to 25,525tons while average realization declined 2% QoQ to Rs26,750/ton. Sponge realization was up 7% QoQ at Rs16,900/ton.
- Ferro alloy division revenue grew 2% QoQ to Rs1.05b on higher volumes. Ferro alloy sales tonnage increased 8% QoQ to 16,441tons while realization declined 6% QoQ to Rs59,783/ton.
- EBITDA increased 27% QoQ to Rs205m, well below our estimate of Rs378m due to poor performance from ferro alloy division. Steel division EBIT increased 3x QoQ to Rs110m, while ferro alloy division EBIT declined 38% QoQ to Rs85m. The sharp decline in ferro alloy EBIT was due to decline in realization and higher raw material prices. Landed iron ore cost also increased 7% QoQ to Rs8,075/ton.

### Pellet plant failed to operate for too long; FY12E EPS cut 30%; downgrade to Neutral

- The 0.6mtpa pellet plant has failed to operate satisfactorily even after two years of operations and numerous modifications; the company has paid dearly by way of lost opportunity. The spread between cost of pellet and market price is too big to ignore operational failure for such a long period. The plant produced 45,848tons of pellets in 3QFY11. Captive naxal-affected mine located at Rajnandgaon has not yet re-started.
- We have cut our FY11E EPS by 38% to Rs11.6 to factor the lower than expected results for 3QFY11. We have also incorporated lower pellet production and higher raw material costs in our FY12 estimates. We have cut FY12E EPS by 30% to Rs25.3 from Rs36.5 earlier. The stock is trading at 9.1x FY12E EPS and an EV of 9.1x FY12E EBITDA.

Y/E MARCH	QUARTERLY PERFORMANCE (STANDALONE)										(RS MILLION)	
	FY10				FY11				FY10	FY11E		
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE				
DRI Sales ('000 tons)	40	47	45	54	51	33	24	25	186	234		
Ferro Alloys Sales ('000 tons)	5	8	11	12	14	15	16	16	36	60		
Ferro Alloys (Rs/ton)	40,652	48,343	56,061	59,053	58,190	63,580	59,783	56,783	53,088	44,914		
<b>Net Sales</b>	<b>931</b>	<b>1,020</b>	<b>1,537</b>	<b>1,740</b>	<b>2,167</b>	<b>2,002</b>	<b>2,136</b>	<b>2,161</b>	<b>5,228</b>	<b>8,466</b>		
Change (%)	-63.7	-70.3	-29.3	27.3	132.8	115.1	109.4	40.6	-45.2	61.9		
Total Expenditure	884	958	1,225	1,393	1,669	1,841	1,931	1,866	4,461	7,307		
As a % of Net Sales	95	94	80	80	77	92	90	86	85	86		
<b>EBITDA</b>	<b>46</b>	<b>62</b>	<b>313</b>	<b>347</b>	<b>498</b>	<b>161</b>	<b>205</b>	<b>295</b>	<b>767</b>	<b>1,159</b>		
As % of Net Sales	5.0	6.0	20.3	19.9	23.0	8.1	9.6	13.6	14.7	13.7		
Interest	17	25	39	47	27	57	21	11	127	116		
Depreciation	81	106	84	117	136	136	138	136	388	546		
Other Income	3	21	8	41	8	26	34	13	73	82		
<b>PBT (before EO Inc.)</b>	<b>-49</b>	<b>-49</b>	<b>199</b>	<b>224</b>	<b>343</b>	<b>-5</b>	<b>80</b>	<b>161</b>	<b>325</b>	<b>579</b>		
EO Income(exp)	125	60	213	48	-137	252	12		447	127		
<b>PBT (after EO Inc.)</b>	<b>76</b>	<b>11</b>	<b>412</b>	<b>272</b>	<b>206</b>	<b>247</b>	<b>92</b>	<b>161</b>	<b>772</b>	<b>706</b>		
Total Tax	16	-4	70	58	69	71	29	30	140	197		
% Tax	21.3	-36.7	17.0	21.2	33.2	28.6	31.0	18.4	18.1	28.0		
<b>Reported PAT</b>	<b>60</b>	<b>15</b>	<b>342</b>	<b>214</b>	<b>138</b>	<b>176</b>	<b>63</b>	<b>131</b>	<b>632</b>	<b>508</b>		
<b>Adjusted PAT</b>	<b>-38</b>	<b>-67</b>	<b>165</b>	<b>176</b>	<b>229</b>	<b>-4</b>	<b>55</b>	<b>131</b>	<b>185</b>	<b>412</b>		
Change (YoY %)	-na-	-na-	92.2	-na-	-695.8	-na-	-na-	-20.5	-86.7	122.7		

E: MOSL Estimates

Sarda Energy and Mineral's standalone adjusted PAT for 3QFY11 was Rs55m (down 67% YoY) v/s a loss of Rs4m in 2QFY11. Reported standalone PAT of Rs63.4m included Rs12m of forex gains.

### **Revenue grew 7% QoQ due to higher steel volumes; ferro alloy realization declined 6% QoQ**

- Net sales increased 7% QoQ to Rs2.1b. Steel division revenue grew 10% QoQ to Rs1.1b due to higher steel volumes. The company produced more steel and sold less sponge iron during the quarter. Saleable steel product (billets and wire rods) volumes grew 49% QoQ to 25,525tons while average realization declined 2% QoQ to Rs26,750/ton.
- Sponge iron production declined 13% QoQ to 51,466tons while steel production was up 66% QoQ to 39,523tons. Ferro alloy production increased 1% QoQ to 16,195tons. Sponge iron sales volumes declined 27% QoQ to 23,937tons, as the company produced more steel. Sponge realization was up 7% QoQ at Rs16,900/ton.
- Coal mining at Karwahi open cast mine is ramping up in line with the requirement of 360ktpa sponge iron facilities. The company produced 106,037tons of coal during 3QFY11.
- Ferro alloy division revenue grew 2% QoQ to Rs1.05b on higher volumes. Ferro alloy sales tonnage increased 8% QoQ to 16,441tons while realization declined 6% QoQ to Rs59,783/ton.
- The company sold less power, as power rates remain subdued and decided to produce steel. Sales volumes declined 83% YoY to 6.55MU.

### **Raw material cost inflation continues to perturb; 20MW CPP at Raipur gets statutory clearances**

- EBITDA increased 27% QoQ to Rs205m, well below our estimate of Rs378m due to poor performance from ferroalloy division.
- Steel division EBIT increased 3x QoQ to Rs110m, while ferro alloy division EBIT declined 38% QoQ to Rs85m. The sharp decline in ferroalloy EBIT was due to decline in realization and higher raw material prices. Landed iron ore cost also increased 7% QoQ to Rs8,075/ton.
- Sarda has recently received consent to operate the third FBC boiler installed at Raipur plant, which will take its captive power generating capacity to 81.5MW. We expect faster ramp up of the power unit, enabling captive power for full operations at Raipur even at higher capacity utilization.
- The Rs5.5b ferro project at Vizag is progressing on schedule to get commissioned by 1QFY13. Production capacity would be 125ktpa, with 2\*33 MVA submerged arc furnace and 80MW CPP.

**Quarterly operational performance**

	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11
<b>Production (tons)</b>							
Coal	80,718	0	0	119,084	93,314	99,501	106,037
Iron ore Pellets					54,615	18,741	45,848
Sponge iron	42,675	49,440	51,561	59,112	50,329	59,353	51,466
<b>Steel</b>	<b>663</b>	<b>3,320</b>	<b>4,951</b>	<b>3,168</b>	<b>2,218</b>	<b>23,864</b>	<b>39,523</b>
Ingots	663	2,381	1,737	0	0	0	0
Wire Rod							12,899
Billets	0	939	3,214	3,168	2,218	23,864	26,624
Ferro Alloys	1,795	8,871	11,630	13,522	14,463	15,994	16,195
Power (MU)	53	64	110	104	104	104	113
<b>Sales (tons)</b>							
Sponge iron	39,729	47,204	45,206	54,298	51,229	32,832	23,937
<b>Steel</b>	<b>568</b>	<b>1,829</b>	<b>4,957</b>	<b>2,564</b>	<b>5,104</b>	<b>17,078</b>	<b>25,525</b>
Ingots	40	1,829	2,915	48	0	0	0
Wire Rod							13,881
Billets	528	0	2,042	2,516	5,104	17,078	11,644
Ferro Alloys	5,273	7,716	11,252	11,525	13,800	15,217	16,441
Power (MU)	35	10	38	21	21	3	7

Source: Company/MOSL

**Pellet plant failed to operate for too long; FY12E EPS cut 30%; downgrade to Neutral**

- Material and labor movement at the naxal-affected mine located at Rajnandgaon had started in 2QFY11 and the management was confident about re-starting mining operations in 2HFY11. However, the operational difficulties seem to outweigh the company's efforts in starting mining. We have not factored in any captive iron ore production in FY11.
- The 0.6mtpa pellet plant continues to operate at lower capacity utilization even after undergoing modifications to accommodate high moisture fines during 2QFY11. It produced 45,848tons of pellets in 3QFY11. The grinding unit is expected to undergo further technical modification in the next few months, which will limit the ramp-up of capacity utilization.
- The pellet plant has failed to operate satisfactorily even after two years of operations and numerous modifications; the company has paid dearly by way of lost opportunity. The spread between cost of pellet and market price is too big to ignore operational failure for such a long period. This has raised concerns on the management's operational and execution skills.
- We have cut our FY11E EPS by 38% to Rs11.6 to factor the lower than expected results for 3QFY11. We have also incorporated lower pellet production and higher raw material costs in our FY12 estimates. We have cut FY12E EPS by 30% to Rs25.3 from Rs36.5 earlier. The stock is trading at 9.1x FY12E EPS and an EV of 9.1x FY12E EBITDA. We downgrade the stock to **Neutral**.

## Sarda Energy & Minerals: an investment profile

Sarda Energy and Minerals (SEML) produces steel via sponge iron route, having 240ktpa of crude steel capacity and 360ktpa of sponge at Siltara, Raipur (Chhattisgarh). It is also one of the largest ferroalloy producers, with a capacity of 72ktpa and 81.5MW of captive power plant. The company has been allotted captive iron ore as well as coal mines. Its recently commissioned 0.6mtpa pellet plant converts iron ore fines into pellets, thus reducing lump requirement. SEML is a play on sponge iron prices and power. There will be significant savings in the cost of production of steel post starting of captive mines.

### Key investment arguments

- Pellet production is expected to ramp up faster in FY12, as the plant is stabilized post technical modifications. Operations at captive iron ore mine are also expected to restart in FY12.
- SEML is investing Rs5.5b into a Greenfield ferro project (125ktpa with 2\*33 MVA submerged arc furnace and 80MW CPP) at Vizag. The project is expected to get commissioned by 1QFY13.

### Key investment risks

- Earnings are highly leveraged to ferroalloy and steel prices.

### Recent developments

- The Committee of Directors has allotted 1.8m equity shares of Rs10 each on preferential basis to Asia Minerals Limited, Hongkong, at a premium of Rs500/share on 31 December 2010.

### Valuation and view

- The stock trades at 9.1x FY12E EPS and an EV of 9.1x FY12E EBITDA.

### Sector view

- Indian steel demand is expected to grow at 10-12% over FY10-12, driven by planned infrastructure investment by the government and a rebound of industrial capex. Industrial production has started growing in double digits due to the economic recovery and a boost from stimulus packages. Auto and white goods demand has started growing in double digits. Large power capacity addition will drive industrial production further. According to WSA, Indian steel demand is expected to grow 13.6% in 2011. We remain positive about domestic steel companies.

### Comparative valuations

		Sarda Energy	Monnet Ispat	Godawari Power
P/E (x)	FY11E	19.8	10.6	6.9
	FY12E	9.1	9.3	5.4
P/BV (x)	FY11E	1.3	1.8	0.9
	FY12E	1.1	1.5	0.9
EV/Sales (x)	FY11E	1.5	3.2	1.0
	FY12E	1.5	3.0	1.0
EV/EBITDA (x)	FY11E	11.1	11.4	5.7
	FY12E	9.1	10.2	4.3

### Shareholding Pattern (%)

	Dec-10	Sep-10	Dec-09
Promoter	66.5	70.1	70.1
Domestic Inst	7.4	7.9	9.1
Foreign	11.7	6.6	8.9
Others	14.4	15.4	11.9

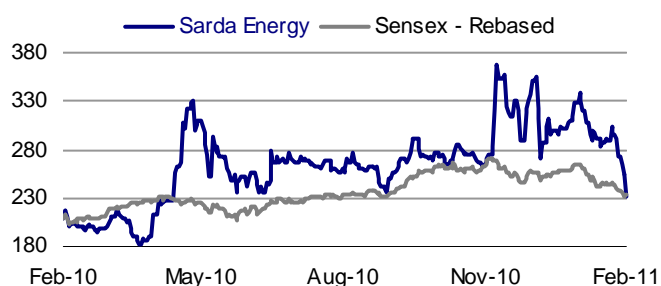
### EPS: MOSL forecast v/s consensus (Rs)

	Most Forecast	Consensus Forecast	Variation (%)
FY11	11.6	27.1	-57.1
FY12	25.3	40.2	-37.1

### Target Price and Recommendation

Current Price (Rs)	Target Price (Rs)	Upside (%)	Reco.
231	-	-	Neutral

### Stock performance (1 year)



## Financials and Valuation

INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2009	2010	2011E	2012E	2013E
<b>Net sales</b>	<b>9,488</b>	<b>5,228</b>	<b>8,466</b>	<b>9,231</b>	<b>9,838</b>
Change (%)	51.8	-44.9	61.9	9.0	6.6
Total Expenses	7,258	4,461	7,307	7,730	8,144
<b>EBITDA</b>	<b>2,230</b>	<b>767</b>	<b>1,159</b>	<b>1,501</b>	<b>1,694</b>
% of Net Sales	23.5	14.7	13.7	16.3	17.2
Deprn. & Amortization	279	388	546	451	475
<b>EBIT</b>	<b>1,951</b>	<b>379</b>	<b>613</b>	<b>1,050</b>	<b>1,218</b>
Net Interest	46	127	116	-16	-121
Other income	37	73	82	66	66
<b>PBT before EO</b>	<b>1,942</b>	<b>325</b>	<b>579</b>	<b>1,132</b>	<b>1,405</b>
EO income	-450	447	127		
<b>PBT after EO</b>	<b>1,492</b>	<b>772</b>	<b>706</b>	<b>1,132</b>	<b>1,405</b>
Tax	258	140	197	226	281
Rate (%)	17.3	17.7	28.0	20.0	20.0
<b>Reported PAT</b>	<b>1,234</b>	<b>632</b>	<b>508</b>	<b>906</b>	<b>1,124</b>
<b>Adjusted PAT</b>	<b>1,606</b>	<b>268</b>	<b>417</b>	<b>906</b>	<b>1,124</b>
Change (%)	32.2	-83.3	55.8	117.3	24.1

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2009	2010	2011E	2012E	2013E
Share Capital	340	340	358	358	358
Reserves	4,793	5,305	6,590	7,370	8,369
<b>Share holders funds</b>	<b>5,133</b>	<b>5,646</b>	<b>6,949</b>	<b>7,729</b>	<b>8,727</b>
Loans	5,330	4,595	5,095	5,595	6,095
Secured	5,247	4,472	4,972	5,472	5,972
Unsecured	83	123	123	123	123
Deferred tax liability (net)	282	286	286	286	286
<b>Capital Employed</b>	<b>10,745</b>	<b>10,527</b>	<b>12,330</b>	<b>13,610</b>	<b>15,108</b>
Gross Block	4,984	5,913	6,263	6,613	6,963
Less: Accum. Deprn.	1,468	1,468	2,014	2,464	2,940
<b>Net Fixed Assets</b>	<b>3,516</b>	<b>4,445</b>	<b>4,249</b>	<b>4,148</b>	<b>4,023</b>
Capital WIP	3,554	3,554	4,704	6,304	7,804
Investments	726	665	665	665	665
<b>Curr. Assets</b>	<b>3,522</b>	<b>2,823</b>	<b>3,644</b>	<b>3,498</b>	<b>3,680</b>
Inventories	996	1,520	1,392	1,517	1,617
Sundry Debtors	183	144	812	885	943
Cash and Bank	353	247	528	183	207
Loans and Advances	1,991	912	912	912	912
<b>Curr. Liability &amp; Prov.</b>	<b>573</b>	<b>959</b>	<b>931</b>	<b>1,005</b>	<b>1,063</b>
Sundry Creditors	454	840	812	885	943
Other Liabilities & prov.	119	119	119	119	119
<b>Net Current Assets</b>	<b>2,949</b>	<b>1,864</b>	<b>2,713</b>	<b>2,493</b>	<b>2,617</b>
<b>Application of Funds</b>	<b>10,745</b>	<b>10,527</b>	<b>12,330</b>	<b>13,610</b>	<b>15,108</b>

E: MOSL Estimates

RATIOS					
Y/E MARCH	2009	2010	2011E	2012E	2013E
<b>Basic (Rs)</b>					
<b>EPS</b>	<b>47.2</b>	<b>7.9</b>	<b>11.6</b>	<b>25.3</b>	<b>31.4</b>
Cash EPS	55.4	19.3	26.9	37.8	44.6
BV/Share	140.8	155.8	183.8	205.6	233.4
DPS	3.0	3.0	3.0	3.0	3.0
Payout (%)	9.7	18.9	24.8	13.9	11.2
<b>Valuation (x)</b>					
P/E	4.9	29.4	19.8	9.1	7.4
Cash P/E	4.2	12.0	8.6	6.1	5.2
P/BV	1.6	1.5	1.3	1.1	1.0
EV/Sales	1.4	2.3	1.5	1.5	1.4
EV/EBITDA	5.8	15.9	11.1	9.1	8.4
Dividend Yield (%)	1.3	1.3	1.3	1.3	1.3
<b>Return Ratios (%)</b>					
EBITDA Margins	23.5	14.7	13.7	16.3	17.2
Net Profit Margins	16.9	5.1	4.9	9.8	11.4
RoE	33.5	5.0	6.3	12.3	13.4
RoCE	18.2	3.6	5.0	7.7	8.1
RoIC	31.9	6.3	9.5	16.3	18.9
<b>Working Capital Ratios</b>					
Fixed Asset Turnover (x)	1.9	0.9	1.4	1.4	1.4
Asset Turnover (x)	0.9	0.5	0.7	0.7	0.7
Debtor (Days)	7	10	35	35	35
Inventory (Days)	38	106	60	60	60
Creditors (Days)	17	59	35	35	35
<b>Growth (%)</b>					
Sales	51.8	-44.9	61.9	9.0	6.6
EBITDA	32.4	-65.6	51.0	29.6	12.8
PAT	32.2	-83.3	55.8	117.3	24.1
<b>Leverage Ratio (x)</b>					
Current Ratio	6.1	2.9	3.9	3.5	3.5
Interest Cover Ratio	42.5	3.0	5.3	-66.3	-10.1
Net Debt/Equity	1.0	0.8	0.7	0.7	0.7

CASHFLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2009	2010	2011E	2012E	2013E
Pre-tax profit	1,492	772	706	1,132	1,405
Depreciation	252		546	451	475
(Inc)/Dec in Wkg. Cap.	-992	980	-567	-126	-100
Tax paid	-170	-136	-197	-226	-281
<b>CF from Op. Activity</b>	<b>535</b>	<b>1,615</b>	<b>487</b>	<b>1,231</b>	<b>1,500</b>
(Inc)/Dec in FA + CVMP	-2,648	-929	-1,500	-1,950	-1,850
(Pur)/Sale of Investments	-546	62			
<b>CF from Inv. Activity</b>	<b>-3,195</b>	<b>-867</b>	<b>-1,500</b>	<b>-1,950</b>	<b>-1,850</b>
Equity raised/(repaid)	47		920		
Debt raised/(repaid)	2,091	-735	500	500	500
Dividend (incl. tax)	-119	-119	-126	-126	-126
Other financing activities					
<b>CF from Fin. Activity</b>	<b>2,019</b>	<b>-854</b>	<b>1,295</b>	<b>374</b>	<b>374</b>
<b>(Inc)/Dec in Cash</b>	<b>-640</b>	<b>-106</b>	<b>282</b>	<b>-345</b>	<b>24</b>
Add: opening Balance	993	353	247	528	183
<b>Closing Balance</b>	<b>353</b>	<b>247</b>	<b>528</b>	<b>183</b>	<b>207</b>



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**Sarda Energy & Minerals**

- |   |    |
|---|----|
| 1. Analyst ownership of the stock                       | No |
| 2. Group/Directors ownership of the stock               | No |
| 3. Broking relationship with company covered            | No |
| 4. Investment Banking relationship with company covered | No |

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