

Visa Steel Ltd

March 11, 2008

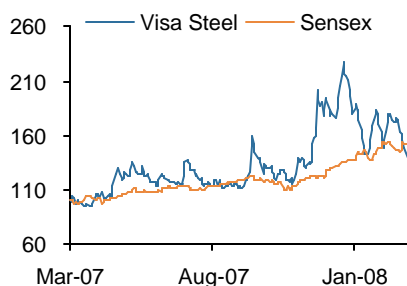
Sector: Metals

| | |
|-------------------------------|-----------|
| Sensex: | 15,924 |
| CMP (Rs): | 39.0 |
| 52 Week h/l (Rs): | 66.6/22.5 |
| Market cap (Rscr) : | 429 |
| 6m Avg vol BSE&NSE ('000Nos): | 898.9 |
| No of o/s shares (mn): | 110 |
| FV (Rs): | 10 |
| Bloomberg code: | VISA IN |
| Reuters code: | VISA.BO |
| BSE code: | 532721 |
| NSE code: | VISASTEEL |

Shareholding pattern

| | |
|------------------------|------------|
| December 2007 | (%) |
| Promoters | 72.7 |
| Foreign & institution | 5.6 |
| Non promoter corp hold | 6.7 |
| Public & others | 14.9 |

Share price trend



We recently met the management of Visa Steel Ltd, a part of the Visa group and returned with a positive view. Visa Steel is a multi-product company with a product portfolio that includes pig iron, sponge iron, coke and chrome concentrates. Visa Steel currently has a capacity of 0.225 mtpa pig iron, 0.3 mtpa sponge iron, 0.4 mtpa coke oven and 50MW of captive power plant. With the new capacities operational and price dynamics remaining positive for the company, we expect Visa Steel's revenue to witness a 44.3% CAGR in top-line and an 88.2% CAGR in PAT over FY07-10.

Visa Steel's coke division to add Rs3.4bn in FY09E and Rs4.5bn in FY10E

Visa Steel's coke making capacity is greater than its captive consumption and is used for merchant sales of coke. With supplies of coking coal secured by the company at rates below spot prices, OPM for the coke division is expected to be ~30%. Spot prices of coking coal and coke are expected to be around US\$300 per ton and US\$500 per ton respectively over the next two years. We expect Visa Steel's coke division to add Rs3.4bn in FY09 and Rs4.5bn in FY10 to its topline.

Revenue to witness a CAGR of 44.3% over FY07-10E

The company has added 0.3 mtpa of sponge iron making capacity and a captive power plant of 50 MW this quarter. With the new capacities operational and price dynamics remaining positive for the company, Visa Steel's revenue is expected to witness a CAGR of 44.3% CAGR in top-line over FY07-10. We expect Visa Steel's revenue to be Rs13.4bn in FY09 and 15.9bn in FY10 in spite of a drop in the trading income.

JV with Baosteel, to be beneficial in the long term

Visa Steel signed a JV with Baosteel, China's largest steel company to set up a 0.1 mtpa ferro chrome plant in Orissa. The Chinese company has promised to pick up 70% of the production and the rest will be sold in the spot markets. The JV is expected to mark the beginning of a long term relationship, wherein Visa Steel will be benefited by the expertise of Baosteel.

Valuation

At the CMP of Rs39, the stock trades at 4.1x FY09E EPS of Rs9.5 and at 3.1x FY10E EPS of Rs12.4. On an EV/EBIDTA basis, the company is trading at 5.5x FY09E and 4.2x FY10E.

Valuation summary

| Rs mn | FY06 (12) | FY07 (12) | FY08E (12) | FY09E (12) | FY10E (12) |
|-------------------|--------------|--------------|---------------|---------------|---------------|
| Revenues | 3,868 | 5,312 | 7,163 | 13,370 | 15,969 |
| yoy growth (%) | | 37.3 | 34.8 | 86.7 | 19.4 |
| EBITDA | 367 | 505 | 654 | 2,314 | 2,996 |
| EBITDA margin (%) | 9.5 | 9.5 | 9.1 | 17.3 | 18.8 |
| PAT | 125 | 205 | 260 | 1,040 | 1,367 |
| yoy growth (%) | | 64.6 | 26.6 | 300.3 | 31.4 |
| EPS (Rs) | 1.1 | 1.9 | 2.4 | 9.5 | 12.4 |
| P/E (x) | 34.4 | 20.9 | 16.5 | 4.1 | 3.1 |
| P/BV (x) | 1.4 | 1.4 | 1.3 | 1.0 | 0.7 |
| EV/EBITDA (x) | 10.0 | 15.0 | 19.1 | 5.5 | 4.2 |
| ROE (%) | 4.2 | 6.5 | 7.6 | 23.3 | 23.4 |
| ROCE (%) | 7.6 | 6.2 | 5.4 | 17.4 | 20.3 |

Source: Company, India Infoline Research

India Infoline Research Team

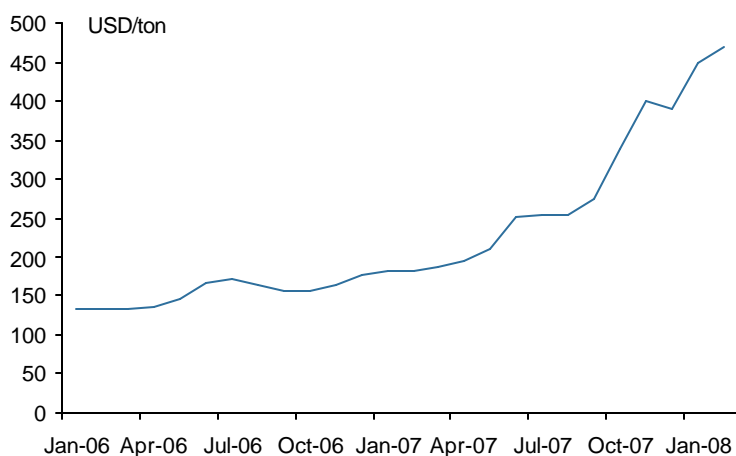
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Rationale

Coke prices at all time high

Coke prices over the past one year have surged more than 100% led by strong demand from steel manufactures and the Chinese Government levying export taxes on raw materials. Rampant demand from China's rapidly expanding steel sector is helping to underpin the strength in merchant coke prices. Local coke prices are currently trading at US\$470 per ton and there are no signs of prices cooling off.

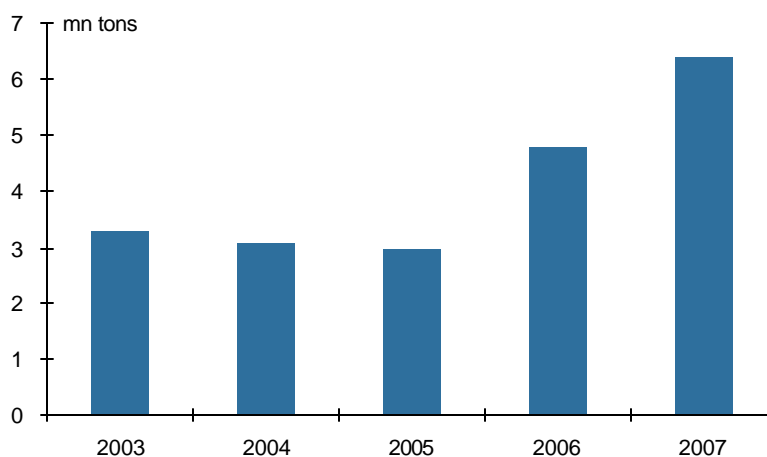
Chinese export prices fob of coke



Source: CRU, India Infoline Research

China has accounted for an increasingly large proportion of world coke production. In 2007 China produced 328.8mn tons of coke, accounting for more than 60% of world output. Last year Chinese coke demand rose by almost 30mn tons, fuelled by a 16% rise in blast furnace output. China's steel production is expected to grow at 8-10% yoy in 2008, which in turn will necessitate an additional 20mn tons of coke consumption. Increasing demand in China coupled with seasonal factors will keep export supply on a tight. At the same time rocketing prices for coking coal have led to a sharp rise in the costs of coke production. When coupled with the 25% export duty levied on Chinese coke there appears to be less scope for prices to retreat markedly anytime soon.

India's coke imports



Source: CRU, India Infoline Research

Imports of coke and coking coal account for majority of the demand in India. The coking coal reserves in India consist mainly of lower grade which cannot be used for steel manufacturing. In 2007, India imported around 6.4mn tons, a rise of 33.3% over the 4.8mn tons imported in 2006. China accounts for most of the coke imports into India. With steel making capacities on the rise, demand for coke is expected to follow. As a result coke prices are expected to remain high in India.

Visa Steel's coke division to drive profitability

Visa Steel has eight coke oven batteries of 50,000 tons each. Visa Steel's total capacity of 0.4 mtpa is quite higher than its captive consumption. With coke prices rising in the last one year, Visa Steel will be a major beneficiary. Visa Steel imports coking coal from Australia and converts it into coke. The landed cost of coking coal for Visa Steel is ~US\$160-175 per ton, which is quite below the average spot price of US\$330 per ton. The agreement with its sister concern in Australia is expected to continue over the next two years leading to higher margins.

The operating cost of converting coking coal to coke is around US\$10 for the company. On an average 1.45-1.5 tons of coking coal is required for one ton of coke. The manufacturing cost of coke for Visa Steel comes at US\$270. With coke prices trading around US\$470 and expected to rise further, Visa Steel will have an OPM of ~40%. We expect Visa Steel to sell more than 50% of its coke production, adding Rs3.4bn in FY09 and Rs4.5bn in FY10 to its top-line.

Capacity additions to show results by FY09

Visa Steel in FY07 had an installed capacity of 0.225 mtpa of pig iron, 0.4 mtpa coke oven plant and 50,000 tpa ferro chrome plant. The company in the current financial year is expected to achieve half of its capex plan of Rs18bn. The sponge iron making capacity of 0.3 mtpa and a captive power plant of 50 MW is expected to start operations this quarter. The company expects to start commercial production of sponge iron from Q1 FY09. The second half of the capex plan of moving up the value chain by setting up capacities of bar & wire rod of special and stainless steel is expected to be operational in FY10. The company is also expected to increase its power generating capacity to 75 MW by adding up a coal based power plant.

Capacity plan addition

| ('tons) | FY07 | FY08 | FY10 |
|---------------------------|---------|---------|---------|
| Pig iron | 225,000 | 225,000 | 225,000 |
| Sponge iron | | 300,000 | 300,000 |
| Ferro Chrome | | 50,000 | 50,000 |
| Coke oven batteries | 300,000 | 400,000 | 400,000 |
| Special & stainless steel | | | 500,000 |
| Bar & Wire rod | | | 500,000 |
| Power (MW) | | 50 | 75 |

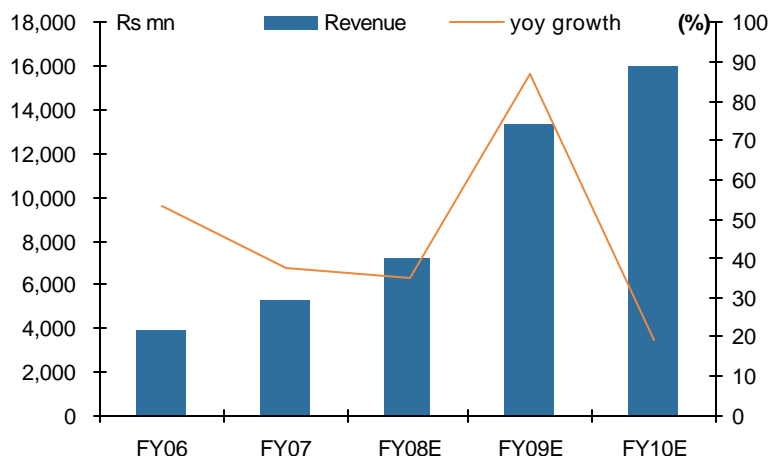
Source: Company, India Infoline Research

Visa Steel's capacity additions come at a time when the demand for metallics is high and is expected to continue further. Metallic prices have increased 30% yoy and are expected to continue around the current levels. Visa Steel is setting up its sponge iron plant of 0.3 mtpa to reduce the impact of rising coke prices. The sponge iron process uses coal as a raw material which is easily available in India. Further moving up the value chain by setting up special & stainless steel capacity and bar & wire rod mill will lead to higher realization and also provide price stability for the company.

Revenue to witness a CAGR of 44.3% over FY07-10E

We expect Visa Steel to gather momentum from FY09. Visa Steel's revenues in FY08 will be largely driven by trading income. Breakdown of Visa Steel's blast furnace led to a drop in the manufacturing income. Relining of refractory is expected to be completed in this quarter and the plant is expected to commence commercial production at full capacity by the start of FY09. Income from trading activities is expected to contribute ~46% of the total revenue for Visa Steel. We expect revenues from trading activity to reduce in the next two years to 10% in FY09 and 3% in FY10.

Revenue estimates



Source: Company, India Infoline Research

Visa Steel is expected to witness a CAGR of 44.3% CAGR in topline over the FY07-10. The surge in revenues is on account of the rise in production capacities of metallic and coke. Topline for the company is expected to increase to Rs7.1bn in FY08 mainly due to higher income from trading income. With new production capacities expected to commence commercial production after FY08, Visa Steel's revenue is expected to rise to Rs13.4bn in FY09 and 15.9bn in FY10.

OPM to expand post FY08

OPM in FY08 is expected to remain muted in FY08 on account of rise in trading income and lower production of pig iron. Visa Steel's pig iron production is expected to remain subdued in FY08. Adding to pressure on OPM is the rise in raw material costs over the last one year. OPM is expected to expand to 16.8% in FY09 and 18.3% in FY10 led by rise in coke and metallic sales. Higher utilisation of pig iron capacity and commercial production of sponge iron will lead to higher margins in the next two years.

JV with Baosteel, to be beneficial in the long term

Visa Steel signed a joint venture agreement with Baosteel, China's largest steel company to set up a 0.1 mtpa ferro chrome plant in Orissa. The joint venture company, Visa Bao will be a subsidiary of Visa Steel, which will hold a 51% stake, while Baosteel Trading Co Ltd will own 35%. Visa Comtrade AG, Switzerland, the trading and logistics arm of the Visa Group, will hold the remaining 14%. The Baosteel JV would start production by FY10. The project will entail an investment of Rs2.6bn, to be financed through a debt equity mix of 65:35. The Chinese company has promised to pick up 70% of the production. The rest will be sold in the local market and part will be exported. Chrome ore for the new plant would come from the Orissa Mining Corporation.

Captive resources

Iron ore: Visa Steel has entered into long-term agreement with OMDC and SESA Goa for supply of iron ore. The landed cost of iron ore for Visa Steel is ~Rs2,500 per ton. The Company is expected to renew this contract in March, 2009. We expect the landed cost of iron ore to be Rs4,000 per ton in FY09 and FY10. The company has applied for lease of iron ore mines in Orissa and is expected to receive it soon. The company also has a chrome ore mine under its 89% subsidiary Ghotaringa Minerals Ltd. The company, currently, sources its Chrome ore for the ferro-alloy division at a rate of Rs10,000 per ton from the open markets. With the mine operational, landed cost of chrome ore will reduce drastically to Rs1,500-2000 per ton. The mine is expected to be operational by the second half of FY10.

Coal/Coke: Visa Steel would not be much affected by the steep rise in coke prices. Visa Steel has captive coke oven batteries, which insulates it from the rising coke prices. It sources its coking coal requirement from one of its group companies in Australia. The landed cost of coking coal is ~US\$160-175 on account of the agreement. For the coal required in sponge iron manufacturing, the company is in negotiations with Coal India. The Company expects landed cost from Coal India to be below spot prices. Also, the company has been awarded the Patrapara coal block in Orissa along with six other companies. The mine is believed to have reserves of 650mn tons of which Visa Steel's share is ~50mn tons. The mine is expected to be operational by FY11.

Power: Visa Steel is setting up 75MW captive power plant (CPP). Out of this 75MW, it expects 50MW Waste Heat Recovery based Power Plant to be operational by this March and additional 25MW coal based power plant to be operational by March, 09. Visa Steel currently purchases power at a cost of Rs3 per unit. The WHRB plant will reduce the company's power cost to less than Re1 per unit.

Valuations

We expect Visa Steel's PAT to witness a CAGR of 88.2% over the period FY07-10. At the CMP of Rs39, the stock trades at 4.1x FY09E EPS of Rs9.5 and at 3.1x FY10E EPS of Rs12.4. On an EV/EBIDTA basis, the company is trading at 5.5x FY09E and 4.2x FY10.

Company background

Management profile

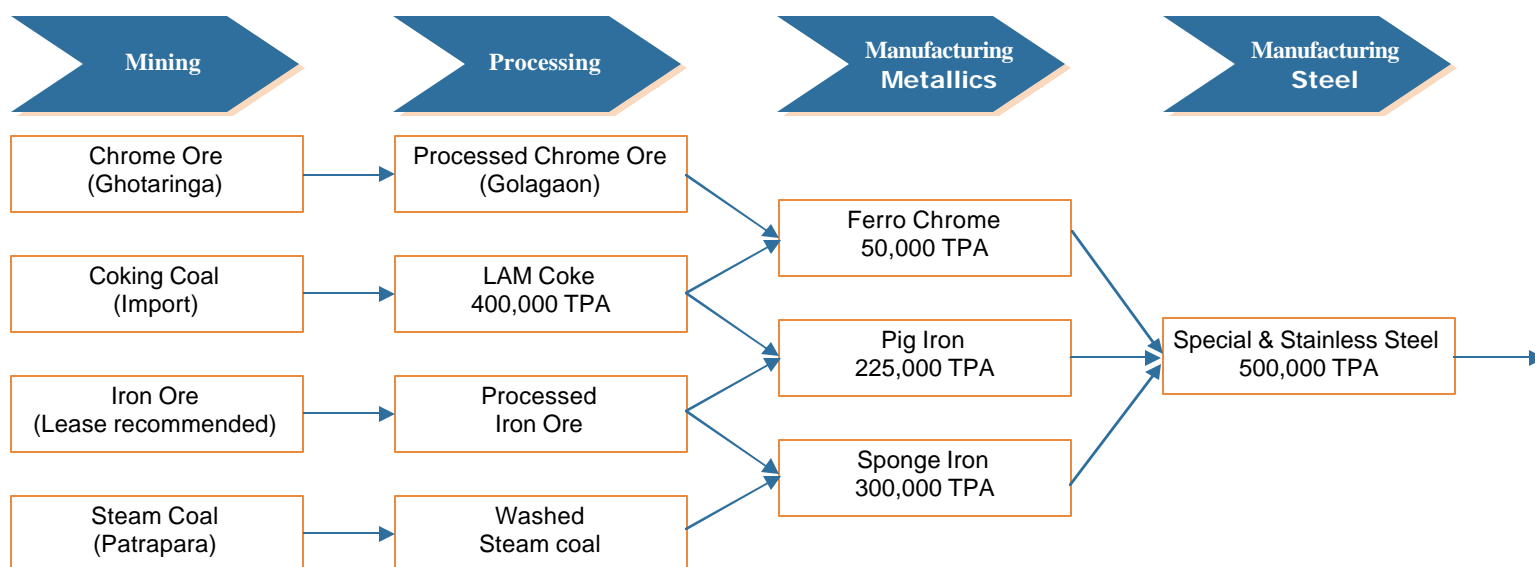
| Name | Designation |
|-------------|-------------|
| V Saran | Chairman |
| V Agarwal | MD |
| M K Digga | CFO |
| M S Verma | Director |
| P K Khaitan | Director |
| V Agarwal | Director |

Source: Company

VISA Steel Ltd is a part of the VISA Group, which has a decade long experience in the minerals and metals industry. VISA Steel has its manufacturing units in Kalinganagar and Golagaon. Visa Steel is a multi-product company with a product portfolio that includes pig iron, sponge iron, coke; chrome concentrates and iron ore fines. The Company is currently operating a Blast Furnace with production capacity of 0.225 mtpa of Pig Iron, a Stamp Charged Coke Oven Plant of 0.4 mtpa and a Chrome Ore Beneficiation Plant & a Chrome Ore Grinding Plant with capacity of 0.1 mtpa each. The company is setting up a 0.3 mtpa sponge iron plant and a 50 MW power plant at its Kalinganagar facility. The company is setting up an integrated 1.5 mtpa Special and Stainless Steel Plant at Kalinganagar Industrial Complex, Orissa and also plans to set up integrated steel plants in the other minerals rich states of Chhattisgarh and Jharkhand.

The company has formed a JV agreement with Baosteel for setting up a 0.1 mtpa ferro-chrome plant in Orissa, in which Visa Steel will hold a 51% stake.

Visa Steel's value chain



Source: Company

Concerns

- **Delay in commissioning projects:** Delays in commissioning of special & stainless steel plant will lead to a drop in revenues for the company.
- **Rising raw material prices:** Rising prices of key raw materials could lead to contracting margins if the company is unable to pass on rising costs to the consumers.
- **Economic slowdown:** A slowdown in the economy will postpone various industries capex plans, which in turn will lead to a reduction in demand for Visa Steel's products.

Financials

Income statement

| Period to (Rs mn) | FY07 (12) | FY08E (12) | FY09E (12) | FY10E (12) |
|-------------------------|--------------|---------------|---------------|---------------|
| Net Sales | 5,312 | 7,163 | 13,370 | 15,969 |
| Operating expenses | (4,875) | (6,580) | (11,120) | (13,053) |
| Operating income | 437 | 583 | 2,250 | 2,916 |
| Other income | 67 | 71 | 64 | 80 |
| PBIDT | 505 | 654 | 2,314 | 2,996 |
| Interest | (64) | (107) | (139) | (139) |
| Depreciation | (98) | (113) | (435) | (572) |
| Profit before tax (PBT) | 343 | 434 | 1,739 | 2,285 |
| Tax | (138) | (175) | (699) | (918) |
| Profit after tax (PAT) | 205 | 260 | 1,040 | 1,367 |

Balance sheet

| Period to (Rs mn) | FY07 (12) | FY08E (12) | FY09E (12) | FY10E (12) |
|---------------------------|--------------|---------------|---------------|---------------|
| Sources | | | | |
| Share capital | 1,100 | 1,100 | 1,100 | 1,100 |
| Reserves | 2,066 | 2,326 | 3,366 | 4,733 |
| Net worth | 3,166 | 3,426 | 4,466 | 5,833 |
| Loan funds | 4,986 | 8,595 | 8,847 | 8,963 |
| Def tax liability | 198 | 212 | 280 | 310 |
| Total | 8,350 | 12,233 | 13,593 | 15,106 |
| Uses | | | | |
| Gross block | 2,663 | 5,663 | 11,163 | 14,663 |
| Accd depreciation | (170) | (276) | (711) | (1,283) |
| Net block | 2,493 | 5,387 | 10,452 | 13,380 |
| Capital WIP | 3,727 | 6,200 | 2,000 | 500 |
| Total fixed assets | 6,220 | 11,587 | 12,452 | 13,880 |
| Investments | 9 | 9 | 9 | 9 |
| Total current assets | 3,843 | 3,099 | 5,546 | 6,384 |
| Total current liabilities | (1,826) | (2,462) | (4,413) | (5,167) |
| Net working capital | 2,017 | 637 | 1,133 | 1,217 |
| Miscellaneous exp | 105 | - | - | - |
| Total | 8,350 | 12,234 | 13,593 | 15,106 |

Key ratios

| Period to | FY07 (12) | FY08E (12) | FY09E (12) | FY10E (12) |
|---------------------------------|--------------|---------------|---------------|---------------|
| Per share ratios (Rs) | | | | |
| EPS | 1.9 | 2.4 | 9.5 | 12.4 |
| Div per share | - | - | - | - |
| Book value per share | 28.8 | 31.1 | 40.6 | 53.0 |
| Valuation ratios (x) | | | | |
| P/E | 20.9 | 16.5 | 4.1 | 3.1 |
| P/BV | 1.4 | 1.3 | 1.0 | 0.7 |
| EV/sales | 1.4 | 1.7 | 0.9 | 0.8 |
| EV/PBIT | 18.5 | 23.1 | 6.7 | 5.2 |
| EV/EBIDTA | 17.3 | 21.4 | 5.6 | 4.3 |
| Profitability ratios (%) | | | | |
| OPM | 8.2 | 8.1 | 16.8 | 18.3 |
| PAT | 3.9 | 3.6 | 7.8 | 8.6 |
| ROCE | 6.2 | 5.4 | 17.4 | 20.3 |
| RONW | 6.5 | 7.6 | 23.3 | 23.4 |
| Liquidity ratios | | | | |
| Current ratio | 2.1 | 1.3 | 1.3 | 1.2 |
| Debtors days | 28.0 | 17.0 | 21.0 | 19.0 |
| Inventory days | 82.0 | 87.0 | 82.0 | 80.0 |
| Creditors days | 125.0 | 125.0 | 120.0 | 118.0 |
| WCC | (15.0) | (21.0) | (17.0) | (19.0) |
| Leverage ratios | | | | |
| Debt / Total equity | 1.6 | 2.5 | 2.0 | 1.5 |

Cash flow statement

| Year to (Rs mn) | FY07 (12) | FY08E (12) | FY09E (12) | FY10E (12) |
|---------------------------|--------------|---------------|---------------|---------------|
| Operating cash flow | 455 | 578 | 1,683 | 2,108 |
| Add/less wking capt chngs | (314) | 174 | 130 | 185 |
| Net operating cash flow | 141 | 752 | 1,814 | 2,293 |
| Investing cash flow | (3,770) | (5,461) | (1,300) | (2,000) |
| Financing cash flow | 2,869 | 3,360 | (409) | (36) |
| Net increase in cash | (759) | (1,349) | 104 | 257 |
| Cash at start of the year | 2,487 | 1,728 | 380 | 484 |
| Cash at end of the year | 1,728 | 380 | 484 | 741 |

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