# VISA STEEL LTD.

Stabilisation pangs...

Q2 FY 2007 update

## COMPANY DETAILS

| | |
|---|---|
| Auditors | M/s Lovelock & Lewes. |
| Bankers | SBI, Syndicate Bank, ICICI Bank |
| MD | Mr. Vishal Agarwal |
| Regd. office | 11 Ekamra Kannan Nayapalli<br>751 015, Bhubaneswar, Orrisa |
| Plant Locations | Kalinganagar, Orissa |
| Website | www.visasteel.com |

## SCRIP DETAILS

| | |
|---|---|
| Market Capitalisation | Rs. 3.4 bn. |
| Book Value per share | Rs. 27 |
| Equity Shares O/S (F.V. Rs 10) | 110 mn. |
| Median Volumes (8 mths) | 58,300 (BSE+NSE) |
| 52 Week High/Low | Rs.62 / 23 |
| BSE Scrip Code | 532721 |
| NSE Scrip Code | VISASTEEL |
| Reuters Code | VISA.BO |

## SHAREHOLDING PATTERN (%)

| Qtr. Ended | Mar-06 | Jun-06 | Sep-06 |
|---|---|---|---|
| Promoters | 72.7 | 72.7 | 72.7 |
| MFs/FI's | 2.1 | 0.8 | - |
| FIIs | 13.4 | 14.1 | 15.6 |
| NRI/OCBs | 0.2 | 0.1 | 0.4 |
| Pvt. Corp. Bodies | 2.7 | 3.0 | 2.5 |
| Others | 8.9 | 9.3 | 8.8 |

## KEY FINANCIALS (STANDALONE)

| Rs Mn | Quarter Ended | | | Year Ended (March) | | |
|---|---|---|---|---|---|---|
| | Mar-06 | Jun-06 | Sep-06 | 2006 | 2007E | 2008E |
| Net Sales | 1,089 | 1,125 | 1,497 | 3,840 | 5,302 | 8,795 |
| *YoY Gr. (%)* | 65.1 | *76.2* | *46.0* | *55.0* | *38.1* | *65.9* |
| Op. Profits | 85 | 111 | 117 | 361 | 689 | 1,231 |
| *OP. Marg. (%)* | *7.8* | *9.8* | *7.8* | *9.4* | *13.0* | *14.0* |
| Net Profits | 22 | 81 | 56 | 124 | 382 | 574 |
| Eq. Capital | 1,100 | 1,100 | 1,100 | 1,100 | 1,100 | 1,100 |

## KEY RATIOS

| Year Ended (March) | EPS (Rs.) | ROCE (%) | RONW (%) | P/E (x) | EV/Sales (x) | EV/EBIDT (x) |
|---|---|---|---|---|---|---|
| 2006 | 1.1 | 12.8 | 6.7 | 27.5 | 1.3 | 9.6 |
| 2007E | 3.5 | 15.6 | 12.8 | 8.9 | 1.3 | 8.7 |
| 2008E | 5.2 | 15.9 | 17.5 | 5.9 | 1.3 | 3.3 |

## SUMMARY


- Visa Steel Ltd. (VSL) posted a 46% YoY rise in sales to Rs 1. 5 bn in Q2FY07. This was mainly due to spurt in trading revenues during the quarter.
- Revenues from manufacturing business increased by 8% YoY to Rs 672 mn. Hot metal production at 45k mt in Q2FY07, was higher by 26% YoY and 3% QoQ basis, where as pig iron production was 41k mt (+23% YoY and +4% QoQ). VSL also produced ~5k mt of coking coal, which was captively consumed for pig iron production.
- Pig Iron sales volumes improved by 6% YoY to 37k in Q2FY07. Effective net realisation increased by ~15% YoY to Rs 14k/mt in Q2FY07.
- Trading business revenues at Rs 875 mn, were higher 71% YoY and 85% QoQ, as the company offloaded its iron ore fine and coking coal inventory in Q2FY07, expecting further softening of prices.
- Coke production suffered during the quarter, due to breakdown of one of the machinery, which had to be imported. The company expects its coke oven batteries to fully stabilise by Dec'06.
- Op. profits were at Rs 117 mn (+61% YoY & 6% QoQ) in Q2FY07, due to improvement in realisations and higher volumes of pig iron. OPM improved by 70 bps to 7.8%, but declined by 200 bps QoQ, as due to higher contribution from low margin trading business, which in fact suffered losses during the quarter.
- Other income increased to Rs 7 mn in Q2FY07 as compared to Rs 2 mn in Q2FY06. Depreciation charges increased by 72% YoY to Rs 20 mn, due to capitalisation of coke oven batteries.
- Higher op. profits, spurt in other income and dip in interest charges, helped the company report 180% jump in net profits to Rs 56 mn in Q2FY07.
- *VSL has potential to emerge as one of the largest players in special & alloy steel, in India. This along with the group's implementation skills, scalability potential and financial closure of the project, we maintain a 'BUY'.*


| Nov 10, 2006 | Sensex :13283 | Nifty : 3835 | CMP : Rs 31 | Recomm : BUY |
|---|---|---|---|---|


Analyst - Rahhul Aggarwal

VSL's results in Q2FY07, were below our expectations, mainly due to losses suffered by the company in its trading business and loss of production of coke due to breakdown.

Net sales of the company increased to Rs 1.5 bn in Q2FY07 (+46% YoY and 33% QoQ). This was mainly driven by higher revenues from the trading business, which jumped 71% YoY and 85% QoQ. Manufacturing business grew 8% YoY, but was lower by 6% QoQ.

**Table I: Existing Capacities (Sep'30, 06)**

| Division | Capacity (TPA) |
|---|---|
| 1. Pig Iron | 225,000 |
| 2. Chrome Ore Beneficiation Plant | 100,000 |
| 3. Chrome Ore Grinding Plant | 100,000 |
| 4. LAM Coke | 100,000 |

The company produced 45k mt of hot metal in Q2FY07, up by 26% YoY and 3% QoQ. Pig iron production was at 41k mt (+ 23% YoY and 4% QoQ). Pig iron sales increased by 6% YoY to 37k during the quarter. Avg. realisations of pig iron were ~14k/mt in Q2FY07.

VSL's coke production was just ~5k mt during the quarter, because of breakdown at one of the parts of its coke oven batteries. VSL's plans to commission all 4 set of batteries (4x100k mt) by Sep'06, got delayed by almost 2-3 months due to heavy monsoon and initial teething problems. The company commissioned 2 more set of batteries (100k x2 mt) in Oct'06 and Nov'06, and expects both of these to stabilise by the end of Q3FY07. The last set of batteries (100k mt) is expected to commission by Dec'06.

The trading business of the company, which includes exporting iron ore fines and coal imports suffered badly during the quarter due to strengthening of rupee against dollar and softening of coking coal prices. The company off-loaded its high cost inventory in anticipation of further decline in the prices of coking coal. Also, non-availability of rakes, adversely impacted its iron ore fines business as the stock had to be moved via road resulting in high freight charges. All this led to the company suffering a loss of Rs 15 mn at PBIT level in Q2FY07.

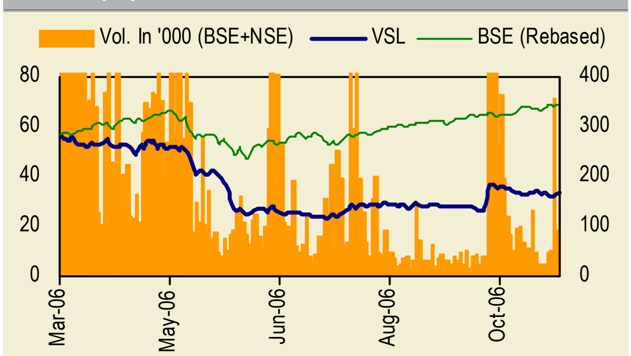
The company procures iron ore from local suppliers and has tied up with Sesa Goa & OMC and its current landed cost works out to ~Rs 1800/mt. The coking coal is imported from Australia, and prices of hard coking coal have been around $110-115/mt (FOB). The company also had to source coke from outside, due to breakdown in its coke oven batteries, at an the average cost of ~$190-200/mt (CIF).

Operating profit of the company increased by 61% YoY to Rs 117 mn in Q2FY07. OPM at 7.8% was also higher by 70 bps YoY, but took a hit of 200bps QoQ because of increased share of low margin (infact made losses during this quarter) trading revenues.

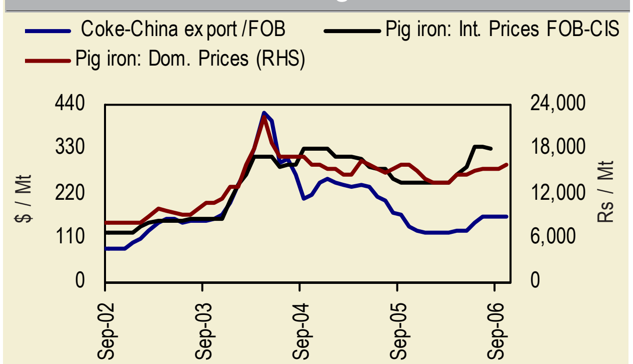
VSL's net interest charges at Rs 16 mn was although down by 46% YoY, but increased 809% QoQ and is expected to increase further in coming quarters due to increased debt, as the work on the expansion project gets into full swing. Depreciation charges were also up 72% YoY and 9% QoQ, due to capitalisation of coke oven batteries.

Net profits of the company increased by 180% YoY to Rs 56 mn. However, the same were lower by 31% QoQ, due to higher capital charges and losses in trading business.

**Scrip performance vis-a-vis BSE Sensex**




**Price trend of Pig Iron & Coke**




Source: SBB, Cris-Infac

VSL is setting up 0.5 mn of special and stainless steel capacity at its existing facility in Kalinganagar (Orissa), at a total cost of Rs 11.5 bn. This project is planned to be funded via debt:equity ratio of 65:35, with the debt being tied up at ~9% p.a. The equity portion is met via IPO proceeds (~Rs 2 bn raised in Mar'06 by issue of 35 mn share at Rs 57/share, out of which promoters subscribed to 5 mn shares at the same price) and internal accruals of the company.

The expansion envisages a 300K tpa sponge iron plant (2 X 500 tpd kilns), a steel making plant of 500K tpa and two power plants ( 25 MW each). It will also have a 50K tpa ferro chrome plant, operating on two 16.5 MVA furnaces, servicing captive requirements.

The schedule of completion of these projects is elaborated in Table II.

**Table II: Proposed Capacities**

| Expansion Plans | Capacity (TPA) | Expected Completion |
|---|---|---|
| Coke Oven Batteries | 300,000 | Dec '06 |
| Ferro Chrome | 50,000 | Mar '07 |
| Sponge Iron | 300,000 | Sept '07 |
| Special & Stainless Steel | 500,000 | Mar '08 |
| Power (MW) | 50 | Sep '07 |
| Project Cost (Rs. bn) | 11.5 | Mar'08 |
| Funded via Debt:Equity | 65:35 | |
| Debt (Rs. bn) | 7.5 | |
| IPO money raised (Rs. bn) | 2.0 | Mar'06 |
| Internal accruals (bal.) (Rs. bn) | 2.0 | |

The sponge iron plant would be based on Lurgi technology and the steel making would be via the EAF/ AOD/ LRF/ VD/VOD route. The same would have continuous casting facility also.

The total power requirement of the company upon commissioning all the projects is expected to be 115 MW. VSL plans to set up two 25 MW waste heat recovery based power plants initially, to tap its flue gases. It also has power supply arrangement with the state grid for ~40MW. There is potential to set up another 25 MW power plant at a later date, based on the char and fines from its sponge iron plant.

Civil and fabrication work on sponge iron, power and ferro alloys plant has already started and orders for long delivery items has also been placed. Negotiations are on for supply of equipment for special and stainless steel plant and orders are expected to be placed by the end of Q3FY07.

**Raw Material Linkages**

VSL has a chrome ore mine ( via its 89% subsidiary Ghotaringa Minerals Ltd) which is expected to meet majority of its chrome ore demand, once ferro chrome furnaces go on stream.

Also, a coal block in the Patrapara coal block (Talcher) has been allotted to the company. It envisages setting up a coal washery and meet its entire steam coal requirements via this mine.

For coking coal( req. of ~600K tpa), it has arrangement with Millennium Coal Pty Ltd. (Australia).

VSL has also signed a MoU with Orissa govt for allotment of an iron ore mine to suffice its requirement. The company has already emerged as front runner for the allotment of iron ore mines following recommendation of HOODA committee, which the company already satisfies. However, till its allocation, iron ore requirement would be met from local suppliers like Sesa Goa, OMC, etc.

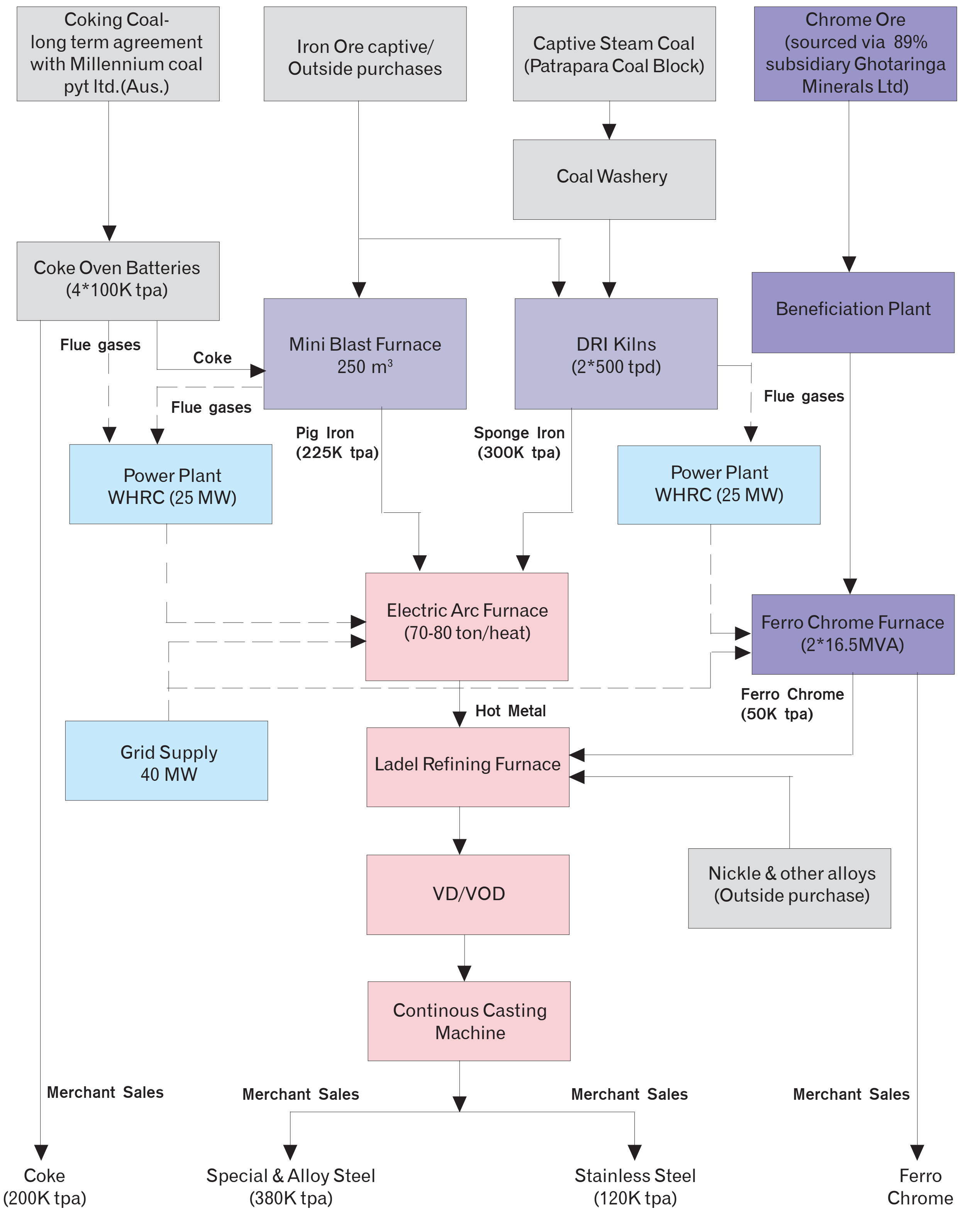
**Outlook**

The company has planned its expansion project in such a manner, that it would be able to make merchant sales of pig iron, power, sponge iron, power and ferro alloys, till the final 0.5 mn mt special and alloy steel plant comes up in Mar'08. This will help the company generate revenues & earnings stream during the project implementation stage.

Due to subdued performance during this quarter and lower than expected coke production, we have revised downwards our profits estimates for FY07. However, we remain positive on the long term growth prospects of VSL, as the company has high scalability potential, once all its facilities go on stream and the company stabilises its operations. At 0.5 mn tpa, the company has potential to post turnover of Rs 25 bn & net profits of Rs 1.7 bn in FY10.

At CMP of Rs 31, VSL is trading at a P/E of 5.9x and EV/ EBIDTA of 3.3x, discounting its FY08 nos. While these appear to be on the higher side in comparison to its peers like Mukand Ltd & Mahindra Ugine, VSL is in investment phase, the benefits of which will start accruing from FY09.

*VSL has potential to emerge as one of the largest players in special & alloy steel, in India. This along with the group's implementation skills, scalability potential and financial closure of the project, we maintain our 'BUY' recommendation.*




*Note: VSL is setting up integrated special and stainless steel plant of 0.5 mn tpa, to be commissioned in phases by Mar'08. Till that date, it will have merchant sales of pig iron, sponge iron, coke and ferro chrome, as these facilities will be commissioned first.*

| Financial results for the quarter and half year ended Sep'30, 2006 (Standalone) | | | | | | | |
|---|---|---|---|---|---|---|---|
| Particulars (Rs mn) | Quarter Ended | | | Half Year Ended | | | Yr Ended |
| | 30/09/06 | 30/09/05 | Gr % | 30/09/06 | 30/09/05 | Gr % | 31/03/06 |
| **Net Sales** | **1,497** | **1,025** | **46.0** | **2,623** | **1,664** | **57.6** | **3,840** |
| **Total Expenditure** | **1,380** | **952** | **44.9** | **2,394** | **1,528** | **56.7** | **3,480** |
| (Inc)/dec in Stock in Trade | 47 | (24) | | 76 | (405) | | (222) |
| Consumption of Raw Material | 511 | 389 | 31.5 | 923 | 683 | 35.1 | 1,502 |
| Staff cost | 13 | 17 | (26.6) | 21 | 22 | (2.3) | 42 |
| Cost of Trading Goods | 706 | 495 | 42.6 | 1,163 | 1,027 | 13 | 1,709 |
| Other Expenses | 104 | 75 | 37.6 | 210 | 202 | 4.4 | 449 |
| **Operating Profit** | **117** | **73** | **60.5** | **228** | **136** | **68.3** | **361** |
| Other income | 7 | 2 | | 17 | 2 | | 6 |
| **PBDIT** | **124** | **75** | **65.3** | **245** | **138** | **77.8** | **367** |
| Interest (Net) | 16 | 30 | (46.3) | 18 | 53 | (66.2) | 118 |
| Depreciation | 20 | 12 | 71.7 | 39 | 23 | 71.0 | 50 |
| **PBT** | **88** | **33** | **164.4** | **188** | **62** | **204.3** | **200** |
| ( - ) Provision for current tax | 11 | 6 | 84.5 | 22 | 8 | 165.8 | 17 |
| ( - ) Provision for deferred tax (net) | 20 | 7 | 188.9 | 27 | 9 | 186.6 | 55 |
| ( - ) FBT | 1 | 1 | 108.3 | 2 | 1 | 66.7 | 3 |
| **Net Profit** | **56** | **20** | **180.4** | **137** | **43** | **219.3** | **125** |
| Equity Capital | 1,100 | 750 | | 1,100 | 750 | | 1,100 |
| Reserves ( excl rev res) | | | | | | | 1,861 |
| **Basic EPS for the period (Rs.)** | **0.5** | **0.3** | **91.2** | **1.2** | **0.6** | **117.7** | **1.1** |
| **Book Value(Rs)** | | | | | | | **27** |
| **OPM (%)** | **7.8** | **7.1** | | **8.7** | **8.1** | | **9.4** |
| NPM (%) | 3.7 | 2.0 | | 5.2 | 2.6 | | 3.2 |
| **Production (Mt '000)** | | | | | | | |
| Hot Metal | 45 | 35 | 26.3 | 88 | 64 | 37.5 | |
| Pig Iron | 41 | 33 | 23.4 | 80 | 60 | 33.2 | 141.9 |
| **Sales (Mt '000)** | | | | | | | |
| Pig Iron | 37 | 35 | 5.8 | 80 | 46 | 74.9 | 127.7 |

## Segmentwise results for the quarter & half year ended Sep'30, 2006 (Standalone)

| Particulars (Rs mn) | Quarter Ended | | | Half Year Ended | | | Yr Ended |
|---|---|---|---|---|---|---|---|
| | 30/09/06 | 30/09/05 | Gr % | 30/09/06 | 30/09/05 | Gr % | 31/03/06 |
| **Segement Revenue** | | | | | | | |
| a) Manufacturing | 672 | 622 | 8.0 | 1,397 | 743 | 88.0 | 2,150 |
| b) Trading | 875 | 510 | 71.4 | 1,346 | 1,028 | 30.9 | 1,967 |
| **Total Income (incl. other income)** | **1,547** | **1,133** | **36.6** | **2,743** | **1,771** | **54.9** | **4,116** |
| **Segment PBIT** | | | | | | | |
| a) Manufacturing | 152 | 54 | 181.8 | 294 | 88 | 234.4 | 242 |
| b) Trading | (15) | 50 | (130.5) | 6 | 80 | (92.0) | 193 |
| **Segment Profit** | **137** | **104** | **31.9** | **300** | **168** | **78.5** | **435** |
| Less: Unallocable Selling, General & | | | | | | | |
| Admin expenses(net of income) | 33 | 40 | (18.8) | 94 | 53 | 77.1 | 117 |
| Less: Depriciation | | | | | | | |
| **Total PBIT** | **104** | **63** | **64.1** | **206** | **115** | **79.2** | **317** |
| Less: Interest | 16 | 30 | (46.3) | 18 | 53 | (66.2) | 118 |
| **PBT** | **88** | **33** | **164.4** | **188** | **62** | **204.3** | **200** |
| ( - ) Provision for current tax | 11 | 5.7 | 84.5 | 22 | 8 | 165.8 | 17 |
| ( - ) Provision for deferred tax (net) | 20 | 6.8 | 188.9 | 27 | 9 | 186.6 | 55 |
| ( - ) FBT | 1 | 0.6 | 108.3 | 2 | 1 | 66.7 | 3 |
| **Net Profit** | **56** | **20** | **1.8** | **137** | **43** | **219.3** | **125** |
| **Capital Employed** | | | | | | | |
| a) Manufacturing | 2,922 | 819 | | 2,922 | 819 | | 2,887 |
| b) Trading | 170 | 14 | | 170 | 14 | | 29 |
| c) Unallocable | 7 | 52 | | 7 | 52 | | 45 |
| **Total** | **3,098** | **884** | | **3,098** | **884** | | **2,961** |
| **PBIT Margin (%)** | | | | | | | |
| a) Manufacturing | 22.6 | 8.6 | | 21.0 | 11.8 | | 11.3 |
| b) Trading | (1.7) | 9.7 | | 0.5 | 7.8 | | 9.8 |
| **Total** | **8.8** | **9.1** | | **10.9** | **9.5** | | **10.6** |
| **ROCE (%)** | | | | | | | |
| a) Manufacturing | 20.8 | 26.3 | | 20.1 | 21.5 | | 8.4 |
| b) Trading | (35.6) | 1,412.9 | | 7.6 | 1,141.2 | | 669.1 |
| **Total** | **17.6** | **46.8** | | **19.4** | **38.0** | | **14.7** |
| **Sales Mix (%)** | | | | | | | |
| a) Manufacturing | 43.5 | 55.0 | | 50.9 | 41.9 | | 52.2 |
| b) Trading | 56.5 | 45.0 | | 49.1 | 58.1 | | 47.8 |
| **Total** | **100.0** | **100.0** | | **100.0** | **100.0** | | **100.0** |

# Team

## Equity Desk

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|---|---|---|---|
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## Research

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| Sameer Ranade | - *Capital Goods / Utilities* | sameerr@pinc.co.in | 91-22-66186381 |
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| Abhishek Gangwani | - *Associate* | abhishekg@pinc.co.in | 91-22-66186385 |

## Institutional Sales:

| | | |
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## Dealing

| | | |
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| Manoj Parmar / Raju Bhavsar | equity@pinc.co.in | 91-22-66186323 |

## Business Development / New initiatives:

| | | |
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## Derivative Desk

| | | | |
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| Nilesh G. Inamdar | - *Dealer* | nileshg@pinc.co.in | 91-22-66186347 |

## PMS Desk

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| Hormasd Sumariwalla | hormasds@pinc.co.in | 91-22-66186389 |

## Directors

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