

Antique Stock Broking Limited



“ Indian Steel industry “today” is on the threshold of a major change as it gears up to give substance to an expansion plan that is ambitious by any standard. Joining forces with ‘primary producers’ are ‘secondary producers’, whose emergence in the post-liberalized decade had been initially modest. However over the years, they have made a significant contribution to the growth of the domestic iron and steel industry in terms of spread, capacity, production and commodity basket. We acknowledge their growing contribution in the Indian steel space and take a fresh look at the segment, traditionally labeled as secondary Steel producers,”

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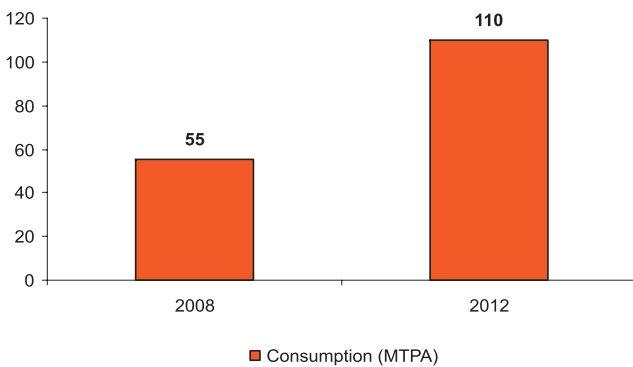
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Investment Highlights

India will consume 110 million tonnes of steel by 2012

The government of India has lined up an investment of USD 500 billion on infrastructure spending under 11th five year plan (2007-11). This will require India to consume additional 50-70 million tonnes of steel in the next 3-4 years. The annual demand for steel in India is growing by about 13% against production growth of just over 6 %

Projected Steel consumption

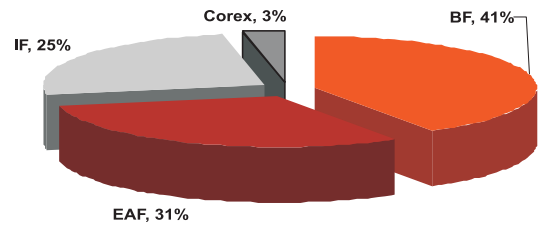


Source: Antique Research

Secondary Steel producers critical to meet India's steel demand

Primary integrated producers in the country produce majority of flat products (70%) and secondary producers (EAF Based) produce most of the long products (70%). Globally, 65.4% of crude steel is produced by BF/BOF route, 31.7% by EAF route and rest by Open Hearth method. In India, blast furnace/BOF route dominates with 41% share, followed by induction furnace at 31%, EAF at 25% and COREX at 3%.

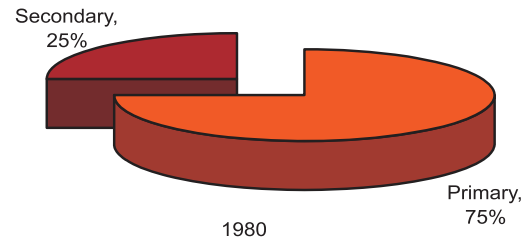
Market share by production route (FY08)



Source: Antique Research

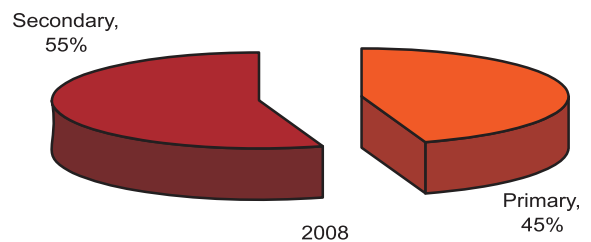
Over the years secondary steel producers have grown leaps and bounds. Their share in the total Indian steel production was close to 25% in the 80's which has grown to almost 55% currently. It started off as a support for the primary steel producers in the early 70's which over the years evolved and came in sync with the primary producers.

Market share Primary vs Secondary (1980)



Source: Antique Research

Market share Primary vs Secondary (2008)

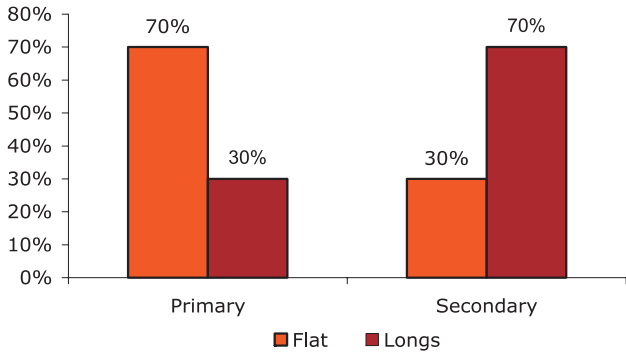


Source: Antique Research

Dominance in Long product Segment

Secondary producers are more dominant in the long product segment which is witnessing a huge demand from construction boom in India. While the primary producers enjoy 70% of the market share in flat products, its completely opposite in the long product segment where the secondary producers lead the 70% market share.

Long product vs Flat products



Source: Antique Research

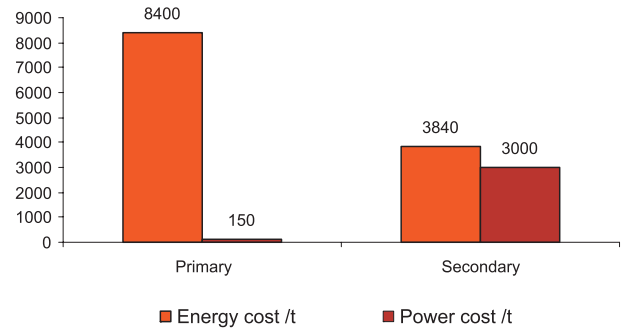
Indian Steel Industry is highly energy intensive

Indian steel industry is characterized by fragmentation, particularly in the downstream segment, with a large number of unorganized players. Energy intensiveness of Indian steel industry is highlighted by its consumption of about 10% and 27% of total electricity & coal consumed respectively by the entire Indian industry.

Secondary Steel producers better off in terms of energy consumption

The electric arc furnace (EAF), on an average, consumes 750 Kwh of power to produce one tonne of steel. In the current scenario, the cost of coke, which is at \$650-700/t (equivalent to 15,000 kWh of captive electricity), has made EAF one of the most cost and power-efficient routes of producing steel. Even at normalized rates of \$120-150/t, the cost of production (COP) through EAF is 15-20% economical than the traditional blast furnace route of production. Energy cost under normal conditions

Energy Consumption (Primary vs Secondary)

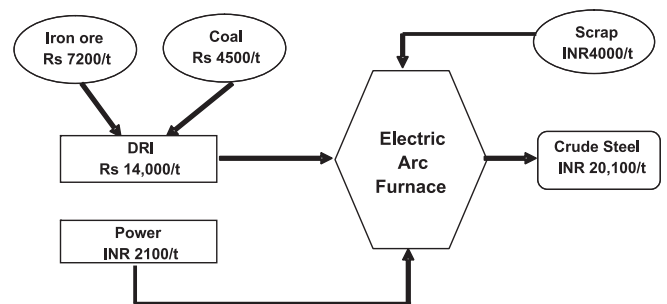


Source: Antique Research

Secondary Steel producers has low cost production technology

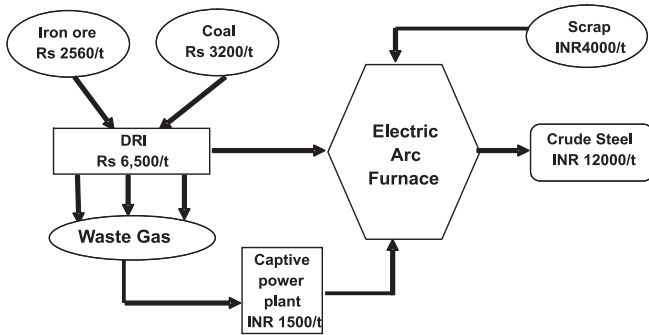
Cost of production of steel depends on technology employed for production and extent of backward integration, sourcing of power and raw material. Typically power consumption per tonne of steel produced ranges between 750-1000 Kwh. Raw material accounts for 50- 60% and energy (coal and power) 25-35% of total cost of production. India has self sufficiency in iron ore and coal but for coking coal, coke and scrap it has to depend upon imports.

Cost of Production (Non Integrated Secondary)



Source: Antique Research

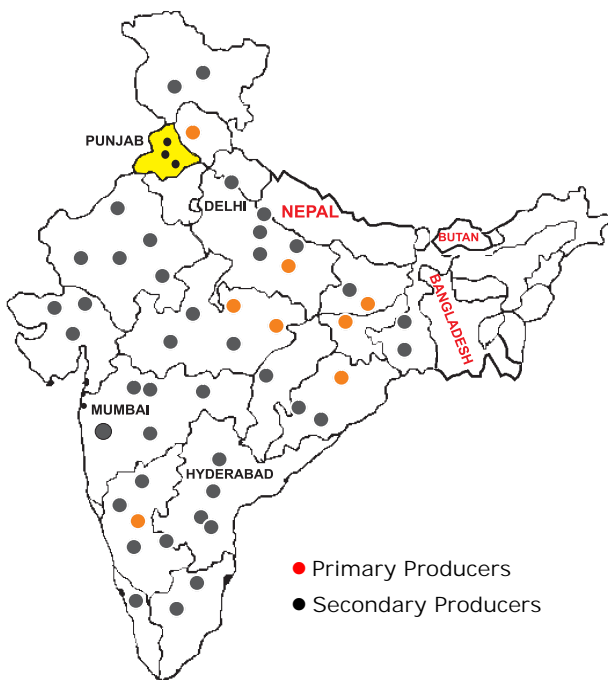
Cost of Production (Integrated Secondary)



Source: Antique Research

Geographically well spread

One of the other important aspects of the emerging importance of secondary producers is their geographical spread. The emergence and presence of this heterogeneous group of units, with their varied commodity basket in different parts of the country, have helped steel reach the common man and, of course, the local industry, aiding in turn, the growth of the regional industry and hence the overall economy.



Secondary steel sector - To lead the road ahead

As per the projected plan, India will consume an additional 50-70 mt of steel to accomplish the infrastructure spending outlined in the 11th Five Year Plan. The Indian steel industry is highly dependent on the secondary steel sector, which currently contributes 60% of the total finished steel production in India. Secondary steel producers dominate the long steel product segment, which is the primary feedstock for the infrastructure and construction industry. Provisional data indicates that the secondary steel sector is growing more rapidly than the primary steel sector. While the primary steel sector's production grew by 2.2% (y-o-y) in 2007-08, the secondary steel sector clocked a robust growth of 7% (y-o-y). We believe, going forward, the secondary steel sector will continue to outpace primary steel producers in terms of growth led by Strong cash flow, flexible product mix, raw material security and rising degree of integration. We believe secondary producers are formulating efficiency-enhancement plans with an eye on current market trends and their possible future unfolding.

In this report we cover four companies which are fairly integrated in terms of forward and backward operations offering significant cost advantages

Winners

Adhunik Metaliks Limited -Rich in natural resources (CMP: INR 102, TP: 160, Buy)

AML owns a 'treasure chest' in the name of Orissa Manganese and Minerals Limited (OMM), a 100% merchant mining subsidiary. AML has estimated iron ore and manganese ore reserves of 90 mt and 50 mt, respectively. The mines are operational and remain one of the key drivers of the company's profitability on the back of soaring iron ore and manganese ore prices. Besides, it has also been allotted captive iron

ore and coal mines with reserves of 25 mt and 62 mt, respectively, for their steel-making operations. Further, it is in the process of setting up an independent power plant (IPP) of 1,000 MW, for which it has been allotted a captive coal mine with estimated reserves of 65 mt. The financial closure of the first phase of the IPP comprising 250 MW is completed, which is expected to go on-stream in FY11. AML has captive power generation facilities, which take care of its entire power requirement at steel-making facilities. AML is rapidly emerging as a mining-cum-steel-cum-power player with more than 0.25 billion tonnes of natural resources under its belt. We expect the company's consolidated EBITDA to grow at a CAGR of 95% over FY08-10e.

Sarda Energy and Minerals Limited - Getting Integrated (CMP: INR 278, TP: 380 Buy)

SEML is one of the few secondary steel makers, with an operational iron ore mine. Besides, the company has been allocated coal and manganese ore mines. The commencement of these mines will complete the entire backward-integration chain and lead to re-rating of this stock. Captive mines will provide raw material security, besides ensuring low-cost raw material. Further, the company has lined up a robust expansion plan, which will strengthen the volume growth over the next 2 years. It has captive power generation facilities of 48 MW, which meets its entire energy requirement. We expect the EBITDA and PAT of SEML to grow at a CAGR of 54% and 51%, respectively, over FY08-10e.

Godawari Ispat and Power Limited - Strong volume growth and increasing backward-integration (CMP: INR 198, TP: 310 Buy)

GPIL has just completed its robust capacity expansion plan, which was scheduled for FY08. We expect a CAGR revenue growth of 20% over 2008-10e on the back of

new capacities going on-stream and higher capacity utilizations of existing facilities. The company has been allotted a captive iron ore mine, with estimated reserves of 15 mt, for which the company received the in principle forest clearance recently. Additionally, it has received a prospecting licence (PL) for an iron ore mine, with estimated reserves of 60 mt. It has also been allotted captive coal mines with its share of reserves to the extent of 100 mt in consortium with other corporates. We expect the mines to become operational in the next 2 years, and benefits to start accruing post-FY10. GPIL has a captive power plant with a capacity of 53 MW, which ensures cheap availability of power for its entire operations demand.

Led by strong volume growth and attractive product mix, we expect healthy earnings growth for GPIL. While its revenue is expected to grow at a CAGR of 20% over the next 2 years, its net profit will grow at a CAGR of 50% on the back of captive power, higher economies of scale and increasing proportion of raw material linkages.

VISA steel - Small, but raring to grow (CMP: INR 48, TP: 70 Buy)

VSL is rapidly moving upwards along the vertical integration chain. It is just left with the last leg of complete vertical integration, which will be completed with the installation of a 500-ktpa special steel unit by H1FY11. Its efforts towards establishing backward-integration resulted in the allocation of a captive coal mine at Patrapara in Orissa. Additionally, the company has been recommended a captive iron ore mining lease in Orissa, which is likely to materialize soon. VSL acquired Ghotaringa Minerals Limited (89% subsidiary), which has access to chrome deposits. Chrome ore will ensure steady supply of cheap chrome ore to its ferro-chrome unit. We expect a revenue and EBITDA of VSL to grow at a CAGR of 50% & 95% respectively over 2008-10e.

Comparative valuation

Particulars Year	Antique EPS F'cast		B'berg EPS F'cast		Antique Rating	Target Price INR	Potential Upside	Antique vs Consensus	
	FY09e	FY10e	FY09e	FY10e				FY09e	FY10e
Sarda Energy & Minerals Limited	49.5	80.4	48.3	85.1	BUY	380	48%	2%	-5%
Adhunik Metaliks Limited	22.5	37.4	14.8	25.1	BUY	160	55%	52%	49%
Godawari Power & Ispat Limited	45.9	74.0	50.4	64.6	BUY	310	58%	-9%	15%
Visa Steel Limited	11.4	17.5	15.1	14.3	BUY	70	50%	-24%	23%

Peer valuation

Company name	B'berg Code	Mcap (INRm)	Antique Rating	PE		EV/EBITDA		P/BV	
				FY09e	FY10e	FY09e	FY10e	FY09e	FY10e
Sarda Energy & Minerals Limited	SEML IN	8,715	BUY	5.3	3.2	3.0	2.2	1.8	1.1
Adhunik Metaliks Limited	AML IN	9,442	BUY	4.2	2.5	4.4	2.8	1.4	0.9
Godawari Power & Ispat Limited	GPIL IN	5,517	BUY	4.3	2.7	3.6	2.5	1.4	1.0
Visa Steel Limited	VSL IN	5,181	BUY	4.0	2.6	6.2	3.4	1.0	0.7

Secondary Steel producers, not secondary anymore

Overview

Since the deregulation of the steel industry in India in 1991, the Indian iron and steel industry has come a long way to occupy a dominant position in the socio-economic development of the country. Today, India is the world's fifth-largest producer of steel, with a production capacity of close to 55 mt. In the last 5 years, Indian steel consumption grew at a CAGR of 9.5%. India's per capita steel consumption at 40 kg is fairly insignificant as compared with 150 kg and 300 kg for the world and China, respectively. This clearly indicates that the Indian iron and steel industry is due for a significant and rapid growth going forward.

Steel industry performance - FY08

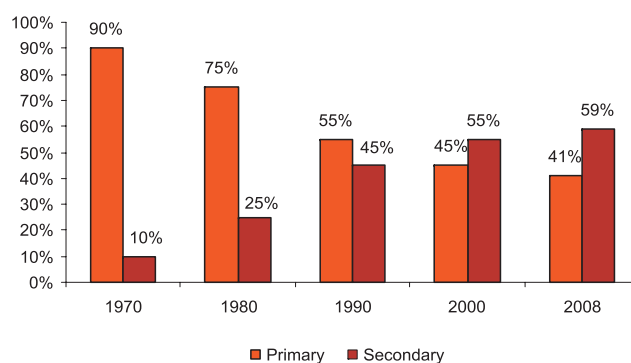
India produced a total of 55.26 mt of steel in FY08, up 5.2% (y-o-y). While primary producers contributed to 35% (+2.2% y-o-y) of the total production, secondary steel producers contributed 70% (+7% y-o-y). During this period, steel exports declined by 3.7% to 5.05 mt. Steel imports were at an estimated 7.18 mt, up 45.7% y-o-y. Real consumption grew by 10.7% to 51.8 mt as against 46.8 mt in the previous year. India became a net importer of steel for the first time in many years to the tune of 2 mt in 2007

Evolution of Secondary Steel Sector

The 1970s saw the emergence of the secondary sector (small-scale steel producers who opted for the scarp-DRI based EAF/IF routes) to meet primarily local demand. Semi-finished ingots/billets produced by this

segment, in turn, led to the commissioning of a large number of re-rolling units to convert the semi-finished steel into bars and rods to be used mainly by the construction industry. Today, the secondary producers segment is distinctly heterogeneous, not only in its composition but also spread, capacity level, capacity utilization and production/items of production. It consists mainly of mini blast furnace units, sponge iron producers, IF and EAF units, re-rolling (RR) units, wire-drawing units.

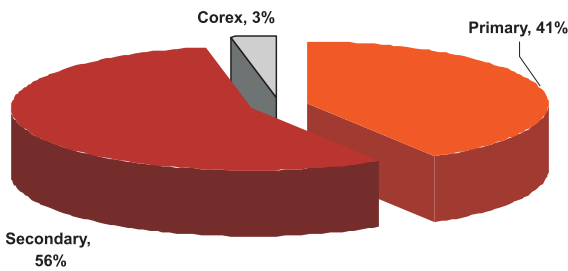
The rise of Secondary Steel Producers



Source: JPC, Antique Research

Provisional data for 2007-08 indicates that production for sale by primary producers was at 18 million tonnes (mt), while it was 37 mt for secondary producers combined. Respective growth rates were 2.2% and 7% over the same period in the previous year. The secondary sector contributed as much as 65% of the total finished non-alloy steel production, the remaining being the share of primary producers. In fact, a study of the share/contribution of the secondary steel sector over the last 3 years indicates its dominance everywhere, from pig iron (80% as compared with 74% in 2003-04) to finished (non-alloy) steel (65% as compared with 59% in 2003-04), and in the case of sponge iron, the growth has been led by secondary producers alone. Bars and rods, and structurals in long products are the categories where the secondary steel sector dominates.

Market share (FY08)



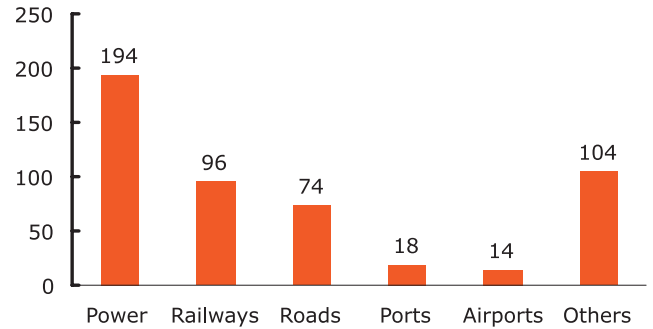
Source: JPC, Antique Research

The most critical aspect of the secondary steel sector's emergence is that it has become the driver of growth in many areas in recent times, aiding and supplementing production by main producers.

Infrastructure spending- Fundamental for strong growth in Indian steel industry

The 11th Five Year Plan envisages an investment of \$500 billion for India's infrastructure development, marking a growth of 180% over the previous Five Year Plan. Significant investments have been lined up to ensure the country's steady and sustained development. Besides, rising income levels and the growing middle class have boosted demand for automobiles and consumer goods substantially. India has also witnessed a healthy construction boom both on the residential and commercial front, which is evident by soaring property prices. Although infrastructure spending is moving currently at a modest pace marred by structural problems and macroeconomic issues, we believe the spending will gain pace gradually, leading to a sustained demand of steel over the next 5-10 years.

Projected infrastructure spending under 11th Five Year Plan (2007-11) USD bn



Source: Planning commission, Antique research

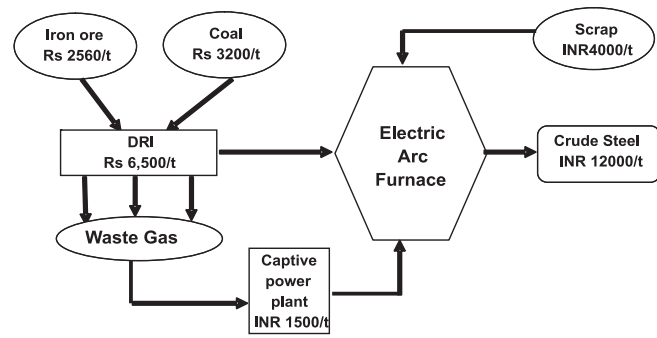
DRI-Scrap-EAF - Low cost production process

One of the strong advantages of secondary steel producers lies in their production process. In the current scenario, wherein blast furnace producers are facing serious issues in terms of securing coking coal supplies at an economical cost, EAF and IF producers are increasingly capitalizing on their production process on the back of non-requirement of coking coal. Generally, their production process requires sponge iron (DRI), which is produced in abundance in India. In fact, India is the world's largest producer of sponge iron. Sponge iron is mixed with scrap and melted in an EAF to produce steel. Most secondary steel producers have their own DRI unit, which is produced at a cheaper cost on the back of domestic availability of iron ore and coal.

One of the critical factors of this production process is power. The electric arc furnace (EAF), on an average, consumes 750-1,000 units of power to produce one tonne of steel. In the current scenario, the cost of coke, which is at \$650-700/t (equivalent to 15,000 kWh of captive electricity), has made EAF one of the most cost and power-efficient routes of producing steel. Even at normalized rates of \$120-150/t, the cost of production (COP) through EAF is 10-15% economical than the traditional blast furnace route of production.

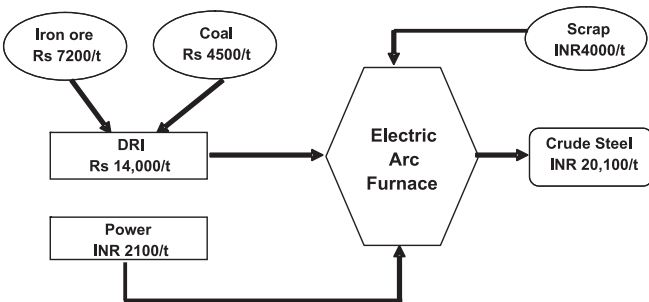
Currently, blast furnace producers are facing serious issues in terms of securing energy through coking coal supplies at an economical cost. On the other hand, EAF and induction furnace (IF) producers are increasingly capitalizing on their production process via easy availability of energy through coal and waste gas. Generally, their production process requires sponge iron (DRI), which is produced in abundance in India. A DRI unit provides significant advantage by emitting waste gas, which is tapped to produce cheap captive power.

COP: Integrated Secondary



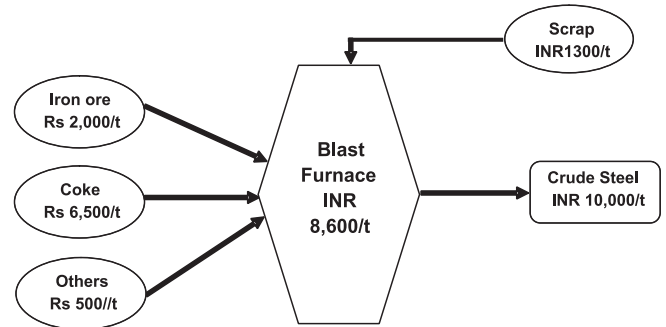
Source: Company, Antique research

COP: Non Integrated Secondary



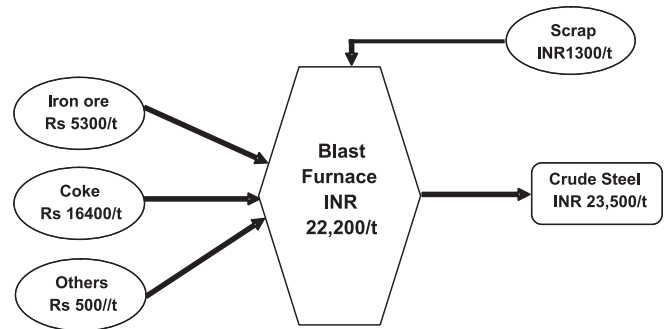
Source: Company, Antique research

COP: Primary Integrated



Source: Company, Antique research

COP: Primary Non Integrated



Source: Company, Antique research

Consumption norm

Tonnes	Units	Primary	Secondary
Iron Ore	Tonnes	1.6	1.7
Coal	Tonnes	-	1.6
Coke	Tonnes	0.6	-
Power	Kwh	25	1,000

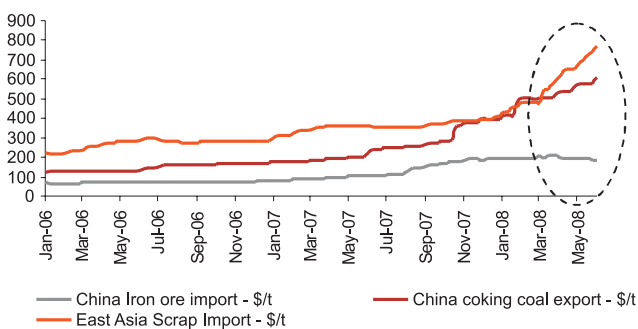
Source: Company, Antique research

This production process insulates producers from dependence on the imported raw material and its volatile prices. All of our stock picks have integrated facilities in terms of their own DRI production and captive power generation facilities. This provides a significant cost benefit to these producers, thus resulting in handsome margins.

Backward-integration - Key to sustainable growth

Rising steel prices have increasingly become the focal point. Never in the past many years has the market witnessed such a steep rise in steel-making raw material price. Had it not been for the strong demand supporting high steel prices, half of non-integrated steel makers would have been wiped out of the market. Backward-integration provides low cost of production and significant margin of safety, which keep earnings insulated even in cyclical downturns. While integrated steel producers make super normal profits in cyclical upturns, they manage to make normal profits in a stable cycle.

Rising raw material prices (source)



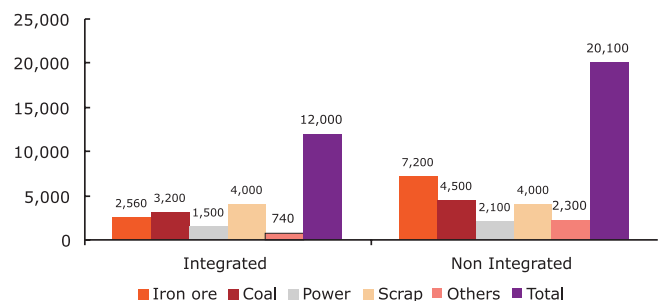
Source: Bloomberg, Antique research

Integration benefits

Integration across the process chain is one of the key advantages of secondary steel producers. Generally, standalone DRI producers enjoy an operating margin of 6-9% under normal market conditions. Producers with a captive power unit enjoy a slightly higher margin in the range of 12-16%. Further, producers having backward linkages in terms of captive iron ore and captive coal mines enjoy the best margins in the range of 30-35%. Growth in the Indian steel sector in the last 5 years has boosted the confidence of secondary steel makers, who have realized the importance of integration for maintaining earnings stability in turbulent market conditions.

Rising raw material prices, coupled with tight supplies, has led the whole steel industry scramble for backward-integration through acquiring captive raw materials to ensure raw material security at economical cost. India, with huge reserves of iron ore and coal, remains one of the lowest cost producers of steel in the world. In such a scenario, steel makers with backward-integration would remain the clear winner. While cheap raw materials will keep their production cost low, high steel prices on the back of cost-push will substantially enhance their margin of safety.

COP comparison (Integrated Vs Non Integrated)



Source: Antique research

Strong local political connection

One of the biggest disadvantages for steel manufacturers in India is securing requisite regulatory approvals on a timely basis. That is one of the key reasons for consumption growth outpacing production growth in India on a y-o-y basis. We have identified one factor, which we believe, plays a key role in the growth and expansion of steel manufacturers in India and that is the hold and ties of these steel makers with the local government. Though secondary steel producers are small in size as compared with primary producers, they enjoy significant advantages in term of speedy capacity expansion on the back of strong ties with the local government and modest capital investment.

Challenges and opportunities ahead

All these factors make it imperative to inquire into the secondary sector's prospects of growth. Setting apart the diversity, one discovers that segments such as sponge iron, IF and re-rolling are poised for fresh spurt in expansion, which entails challenges and issues to be addressed. For example, for sponge iron, where there has been a major mushrooming of coal-based units in mineral-rich states, the prospects for future growth are bright having a direct linkage with growth in steel. However, main challenges facing this segment are acquiring adequate quantity of iron ore and proper grade of coal, besides dealing with environmental issues.

Similarly, for the IF segment, the low investment cost and flexibility in operation are major edges for this leading consumer of coal-based DRI. Prospects for future growth are directly tied with growth in its downstream consumer industry (re-rolling), which in turn, would encourage growth in the DRI industry. Moving over to the re-rolling segment, challenges include facing market volatility, especially prices and

operational factors like high-energy consumption. Prospects for future growth may be considered bright, given the pace and scale of infrastructure/construction activities.

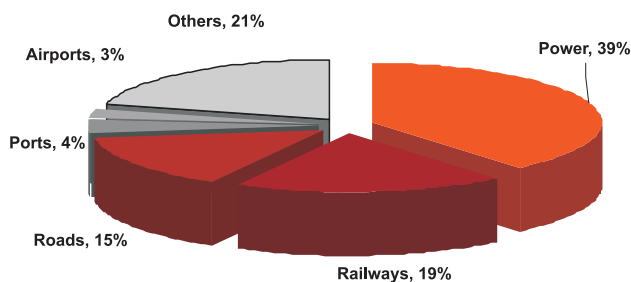
Such prospects are captured in the projections of the Government of India's 11th Five Year Plan, which indicate that the share of secondary producers in total crude steel production would rise from the present below-50% mark to 53% at the end of the plan period, as the secondary sector consolidates its position further.

Boosters

Need for long steel products under planned infrastructure development

The 11th Five Year Plan envisages an investment of \$500 billion for India's infrastructure development, marking a growth of 180% over the previous Five Year Plan. Significant investments have been lined up to ensure the country's steady and sustained development. Besides, rising income levels and the growing middle class have boosted demand for automobiles and consumer goods substantially. India has also witnessed a healthy construction boom both on the residential and commercial front, which is evident by soaring property prices. Although infrastructure spending is moving currently at a snail's pace, marred by structural problems and macroeconomic issues, we believe the spending will gain pace gradually, leading to a sustained demand of steel over the next 5-10 years.

Projected infrastructure spending under 11th Five Year Plan (2007-11)



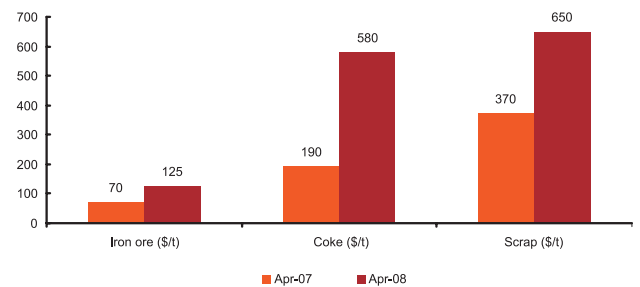
Source: Planning Commission, Antique Research

Higher efficiency through Production integration

A question that is niggling at everyone in the steel industry today is the raw material pricing.

Soaring raw material prices has significantly impacted operating margins of non-integrated steel makers, who have to depend on the spot market or long-term contracts to meet their raw material requirements. Raw material prices have climbed by as much as 65% and 200% for iron ore and coking coal, respectively, as compared with 2007 levels. Prices are expected to rise further in a couple of years. In the current market, the landed cost of captive iron ore costs at around INR 800-1000/t (\$20-25) vis-à-vis the contracted cost of INR 3,500/t and the spot market cost of INR 5,000-5,500. Similarly, steel makers with captive mines for coking coal have to incur a modest \$50-70/t against \$300/t in the spot market. Therefore, we strongly believe that backward-integration in terms of captive raw material will make potential leaders in steel-making going forward.

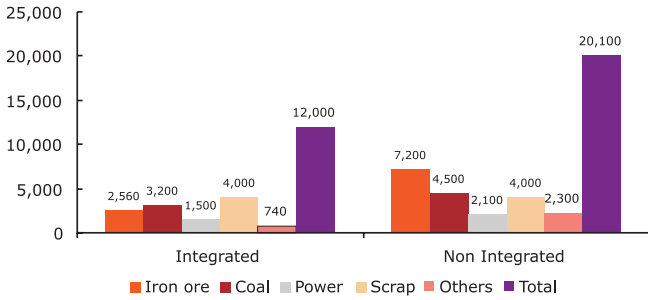
Change in raw material prices



Source: Antique Research

The chart below clearly shows the benefit enjoyed by integrated steel-makers having captive mines as against non-integrated steelmakers, depending on contract and spot market purchases. Such significant cost-push severely impacts operating margins of steelmakers in an environment, where they are unable to pass on the complete cost hike to end-users.

COP Comparison - Integrated Vs Non Integrated



Source: Antique research

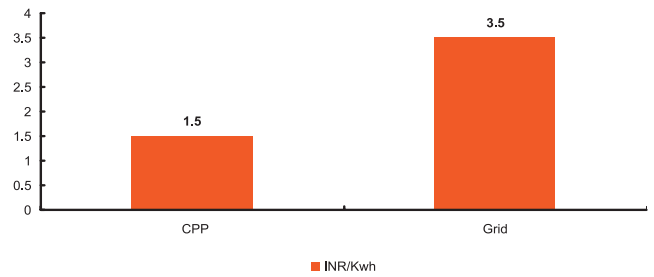
We strongly believe that in a scenario, where raw material costs are expected to increase year-on-year, except for integrated players, it would be extremely difficult for non-integrated steelmakers to maintain or insulate their operating margins. Integrated steelmakers remain clear winners in the steel industry today.

Captive Power generation

DRI-SCRAP-EAF is a power-intensive route. EAF depends on electric power for producing melting steel. Steelmakers source power either from the state grid or from their own captive power facilities. Captive facilities provide significant cost advantage, as power generation cost is much cheaper than purchase cost from external sources. Most steelmakers producing steel through this route have the advantage to tap waste heat gases emanating from the DRI kiln to produce power. It benefits are twofold: the cheaper cost of generation and additional revenue through sale of carbon credits. While the cost of generation through CPP is around INR 1-1.5/unit, the cost of purchase through grid is anywhere between INR 3.5-4/unit. This implies a saving of INR 1.5 per unit. EAF consumes an average of 800 units of power to produce one tonne of steel. It means a savings of 1,200/t of steel production. We believe captive power facilities remain a significant ad-

vantage with secondary steel producers in terms of power availability and cheap cost.

Cost of power comparison

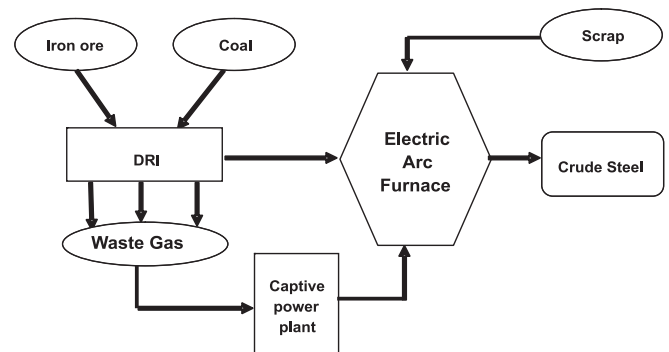


Source: Planning Commission, Antique Research

Low cost production route

Most secondary steel producers produce steel through the DRI-SCRAP-EAF route, which eliminates the dependence of steelmakers from coking coal, which currently has availability and affordability issues. India is abundantly rich in iron ore and thermal coal reserves, which remains an advantage for secondary steel producers. They need iron ore and thermal coal to produce DRI, which is readily available domestically at an economical cost.

Production route - Secondary Producers



Source: Antique Research

One of the critical factors of this production process is power. EAF, on an average, consumes 750-850 units of power to produce one tonne of steel.

In the current scenario, the cost of coke, which is at \$650-700/t (equivalent to 15,000 kWh of captive electricity), has made EAF one of the most cost and power-efficient routes of producing steel. Even at normalized rates of \$120-150/t, the COP through EAF is 10-15% economical than the traditional blast furnace route of production.

However, steelmakers with backward-integration enjoy a higher margin of safety. In recent times, we have seen that rising scrap prices have led to higher substitution of scrap with sponge iron. In the current scenario, where steelmakers depending on coking coal for steel production are facing tight supplies and high cost issues, integrated secondary steel producers, with domestic availability of iron ore and thermal coal and captive power, are in a much better position to cater to the country's growing demand for steel.

Busters

Macroeconomic conditions

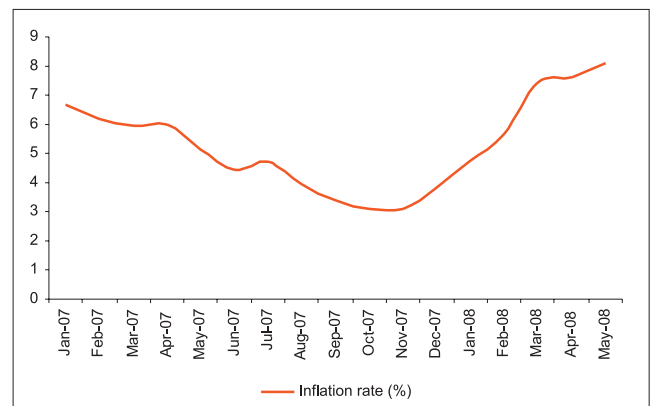
On numerous occasions, we have seen the Central government tightening its monetary policy 2007 on the back of rising inflation. Inflation has already surpassed 10% levels. Tightening of monetary policy has eased the economic growth in the past 3 quarters. Further, tighter monetary policy resulted in weaker credit conditions and consumer durable demand, while the rising rupee affected export earnings. This also affected the manufacturing sector, where output growth has markedly slowed in the second half of 2007. The Budget 2008-09 for fiscal the year projects the fiscal deficit to 3% of GDP, and tax revenues to 13% of GDP. However, the budget omits large subsidies for food, oil and fertilizers, which we expect will bring the actual deficit closer to 8% of GDP. The upside risk to our expected fiscal deficit is further supported by the farm loan waiver to the tune of \$15 billion, and the revision of the sixth pay commission.

Cumulative monetary tightening, appreciating rupee and weaker global economy will slow down the Indian expansion in 2008. We believe, with rising food and crude oil price, inflation will continue to gain in the coming months, despite of government's best efforts. The widening fiscal deficit will impact the planned infrastructure spending. While high inflation will keep the interest rates high discouraging private participation, a widening fiscal deficit will see the industrial growth and infrastructure spending easing off.

We feel prevailing macroeconomic conditions in India might slow down the steel demand growth in the near term. We have already seen the government intervention in pricing of steel products and tightening policies in the form of imposing export taxes. However, we expect the conditions to improve in the second half of FY09 on the back of government efforts to improve

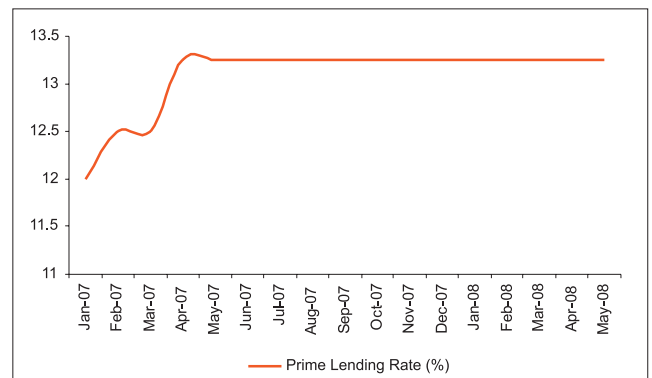
macroeconomic issues. We remain cautious on the Indian steel sector for the next 12 months, but maintain our bullish view on its sustained long-term growth.

While inflation never seems to get tired of climbing up ...



Source: Bloomberg

Interest rate seems to maintain a straight path



Source: Bloomberg

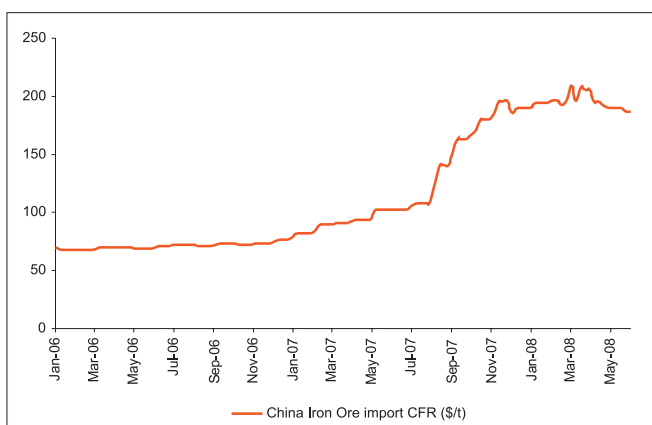
Draconian raw material prices

Although India is rich in iron ore and thermal coal reserves, raw material procurement remains a major challenge for Indian steel producers. While most steel producers aspire for captive mines, only handful of

steelmakers in India enjoys such facility. The way raw material prices have shot up recently, every steelmaker has now started to scout for captive mines.

Steelmakers are facing issues on iron ore front in two areas: rising prices and difficulty in securing raw material linkages. Iron ore exports to China from India, on a spot price basis, have hit the industry very hard. As much as 50% of the total production of iron ore is exported out of India. To overcome this issue, the government increased the export duty on iron ore and concentrate by imposing an export duty of 15%. China's soaring demand for iron ore has increased prices by almost 250% in the last one year in the international market. Iron ore, which commanded a price of \$50 in January 2007, is today ruling at \$180-200. Therefore, all iron ore miners, including NMDC, are stepping up iron ore prices to match international prices. Similarly, coal prices saw a steep jump in prices (almost 200% from the previous year) on the back of strong global demand, increasing logistics cost and natural disturbances in some part of mineral-rich nations.

China Iron ore import prices

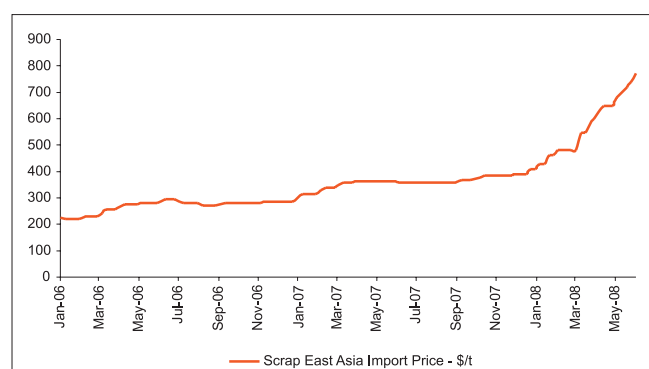


Source: Bloomberg

There has been a steep surge in global scrap steel prices on the back of strong demand from EAF producers and general supply shortage. Prices in the US rose to \$680

per tonne, up by \$160 per tonne above the price of heavy melting scrap at about \$520 per tonne and \$100 per tonne above the shredded scrap at \$580 per tonne. Prices of East Asia Imports increased from \$220 per tonne in May 2007 to \$700 per tonne in May 2008.

East Asia Scrap Import Prices



Source: Bloomberg

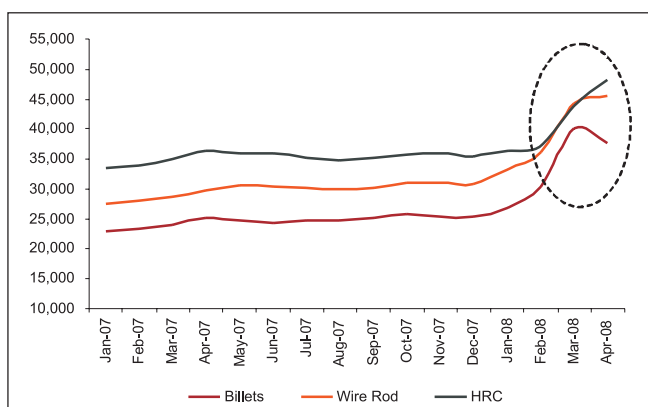
Steelmakers, who depend on the spot market for raw material supplies, do not find the business viable anymore. A cap on the selling price and restriction on exports are further adding to the woes of steel companies, which are already troubled on the margin front. We feel it high time the government started looking at these issues to ensure a long-term sustainable growth of the Indian iron and steel industry

High steel prices

Rising steel prices have become the focal point today. On the back of a strong domestic demand and rising raw material costs, considered to be a worldwide phenomenon, trends in domestic steel prices have been both strong and steady throughout 2007-08. Rise in steel prices has been substantial for both long and flat steel during 2007-08 vis-à-vis 2006-07 average domestic prices of HRC, which have shown an increase of 10% during 2007-08 as compared with 2006-07. But between April 2007 and March 2008, the same rose by 27 per cent, aided by a strong 21% growth in Q3 2008,

the period during which average international prices of HRC reported to have increased by 35 %. Similarly, long steel prices followed the same trend. Long product prices rose as much as 50% y-o-y in April 2008. High steel prices have adversely affected end-user industries such as infrastructure, construction and automobile, which is clearly visible in the declining m-o-m growth. While rising flat product prices have affected the demand from the automobile industry, soaring long product prices have adversely impacted the construction and infrastructure industry, given the fact that long product prices rose higher than flat product prices.

Rising Steel prices (INR/t)



Source: JPC, Antique research

Government intervention - A huge risk

We remain very cautious on the steel prices prevailing in the market today. Though the steel prices remain very strong in the global market, same is not the case in the domestic market. Deteriorating macro economic conditions in the domestic market has compelled the government to intervene in the pricing mechanism of commodity producers like steel and cement. In this context the steel producers in India consented to hold the steel prices for three month from May 08 to July 08 to control the rising inflationary pressure with the domestic economy. However it is evident that even after price holding for three months the macro economic condi-

tions doesn't seem to improve. Rising input cost is severely affecting the margins of steel producers and if in such scenario if they are not allowed to pass on the cost push to the end users we might see a significant slowdown in the earnings of Indian steelmakers

Sensitivity of earnings to price changes

Steel prices are the primary drivers of earnings for any steel company. As such the earnings of a steel company is highly sensitive to steel price changes. In the current situation wherein the steel prices have gone over the roof, we think further upside is capped while a downside is inevitable.

We have already assumed a 15-20% discount in our steel price assumption for FY09e. Steel prices in India are already trading at a discount of 20%-30% to the global prices. As such we believe that the valuation of our companies have already factored in any steel price correction in FY09e

Steel & RM price assumption (INR/t)

Products	6 mth avg	Assumption	Prem/Disc
Sponge Iron	21,200	17,000	-20%
Billets	34,000	30,000	-12%
Rolled Products	40,000	35,000	-13%
Ferro Alloys	90,000	60,000	-33%
Cost Assumptions	Captive	Contracted	Spot
Iron ore	1,250	4,000	5,500
Coal	1,000	2,000	3,800
Power	2.0	3.0	4.0

Source: Company, Antique research

End-user industry concerns

Key drivers of the soaring steel demand in India are industries related to infrastructure, construction, automobile and power. In recent years, the Indian steel sector has witnessed considerable amount of investment plans from both existing and emerging players on the back of strong demand growth from the end-user segment. However, things have changed in the last 6 months. End-users, who were key drivers of steel

consumption in India, have been facing tough times, led by deteriorating macroeconomic conditions, global credit crisis, high interest rates and general economic uncertainty.

Infrastructure

The infrastructure sector comprises roads, railways, airports and power. The 11th Five Year Plan has lined up massive investments in the entire related sector. The projected investment towards infrastructure during the 11th Five Year Plan is likely to be \$500 billion, an increase of 180% over the 10th Five Year Plan. Due to the focus on infrastructure, the demand for long products is gradually increasing, and the ratio of flat to long product narrowing. This explains the reason why flat steel prices rose just 30% as against a 60% jump in long steel prices. Though this remains a positive for secondary steelmakers, who dominate the long product market, rising steel prices are stabbing them from behind. While high steel prices are escalating the project cost (thus affecting margins), worsening macroeconomic conditions like high interest rates and rising fiscal deficit are keeping investments at bay. This has already started taking a toll on infrastructure spending and industrial production growth as highlighted below.

Construction

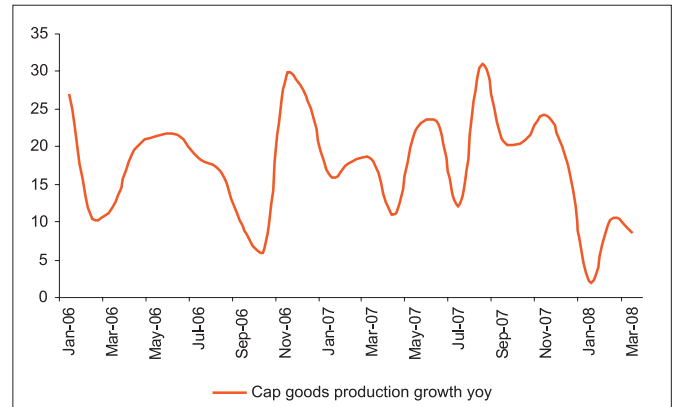
Over a period of 5 years, India has seen massive investments in the construction sector. Favorable interest rates and rising income levels of the Indian middle class contributed to the spurtd the demand for housing and commercial spaces. The construction industry has been witnessing a growth rate of 12-14% in recent times. However, worsening credit conditions, coupled with high interest rates and soaring steel prices, have adversely affected the gorwth in the construction sector. Any slowdown in the construction sector will have an adverse impact on the demand for long products, which in turn will affect the growth of secondary steel producers, who are predominantly long steel makers.

Slowing industrial production growth



Source: Bloomberg

Declining capital goods production growth



Source: Bloomberg

House View

We believe Indian iron and steel industry has a long way to go. Being the world's fifth-largest producer of steel with an average per capita consumption of just 40 kg reflects a dire need and immense scope for the industry growth.

Fundamentally, the Indian steel industry holds its grounds...

.....in the long-term on the back of huge investments lined up in infrastructure (\$500 billion during the 11th Five Year Plan). However, in the near term, risk arises from worsening macroeconomic conditions, tightening of policy, and the inability of companies to pass on the increase in raw material prices. Although we are bullish on the Indian iron and steel industry's long-term growth, we feel it has entered a turbulent phase of uncertain and lethargic growth.

We maintain a cautious stance on the Indian steel sector...

.....on the back of uncertain and sluggish growth in construction, infrastructure and automobile sectors, which are supposedly the key drivers of iron and steel industry. Additionally, deteriorating macroeconomic conditions, led by high inflation and high interest rates, are looming large on the Indian economy in general, which will affect the infrastructure spending and capital investment both on the public and private front. Soaring raw material cost has sent steel prices through the roof, which has invited buyer's resistance, thereby dampening the consumption growth. Recent developments, including a cap on the selling price, restriction on exports, a weak rupee and higher input prices, have added to the woes of steel companies, which are already troubled on the margin front. We believe these developments will not only severely hurt the profitabil-

ity of the steel industry, but also discourage investors from making new investments in the sector. While there is risk in investing in this sector, which is mired by uncertainty and political intervention, **Investments with a long-term perspective in highly integrated steel makers with an attractive product mix remains a rational option for value investors.**

The domestic steel demand is growing at over 11-12 %, whereas the supply is lagging behind at about 6%.

As major expansion plans are expected to go on-stream from FY09-10, with the exception of the 1.8-mt expansion of Tata Steel (expected by June 2008) and the 3-mt expansion of JSW Steel (expected by September 2008), the supply of steel is expected to remain tight. We believe this throws up a significant opportunity for the secondary steel producers to grow and support the expanding Indian steel market. We expect to see an increasing contribution from the secondary steel sector in meeting the expanding steel demand in India. We are more inclined towards integrated secondary steel players, who remain insulated from the raw material cost escalation and enjoy high margin of safety. The Indian steel industry has ended 2007-08 on a buoyant note, in the backdrop of Indian economy, growing at a projected 9% growth rate. We believe the underlying potential of a strong growth in the Indian iron and steel industry will lead to a phase, which would in all likelihood witness the secondary steel sector further gaining dominance and criticality in the overall operations of the Indian iron and steel industry.

Catalyst

We believe if a positive development in the form of government policy (roll-back of the export duty or input prices by government-owned companies) takes place, or in case material prices stabilise or decline globally, there could be a dramatic change.

Conclusion

The Indian steel industry is in a distinct mood of consolidation. Long-term plans for capacity expansion, changes in product-mix, smoothening out raw material availability, cost-cutting and efficiency-enhancement plans are all being formulated with an eye on the current market trends and its possible future unfolding. The sustained continuity of the upturn in the market has in fact reinforced the ability of indigenous steel producers to take bold initiatives in modernization/upgradation/restructuring and consolidation.

Although things appear uncertain in the short term, led by various combinations of factors, we believe that long-term prospects for the India's iron and steel industry remains undisturbed. The unfolding of growth in the Indian steel sector will drive the growth of secondary steel producers. However, we feel steelmakers need to improvise drastically in terms of their raw material sourcing, higher degree of integration, growth strategy, and product mix and cost control. We are highly inclined towards integrated steelmakers in this space, and feel that steel makers with backward and forward-integration will remain clear winners in the time to come.

Strong demand and rising raw material costs have led to a sharp increase in domestic steel prices. Data indicate that the rise in prices has been substantial for both long and flat steel during 2007-08 vis-à-vis 2006-07. Currently, steelmakers are enjoying high steel prices on the back of global demand mismatch and high input cost. However, we feel with inflationary pressures mounting high, there is a tremendous pressure on the government to control the sustained rise in steel prices. We believe this is one issue, which is going to be with industry for quite some time.

We believe Indian steel producers will face difficult times

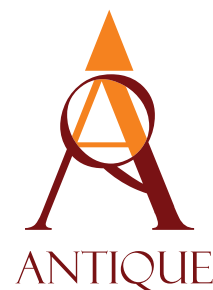
ahead, especially non-integrated players, who will be hit severely on the soaring input cost front, supported by capped realisation prices. We, however, remain highly positive for the integrated steel makers. We maintain a cautious stance on the Indian steel outlook for the next 2-3 quarters, and expect the consumption growth rate to soften at 8% over the next 2 years till FY10 to 62 mt. However, the supply growth in the domestic market will remain laggard, and sluggish of imports from the global market will keep prices firm.

Our preferred pick in the secondary steel sector lies with companies with a higher degree of integration (backward and forward), value-added product mix, and a visionary management. We believe the above three ingredients are most critical to achieve a long-term sustainable growth, given the cyclical nature of the steel industry. Based on this, we have identified four companies, which we feel have tremendous growth potential in the long run, and are currently taking strategic steps to make it happen.

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Sarda Energy & Minerals Limited

Rising rapidly on integration chain



Buy

CMP: INR 278

Target Price: INR 380

July 2008

Strictly confidential

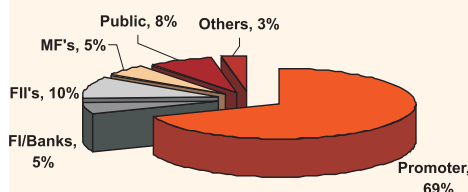
Market Data

Sector	:	Metals & Mining
Listing	:	BSE & NSE
Free Float (m)	:	17
Market Cap (INRm)	:	8,715
O/S Shares (m)	:	34
2 week avg vol. (x)	:	5,586
Face Value (INR)	:	10
Bloomberg	:	SEML IN
Reuters	:	SEML.BO
52-wk Hi/Lo (Rs)	:	695/173

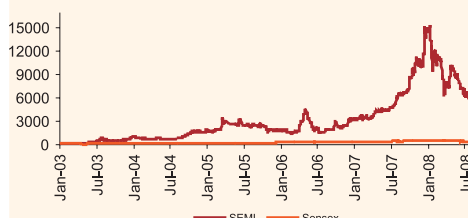
Price Performance

	1m	3m	6m	12m
Absolute (%)	6.0	(29.5)	(33.3)	26.2
Relative (%)	21.3	(20.2)	(22.2)	35.0

Share Holding Pattern



Share Price Performance



Sumeet Singhania

sumeet@antiquelimited.com
+91 22 4031 3431

- **Captive Iron ore:** SEML is expected to meet 40% and 70% of its iron ore requirements from its captive mines in FY09e and FY10e, respectively. This will lead to savings of INR 680 million in FY09e and INR 730 million in FY10e.
- **Strong Volume Growth:** An INR 4.5 billion capex over the next 12 months coupled with capacity utilisation ramp-up, will drive the revenue growth at a CAGR of 33% over 2008-10e.
- **Captive Power:** The company has plans to expand its captive power generation capacity from the current 48 MW to 215 MW. We expect surplus power sales to contribute INR 500 million and INR 550 million to the topline in FY09e and FY10e, respectively.
- **Captive Coal:** SEML expects to commence its captive coal mining operations in 4QFY09, and meet 20% of its total coal requirements through captive mines in the current year. This will further expand margins and boost earnings.
- We expect EBITDA and NPAT of SEML to grow at a CAGR of 54% and 51%, respectively, over 2008-10e.

Valuations

At the CMP of INR 278, the stock is trading at 3.2x and 2.2 x of FY10 estimated EPS and EV/EBITDA, respectively. We assign a target PE and EV/EBITDA multiple of 4x to our FY10 estimated EPS and EV/EBITDA to arrive at our target price of INR 380. We initiate coverage on this stock with a 'buy' recommendation. The attraction of the stock stems from its 2-year EPS CAGR of 48%, and the total potential upside of 47% to our target price.

Risk

- Delay in the commencement and ramp-up of mining operations,
- Weak steel prices and lower-than-expected volume growth,
- Slower commissioning of power generation facilities.

Key financials

INRm	2008e	2009e	2010e	2011e
Revenues	6,248	9,249	11,079	11,277
EBITDA	1,734	2,974	4,080	4,530
NPAT	1,214	1,699	2,761	3,139
EPS (INR)	37.2	49.5	80.4	91.4
P/E (X)	7.0	5.3	3.2	2.8
EV/EBITDA (X)	5.2	3.0	2.2	2.0
P/BV (X)	2.6	1.8	1.1	0.8

Source: Antique Research

Rich experience, rich resources, rich operations

Background

Sarda Energy and Minerals Limited (SEML), erstwhile Raipur Alloys Steel Limited, is one of India's leading and completely integrated steel manufacturers. SEML was formed out of the amalgamation of Raipur Alloys Steel Limited with Chattisgarh Electricity Company and Raipur Gas in 2007. The company is among the lowest cost producers of high-quality steel ingots and billets, besides other products such as sponge iron, rolled products and premium grade ferro alloys. SEML, which holds the status of a Star Export House, is one of the leading exporters of ferro alloys in India.

Steel operations

Installed capacity	Unit	Pre-expansion FY2008	Post-expansion FY 2009	Investment INRm	Expected Date
Sponge iron	Kt	210	360	750	H1-09
Billets	Kt	200	200	-	N.A
Ingots	Kt	40	40	-	N.A
Ferro alloys	Kt	66	66	-	N.A
Power plant	Mw	48	78	1,000	H2-09
Pallets	Kt	-	600	1,250	H2-09
Coal washery	Kt	-	1,000	260	H1-09
FBC boiler	TPH	-	90	250	H1-08

Source: Antique research

** Entire 150 kt of wire rod capacity, along with 30 kt of steel wire capacity, lies with R R Ispat, which is a 100% subsidiary of GPIL*

Mining assets

Product	Location	Reserves (MT)	Production (MT)	Status
Iron ore	Rajnandgoan	20	0.3	Operational; the company plans to step up the production capacity to 1.5 mtpa.
Iron ore	Chattisgarh	200	-	PL received; the company is in process of getting required approvals.
Iron ore	Narangsur	50	-	PL received; the company is in process of getting required approvals.
Coal	Raigarh	67	-	Production started from April 2008; expected capacity 1.2 mtpa; current run rate at 300 ktpa.
Coal	Madanpur	36	-	Allocated in consortium; SEML share 25%; expected to commence by end-2011
Manganese ore	Goa	6	-	Operational; benefits to accrue in FY09.

Source: Company, Antique research

Strong volume growth led by robust capex

Diversified volume expansion to provide de-risked growth

SEML is aggressively stepping up its capacities across the value chain, wherein it is enhancing its sponge iron and steel melting capacities by 70%, combined with the power generation capacity from the current 48 MW to 78 MW in FY09 to 250 MW in the long term. Additionally, it is also setting up a 600-ktpa palletisation plant and a 1,000-ktpa coal washery, which is expected to come on-stream in FY10. The total planned expansion entails a capital investment of INR 4.5 bn over the next two years. We believe that the expansion is well-timed, as the shortage in steel supply underpinned by ballooning input cost pressure will help SEML reap benefits of rising steel prices.

Capex Funding Pattern

Funding pattern	INRm
Total Investment	4,500
ECB (Axia Bank Singapore)	2,640
Loan from SBI	600
Equity issue to Lehman, Mauritius & IDFC	800
Share Warrents	47
Internal Accruals	413

Source: Company, Antique research

Increase in rolling capacities to boost revenues and margins

Earnings to roll on increasing rolled product sales

Rolled products such as billets and ingots fetch better price realisations as compared with metallic products like sponge iron and pig iron. With increasing steel melting capacities, we expect greater consumption of sponge iron internally and reduced external sales. Currently, 40% of sponge iron is used internally for rolled products. With incremental rolled capacities coming on-stream, we expect the share to go up to 65%. Higher price realisations, coupled with volume growth in rolled products, are expected to increase the share of rolled products in the revenue mix by 10% to 40% from the current 30%.

Increase in captive power capacity to save significant cost

Powerful 'power' growth

SEML expects to take its power generation capacity from the current 48 MW to 250 MW in the next 3-5 years. The company plans to set up a thermal power plant with a capacity of 150 MW, for which a coal block has already been allotted to it. The power plant will be funded through a debt-equity ratio of 70:30. The company expects to achieve the financial closure in the next 12-18 months. A significant increase in power generation capacity is planned on the back of economising the cost of production.

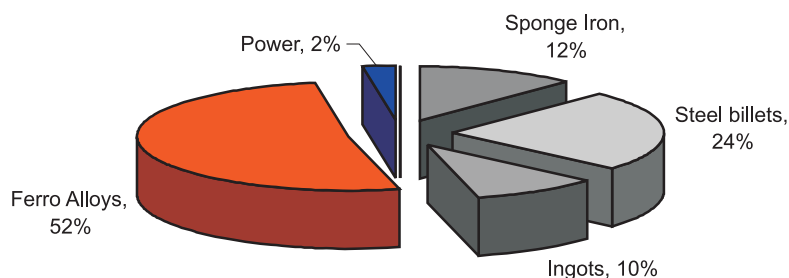
Shifting gear from steel maker to steel-cum-mineral-cum-power player

SEML is aiming to make a paradigm shift from an absolute steel player to a mineral-cum-energy-cum-steel player by increasing its power generation capacity and ramping up mining blocks. We believe this will lend stability to earnings, as captive power and raw material will reduce the cost of steel making, while merchant power sales will significantly offset the earnings volatility in the steel business.

Shifting Revenue Mix

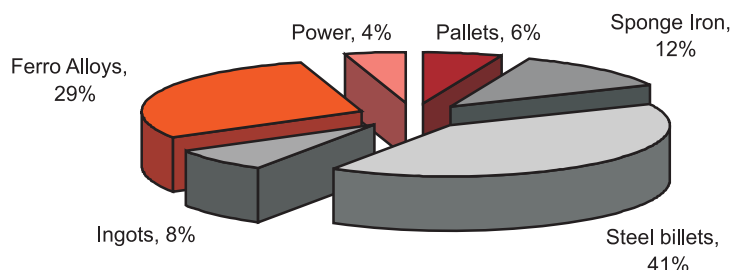
Increasing share of value added products in the product mix over the next two years will provide earnings stability and growth through better price realisations and contractual demand. We expect the share of billets and ingots to rise from current 34% to 50% in FY10.

Revenue Mix (2008)



Source: Company, Antique research

Revenue Mix (2010e)



Source: Company, Antique research

Raw material integration to catapult margin expansion

SEML is among the few private players in India to own operational iron ore and coal mines. While the iron ore mine is operational since FY07, the coal mine is expected to commence operations in H209. The company expects to meet 40% of its iron ore and 20% of its coal requirements through captive mines in FY09. SEML has also received allotment of a manganese ore mine in Goa, which is expected to become operational in H209. It has received the permission for enhancing its iron ore production from the current 0.3 mtpa to 1.5 mtpa. SEML has stepped up its production ramp-up plans, and we believe it will start meeting its entire raw material requirements from its captive mines from FY11.

SEML has been allotted a prospecting licence for five iron ore mines, with estimated combined reserves of 250 mt in Chattisgarh. Additionally, the company has been allotted a coal block at Madanpur in Chattisgarh in a consortium, where the company has a share of 36 mt.

Captive iron ore and coal mines to boost the bottom line

Prospecting licence for additional five iron ore mines

SEML's effective iron ore cost forecast

Iron ore	Units	2008	2009e	2010e	2011e
Captive	%	40%	50%	70%	100%
External	%	60%	50%	30%	0%
Captive	INR/t	1000	1100	1200	1300
External	INR/t	4500	4200	4000	3500
Blended Cost	INR/t	3100	2650	2040	1300

Source: Company, Antique research

SEML's effective coal cost forecast

Coal	Units	2008	2009e	2010e	2011e
Captive	%	0%	20%	50%	50%
Contract	%	40%	40%	40%	50%
Spot		60%	60%	10%	0%
Captive	INR/t	0	800	875	950
External	INR/t	2200	2400	2000	1800
Spot		3000	2800	2500	2250
Blended Cost	INR/t	2200	2400	1375	1375

Source: Company, Antique research

Iron ore

Operational iron ore mines with estimated reserves of 20 mt

SEML owns an operational iron ore mine at Rajnandgoan in Chattisgarh, with estimated reserves of 20 mt. Currently, it has a production licence for 300 ktpa, which has been further raised to 1,500 ktpa. The company meets 50% of its iron ore requirements through its mines, and the rest through long-term contracts and the spot market. With the permission to enhance the production capacity to 1,500 ktpa, we believe, the company will be able to meet 100% of its iron ore requirements by FY11 through its captive mines.

Further, SEML has been allotted a prospecting licence for five iron ore mines, with estimated reserves of 250 mt in Chattisgarh. If the company is able to secure requisite approvals in time, then these mines would become operational in the next 3-4 years.

Iron ore mined is in the form of fines and lumps. Currently, lumps are consumed by the company's sponge iron units, while fines are sold in the open market. The company is setting up a 600-ktpa palletisation plant to convert iron ore fines into pallets, which command better value in the market.

Captive coal mines expected to commence in H109

Coal

SEML has coal mines at Raigarh in Chattisgarh, with estimated reserves of 67 mt. Besides, the company has also been allotted a coal mine at Madanpur in Chattisgarh in consortium with other companies, wherein it holds a 25% interest equivalent to a share of 36 mt in total reserves. The coal mine at Raigarh is expected to commence production in Q1FY09. The company expects to meet 20%, 50% and 100% of its coal requirements through its captive mines in FY09, FY10 and FY11, respectively. The mine at Madanpur is expected to commence production in end-FY11

Captive manganese mines to integrate ferro-chrome operations

Manganese ore

Currently, SEML procures manganese ore through imports, for which it has a strong linkage. However, to reduce its dependence on the imported ore, the company has identified a manganese ore mine in Goa; it is in advanced stages of acquiring it. The mine has estimated reserves of 6 mt.

Captive power plant to ensure cheap electricity for steel operations

Power generation

SEML has an installed capacity of 48 MW, which is being expanded to 78 MW in FY09. The power is generated by utilising waste heat gas, which significantly reduces the cost of generation. We believe that the expanded capacity of 78 MW will be sufficient to meet the company's entire power requirements on the enhanced capacity. Any surplus power will be sold in the open market, boosting the topline. SEML has signed an MoU with the Chattisgarh state government to set up a 1,100-MW power plant. This project is in planning stage and the funding pattern is not yet announced by the company. We have not considered this project into our valuations.

In house sponge iron to benefit on the back of rising scrap prices

Increasing substitution of sponge iron in steel making, due to skyrocketing of scrap prices

Traditionally, India has been the world's leading producer of sponge. Of late, the sponge iron industry has witnessed significant growth, primarily led by increasing substitution of sponge iron, due to skyrocketing scrap prices and coking coal supply constraints. Sponge iron uses non-coking coal, which is available in India in large quantities. Considering the coking coal supply constraint underpinned by rising scrap prices, we believe sponge iron will remain the preferred route for steel making in India. SEML will be a clear beneficiary in this segment, as it is completely insulated from the raw material availability and cost escalations through its captive mines. We expect SEML's low cost advantage to lead to a significant margin expansion in a rising metal price scenario.

High raw material, coupled with strong demand, will keep the steel prices firm

EBITDA to jump from current 25% to 35% in FY10e

Industry outlook

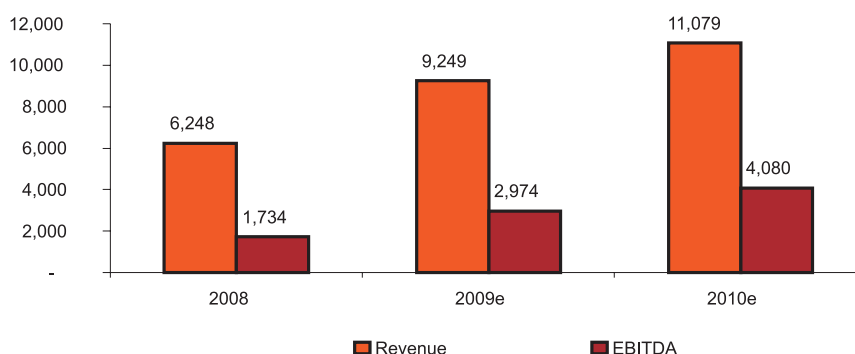
We reiterate our view that raw material integration remains the key to survival in the current global steel scenario. Globally, iron ore contract prices have jumped by 65% in 2008 as against the previous year. Iron ore prices in the spot market have almost doubled. Strong demand for coal, on account of power shortages in China and South Africa, has seen coal prices going through the roof. While coking coal prices firmed up on the back of the demand-supply gap, strong demand from power utilities companies drove thermal coal prices. Even in the domestic market, NMDC, the largest supplier of iron ore in India, has raised long-term prices by 50% to 1,800/t as against the previous year.

Strong demand, coupled with high input cost, has kept global steel prices firm. Benchmark HRC prices rose to \$1,100/t in western markets. Even domestic market prices shot up on the back of global prices. However, rising inflation forced the government to contain steel prices in the domestic market. There is a difference of \$175-300/t between global and domestic HRC prices. We believe this is a temporary phenomenon, and steel makers in India will be able to enjoy high prices once macroeconomic conditions in the country improve.

Financial outlook

We expect SEML's revenues to grow at a CAGR of 33% over FY08-10e on the back of additional DRI and steel billet capacities coming on-stream in FY09. An EBITDA margin is likely to go up from the current 28% to 37% in FY10e, primarily due to incremental sourcing of raw materials from their captive mines. As regards its profitability, we expect its net profit margin to improve from 19% in FY08e to 25% in FY10e. This would be mainly due to a substantial reduction in cost on account of a higher degree of backward linkage contribution from its pallet plant and captive power generation. EBIT margins are also expected to perform in line with EBITDA margins, and increase from 24% in FY08e to 33% in FY10e.

SEML Revenue and EBITDA (INRm)



Source: Company, Antique research

Recommend buy with a target price of INR 380 per share

Valuations

SEML is incrementally moving up the integration chain, with access to significant raw material reserves and additional power generation capacities. We see a significant volume growth on the back of new capacities underpinned by substantial cost saving through captive sourcing of raw materials, providing a strong boost to company's profitability over the next 2 years. SEML is trading at 5.3x FY09e and 3.2x FY10e earnings and EV/EBITDA multiple of 3.0x and 2.2x for FY09e and FY10e, respectively. Our target price of INR 380 is based on the average of PE and EV/EBITDA multiple. We initiate coverage on this stock with a 'buy' recommendation and a target price of INR 380. The attraction of the stock stems from its 2-year EPS CAGR of 48% and the total potential upside of 47% to our target price.

Risks

Lower-than-expected volume growth and weaker-than-expected realisation prices remain an upside risk to our target price. The commencement and execution of mining business depends on various regulatory, environment and commercial clearances. Any delay in securing these clearances from authorities may affect the backward linkage chain, thereby generating the risk of high raw material prices and raw material security.

Financials

Profit & Loss account

Year ended Mar 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Total Income	3,642	6,248	9,249	11,079	11,277
Total Expenditure	3,277	4,564	6,374	7,148	6,946
EBITDA	808	1,734	2,974	4,080	4,530
Depreciation	226	221	220	370	415
EBIT	582	1,513	2,754	3,710	4,115
Other income/expenses	436	50	100	150	200
Profit Before Tax	508	1,392	2,427	3,451	3,924
Profit After Tax	426	1,214	1,699	2,761	3,139

Source: Antique Research

Balance Sheet

Year ended Mar 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Fixed Assets	1,955	2,707	2,987	5,617	6,102
CWIP	946	500	3,000	900	-
Investments	219	219	219	219	219
Net Current Assets	1,215	3,062	3,732	5,115	7,821
Total Assets	4,340	6,492	9,943	11,855	14,147
Total Loan Funds	2,087	2,954	4,706	3,857	3,009
Share capital	131	341	341	341	341
Reserves & Surplus	1,786	3,026	4,725	7,487	10,626
Total Liabilities	4,340	6,492	9,943	11,855	14,147

Source: Antique Research

Cash Flow

Year ended 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Net profit before tax	508	1,392	2,427	3,451	3,924
Depreciation	226	221	220	370	415
Interest	75	121	327	259	191
Operating cashflow before WC changes	809	1,734	2,974	4,080	4,530
Adjustment for working capital	30	(566)	(673)	(446)	(102)
Net cashflow from operating activities	769	990	1,573	2,944	3,643
Capex	(905)	(500)	(3,000)	(900)	-
Net cash used in investing activities	(674)	(500)	(3,000)	(900)	-
Net cash used in financing activities	35	791	1,425	(1,107)	(1,039)
Net change in cash	129	1,281	(3)	937	2,604
Opening cash balance	10	214	1,495	1,493	2,430
Closing cash balance	214	1,495	1,493	2,430	5,034

Source: Antique Research

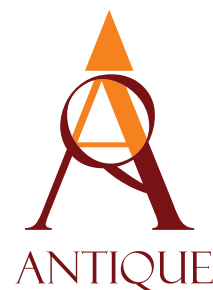
Financial indicators

Year ended Mar 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Growth					
Revenue	69%	72%	48%	20%	2%
EBITDA	287%	115%	71%	37%	11%
EBIT	307%	160%	82%	35%	11%
Pre tax profit	250%	174%	74%	42%	14%
Net profit	254%	185%	40%	63%	14%
EPS	57%	158%	33%	63%	14%
Margins					
EBITDA	22%	28%	32%	37%	40%
EBIT	16%	24%	30%	33%	36%
Pre tax profit	14%	22%	26%	31%	35%
Profit after tax	12%	19%	18%	25%	28%
Ratios					
EPS	14.4	37.2	49.5	80.4	91.4
BPS	70	99	148	228	319
DPS	2.0	3.0	4.0	4.0	4.0
PE	23.3	7.0	5.3	3.2	2.8
P/BV	4.8	2.6	1.8	1.1	0.8
EV/EBITDA	15.0	5.2	3.0	2.2	2.0
ROE	20%	22%	36%	34%	35%
ROCE	13%	15%	24%	28%	32%

Source: Antique Research

Adhunik Metaliks Limited

Integrating Mining Metals & Power



Buy

CMP: INR 102

Target Price: INR 160

July 2008

Strictly confidential

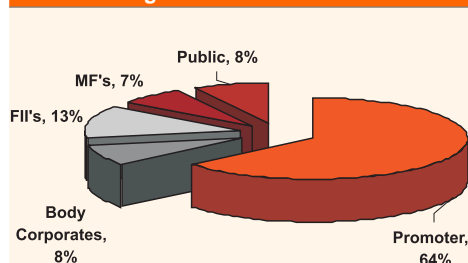
Market Data

Sector	:	Metals & Mining
Listing	:	NSE & BSE
Free Float (m)	:	53
Market Cap (INRm)	:	9,442
O/S Shares (m)	:	91
52-wk Hi/Lo (Rs)	:	252/53
2 week avg vol. (x)	:	74,456
Face Value (INR)	:	10
Bloomberg	:	ADML IN
Reuters	:	ADME.BO

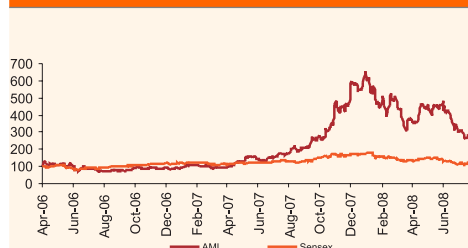
Price Performance

	1m	3m	6m	12m
Absolute (%)	(10.3)	(37.5)	(37.4)	67.2
Relative (%)	(14.3)	(29.3)	(27.0)	78.8

Share Holding Pattern



Share Price Performance



Sumeet Singhania

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+91 22 4031 3431

Acquisition of Orissa Manganese & Minerals Limited (OMML)

OMML, a merchant mining company, is 100% subsidiary of Adhunik Metaliks Limited. It has iron ore and manganese reserves of 90 mt and 60 mt, respectively. While manganese mines are operational, iron ore mines are expected to be operational in 1HFY09. The mining business has high operating margins, which will significantly boost earnings of the company going forward. We expect OMML's operating profit to be INR 1.98 billion and 3.2 billion in FY09 and FY10, respectively.

Strong volume growth led by robust capex

AML is in the midst of expanding its DRI, steel melting and ferro alloy capacity. While steel melting shop will commence production in FY09, DRI and ferro alloy units will go on-stream in FY10. We expect a CAGR growth of 17% in revenues from steel business over FY08-10e on the back of new capacities and higher capacity utilizations.

Increasing focus on backward-integration

AML has captive iron ore and coal mines, with estimated reserves of 25 mt and 42 mt, respectively, for its steel operations. The management is very positive about securing requisite approvals to commence iron ore mining operations by the end of Q2FY09. AML expects to meet 10% and 50% of its iron ore requirements from its captive mines in FY09e and FY10e, respectively. This will bring a healthy jump in operating margins of their steel business.

Power play through Merchant Power Business

AML is setting up an 1,100-MW merchant power plant through a subsidiary in Jamshedpur, with an estimated investment of INR 40 billion. The first phase, comprising 270 MW, has already received the financial closure and is expected to go on-stream in FY11. We have not considered this into our valuation as it is in very early stages of execution.

Valuations

At the CMP of INR 102, the stock is trading at 2.5x and 2.8 x of FY10 estimated EPS and EV/EBITDA. We assign a target PE and EV/EBITDA multiple of 4x to our FY10 estimated EPS and EV/EBITDA to arrive at our target price of INR 160. We initiate coverage on this stock with a 'buy' recommendation. The attraction of the stock stems from its 2-year consolidated EPS CAGR of 105% and the total potential upside of 55% to our target price.

Key financials

INRm	2008	2009e	2010e	2011e
Revenues	10,046	15,147	17,570	20,596
EBITDA	1,713	4,293	6,652	9,209
NPAT	805	2,483	4,133	5,323
EPS (INR)	8.8	22.5	37.4	48.2
PE (X)	10.8	4.2	2.5	2.0
P/BV (X)	2.7	1.4	0.9	0.6
EV/EBITDA (X)	11.0	4.4	2.8	2.1

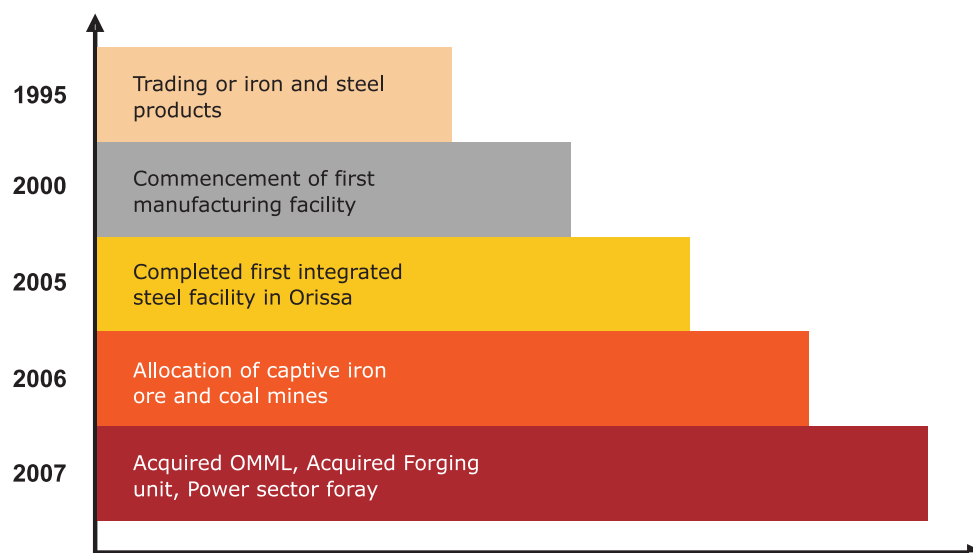
Source: Company, Antique research

Emerging integrated special steel producer

Background

Adhunik Metaliks Limited (AML) is an emerging alloy and special steelmaker, with an integrated business model. It is the flagship company of Kolkata-based INR 25-billion Adhunik Group. Incorporated in 2001, the company started off by trading in iron and steel products. Later in 2005, AML ventured into steel manufacturing by setting up manufacturing facilities at Rourkela in Orissa. Currently, AML is a fully-integrated steel manufacturer, producing value-added alloy steel and stainless steel.

Adhunik growth path



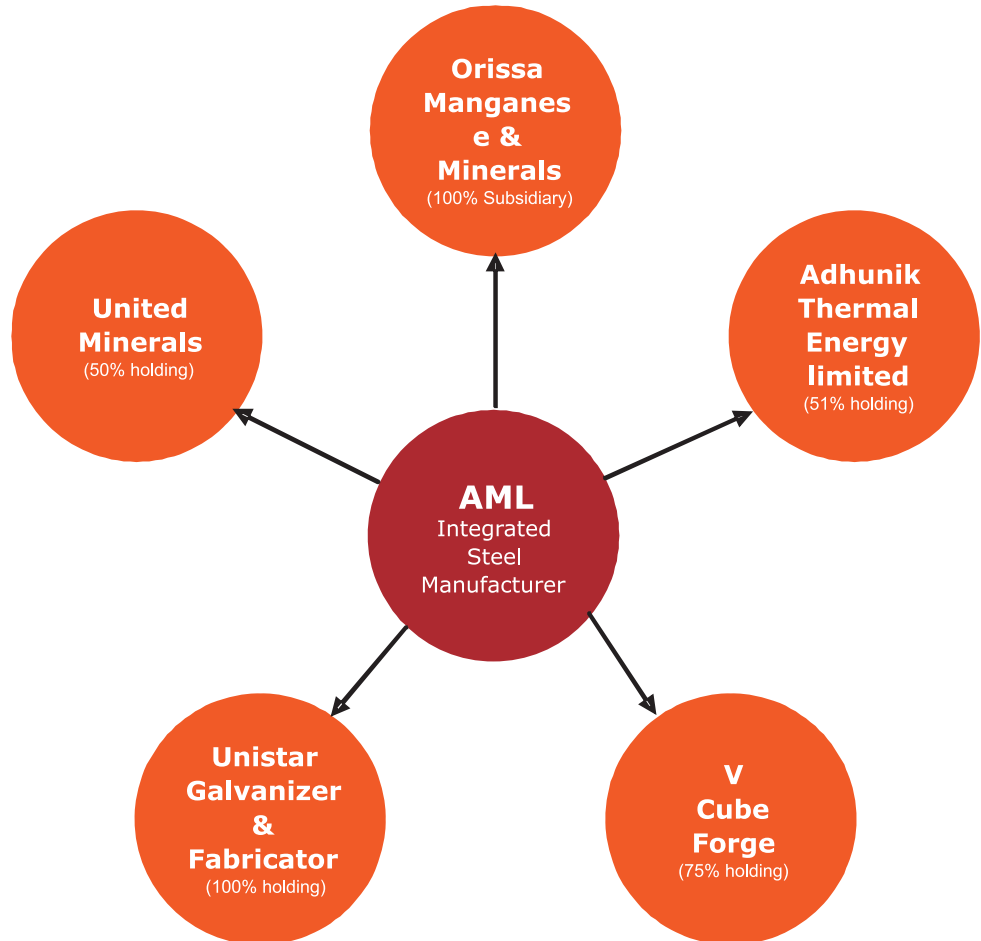
Source: Company, Antique Research

Existing facilities (FY2008)

Products	Unit	Ktpa
Spong iron	Ktpa	150
Pig Iron	Ktpa	180
Steel melting	Ktpa	450
Rolled products	Ktpa	220
Stainless steel	Ktpa	120
Ferro Alloy	Ktpa	38
Power	Mw	17

Source: Company, Antique research

Business structure



Source: Company, Antique Research

Expanding through acquisition route

AML has been aggressively consolidating its business through acquisition of strategically fit companies. In the past 2 years, it has acquired a mining company, a forging unit and a galvanising and fabricating unit. Growth through inorganic route is providing significant synergy in term of earnings growth and revenue diversification.

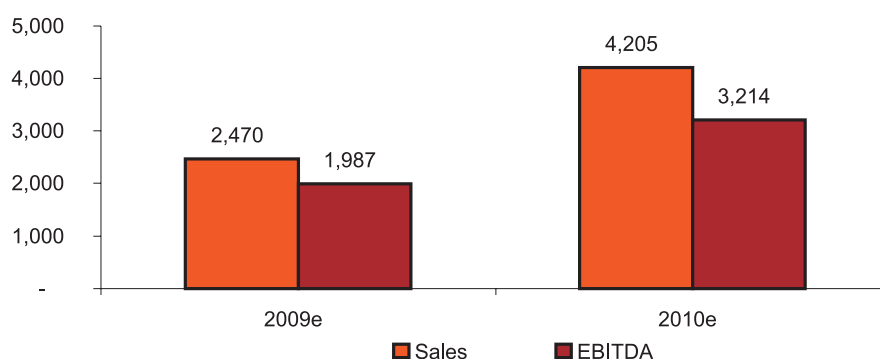
A treasure chest

Orissa Manganese and Minerals Limited (OMML)

AML acquired the merchant mining business of OMML in 2007. This acquisition marked the foray of AML into the mining business. OMML is a 100% subsidiary of AML. Reportedly, OMML was acquired at a purchase consideration of INR 600 million. OMML has estimated reserves of 90 mt of iron ore (Fe content 65+) and 50 mt of manganese ore (35+ manganese content). While iron ore mine is located in Jharkhand, the manganese mine is located in Orissa. Both mines are merchant mines, and AML intends to sell iron and manganese ore in the open market.

We believe this acquisition was a jackpot for the company. Since the acquisition, prices of iron and manganese ore have gone through the roof. AML has already started operations at the mines, and plans to ramp-up production capacities in FY09. We expect OMML to post an EBITDA of INR 1.9 billion in FY09 and INR 3.2 billion in FY10. Earnings from the mining business of OMML remain one of the key drivers of AML's earnings, as mining is a highly profitable business. OMML's expected operating margin, on an average, is at 70% for FY09 and FY10.

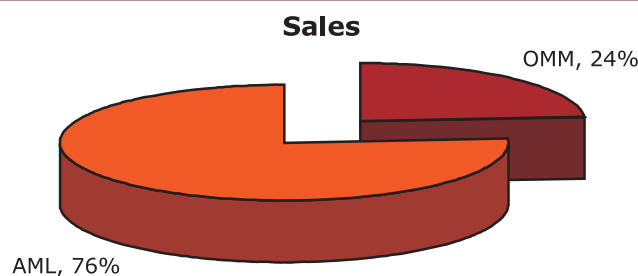
OMML Sales and EBITA



Source: Antique Research

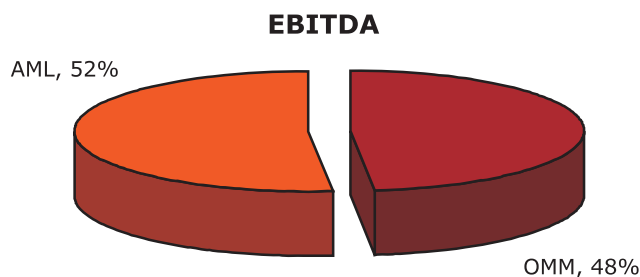
Merchant mining being a high operating margin business we expect OMML to contribute 24% and 48% in the consolidated sales and operating margin of the company respectively in FY09.

OMML vs AML



Source: Antique Research

OMML vs AML



Source: Antique Research

Further value addition within OMML

AML plans to build a pallet plant and a ferro alloy unit within OMML to value-add to iron fines and manganese ore produced. While the pallet plant will have a capacity of 1.2 mt per annum, the ferro alloys unit will have a capacity of 200 ktpa. The total investment planned is estimated at INR 9 billion and the same is expected to come on stream beyond FY11.

V Cube Forge

Vertical integration through acquisition of forging unit

AML acquired a 75% stake in V Cube Forge, a forging company producing forged products for the automobile industry and railways. Production facilities are located in Pune and Aurangabad. Currently, V Cube Forge has a production capacity of 24 ktpa, which AML plans to enhance to 60 ktpa by FY10. The acquisition fits strategically with AML's business, which is increasingly focused towards providing value-added products to the automobile industry. They have already received approval for supplying forged products from a couple of leading auto manufacturers in India.

Unistar Fabricators and Galvanizers Limited (UFGL)

Enriched product mix catering to power and Telecom sector

UFGL is a 100% subsidiary of AML producing electrical and telecom towers. In 2007, AML acquired UFGL at an initial stake of 85%. Later, during the year, AML picked up the balance stake to make it a 100% subsidiary. Manufacturing facilities of UFGL are located in Kolkata and Jamshedpur, with an installed capacity of 30 ktpa. The company caters to nearly all power transmission and engineering companies in India; its clientele includes corporates such as NTPC, BHEL, L&T and PGCIL, among others.

Backward-integration to drive the earnings growth for steel business

Captive iron and coal mines to expand operating margins in medium term

AML has been allotted iron ore and coal mines for its steel-making operations. With the acquisition of these mines, AML is all set to integrate its steel operation with captive mines. While iron ore mines are expected to become operational by H209, coal mines are expected to be operational only by FY11. Although AML will be able to improve its operating margins on account of captive iron ore, it will face cost pressure on the coal and coke front. However, we expect captive iron ore, combined with captive power, to boost operating margins over the next 2 years. We expect the EBITDA of AML to grow from the current 18% to 26% in FY10e.

Iron ore

Particulars	Unit	2008e	2009e	2010e	2011e	2012e
Spot	%	40%	30%	20%	0%	0%
Contract	%	60%	60%	30%	0%	0%
Captive	%	0%	10%	50%	100%	100%
Spot	INR/T	4000	4,000	3750	3,000	3,000
Contract	INR/T	3,000	3,400	3,250	2,900	2,900
Captive	INR/T	0	800	900	1,000	1,000
Effective cost per tonne	INR/T	3,400	3,400	2,175	1,000	1,000

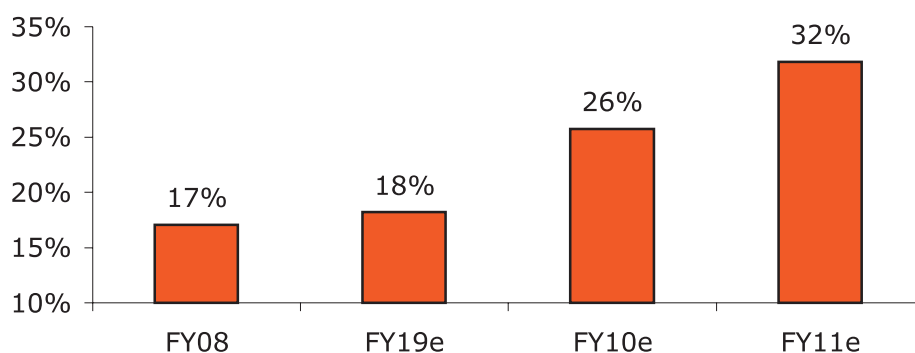
Source: Company, Antique Research

Coal

Particulars	Unit	2008e	2009e	2010e	2011e	2012e
Spot	%	0%	0%	0%	0%	0%
Contract	%	100%	100%	100%	50%	0%
Captive	%	0%	0%	0%	50%	100%
Spot	INR/T					
Contract	INR/T	2000	1500	1500	1200	1200
Captive	INR/T		0	0	700	700
Effective cost per tonne	INR/T	2,000	1,500	1,500	950	700

Source: Company, Antique Research

EBITDA margin for steel operations (%)



Source: Antique Research

Mining assets of AML

Minerals	Company	Reserves	Location	Purpose
Iron ore	AML	25	Keonjhar, Orissa	Captive/Steel
Iron ore	OMML	90	Ghatkuri, Jharkhand	Sale
Coal mines	AML	42	Talchar, Orissa	Captive/Steel
Coal mines	ATEL	65	Ganeshpur, Orissa	Captive/Power
Manganese ore	OMML	50	Patmunda, Orissa	Sale
Graphite ore	OMML	0.03	Daltanganj, Jharkhand	Sale
Limestone and dolomite	OMML	7	Sundergarh, Orissa	Sale

Source: Company, Antique Research

Integrating vertically to produce value-added special steel products

Capacity expansion and value-added product mix to expand operating margins

Recently, AML completed the phase II expansion. It is all set to commence the phase III expansion. In phase II, AML expanded the steel-melting capacity from 250 ktpa to 450 ktpa, besides installing a rolling mill with a capacity of 220 ktpa. AML has also set up a ferro-chrome unit with a capacity of 38 ktpa. It further plans to expand the capacity of its sponge iron unit to 300 ktpa from the current 150 ktpa, and step up its power generation capacity from the current 17 MW to 54 MW by FY10. It also intends to set up an oxygen plant, a coal washery and a sinter plant. AML also plans to set up a pallet plant with a capacity of 1.2 mtpa, and a ferro alloy unit with a capacity of 200 ktpa in OMML.

Proposed facilities

Proposed facilities	Company	Installed capacity	Schedule
Sponge iron	AML	150 ktpa	FY10
Sinter plant	AML	300 ktpa	FY10
Power plant	AML	51 mw	FY10
Ferro alloy	OMML	200 ktpa	FY11
Pallet plant	OMML	1200 ktpa	FY11

Source: Company, Antique Research

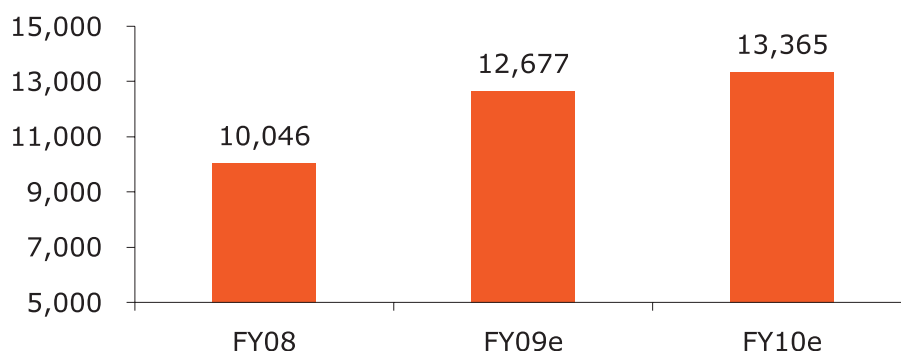
Revenue to grow at a CAGR of 17% over 2008-10e

Funding Pattern

AML in order to fund its robust capex plan had raised capital through issue of equity and equity related instruments. The company issued 11.1 m warrants to the promoters of the company at a price of INR 118 per share. Further the company issued 8.2 million fully convertible debentures to clear water partners at a price of INR 122.6 per share. The company plans to fund the balance through internal accruals. The company further plans to dilute 10-15% of its take in OMML to finance the INR 9 billion capex in OMML.

We expect AML's steel business revenue to growth in the range of 17% (CAGR) over FY08-10e. We believe the strong revenue growth will be led by optimum utilisation of existing and new capacities underpinned by strong steel prices. We also see value-added alloy steel and stainless steel production coming on-stream in FY09 and FY10, respectively, which will not only boost realisations of the company, but also expand its margins.

Revenue growth for steel business (INRm)

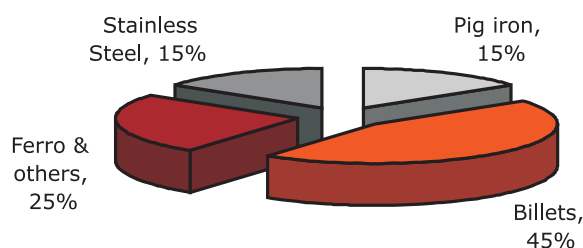


Source: Antique Research

Improving Revenue Mix

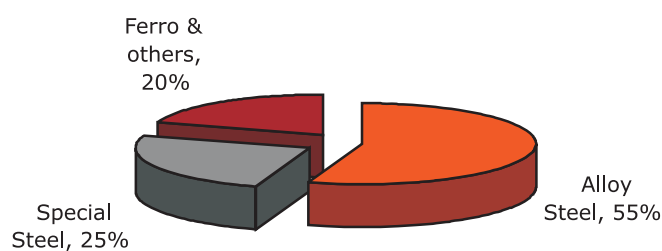
We expect AML's product mix to improve over the next two years from more semis finished products now to more value added products in FY10. High mix of value added products will drive the revenue and earnings growth led by better price realisations.

Revenue mix - FY08



Source: Antique Research

Revenue mix - FY10e



Source: Antique Research

Merchant power business - Earnings diversification

AML holds a 51% stake in Adhunik Thermal Energy Limited (ATEL), and the rest lies with promoters. ATEL is planning to set up a 1,000-MW thermal power plant in Jharkhand and Orissa. The power plant will be established in two phases. Phase I will consist of 270 MW to be set up at Jamshedpur, which is expected to come on-stream by 2012. The balance 700 MW is likely to come on-stream within 2-3 years of the commencement of phase I. AML expects to invest around INR 12 billion in phase I. The project will be funded through a mix of debt and equity, with the debt component amounting to 75%. The financial closure for phase I project has been completed. The company has already acquired the land for the project.

ATEL has been allocated a coal block at Ganeshpur in Orissa to feed its power plant. The block has estimated reserves of 130 mt. ATEL's share in the coal block stands at 65 mt, as the coal block has been allocated in 50-50 JV with Tata Steel. For the development of the mine, the company is in the process of identifying EPC contractors. ATEL expects to sell 60% of power through contracts and the balance through the spot market. The company has already signed an MoU with PTC to supply 135 MW at INR 2.30 per unit. ATEL further proposes to sell 80 MW on a merchant basis at INR 2.80 per unit.

Diversification of revenue through foray into merchant power business

Captive coal block for merchant power plant

First phase comprising 270 MW to go on stream in FY12

The first phase of ATEL's commercial power generation (270 MW) business is expected to commence in FY12. Further, the capacity of the same is likely to be stepped up to 1,000 MW by end-FY15. The debt component of the project cost has already been tied up. Though we are very positive about the power venture of AML, we have not considered the value of its power subsidiary into the valuation of stock on account of lack of execution visibility in the near term. We might consider it as and when we get more visibility on the execution side.

Valuation

Recommend buy with a target price of INR 160 per share

We value the company on the basis of our estimated consolidated EPS and EV/EBITDA for FY10. At the CMP of INR 102, the stock is trading at a PE of 2.5x and EV/EBITDA of 2.8x of our estimates for FY10. We initiate coverage on AML with a 'buy' recommendation, and a 12-month price target of INR 160. The stock provides a potential upside of 55% from current levels.

Risk

1) Lower-than-expected production growth in OMML and AML, ii) Weaker finished steel prices, iii) Delay in securing captive mining approvals, and iv) delay in execution of the expansion project in AML.

Financials

Consolidated Profit & Loss account

Year ended Mar 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Net Sales	7,358	10,046	15,147	17,570	20,596
Expenses	6,208	8,444	10,954	11,018	11,487
EBITDA	1,233	1,713	4,293	6,652	9,209
Depreciation	113	232	379	524	569
EBIT	1,120	1,481	3,913	6,128	8,640
Other income/expenses	83	111	100	100	100
Interest	262	568	700	720	636
Profit Before Tax	858	913	3,214	5,308	7,604
Profit After Tax	775	805	2,483	4,133	5,323

Source: Antique Research

Consolidated Balance Sheet

Year ended Mar 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Fixed Assets	3,566	4,958	6,062	10,023	9,454
CWIP	2,034	2,968	2,984	3,500	7,000
Investments	81	1,387	1,387	1,387	1,387
Net Current Assets	1,988	2,931	7,185	7,605	9,502
Total Assets	7,669	12,762	19,508	25,585	33,849
Total Loan Funds	4,612	8,897	10,630	11,212	13,291
Share capital	912	912	1,104	1,104	1,104
Reserves & Surplus	1,718	2,317	6,639	10,634	15,819
Total Liabilities	7,669	12,762	19,508	25,585	33,849

Source: Antique Research

Consolidated cash Flow

Year ended 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Net profit before tax	858	913	3,214	5,308	7,604
Depreciation	113	232	379	524	569
Interest	262	568	700	720	636
Operating cashflow before WC changes	1,179	1,673	2,264	3,396	4,574
Adjustment for working capital	(787)	(755)	(445)	(438)	(536)
Net cashflow from operating activities	318	785	3,075	4,796	5,551
Capex	(3,199)	(3,078)	(1,500)	(5,000)	(3,500)
Net cash used in investing activities	(3,315)	(4,294)	(1,500)	(5,000)	(4,500)
Net cash used in financing activities	2,119	3,742	(5)	1,224	2,305
Net change in cash	(877)	233	1,570	1,021	3,355
Opening cash balance	1,115	237	470	2,041	3,061
closing cash balance	237	470	2,041	3,061	6,416

Source: Antique Research

Financial indicators

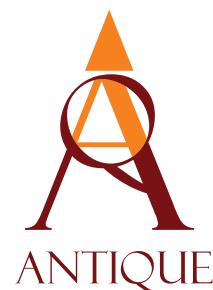
Year ended Mar 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Growth					
Revenue	74%	37%	51%	16%	17%
EBITDA	68%	39%	151%	55%	38%
EBIT	68%	32%	164%	57%	41%
Pre tax profit	56%	6%	252%	65%	43%
Net profit	230%	4%	209%	66%	29%
EPS					
Margins					
EBITDA	17%	17%	28%	38%	45%
EBIT	15%	15%	26%	35%	42%
Pre tax profit	12%	9%	21%	30%	37%
Profit after tax	11%	8%	16%	24%	26%
Ratios					
EPS	8.5	8.8	22.5	37.4	48.2
BPS	29	35	70	106	153
PE	20.1	10.8	4.2	2.5	2.0
P/BV	5.9	2.7	1.4	0.9	0.6
EV/EBITDA	17.0	11.0	4.4	2.8	2.1
ROE	29%	25%	32%	35%	31%

Source: Antique Research

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Godawari Power and Ispat Limited

Strong Volume Growth



Buy

CMP: INR 198

Target Price: INR 310

July 2008

Strictly confidential

Market Data

Sector	:	Metals & Mining
Listing	:	NSE & BSE
Free Float (m)	:	10
Market Cap (INRm)	:	5,517
O/S Shares (m)	:	28
52-wk Hi/Lo (INR)	:	376/132
2 week avg vol. (x)	:	21,566
Face Value (Rs)	:	10
Bloomberg	:	GODPI IN
Reuters	:	GODPI.BO

Strong volume growth to drive revenue at a CAGR of 20% over 2008-10e

GPIL completed its planned capacity expansion in FY08, where its sponge iron and billet capacities have been enhanced by 110% and 60%, respectively. Additional capacities coming on-stream, supported by higher utilisation of existing facilities, will drive revenues at a CAGR of 20% over the next 2 years. We expect a y-o-y production growth of 25% in sponge iron and steel billets in FY09.

Increasing focus on backward-integration to expand operating margins

Recently, GPIL received an 'in principle' forest clearance for its captive iron ore mine in Chattisgarh. The company expects to receive other regulatory approvals in the next 3 months and commence production in another 12-18 months. Additionally, the company has been allocated coal mines, for which regulatory clearances are awaited. GPIL is setting up a 600-ktpa palletisation plant, which will further reduce its raw material cost. The same is expected to go on-stream in 2HFY09. Recently, it announced to buy a 75% stake in Ardent Steel, which is in the process of setting up a 600 ktpa pallet plant in Orissa.

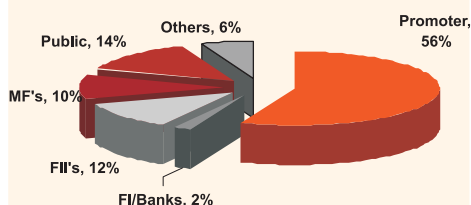
Price Performance

	1m	3m	6m	12m
Absolute (%)	3.9	(3.4)	(18.0)	10.7
Relative (%)	(0.8)	9.4	(4.4)	18.5

Captive power plant to save energy cost and boost operating margins

GPIL raised its captive power generation capacity from 17 MW 2007 to 53 MW in 2008. GPIL now meets its entire power requirement from its captive power unit, and generates additional revenues by the sale of surplus power. GPIL is also making a foray into the independent power production (IPP) business, for which it has already been allocated a coal block. We expect the IPP business to come on-stream by FY12. We have not considered the IPP in our valuation, due to the lack of execution visibility over the next 2 years.

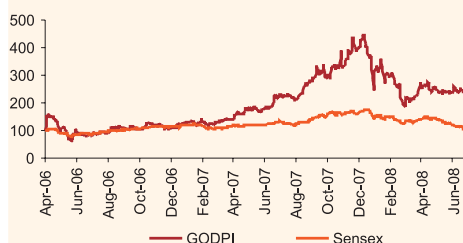
Share Holding Pattern



Valuations

At the CMP of INR 198, the stock is trading at 2.7x and 2.5 x of FY10 estimates EPS and EV/EBITDA. We assign a target PE and EV/EBITDA multiple of 4x to arrive at our target price of INR 310. The attraction of the stock stems from its 2-year EPS CAGR of 50% and the total potential upside of 55% to our target price.

Share Price Performance



Risk

i) The lower-than-expected capacity utilisation will impact revenue growth, ii) Weak steel prices and a steep rise in raw material cost will erode margins, and iii) delay in commencement of mining operations will drag EBITDA margins.

Key financials

INRm	2008	2009e	2010e	2011e
Revenues	8,293	10,475	11,801	11,884
EBITDA	1,614	2,117	3,017	3,944
NPAT	950	1,325	2,134	2,320
EPS (INR)	32.9	45.9	74.0	80.5
PE (X)	6.0	4.3	2.7	2.5
P/BV (X)	1.6	1.4	1.0	0.7
EV/EBITDA (X)	4.7	3.6	2.5	1.9

Source: Antique research

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Emerging steel maker rising up the value chain through forward and backward-integration

Overview

GPIL is a mid-sized integrated steel player producing sponge iron, steel billets, steel wires, wire rods and ferro alloys, besides generating captive power from waste gases produced at its steel manufacturing facilities at Siltara in Chattisgarh. The company has lined up an aggressive capacity expansion plan to set up a coal washery and a 0.6-mtpa palletisation plant at an overall capital expenditure of INR 235 crore by FY10. Additionally, with captive iron ore and coal mines ready for raw material supply by 20011-12, the company should see a significant expansion in its operating margins. GPIL plans to make a foray into independent power production in a big way going forward.

Current & Expected capacities

Product	Unit	2007	2008	2010e
Sponge Iron	Kt	235	495	495
Steel Billets	Kt	250	400	400
Wire Rods	Kt	70	100	100
Steel wires	Kt	93	150	150
Ferro alloys	Kt	17	17	17
Captive power	Mw	28	53	53
Pallet Plant	Kt	-	-	600

Source: Antique research

* Entire 150 kt of wire rod capacity, along with 30 kt of steel wire capacity, lies with R R Ispat, which is a 100% subsidiary of GPIL

Captive raw material - captive power - liquid steel - rolled products

Business model

GPIL has acquired iron ore and coal blocks, thus moving upward in the backward-integration chain. The company expects to source 25% of iron ore requirements from captive mines in FY10. Its 50% iron ore requirements will be met through linkages with NMDC, while another 25% will be purchased from the spot market. We believe the company will meet its entire iron ore requirements from its captive mines by FY12. Similarly, GPIL expects to commence coal mining by FY11, which will cater 25% of its total requirements in the first year, 50% in the following year and 100% by FY13. Currently, the company has linkages for 75% of its total coal requirements. GPIL has a capacity of 53 MW of captive power generation, which takes care of its entire power requirement. The power is generated through waste gas and other waste emanating from its sponge iron plant. While 42 MW of power is generated through waste gas, another 11 MW is generated through coal.

Product mix dominates construction and power grade steel products

GPIL manufactures wire rods and steel wires through the DRI-EAF route. It uses sponge iron scrap as a charge mix to produce liquid steel. While scrap is purchased from the external market, sponge iron is produced in-house. The major production of sponge iron produced is consumed captively to produce steel in the form of billets. Around 70% of billets are transferred to R R Ispat for conversion into wire rods. R R Ispat re-transfers wire rods to GPIL, which in turn, uses it to produce value-added steel wires.

Ferro alloy adding additional margins of the company

Additionally, GPIL also manufactures ferro alloys, which are directly sold in the open market. Raw materials for ferro alloys, too, are sourced from the spot market.

Captive mines to enhance margin of safety

Captive raw material facilities - The earnings booster

Current sourcing: GPIL has made successful efforts towards enhancing its raw material linkages. In FY07, the company had 50% linkages for both iron ore and coal. The remaining portion was met through purchases in the spot market. In FY08, GPIL added new capacities for which it required additional linkages. Currently, it has linkages for 75% coal and 50% iron ore on their expanded capacity. While iron ore is sourced from NMDC, coal is procured from Coal India Limited. In order to reduce the dependence on external sources for its raw material, the company has acquired captive iron ore and coal mines. On the one hand, they will provide raw material security to the company's operations and, on the other it will insulate it from the soaring raw material prices.

Per tonne iron ore cost to the company

Particulars	Unit	2008e	2009e	2010e	2011e	2012e
Captive	%	0%	0%	25%	50%	100%
Contracted	%	50%	50%	50%	50%	0%
Spot	%	50%	50%	25%	0%	0%
Captive - Landed cost	INR/T			1,000	1,050	1,150
Contracted	INR/T	3,000	3,500	3,250	3,000	2,800
Spot	INR/T	4,000	4,500	4,800	4,200	4,200
Effective cost per tonne		3,500	4,000	3,100	2,025	1,150

Source: Company, Antique research

Coal cost to the company

Particulars	Unit	2008e	2009e	2010e	2011e	2012e
Captive	%	0%	0%	0%	25%	50%
Contracted	%	50%	75%	75%	75%	50%
Spot	%	50%	20%	20%	0%	0%
Captive - Landed cost	INR/T	-			750	850
Contracted	INR/T	2,200	2,500	1,800	1,500	1,500
Spot	INR/T	3,000	3,500	3,200	2,500	2,500
Effective cost per tonne		2,600	2,750	2,150	1,350	9,00

Source: Company, Antique research

Mining assets

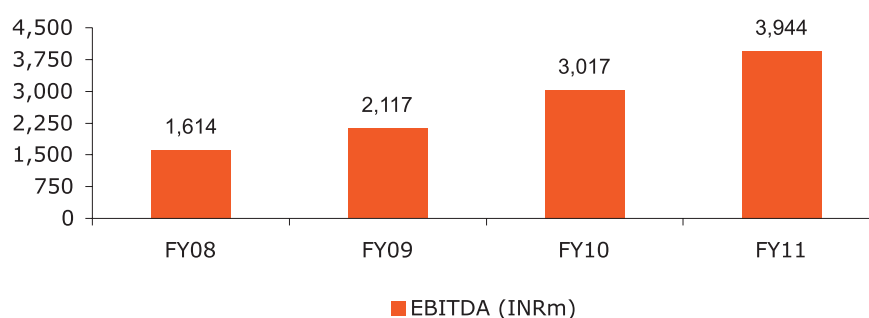
Mines	Location	State	Reserves	Status
Iron ore	Ari Dongri	Chattisgarh	8	Forest clearance received, expected to commence by FY10, Fe content +65
Iron ore	Borai Tibbu	Chattisgarh	7	Pending forest clearance, expected to commence by FY10, Fe content +62
Iron ore	Durg	Chattisgarh	60	PL received, Pending forest clearance, exploration to continue post receipt of regulatory approvals, no time lines for expected production
Coal	Nakia	Chattisgarh	55	Allotted in consortium of 5 members, Total reserve 200 mt, Expected Production FY 2011
Coal	Madanpur	Chattisgarh	17	Allotted in consortium of 7 members, Average grade coal, Expected Production FY 2011
Coal	Madanpur	Chattisgarh	30	Allotted in consortium of 4 members, Average grade coal, Expected Production FY 2011

Source: Company, Antique research

EBITDA margin to jump from the current 21% to 30% in FY10e

A higher degree of raw material integration will see a significant expansion in margins. We expect the EBITDA margin to expand from the current 21% to 26% in FY10e on the back of a steep decline in the raw material cost from captive mines. While effective iron ore cost per tonne is expected to reduce from the current INR 3,500/t to INR 1,150/t in 2012, the effective cost of coal is likely to decline from INR 2,600/t to INR 900/t in 2012e. Moreover, the company is setting up a 600-ktpa palletisation plant, which is expected to come on-stream in FY10. Once on-stream, we expect significant operating efficiencies in terms of better productivity and lower raw material cost.

EBITDA Growth (INRm)



Source: Antique Research

Capex involving INR 2,350 million underway

New capacities and higher utilisation - The revenue driver

GPIL has stepped up its production capacity across the value chain. A major part of the expansion work has already been completed in end-FY08. While the billet capacity was enhanced from 250 ktpa in FY07 to 400 ktpa in FY08, the steel wire capacity was increased from 62.5 ktpa to 90 ktpa. A further capacity expansion, at an outlay of INR 2,350 million, is underway, which is expected to come on-stream by end-FY11. This investment includes a 600-ktpa palletisation plant, a 100-ktpa iron ore beneficiation plant, a 1,200-ktpa iron ore crushing plant and other related infrastructure expenditure.

Phase II capacity expansion underway

Plants	Capex	Capacity	Target
Palletisation plant	1400	600 ktpa	FY10
Iron ore beneficiation plant	220	100 ktpa	FY11
Iron ore crushing plant	120	1200 ktpa	FY11
Railway sliding	120		FY11
Allied Infrastructure	350		FY11
Mining	140		FY11

Source: Company, Antique research

Funding pattern

The total capex of INR 235 million will be funded through a mix of debt and equity in the ratio of 55:45. GPIL issued 1 million warrants to the promoters at INR 324 per share. Further the company raised another INR 1000m from Qualified Institutional Investors. Debt amounting to INR 990m is already tied up with banks and other lending institutions. Debt includes an ECB loan to the extent of USD 10m

Funding Pattern (INRm)

Total Capex	2,350
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Equity	1,360
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Qualified Institutional Placement	1,000
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Warrants issued to promoters	324
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Internal accruals	36
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Debt	990
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Bank Loans	600
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ECB (USD 10m)	390
---------------	-----

Higher capacity utilisation to provide string volume growth

GPIL operated at an average capacity utilisation of 50-55% across the product line in FY08. The company is geared to enhance its capacity utilisation to the extent of 70-75% in FY09 to reap the benefits of high volumes and strong prices. Our calculation shows that the billets and steel wires sales volume will grow at a CAGR of 25% over FY08-10e. We expect the sales revenue to grow at a CAGR of 20% over FY08-10e.

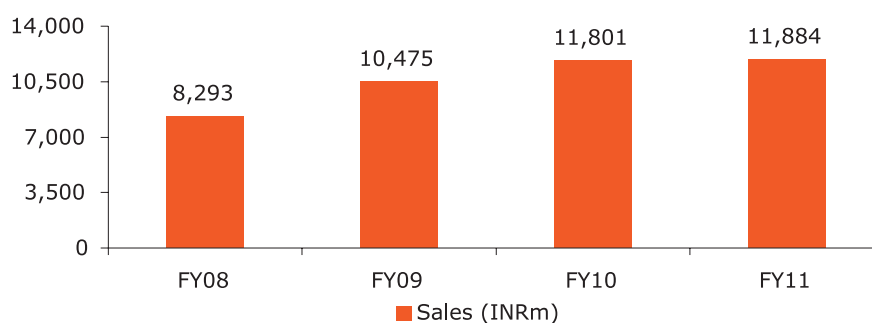
GPIL also manufactures a ferro alloy, which provides better operating margins. Ferro alloy contributes 5% to the company revenue. GPIL has the advantage of

Inorganic growth through acquisition

producing ferro alloys at a comparatively lower cost on account of in-house availability of power, which forms the major cost component in ferro alloy production. Currently, ferro alloys are fetching strong prices on account of robust demand from user industries. GPIL has the advantage of producing ferro alloy at a cheaper price due to captive power. We expect ferro alloy to continue to support margins of GPIL on the back of strong prices, which are expected to persist in the market over FY09-10.

Recently, the company has announced its decision to buy a 75% stake in Ardent Steel, which is in the process of setting up a 600-ktpa palletisation unit in Orissa. The total capex envisaged in Ardent is to the tune of INR 1,800 million. Out of this, INR 1,200 million will be met through external debt, and the balance INR 600 million through equity. GPIL will invest INR 450 million. The company expects to go on-stream in FY11; it will sell the entire production on a merchant basis. We have not considered this in our valuation.

Revenue Growth (INRm)



Source: Antique Research

Price outlook

Steel prices to remain firm on the back of rising raw material prices

We have been witnessing a strong price environment across the iron and steel chain, from raw material to steel metalics to secondary steel products to finished products. Rising raw material prices, coupled with strong demand, have kept prices firm. We believe soaring scrap prices have been instrumental in determining steel metalics prices. While sponge iron rose from INR 12,000/t in FY07 to INR 20,000/t in FY2008, pig iron prices went up by almost 70% from INR 18,000/t to INR 25,000/t. Reportedly, pig iron prices have moved up to \$900/t cfr at Carajás. Similarly, long product prices saw a steep rise in prices on the back of strong demand from the construction sector in FY08. Steel billet prices increased almost 30% from INR 24,000/t in FY07 to INR 35,000/t in FY08.

Although a temporary softening of demand is expected on account of the seasonal factor and the construction slowdown, we believe the strong steel price cycle will be driven persistently by the rising input cost. Strong volume growth, fueled by new capacities and higher capacity utilisations, will help the

CDM benefits to provide additional revenue to the extent of INR 110 million in FY09

Merchant power business to de-risk revenue growth in the medium term

Recommend buy, with a price target of INR 310 per share

company to post a healthy revenue growth. But we expect the company's operating margins to expand only when it starts sourcing a substantial portion of its raw material requirements from its own captive mines. We believe, till such time, benefits accruing from a healthy revenue growth will offset the high raw material prices.

Powering the 'power' ambition

Currently, GPIL generates power only for captive consumption. Of the installed capacity of 53 MW, the company uses the waste flue gas from its sponge iron plant as feedstock to generate 42 MW. The rest is generated from coal rejects. GPIL is also involved in the clean development mechanism (CDM) by generating power through waste gas. Last year, it received 95,000 carbon emission receipts (CER) for the last 2 years of operations. These credits were obtained for only 7 MW of power plant capacity. Currently, the company has 17 MW registered under CDM and another 25 MW is under registration. It expects CER in the range of 150,000 to 175,000 per annum from FY09 onwards on 70% plant utilisation. At an average price of €12.5 per CER, GPIL is expected to generate revenues of over INR 110 million and INR 130 million in FY09 and FY10, respectively.

GPIL is planning to diversify into commercial power production in the next 18-24 months. Currently, the company has a captive power capacity of 53 MW. It plans to set up a coal-based power plant, for which it plans to acquire coal blocks. A consortium led by GPIL has been allotted a coal mine in Chattisgarh with reserves of 243 mt, of which GPIL's share is 63 mt. Requisite environmental clearances to begin operations at these mines are in place, and the bank guarantee has been submitted. However, forest clearance is still awaited. The company plans to speed up the work on the independent power plant once it is through with the current capex involving setting up of a pellet plant. We expect the power business to see light of day by FY12.

Tax exemptions to generate additional revenues

The company enjoys sales tax exemption until FY12 or a maximum of 1.5 times of its gross investment in the project up to FY06, whichever is earlier. GPIL had invested around INR 2.2 billion into its gross block by FY06, and is exempt to the extent of about INR 3.3 billion. GPIL also enjoys income tax exemption under the Section 80-IA on earnings from the captive power generation unit.

Valuation

At the CMP of INR 198, GPIL is trading at 2.7x and 2.5x of FY10 EPS and EV/EBITDA, respectively. We expect the revenue and EBITDA of the company to grow at a CAGR of 20% and 35%, respectively, over FY08-10e. We strongly believe that a healthy volume growth and backward-integration provide significant earnings potential going forward. We value the stock at 4x of our FY10 estimated EPS and EV/EBITDA to arrive at a target price of INR 310.

We initiate coverage on this stock with a 'buy' recommendation with a potential upside of 55% from current levels.

Financials

Profit & Loss account

Year ended Mar 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Net Sales	4,774	8,293	10,475	11,801	11,884
Operating Expenses	3,926	6,679	8,358	8,784	7,940
EBITDA	848	1,614	2,117	3,017	3,944
Depreciation	122	243	307	347	358
EBIT	726	1,372	1,810	2,669	3,587
Net Interest	130	303	351	344	100
Profit Before Tax	620	1,081	1,559	2,426	3,315
Profit After Tax	541	950	1,325	2,134	2,320

Source: Antique Research

Balance Sheet

Year ended Mar 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Net Assets	2,773	3,899	4,814	5,200	5,025
CWIP	1,034	138	216	183	-
Investments	49	49	49	1,549	4,549
Net Current Assets	1,086	3,282	4,264	4,396	3,824
Other Assets	46	46	46	46	46
Total Assets	4,987	7,415	9,389	11,374	13,444
Total Loan Funds	2,894	3,244	3,394	3,094	2,844
Share capital	237	291	291	291	291
Reserves & Surplus	1,837	3,787	5,312	7,597	9,917
Other Liabilities	19	93	393	393	393
Total Liabilities	4,987	7,415	9,389	11,374	13,444

Source: Antique Research

Cash Flow

Year ended 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Net profit before tax	620	1,081	1,559	2,426	3,315
Depreciation	122	243	307	347	358
Interest	130	303	351	344	372
Operating cashflow before WC changes	869	1,627	2,217	3,117	4,044
Adjustment for working capital	(366)	(936)	(533)	(381)	(108)
Net cashflow from operating activities	453	560	1,450	2,445	2,942
Capex	(1,900)	(350)	(1,300)	(700)	-
Net cash used in investing activities	(2,003)	(350)	(1,000)	(2,200)	(3,000)
Net cash used in financing activities	1,632	1,051	(1)	(494)	(622)
Net change in cash	81	1,261	449	(249)	(680)
Opening cash balance	44	125	1,386	1,835	1,587
Closing cash balance	125	1,386	1,835	1,587	907

Source: Antique Research

Financial indicators

Year ended Mar 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Growth					
Revenue	53%	74%	26%	13%	1%
EBITDA	104%	90%	31%	42%	31%
EBIT	111%	89%	32%	47%	34%
Pre tax profit	126%	74%	44%	56%	37%
Net profit	38%	75%	39%	61%	9%
EPS	38%	75%	39%	61%	9%
Margins					
EBITDA	18%	19%	20%	26%	33%
EBIT	15%	17%	17%	23%	30%
Pre tax profit	13%	13%	15%	21%	28%
Profit after tax	11%	11%	13%	18%	20%
Ratios					
EPS	23.3	32.9	45.9	74.0	80.5
BPS	84	125	141	194	274
DPS	3.0	3.0	4.0	4.0	4.0
P/BV	2.4	1.6	1.4	1.0	0.7
PE	7.8	6.0	4.3	2.7	2.5
EV/EBITDA	7.6	4.7	3.6	2.5	1.9
ROE	26%	23%	24%	27%	27%
ROCE	15%	19%	20%	24%	24%

Source: Antique Research

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VISA Steel Limited

Raring to Grow



Buy

CMP: INR 48

Target Price: INR 70

July 2008

Strictly confidential

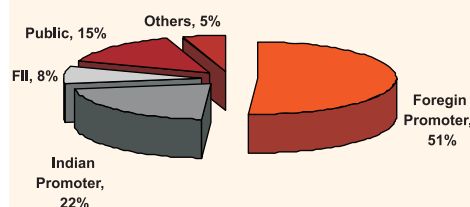
Market Data

Sector	:	Metals & Mining
Listing	:	NSE & BSE
Free Float (m)	:	27
Market Cap (INRm)	:	5,181
O/S Shares (nos.)	:	110
52-wk Hi/Lo (Rs)	:	65/30
2 week avg vol. (x)	:	44,467
Face Value (Rs)	:	10
Bloomberg	:	VISA IN
Reuters	:	VISA.BO

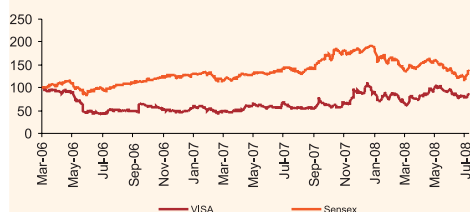
Price Performance

	1m	3m	6m	12m
Absolute (%)	1.8	(1.7)	22.3	38.2
Relative (%)	(14.3)	11.3	42.6	47.8

Share Holding Pattern



Share Price Performance



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Strong revenue growth driven by new capacities and better realisations

VISA Steel Limited (VSL) is in the midst of a robust expansion plan entailing a capex of INR 18 billion. Sixty per cent of the capex has already been accomplished till FY08, and the balance 40% will be accomplished over the next 2 years. We expect its 300-ktpa DRI unit and 50-MW power plant to come on-stream in H1FY09. Higher capacity utilisation, backed by new capacities coming on-stream, will drive the revenue growth at a CAGR of 49% over 2008-10e.

Rising rapidly on backward-integration chain

Thanks to VSL's efforts towards becoming a completely integrated steelmaker, it has been allocated a captive coal mine at Patrapara in Orissa. Additionally, the company has been recommended a captive iron ore mining lease in Orissa, which is expected to materialise soon. VSL has acquired Ghotaringa Minerals Limited (89% subsidiary), which has access to chrome deposits. Captive chrome ore from this mine will boost the efficiency and earnings of VSL's ferro-chrome unit. We expect the company's EBITDA to grow at a CAGR of 95% over the next 2 years.

Captive power unit to generate significant cost benefit

Captive power plant with a capacity of 50 MW, slated to go on stream in H109, is expected to generate significant power cost savings to the extent of INR 350 million in FY09. An additional captive power unit of 25 MW is expected to go on-stream in H2 FY09. This will further add to the bottom line of the company. We expect VSL's net profit to grow at a CAGR of 110% over 2008-10e. Captive power generation results in additional benefits in terms of tax benefits under the Section 80 IA of the Income Tax Act, and revenues through the sale of Certified Emission Reductions (CER) under the clean development mechanism.

Valuations

At the CMP of INR 46, the stock is trading at 2.6x and 3.4x of FY10 of our estimated EPS and EV/EBITDA. We have assigned a discounted PE and EV/EBITDA multiple of 4x to our estimated FY10 EPS and EV/EBITDA to arrive at the target price of INR 70. The attraction of the stock stems from its 2-year EPS CAGR of 110% and the total potential upside of 47% to our target price. We initiate coverage on this stock with a 'buy' recommendation.

Risk

i) Lower-than-expected capacity utilisation, ii) Weak steel prices and hike in raw material prices, and iii) Delay in the commencement of new capacities and mining operations.

Key financials

INRm	FY08a	FY09e	FY10e	FY11e
Revenues	6,828	11,645	15,107	16,308
EBITDA	960	2,061	3,717	4,244
NPAT	432	1,257	1,927	2,104
EPS (INR)	4	11	18	19
PE (X)	11.7	4.0	2.6	2.4
P/BV (X)	1.4	1.0	0.7	0.6
EV/EBITDA (X)	13.3	6.2	3.4	3.0

Source: Antique Research

Fast-emerging integrated special steel player

Background

VSL is a fast-emerging integrated special alloy steelmaker, with a current market capitalisation of more than INR 5.5 billion. The company is in the process of setting up a 0.5 mtpa integrated special alloy steel capacity, which is expected to go on-stream in H1FY11. Established in 1996, VISA Steel Limited is part of the VISA Group, which has a decade-long experience in the minerals and metals industry, with a strong global presence in India, China, Australia, Indonesia, Switzerland, the UK and Hong Kong.

In the midst of a robust capex of INR 18 billion

Operations

VSL is in the midst of a robust capex, involving an investment of INR 18 billion. The completion of this capex will see VSL emerging as a low-cost producer of stainless steel. The company is gradually moving up in the vertical integration chain. With the special steel unit coming on-stream, we expect the vertical integration chain to be complete. It has already incurred more than 60% of the planned capex and is in the process of completing the last phase.

Capex to be funded by mix of debt and equity

Funds for the expansion will be met through a mix of debt and equity at a ratio of 70:30. Both equity and debt portions have been tied up. VSL raised INR 2 billion by diluting a 27.3% stake in the company through an IPO in FY06. Proceeds of this IPO, along with internal accruals, will finance the equity portion of the capex. The debt portion has been tied up with banks and domestic financial institutions.

Attractive product mix

Currently, VSL is operating a blast furnace with a production capacity of 225 ktpa of pig iron, a stamp-charged coke oven plant of 400 ktpa, a ferro-chrome unit of 50 ktpa, and a chrome ore beneficiation plant and a chrome ore grinding plant with capacity of 100 ktpa.

DRI unit and captive power plant to commence in H109

The company is on the verge of commencing its DRI unit, with a production capacity of 300 ktpa, and a 50-MW captive power plant. We expect it to come on-stream before the end of H1FY09.

Entered into a JV with Baosteel to set up a ferro-chrome unit

VSL is also in the process of setting up a special steel capacity with a production capacity of 500 ktpa, which is expected to come on-stream in H1FY011.

VSL entered into a JV with Baosteel to set up a 100-ktpa ferro-chrome plant in Orissa. While the company will hold a 51% stake in the JV, the balance 49% will be held by Baosteel. VSL expects an investment of INR 2.6 billion in this project, which will be funded in the ratio of stockholding in the JV. The entire production from the unit is proposed to be consumed by Baosteel. VSL expects this unit to come on-stream in the next 2 years.

Recently, the company has announced the setting up of an integrated steel complex in Chattisgarh with a capacity of 2.5 mtpa, entailing an investment of INR 100 billion over the next 3-4 years.

Current and projected capacity

Particulars	Unit	FY08	FY09	FY10	FY11
Pig iron	Ktpa	225	225	225	225
Coke	Ktpa	400	400	400	400
Ferro-chrome	Ktpa	50	50	50	50
Chrome ore beneficiation	Ktpa	100	100	100	100
DRI	Ktpa	-	300	300	300
Captive power	Ktpa	-	50	75	75
Special alloy steel	Ktpa	-	-	-	500

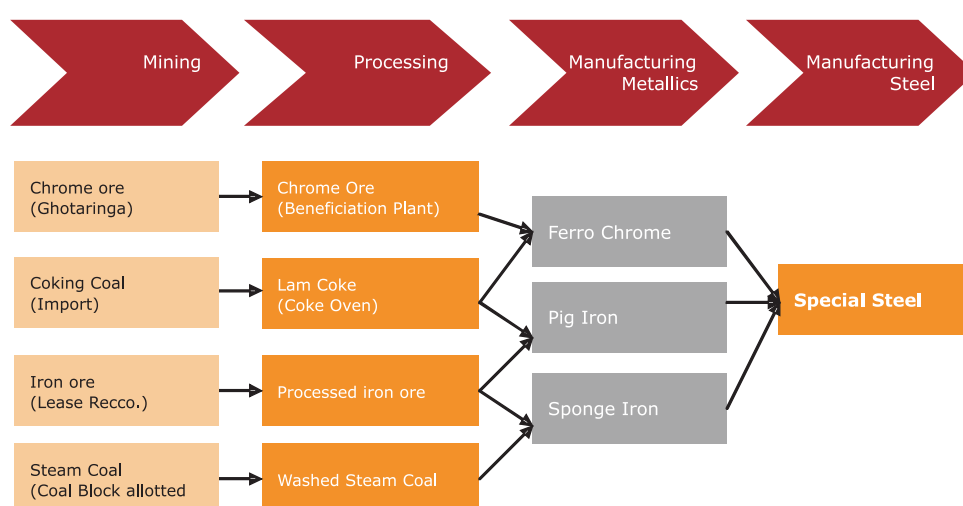
Source: Company, Antique Research

Vertical integration to boost operating margins

Healthy growth in operating margins, led by greater degree of integration

VSL is rapidly moving upwards along the vertical integration chain. It is just left with the last leg of complete vertical integration, which will be completed with the installation of a 500-ktpa special steel unit by H1FY011. The company has just added a DRI unit and a captive power plant, which will commence operations in Q2FY09. While DRI will be mixed with pig iron to produce special steel, captive power will ensure uninterrupted power supply at a lower cost. We expect a greater degree of vertical integration, which will lead to a CAGR of 90% in its operating profits over FY08-10e.

VSL's integration chain



Source: Antique Research

Rising rapidly on the backward-integration chain

Raw material integration

GPIL has stepped up its production capacity across the value chain. VSL is taking aggressive steps towards becoming completely self-sufficient in its raw material requirements. Currently, the company is sourcing raw materials through long-term linkages and the spot market.

The company has been allocated a captive coal mine at Patrapara in Orissa. Additionally, the company has been recommended a captive iron ore mining lease in Orissa, which is expected to materialise soon. VSL has acquired Ghotaringa Minerals Limited (89% subsidiary), which has access to chrome deposits. Currently, Ghotaringa is prospecting for chrome deposits. We believe VSL will start meeting its chrome requirements from its subsidiary in the near future.

Raw material sourcing arrangement

Raw material	Current	Future
Iron ore	Long-term linkage with OMDC, Sesa Goa and tie-up with OMC, Spot	Captive mining lease recommended in Orissa
Coking coal	Long-term purchase agreement with Millenium Coal of Australia	Long-term purchase agreement with Millenium Coal of Australia
Steam coal	Long-term linkage with Mahanadinadi coal fields, spot	Captive coal block at Patrapara (Orissa) allocated
Chrome ore	Spot	Captive from Ghotaringa Minerals Ltd
Power	Captive power plant (50 MW)	Captive power plant (75 MW)

Source: Company, Antique Research

Proximity to raw material sources and the market

Strategic location provides logistics advantage

VSL's manufacturing facilities are located in Kalinganagar and Golagoan in Orissa. Kalinganagar provides significant advantage in terms of proximity to raw material sources and allied infrastructure facilities. In a scenario wherein other steelmakers incur a huge amount of cost in transportation and logistics, VSL's strategic location remains a big positive, which is expected to help the company emerge as a low-cost integrated steel producer.

Kalinganagar offers location and logistics advantages

Raw material	Distance
Iron ore	Daitari: 30 km
Coking coal	Paradip: 120 km
Steam coal	Talchar: 100 km
Chrome ore	Sukinda: 35 km

Source: Antique Research

Infrastructure	Distance
Port	120 km to Paradip Port
Rail	2 km to mail Kolkata Chennai Line Near Banspani-Jhakupura Line
Road	1 km from national highway
Power	10 km to new Duburi grid
Water	5 km to Bhamni River

Source: Company, Antique research

Captive power

VSL is in the midst of setting up a captive power plant. The plant will be set up in a phased manner. While 50 MW (25 MW X 2) is expected to come on-stream in Q2FY09, the other 25 MW (25 MW x 1) will come on-stream in Q1FY10. The captive power plant will be fed by waste heat gas and other rejects from the DRI unit and blast furnace unit. We expect the EBITDA of VSL to grow at a CAGR of 95% over FY 2008-10e.

Product mix driving profitability

VSL's current product mix includes pig iron, coke and ferro alloys. Thanks to soaring raw material prices, supported by strong demand for steel products, VSL has been able to post handsome gains in FY08. Although VSL itself is beleaguered by rising raw material prices, it has been able to pass on the entire cost hike to customers. Moreover, with the captive power plant coming on-stream, the company will be able to save significant costs, leading to the margin expansion.

Rising iron ore and coking coal prices, coupled with strong demand, led to a steep rise in pig iron prices the world over. While there was no respite in the iron ore front, VSL managed to derive the dual advantage through its captive coke batteries. On the one hand, captive coke batteries ensured coke supply to mini blast furnace at a relatively cheaper cost, on the other hand it drove the company's topline by commanding a higher price in a coke-strapped market. Pig iron and coke prices have jumped almost 50% and 75%, respectively, in 2008 over the last year.

Rising scrap prices has led to increasing substitution of scrap with DRI. This has led to a steep hike in sponge iron prices over the last year. Sponge iron prices jumped 50% from INR 12,000/t to INR 20,000/t in 2008. VSL's is setting up a DRI unit, which is expected to come on-stream in Q2 FY09. We expect sponge iron to contribute 20% to total revenues of VSL in FY10.

Similarly, the market witnessed a steep surge in ferro-chrome prices on account of strong export demand and reduced production due to power issues in South Africa, one of the largest producers of ferro-chrome. VSL started its ferro-chrome unit in November 2007, and was able to seize the opportunity of strong ferro-chrome prices for only 5 months in FY08. We expect ferro-chrome prices to remain strong on the back of the rising power cost, power supply shortage in South Africa and strong demand from end-users. According to our estimates, ferro alloys will contribute 20% to total revenues of VSL in FY10.

50-MW power plant to drive cost savings from FY09 onwards

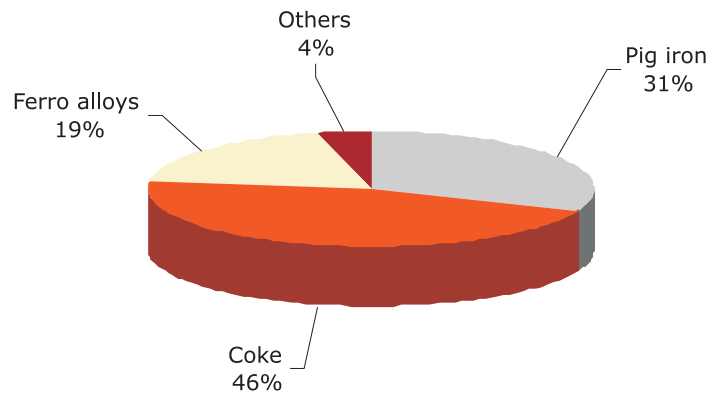
Attractive product mix for the current market

High prices on the back of rising raw material prices

Sponge iron to fetch high realisations on the back of soaring scrap prices

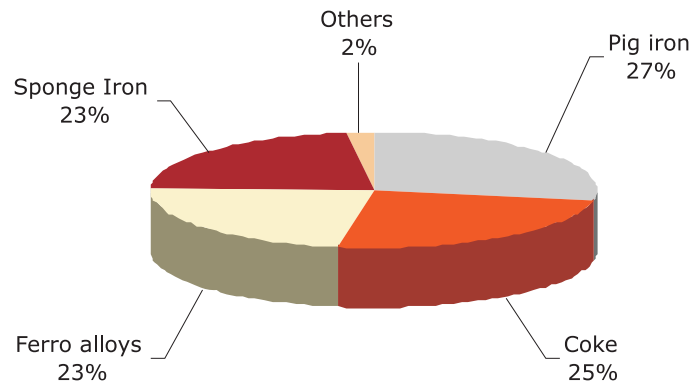
Shifting Revenue mix

Revenue mix (2008)



Source: Company, Antique research

Revenue mix (2010e)

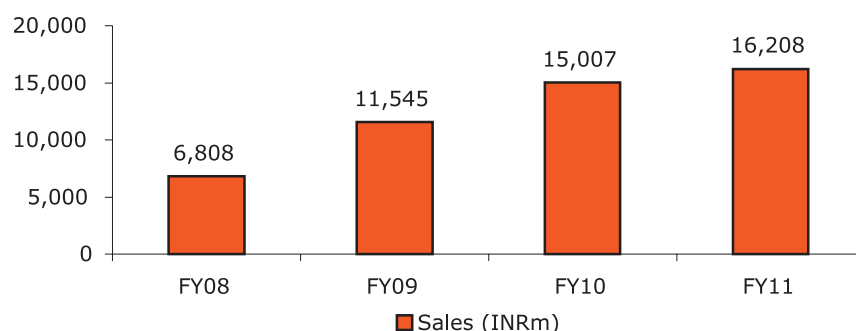


Source: Company, Antique research

EBITDA to grow at a CAGR of 90% over 2008-10e

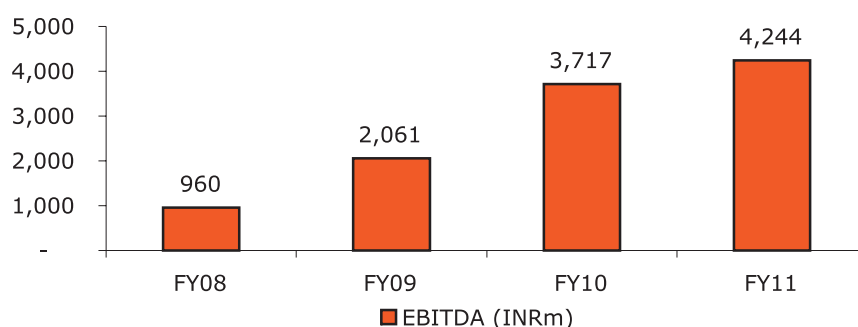
We expect a significant earnings growth over the next 2 years on the back of strong volume growth and higher price realisations. While strong volume growth will be led by new capacities coming on-stream and higher capacity utilisations, the cost saving on account of captive power and a higher degree of vertical integration will lead to a substantial boost in operating margins. We expect revenues and EBITDA of VSL to grow at a CAGR of 49% and 90%, respectively, over FY08-10e.

Revenue growth



Source: Antique research

EBITDA growth



Source: Antique research

Low cost production process

DRI -BF-EAF a low cost production process

VSL has adopted a low-cost production technology by using sponge iron and pig iron as charge mix in the electric arc furnace. Captive availability of sponge iron, pig iron and power provides significant cost economics in the production process. We believe this will enable the company to produce steel products at a competitive cost of production. Further, the company has a ferro-chrome unit, which will ensure captive availability of ferro alloys for its special and stainless steel unit due to come on-stream.

Production chain

(Sponge iron + Pig iron) -----> EAF ----> Liquid Steel ----> Rolled Products

Technological advantages

VSL enjoys technological advantages in coke oven batteries and blast furnace. It uses blowers and stoves in the blast furnace, which provides high production efficiency and lower coke consumption. Similarly, the company uses the stamp-charging technology in coke oven. The stamp-charging technology allows blending of hard coking coal with soft and semi-soft coking coal, which effectively reduces the cost of the charge mix. Moreover, the technology helps produce superior quality of coke, which will enhance the production efficiency of the blast furnace.

Easy availability of steel making raw materials

Process advantage

Sponge iron - Sponge iron requires iron ore and soft coal, which is easily available in India at a relatively cheaper cost. Besides, the sponge iron unit emanates waste heat gas, which is highly used in making cheap power waste heat recovery boiler.

Pig iron - Pig iron unit derives its advantage from availability of captive coke oven batteries, which ensures high quality at a cheap cost. Rejects from the blast furnace is again used to produce captive power through FCB boilers.

EAF

EAF consumes a significant amount of power. But since VSL has its own captive power generation facility, it becomes economical for the company to produce steel products through the EAF route.

Valuation

We value the company on the basis of our estimated EPS and EV/EBITDA for FY10. At the CMP of INR 48, the stock is trading at a PE of 2.6x and EV/EBITDA of 3.4x of our estimates for FY10. Strong realisations for ferro-chrome products, supported by firm pig iron and coke prices, have scaled up revenues and earnings in FY08. Though the raw material cost pressure looms large on the company, we expect the same to be offset by the commencement of its DRI unit and captive power plant in Q2 FY09. We believe there will be a healthy expansion in operating margins of the company on the back of strong volume growth and a higher degree of backward and forward-integration over the next 2 years.

We initiate coverage on VSL with a 'buy' recommendation, with a 12-month price target of INR 70. The stock provides a potential upside of 47% from current levels.

Recommend buy, with a price target of INR 70 per share

Financials

Profit & Loss account

Year ended Mar 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Net Sales	5,379	6,828	11,645	15,107	16,308
Operating Expenses	4,875	5,868	9,583	11,391	12,064
EBITDA	505	960	2,061	3,717	4,244
Depreciation	98	183	313	424	870
EBIT	407	777	1,749	3,293	3,374
Other income/expenses	68	20	100	100	100
Profit Before Tax	343	672	1,571	2,409	2,630
Profit After Tax	205	432	1,257	1,927	2,104

Source: Antique Research

Balance Sheet

Year ended Mar 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Fixed Assets	2,493	3,189	5,591	7,395	15,440
CWIP	3,729	7,856	8,142	8,914	-
Net Current Assets	2,024	2,103	3,473	4,124	5,097
Other Assets	105	105	105	105	105
Total Assets	8,351	13,254	17,311	20,538	20,642
Total Loan Funds	4,986	9,457	12,257	13,557	11,557
Share capital	1,100	1,100	1,100	1,100	1,100
Reserves & Surplus	2,066	2,498	3,755	5,682	7,786
Other Liabilities	199	199	199	199	199
Total Liabilities	8,351	13,254	17,311	20,538	20,642

Source: Antique Research

Cash Flow

Year ended 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Net profit before tax	343	672	1,571	2,409	2,630
Depreciation	98	183	313	424	870
Interest	206	105	177	884	744
Operating cashflow before WC changes	542	960	2,061	3,717	4,244
Adjustment for working capital	(685)	(68)	(338)	(530)	(40)
Net cashflow from operating activities	(158)	651	1,409	2,705	3,678
Capex	(3,505)	(5,000)	(3,000)	(3,000)	-
Net cash used in investing activities	(3,395)	(5,000)	(3,000)	(3,000)	-
Net cash used in financing activities	2,792	4,365	2,623	416	(2,744)
Net change in cash	(761)	17	1,032	121	934
Opening cash balance	2,495	1,734	1,750	2,782	2,903
closing cash balance	1,734	1,750	2,782	2,903	3,837

Source: Antique Research

Financial indicators

Year ended Mar 31 (INRm)	FY07	FY08e	FY09e	FY10e	FY11e
Growth					
Revenue	38%	28%	70%	30%	8%
EBITDA	28%	91%	125%	88%	2%
EBIT	28%	91%	125%	88%	2%
Pre tax profit	72%	96%	134%	53%	9%
Net profit	65%	110%	191%	53%	9%
EPS	15%	110%	191%	53%	9%
Margins					
EBITDA	9%	14%	18%	25%	26%
EBIT	8%	11%	15%	22%	21%
Pre tax profit	6%	10%	13%	16%	16%
Profit after tax	4%	6%	11%	13%	13%
Ratios					
EPS	1.9	3.9	11.4	17.5	19.1
BPS	29	33	44	62	81
PE	14.3	11.7	4.0	2.6	2.4
P/BV	1.6	1.4	1.0	0.8	0.6
EV/EBITDA	9.3	13.3	6.2	3.4	3.0
ROE	6%	12%	26%	28%	24%

Source: Antique Research

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