Shyam Metalics and Energy Limited

Issue Opens	Monday, June 14, 2021
Issue Closes	Wednesday, June 16, 2021
Price Band (in Rs)	303/306
Bid Lot	45 shares and multiples thereafter

IPO UPDATE

Shyam Metalics and Energy Limited

Indian Steel Industry Overview:

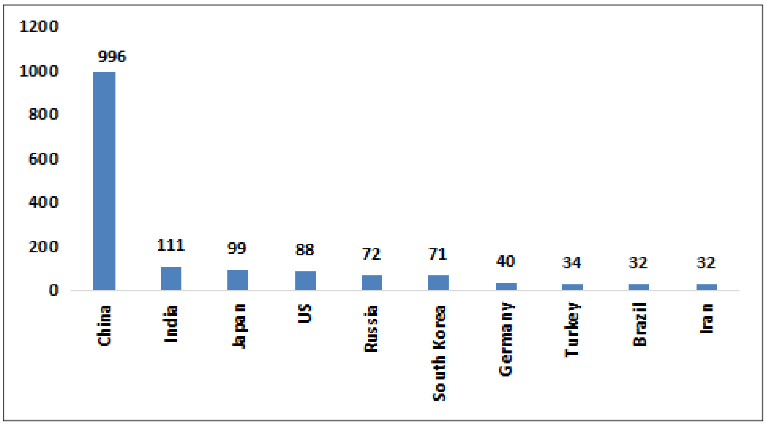
The Indian steel industry is classified on the basis of products (long products and flat products) and on the basis of composition (alloy steel and non-alloy steel). India is the second largest producer of steel in the world with nearly 6% share of global steel production. After a moderate growth trend since 2012, India's steel demand exhibited swift comeback with vigorous growth of 8-9% on-year in FY18. On the flip, the demand momentum slowed down a bit to a level of 1.4% in FY20 on account of the Covid-19 pandemic that dampened the growth prospects from automobile, construction and capital goods segment. As per Crisil's forecast, steel demand is anticipated to continue its strong stride at 5-6% CAGR through FY25 supported by factors such as:

(i) Soft revival in housing sector in the medium term led by affordable housing, rural housing and commercialization of Tier III/IV cities

(ii) Infrastructure projects in metro, road, and urban infra space (which are more steel intensive); and

(iii) Post a drop of 12-14% in the growth estimates in FY21 due to Covid-19 outbreak, the automotive industry has shown signs of improvement. The sector, however, recently witnessed uptick in demand post August 2020 and has given green shoots to the sector.

Exhibit 01: Crude Steel Production in 2019 (in MT)



Source: Company RHP, Progressive Research

Steel Products Demand Analysis:

(a) Alloy and Non-alloy Steel: India steel demand has risen at a modest 5.4% CAGR during past five years (FY15-20). Alloy steel witnessed a decline in demand on account of automobile production FY19 onwards. As a result, the share of alloy in overall steel demand has fallen from 8.8% in 2014-2015 to 6.0% in 2019-2020. On the other hand, non-alloy steel has been growing at a CAGR of 6.0%. Further, long steel demand grew at a CAGR of 3% over past five years (FY15-20) period primarily led by healthy growth in infra and modest growth in housing segment; whereas flat steel on the other hand rose at around 8.6% CAGR during the same period. This has led to share of long steel in overall finished steel demand to fall from 58% in FY15 to 52% in FY20.

(b) Billets: A billet is a section of metal used for rolling into bars, rods and sections. Billets consumption has largely moved in conjunction with long steel production at around 2.5-3% CAGR during past five year period from 2014-15 to 2019-20. Healthy infrastructure demand coupled with modest growth in housing segment drove long steel demand and thereby billets consumption. As per Crisil Report, India's billet consumption is anticipated to increase to ~4% through FY25 led by strong growth in building & construction sector, infrastructure and automotive industry.

SNAPSHOT		
Issue Opens	Monday, June 14, 2021	
Issue Closes	Wednesday, June 16, 2021	
Price Band (Rs)	303/306	
Bid Lot	45 shares and multiples thereafter	
Face Value	Rs10	
Listing	BSE & NSE	
Type of Issue	Fresh Issue & OFS	
Offer Size *(Rs Mn)*	Fresh Issue	6,570
	OFS	2,520
	Total	9,090
*Implied Market Cap *(Rs Mn)*	78,055	
P/E *(based on FY20 Earnings)**	22.9	

**Note: Implied Market Cap & P/E are calculated at upper price band of Rs306*

Issue Allocation	
Reservations	**% of Net Issue**
QIB	50
NIB	15
Retail	35
Total	**100**
Employee Reservation: Upto 300,00 equity shares	

Object of the Offer
• Repayment and/or pre-payment, in full or part, of company's debt and SSPL (one of the subsidiaries) • General corporate purposes

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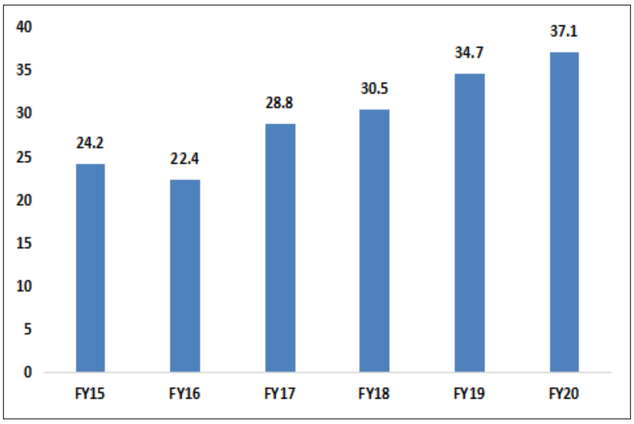
Steel Products Demand Analysis (contd.):

(c) Sponge Iron: Sponge iron, also termed direct-reduced iron, is produced by reducing (removing oxygen) from iron ore to increase free iron content. Its popularly used as a feed in electric furnaces and as a substitute for steel scrap. India is the second largest sponge iron producer, having an annual production of 37 million tonnes, increasing consistently since FY17.

(d) Pellets: Pellets are normally produced in the form of globules from very fine iron ore and mostly used for production of sponge iron in gas based plants, though they are also used in blast furnaces in some countries in place of sized iron ore. Pellets share of exports in the overall production increased from 1.5% in FY16 to around 18% in FY20. On the other hand, the domestic sales of pellets is estimated to have grown at 9% CAGR against a 13% CAGR growth in exports from FY17-20.

(e) Ferro Alloys: Ferro alloys are alloys of iron with a high proportion of one or more than one other element e.g. chromium, manganese or silicon. The requirement of ferro alloys vary depending on the process of steel making and the type of steel that's being produced. Majority of the ferro-alloys capacities (almost two-third) are located in Eastern belt especially in the states of West Bengal and Chhattisgarh. Shyam Metalics and Energy Limited (SMEL) is amongst the largest producer of ferro-alloys domestically with an annual installed capacity of 0.21 MT as of February 2021, with 6.6% share in the capacity.

Exhibit 02: Gross Sponge Iron Production (in million tonnes)



Source: Company RHP, Progressive Research

Exhibit 03: Leading Players (Ferro Alloys)

Players	Ferro Alloy Capacity (FY20)
Shyam Metalics	0.21 MT
IMFA	0.275 MT
Balasore Alloys	0.16 MT
Abhijeet Alloys	0.2 MT
Modern India Concast Ltd	0.20 MT
Shri Girija Alloys and Power	0.15 MT
Tata Steel	0.11 MT
Nava Bharat Ventures Ltd	0.13 MT

Source: Company RHP, Progressive Research

Growth Drivers for Steel Demand:

⇒ **Building and Constructions (B&C):** While in near term B&C demand is expected to be weak with affordable housing being the only saviour, however, in medium term housing market shall witness some soft revival led by rural housing, affordable housing, and commercialization of Tier III/IV cities.

⇒ **Infrastructure:** Demand from the sector is expected to be healthy with increasing activities and swift pace of execution in steel intensive segments such as railways and particularly metros.

⇒ **Automotive:** The sector is expected to eventually recover by FY22 with cars and utility vehicles expected to grow at 17%, commercial vehicles at 29% and 2Ws at 10% post witnessing a drop in growth in FY21.

About the Company:

Shyam Metalics and Energy Limited (SMEL) is one of the leading integrated steel and ferro alloys producer in Eastern region of India in terms of long steel products as of FY20. It is present across the steel sector's value chain- pellets, sponge iron, billets, long steel (structural/TMT), pipe, ferro alloys, railway siding and captive power plant. SMEL has 3 manufacturing units with aggregate operating capacity of 5.71 million TPA with 227 MW of captive power plant (as of December, 2020). Its 2 integrated units are located at Sambalpur, Odisha and Jamuria, West Bengal respectively. One other unit is located at Mangalpur, West Bengal. The Sambalpur and Jamuria plants operate as 'ore to metal' integrated steel manufacturing plants and comprise captive railway sidings, captive power plants, iron pellet, sponge iron, billet, thermo mechanically treated (TMT), wire rod and structural mills, and ferro alloy plants. As of December 31, 2020, SMEL had partnerships with 42 distributors, who stock and sell their finished products across 13 states and one union territory.

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Competitive Strengths:

(i) Integrated operations across value chain: SMEL is one of the leading integrated steel and ferro alloy producer in Eastern Region of India, as of FY20, having presence across the steel sector's entire value chain thereby ensuring better operational and financial performance. SMEL's backward integration includes pellets, sponge iron, and billets. Forward integration is into TMT, Bars, ERW Pipes, and Ferro Alloys. The forward and backward integration activities are generally undertaken by the in-house engineering team in a timely manner.

(ii) Strategic location of manufacturing plants: The manufacturing facilities of the company are strategically located in close proximity to its raw material sources, which enables the company to cut down on the transportation and logistics cost thereby improving the operational efficiency. The manufacturing plants are located within 250 kilometres of the mineral belt in eastern India, including, iron ore, iron ore fines, manganese ore, chrome ore and coal mines- some of the key raw materials.

(iii) Diversified product mix and strong clientele: The products primarily comprise of (i) long steel products, which range from intermediate products, such as, iron pellets, sponge iron and billets and final products, such as, TMT, customised billets, structural products and wire rods; and (ii) ferro alloys with a specific focus on high margin products, such as, specialised ferro alloys for special steel applications. TMT and structural products are sold under the brand 'SEL'. The domestic customers include Jindal Stainless Limited, Jindal Stainless (Hisar) Limited, and Rimjhim Ispat Limited whereas, the international customers include Norecom DMCC, Norecom Limited, POSCO International Corporation, World Metals & Alloys (FZC), Traxys North America LLC, JM Global Resources Limited, Goenka Steels Private Limited and Vijayshri Steel Private Limited.

(iv) Captive Power Plant: SMEL houses captive power plant of 227 MW capacity as of FY20 which typically meets 90% of its power requirement and is self-sufficient. While average grid power is estimated to cost Rs5 to 7 per unit at an all India basis, however, SMEL's power and fuel cost is significantly lower at Rs2.24 per unit as of FY20. Since power is a major raw material this significantly adds to the competitive strength of SMEL.

Exhibit 04: Product and Capacity Utilization Levels

Steel Segment	Capacity as of December 2020
Iron Pellet	2.40 MT
Sponge Iron	1.38 MT
Billets/SMS	0.89 MT
Long steel (wire, rods, structural)	0.82 MT
Ferro Alloys	0.21 MT
Captive Power Plant	227 MW
Wind Power	5.1 MW

Source: Company RHP, Progressive Research

Exhibit 05: Raw Material Sourcing

Raw Material	Source
Iron ore/ Iron ore mines	Mine owners located in Odisha
Chrome ore	Long term linkages with Odisha Mining Corporation Limited, other mine owners and imports
Manganese ore	MOIL Limited, other mine owners and imports
Coal	Fuel supply agreements entered into with Mahanadi Coalfields Limited, Central Coalfields Limited and South Eastern Coalfields Limited, and imports

Source: Company RHP, Progressive Research

Strategies:

(i) Strengthen the market position and increase manufacturing capacities: SMEL intends to strengthen its leading market position in India and achieve better economies of scale by expanding the existing manufacturing capacities and setting up additional manufacturing plants. Off late, the company has various expansions under its radar that includes: at Sambalpur manufacturing plant, the company has installed (a) two iron pellet plants of 300,000TPA and 600,000TPA, sponge iron plant of 165,000TPA, TMT plant of 60,000TPA, wire rod plant of 200,000TPA and a captive power plant of 33MW in FY20; and (b) a billet plant of 63,360TPA in FY19; (ii) at Jamuria manufacturing plant, SMEL has installed (a) a 115,500TPA sponge iron plant and 95,040TPA billet for 9MFY21; (b) an iron pellet plant of 600,000TPA, a sponge iron plant of 99,000TPA, a billet plant of 168,960TPA, a TMT plant of 106,992TPA, a wire rod plant of 200,000TPA and a captive power plant of 30MW in FY20; and (c) a ferro alloy plant of 14,000TPA in FY19. The company ensures to add capacity in a phased manner that would enable it to utilize the capacity at optimal levels.

(ii) Retain focus on cost efficiency: SMEL retains its focus on reducing the operating costs and improving operational efficiencies. This move is supported by continuous investment in new infrastructure at its manufacturing plants and exploring opportunities in order to obtain synergies in existing manufacturing plants.

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Strategies (contd.):

(iii) Introduce new products by leveraging forward integration capabilities: SMEL intends to integrate its operations by using the existing waste and by-products in order to introduce new and high margin products. It is currently in the process of further diversifying the product base by entering into the segments of pig iron, ductile iron pipes and aluminium foil. In particular, the company intends to use the pig iron from its operations to produce ductile iron pipes. In order to market these new products, the company intends to leverage the existing distribution network.

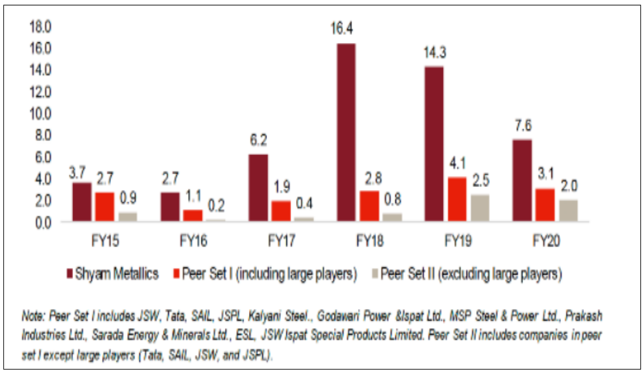
Financials:

Since the onset of the Covid-19 pandemic in March 2020, the operations continued to take place at its manufacturing facilities at Sambalpur plant (since, steel was considered as an essential commodity), however, Jamuria and Mangalpur manufacturing plants were operating with few operational production plants and limited workforce. Despite of the impact of the pandemic, the revenue from operations increased by 19.80% from Rs32,831mn in 9MFY20 to Rs39,331mn in 9MFY21.

The profits came in at Rs4563mn in 9MFY21; whereas the margins reported stood at 18.3%.

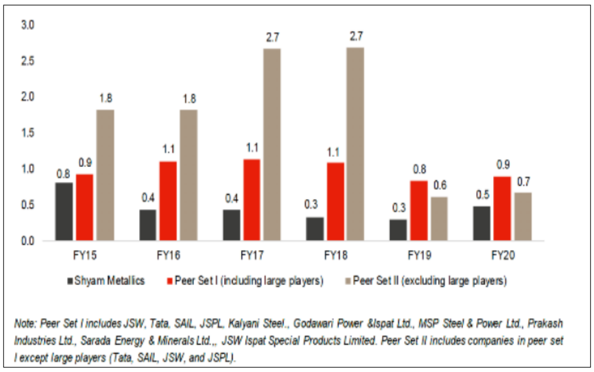
SMEL's interest coverage has declined in last 3 years but still is higher as compared to both peer sets throughout last five year. SMEL's reported an ICR of 7.6x in FY20 as against 3.7x in FY15. SMEL's interest coverage is one of the highest among its competitors. On the other hand, SMEL has been the least leveraged group among peers and as of March, 2020 their gearing was 0.5 which is one of the lowest amongst the competitor. SMEL's gearing has reduced to 0.5 times as of March 2020 from 0.8 times as of March 2015 ; whereas the ratio as of December, 2020 stood at 0.27. This was largely on account of steady cash accruals following healthy operating performance, which helped SMEL reduce its debt consistently to Rs4.1bn as of March 2020, from an elevated levels of approximately Rs6bn as of March 2015.

Exhibit 6: ICR Trend



Source: Company RHP

Exhibit 7: Gearing Ratio Comparison



Source: Company RHP

Exhibit 8: Financials Snapshot

Revenues (Rs mn)	FY18	FY19	FY20	9MFY21
Sales	37,472	46,064	43,629	39,331
EBITDA	7,010	9,447	6,456	7,194
EBITDA Margin %	*18.7*	*20.5*	*14.8*	*18.3*
Net Profit After Tax	5,280	6,368	3,403	4,563
Net Profit Margin %	*14.1*	*13.8*	*7.8*	*11.6*
Earning Per Share	18.2	25.9	14.6	19.5
RoNW (%)	*22.9*	*24.3*	*12.0*	*13.9*

Source: Company RHP, Progressive Research

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Risks & Concerns:

- Loss of any of the suppliers or a failure by the suppliers to deliver some of the primary raw materials such as iron ore, iron ore fines, coal, chrome ore and manganese ore may have an adverse impact on the ability to continue the manufacturing processes.
- Disruption of logistics and transportation services could impair the ability of suppliers to deliver raw materials/ability to deliver products to the customers.
- Steel industry being cyclical in nature; any fluctuations in steel prices may hamper the operations of the company.
- Covid-19 impact and deterioration in general economic conditions impacted the business and operations in the past; the future implications if any are difficult to predict.
- The unexpected loss, shutdown or slowdown of operations at any of the manufacturing plants could have a material adverse effect on operations and financial condition.

Outlook and Recommendations:

SMEL has a diversified product mix at its disposal ranging from pellets, sponge iron, long steel, ferro alloys. Such a diversified base enables the company to de-risk or rather balance itself from the cyclical changes in the steel sector. Having a captive power plant at the company level ensures it to meet almost 90% of its requirement. Furthermore, having a close proximity to raw materials sourcing enables the company in saving on the logistics cost and thereby enhance the operational efficiency. The company has various planned expansions in place in terms of diversifying its presence in DI pipes. The company is also in the process of increasing the capacities of existing manufacturing plants and captive power plants which would boost the installed capacities. Based on the FY20 earnings, the P/E stands at 22.94x. Efficiency improvements, better productivity and cost rationalisation have enabled the company to deliver consistent and strong financial and operational performance over the past years. **We recommend a Subscribe to the IPO with a long term perspective.**

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