Shyam Metalics & Energy Ltd

ICICI direct Research

Price Band ₹ 303-306

UNRATED

June 14, 2021

Shyam Metalics and Energy (SMEL) is a leading integrated metal producing company based in India with a focus on long steel products and ferro alloys. SMEL currently operate three manufacturing plants in Sambalpur in Odisha, along with Jamuria and Mangalpur in West Bengal. SMEL has the ability to sell intermediate and final products across the steel value chain. The company is among the largest producers of ferro alloys in terms of installed capacity in India, as of February 2021. As of March 31, 2020, SMEL was also one of the leading players in terms of pellet capacity and the fourth largest player in the sponge iron industry in terms of sponge iron capacity in India.

Integrated operations across steel value chain…

SMEL's 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. The integrated nature (backward and forward integration) of the manufacturing plants has resulted in control over all aspects of the operations (with the exception of sourcing of primary raw materials) as well as operating margins, thereby enabling the company to focus more on quality and create multiple points of sale across the steel value chain.

Strategically located manufacturing plants…

The company's manufacturing plants are strategically located in close proximity to raw material sources, which will lower transportation costs and provide significant logistics management and cost benefits thereby improving operating margins. The manufacturing plants are located within 250 km of the mineral belt in eastern India, including, iron ore, iron ore fines, manganese ore, chrome ore and coal mines, which are primary raw materials. The strategic location of the manufacturing plants has helped in creating synergies as well as in achieving economies of scale and operational efficiencies. Further, the manufacturing plants are well connected by roads, railways and ports.

Key risk & concerns

- Loss of any suppliers or failure of suppliers to deliver some primary raw materials like iron ore, iron ore fines, coal, chrome ore and manganese ore may have an adverse impact on SMEL's ability to continue its manufacturing process without interruption and its ability to manufacture and deliver the products to customers without any delay
- SMEL's manufacturing plants and sources of raw materials are primarily concentrated in eastern India and any adverse developments affecting this region could have an adverse effect on business, results of operations and financial condition

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Particulars

Issue Details	Amount
Issue Opens	June 14, 2021
Issue Closes	June 16, 2021
Issue Size (₹ Crore)	909
Issue Type	Fresh Issue & Offer for Sale
Price Band (₹)	303-306
No of Shares on Offer (Crore)*	2.97
Minimum lot size	45
Face Value (₹)	10

*- At upper price band of ₹306, Fresh issue of 2.15 crore shares and Offer for sale of 0.82 crore shares

Shareholding

Shareholding	Pre-offer(%)	Post-offer(%)
Promoter	100.0	88.35
Public	0.0	11.65
Total	100.0	100.0

Objects of issue

Objects of the issue	₹ Crore
Repayment and/or pre-payment of debt of the company & SSPL, one of the subsidaries	470
General Corporate Purpose	*
Total Fresh issue Proceeds	**657**
Offer for Sale (₹ crore)	**252**

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IPO Review

ICICI Securities – Retail Equity Research

Key Financial Summary

(₹ Crore)	FY18	FY19	FY20	9MFY20	9MFY21
Net Revenue	3,747	4,606	4,363	3,283	3,933
EBITDA	701	945	646	453	719
EBITDA Margins (%)	18.7%	20.5%	14.8%	13.8%	18.3%
Adj.PAT	424	604	340	261	456
Diluted Adj. EPS (₹)	16.6	23.7	13.3	10.2	17.9
EV/EBITDA	11.7	8.7	13.9	-	-
P/E	18.4	12.9	22.9	-	-
ROE (%)	23.0	24.0	12.0	-	-
ROCE(%)	22.8	27.4	10.9	-	-

*Source: RHP, ICICI Direct Research, * P/E and EV/EBITDA calculated at upper price band of ₹306*

Company background

Shyam Metalics and Energy (SMEL) is a leading integrated metal producing company based in India with a focus on long steel products and ferro alloys. SMEL currently operate three manufacturing plants in Sambalpur in Odisha along with Jamuria and Mangalpur in West Bengal. SMEL has the ability to sell intermediate and final products across the steel value chain. The company is among the largest producers of ferro alloys in terms of installed capacity in India, as of February 2021. As of March 31, 2020, SMEL was also one of the leading players in terms of pellet capacity and the fourth largest player in the sponge iron industry in terms of sponge iron capacity in India. SMEL has a consistent track record of delivering operating profitability. Since the commencement of operations in FY05, it has delivered positive EBITDA in each fiscal year.

SMEL currently operate three manufacturing plants in Sambalpur, Jamuria and Mangalpur. As of December 31, 2020, the aggregate installed metal capacity of manufacturing plants was 5.71 million tonnes per annum (MTPA) (comprising intermediate and final products). Manufacturing plants also include captive power plants with an aggregate installed capacity of 227 MW, as of December 31, 2020. The company is also in the process of increasing the capacity of existing manufacturing plants and captive power plants, which is expected to increase aggregate installed metal capacity (comprising intermediate and final products) from 5.71 MTPA, as of December 31, 2020, to 11.60 MTPA and captive power plants aggregate installed capacity from 227 MW, as of December 31, 2020, to 357 MW. These proposed expansions are expected to become operational between FY22 and FY25. In addition, SMEL is in the process of commissioning an aluminium foil rolling mill at Pakuria in West Bengal with a proposed installed capacity of 0.04 MTPA, which is expected to become operational in FY22.

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. Integrated manufacturing plants are fungible by design, which provides the company with the ability to quickly adapt to continuously evolving market conditions, change production and product offerings and optimise operating margins thereby insulating from price volatility. Further, the Mangalpur plant comprises sponge iron and ferro alloy plants, and a captive power plant. The company has eight captive power plants that utilise non-fossil fuels, such as, waste, rejects, heat and gas, generated from operations to produce electricity, and thereby enable to operate at lower power costs. In FY18, FY19 and FY20, and the nine months ended December 31, 2020, power units produced from captive power plants accounted for 90.06%, 87.32%, 85.19% and 79.58%, respectively, of total power units consumed.

The company primarily produce intermediate and long steel products, such as iron pellets, sponge iron, steel billets, TMT, structural products, wire rods, and ferro alloys products with a specific focus on high margin products, such as, customised billets and specialised ferro alloys for special steel applications. SMEL also undertakes conversion of hot rolled coils to pipes, chrome ore to ferro chrome and manganese ore to silico manganese for an Indian steel conglomerate. The company is also currently in the process of further diversifying its product portfolio by entering segments like pig iron, ductile iron pipes and aluminium foil.

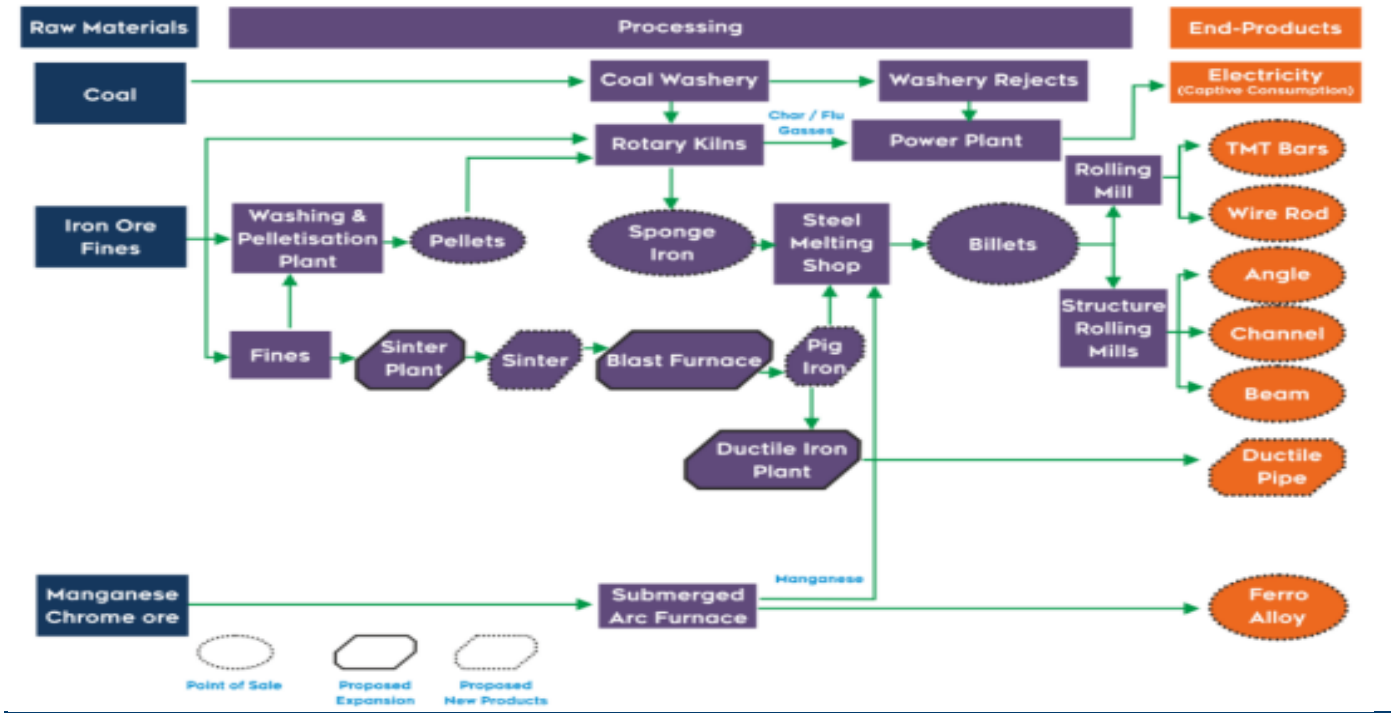
Investment Rationale

Integrated operations across steel value chain

SMEL's 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. The integrated nature (backward and forward integration) of the manufacturing plants has resulted in control over all aspects of the operations (with the exception of sourcing of primary raw materials) as well as operating margins, thereby enabling the company to focus more on quality and create multiple points of sale across the steel value chain. The backward integration activities, include setting up of iron pellet plants and installation of rotary kilns to produce sponge iron. The company utilise the sponge iron produced to further manufacture billets, which are not required to be reheated and are directly utilised by the rolling mills to produce TMT bars and wire rods, thereby resulting in cost efficiencies. The forward integration activities, include, diversification of product mix by utilising the billets to produce value added products, such as, TMT bars, structural products and wire rods, which enable to de-risk the revenue streams and expand product offerings. The forward and backward integration activities are generally undertaken by in-house engineering team who conceptualise and execute such activities in a timely manner with the help of various construction equipment owned by the company. The integrated nature of operations enables the company to maintain greater control over operating margins.

The following flowchart highlights the integrated nature of operations:

Exhibit 1: Integrated nature of operations



Source: RHP, ICICI Direct Research

Strategically located manufacturing plants …….

The company's manufacturing plants are strategically located in close proximity to raw material sources, which lowers transportation costs and provide significant logistics management and cost benefits thereby improving operating margins. The manufacturing plants are located within 250 km of the mineral belt in eastern India, including, iron ore, iron ore fines, manganese ore, chrome ore and coal mines, which are primary raw materials. The strategic location of the manufacturing plants has helped in creating synergies as well as achieving economies of scale and operational efficiencies.

Further, the manufacturing plants are well connected by roads, railways and ports. The manufacturing plants are located close to raw material sources and are supported by strong logistics infrastructure such as private railway siding, which enables to reduce the logistical costs associated with the transportation of raw materials and products. In particular, Sambalpur and Jamuria manufacturing plants have their own captive railways sidings. SMEL is one of the few integrated metal producing companies in India with captive railway sidings, as of March 31, 2020. Transportation by rail has resulted in reduction of freight costs and turnaround time of transportation of raw materials to manufacturing plants and products to customers. The ports nearest to Odisha manufacturing plant are Dhamra and Paradip, which are situated within a radius of 300 km while Visakhapatnam port is situated within a radius of 600 km from the Odisha manufacturing plant. The ports nearest to West Bengal manufacturing plants are Kolkata and Haldia, which are situated within a radius of 300 km from West Bengal manufacturing plants. Strategic location of manufacturing plants has enabled the company to export products to international customers in a cost efficient manner.

Diversified product mix with strong focus on value added products like ferro alloys, association with reputed customers, robust distribution network…

SMEL's products primarily comprise (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. The company also undertakes conversion of hot rolled coils to pipes, chrome ore to ferro chrome and manganese ore to silico manganese for an Indian steel conglomerate. The forward and backward integration of manufacturing plants has resulted in multiple points of sale across the steel value chain and provided the company with flexibility to sell intermediate products as well as use them for captive consumption, depending on the demand. This has resulted in a diversified product mix, which has reduced dependency on a particular product and de-risked revenue streams.

Strong financial performance and credit ratings…

Focus on continuous efficiency improvements, improved productivity and cost rationalisation has enabled the company to deliver a consistent and strong financial and operational performance. Further, since the commencement of operations in FY05, the company has delivered a positive EBITDA in each fiscal year. SMEL also obtained strong credit ratings. In particular, the company and its subsidiary, Shyam SEL and Power Ltd, has received Crisil A1+, Crisil AA-/ Stable, and Crisil A1+ rating from Crisil for their short-term (bank facilities) rating, long-term (bank facilities) rating and commercial paper, respectively. In addition, the company and its subsidiary, Shyam SEL and Power, has received CARE A1+, CARE AA-/ Stable, and CARE A1+ rating from CARE for their short-term (bank facilities) rating, long-term (bank facilities) rating and commercial paper, respectively.

Key risks & concerns

Loss of supplies or failure of suppliers to deliver some primary raw materials may have adverse impact on SMEL's manufacturing operations…

SMEL's ability to remain competitive, maintain costs and profitability depend, in part, on its ability to source and maintain a stable and sufficient supply of raw materials at acceptable prices. The company procures some of its primary raw materials, such as (i) iron ore, iron ore fines and manganese ore on a purchase order basis; (ii) with the exception of fuel supply agreements that it has entered into certain parties, which accounted for 56.45% of its total coal purchases in FY20, the company imports coal on a purchase order basis; and (iii) chrome ore (with the exception of long term linkages with Odisha Mining Corporation) on a purchase order basis and has not entered into long term contracts for the supply of such raw materials.
Accordingly, it may encounter situations wherein the company may be unable to manufacture and deliver its products due to, among other reasons, inability to predict the increased demand for its products. As a result, the success of its business is significantly dependent on maintaining good relationships with raw material suppliers. Absence of long-term supply contracts are subject to risks such as price volatility caused by various factors such as commodity market fluctuations, currency fluctuations, climatic and environmental conditions, production and transportation cost, changes in domestic as well as international government policies, and regulatory and trade sanctions. Since the company also imports a certain amount of raw materials from international suppliers, it remains susceptible to the risks from raw material price fluctuations as well as import duties, which could result in a decline in operating margins. Although SMEL has not faced significant disruptions in the procurement of raw materials in the past, there can be no assurance that it will procure the quantities and quality of raw materials commensurate with its requirements in the future. Further, any delay/failure to deliver or delivery of wrong or sub-standard raw materials by suppliers may have a material and adverse effect on business, results of operations and financial condition.

Steel industry characterised by volatility in prices of raw materials, energy which may adversely affect profitability

Steel production requires substantial amounts of raw materials and energy, including iron ore, iron ore fines, non-coking coal and coke, scrap and power, which are subject to significant price volatility. The production of steel is capital intensive, with a high proportion of fixed costs to total costs. Consequently, steel producers generally seek to maintain high capacity utilisation. If capacity exceeds demand, there is a tendency for prices to fall sharply if supply is largely maintained. Conversely, expansion of capacity requires long lead times so that, if demand grows strongly, prices increase rapidly, as unutilised capacity cannot be brought on line as quickly. The result can be substantial price volatility.

SMEL's manufacturing plants, sources of raw materials primarily concentrated in eastern India exposes it to geographical risk...

As of the date of the red herring prospectus, the company owns and operates three manufacturing plants in West Bengal and Odisha. It procures its raw materials such as iron ore, iron ore fines, coal, pig iron, manganese ore, chrome ore and coke from these states. SMEL is also in the process of commissioning an aluminium foil rolling mill at Pakuria in West Bengal. Further, a portion of revenue from sale of manufactured products is also derived from the eastern region of India. In FY18, FY19 and FY20 and the nine months ended December 31, 2020, revenue from sale of manufactured products from the eastern region of India accounted for 29.12%, 49.75%, 35.04% and 34.47%, respectively, of its total revenue from sale of manufactured products.

Any materially adverse social, political or economic development, natural calamities, civil disruptions in the eastern region of India could adversely affect, among others, manufacturing operations and transport operations, and require a modification of business strategy, or require to incur significant capital expenditure or suspend operations. Any such adverse development affecting continuing operations at manufacturing plans could result in significant loss due to inability to meet customer contracts and production schedules, which could materially affect business reputation within the industry. While there has been no material impact of natural disasters on the assets of the company in the past, the occurrence of, or inability to effectively respond to, any such events or effectively manage the competition in the region, could have an adverse effect on business, results of operations, financial condition, cash flows and future business prospects.

Demand, pricing in steel industry is volatile, sensitive to cyclical nature of the industries…

Steel prices fluctuate based on a number of factors, such as, the availability and cost of raw material inputs, fluctuations in domestic and international demand and supply of steel and steel products, international production and capacity, fluctuation in the volume of steel imports, transportation costs, protective trade measures and various social and political factors, in the economies in which the steel producers sell their products and are sensitive to the trends of particular industries, such as, the construction and machinery industries. When downturns occur in these economies or sectors, it may lead to a reduction in demand, which may lead to a decline in steel prices. This may, in turn, have a material adverse effect on the company's business, results of operations, financial condition and prospects.

Financial summary

Exhibit 2: Profit and loss statement ₹ crore

Year end March	FY18	FY19	FY20	9MFY21
Total Operating Income	**3,747**	**4,606**	**4,363**	**3,933**
Growth (%)	-	23	-5	-
Raw Material Expenses	2,371	2,786	2,678	2,455
Gross Profit	**1,376**	**1,820**	**1,685**	**1,478**
Employee Cost	106	145	168	125
Other Operating Expenses	569	730	871	634
EBITDA	**701**	**945**	**646**	**719**
Growth (%)	-	35	-32	-
Other Income	78	78	32	63
EBITDA, including OI	**779**	**1,023**	**678**	**782**
Depreciation	215	195	297	220
Net Interest Exp.	49	64	86	56
Share of P&L in Associates	2	0	0	0
PBT	**517**	**764**	**295**	**506**
Total Tax	-11	127	-45	50
PAT	**528**	**637**	**340**	**456**
Non Controlling Interest	104	33	0	0
Adj.PAT after Minority Int.	**424**	**604**	**340**	**456**

Source: RHP, ICICI Direct Research

Exhibit 3: Cash flow statement ₹ crore

Year end March	FY18	FY19	FY20	9MFY21
Net cash flow from operating activities (A)	247	457	85	657
Net cash from investing activities (B)	-142	-567	-277	-231
Net cash from financing activities (C)	-162	112	212	-456
Effect of Foreign Exchange Fluctuation (D)	24	0	0	16
Net Changes in Cash & Cash Equivalents (A+B+C+D)	**-33**	**2**	**20**	**-14**
Cash and cash equivalents at the beginning of the year	41	8	10	30
Closing Cash & Cash Equivalents	**8**	**10**	**30**	**15**
Other Bank Balance	45	88	92	163
Closing Cash & Bank Bal.	**53**	**98**	**121**	**178**

Source: RHP, ICICI Direct Research

Exhibit 4: Balance sheet ₹ crore

Year end March	FY18	FY19	FY20	9MFY21
Liabilities				
Share Capital	47	234	234	234
Reserves	1,807	2,256	2,592	3,052
Total Shareholders Funds	**1,854**	**2,490**	**2,826**	**3,285**
Minority Interest	210	4	4	4
Long Term Borrowings	202	213	351	183
Net Deferred Tax liability	110	73	0	0
Other long term liabilities	88	235	289	236
Long-term provisions	6	6	27	10
Current Liabilities and Provisi	.			
Short term borrowings	279	443	921	682
Trade Payables	447	311	502	354
Other Current Liabilities	275	278	283	324
Short Term Provisions	0	0	1	28
Total Current Liabilities	1,002	1,032	1,707	1,388
Total Liabilities	**3,471**	**4,052**	**5,204**	**5,105**
Assets				
Net Block	1,723	1,731	1,969	1,838
Capital Work in Progress	91	358	235	351
Non-current investments	62	68	72	70
Other Non Current Assets	99	109	342	532
Current Assets, Loans & Adva	.			
Current Investments	133	205	72	98
Inventories	558	732	1,487	1,150
Sundry Debtors	369	213	259	244
Cash and Bank	53	98	121	178
Loans and Advances	6	47	4	16
Other Current assets	375	491	642	628
Current Assets	1,495	1,787	2,585	2,313
Total Assets	**3,471**	**4,052**	**5,204**	**5,105**

Source: RHP, ICICI Direct Research

Exhibit 5: Key ratios

Year end March	FY18	FY19	FY20	9MFY21
Per share data (₹)				
Adj. Diluted EPS	16.6	23.7	13.3	17.9
Cash EPS	25.1	31.3	25.0	26.5
BV	73.0	98.0	111.0	129.0
Cash per share	7.0	12.0	8.0	11.0
Operating Ratios (%)				
EBITDA Margin (%)	18.7	20.5	14.8	18.3
PAT Margin (%)	11.3	13.1	7.8	11.6
Debtor Days	36	17	22	-
Inventory Days	54	58	124	-
Creditor Days	44	25	42	-
Return Ratios (%)				
ROE(%)	23.0	24.0	12.0	-
ROCE(%)	22.8	27.4	10.9	-
Solvency Ratios				
Debt /EBITDA	0.5	0.4	1.8	-
Debt / Equity	0.2	0.2	0.4	-
Current Ratio	1.5	1.7	1.5	-
Valuation Ratios (x)				
EV/EBITDA	11.7	8.7	13.9	-
P/E	18.4	12.9	22.9	-
P/B	4.2	3.1	2.8	-
EV/Sales	2.2	1.8	2.0	-
Mcap/Sales	2.1	1.7	1.8	-

*Source: RHP, ICICI Direct Research, * Valuation ratios calculated at upper price band of ₹306*

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