

**Shyam Metals & Energy IPO – will Rise and Shine**

- Small Cap: ₹7,800 cr. Mkt cap
- Date: 12<sup>th</sup> June 2021

- Sector – Steel industry
- IPO Opens 14-16<sup>th</sup> Jun, at ₹303-306/share
- Valuations: P/E - 12.8, EV/EBITDA - 8.1
- Advice: SUBSCRIBE

**Summary:**

- The global steel cycle is on an upswing. Global and domestic demand for steel is rising, and many India based steel plants are running at good capacity utilizations.
- SMEL have a good financial strength, low debt, fair cash and ability to invest in their balance sheet.
- Integrated operations, proximity to RM sources, in house power generation and captive railway sidings build into a low cost operating model, which is good in a commodity industry.
- Growth plans are good including new products launch and doubling of mfg. capacity over 5 years.
- This IPO will also help SMEL to reduce debt and strengthen the balance sheet for planned growth.
- Key risks are 1) dip in steel cycle or Indian steel prices 2) high competition 3) steel price control by Gol 4) Rising iron ore and power costs.
- **Opinion: Investors can SUBSCRIBE to this IPO with a 1-2 year perspective.**

Here is a note on Shyam Metals and Energy Ltd (SMEL) IPO.

**IPO Offering highlights**

- The IPO opens from 14-16<sup>th</sup> Jun 2021 in a Price Band of ₹303-306 per share
- Total IPO size is ₹909 cr. of 2.97 cr. shares, about 12% of the equity shares. The IPO includes a fresh issue of ₹657 cr. and an Offer for Sale (OFS) of the remaining value, making up 0.82 cr. shares.
- The lot size is 45 shares and Face Value is ₹10 per share.
- Objects of the offer: **Table 1:** The Fresh Issue of up to ₹657 cr. will be utilized in following manner:

Particulars	Amount which will be financed from Net Proceeds	Estimated Utilisation of Net Proceeds in Fiscal 2022
Repayment and/or pre-payment of debt of Company and SSPL, one of its Subsidiaries	470 cr.	470 cr.
General corporate purposes	187 cr.	187 cr.

- The promoters own 100 % in SMEL which will fall to 88.35% post-IPO.
- The IPO share quotas for QIBs: 50%, Non-Institutional Investors 15% and Retail is 35%.
- In the grey market, the price of SMEL is at ₹436, a 42% premium to IPO price.

**Introduction**

- SMEL is a leading integrated metal producer with a focus on long steel products and ferro alloys.
- In FY20 the Revenues, EBITDA and Profits of SMEL were ₹4,395 cr., ₹678 cr. and ₹340 cr. resp.

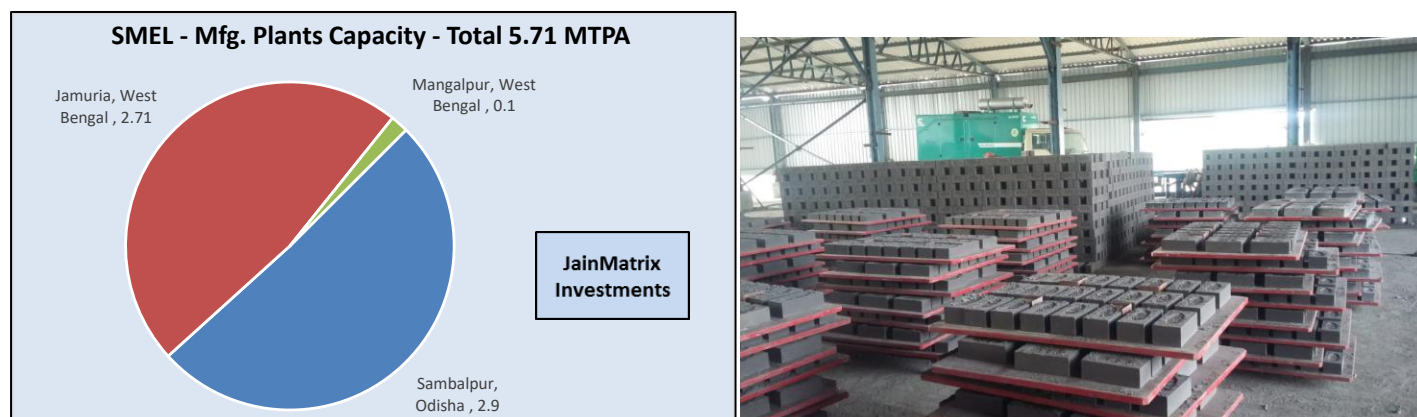
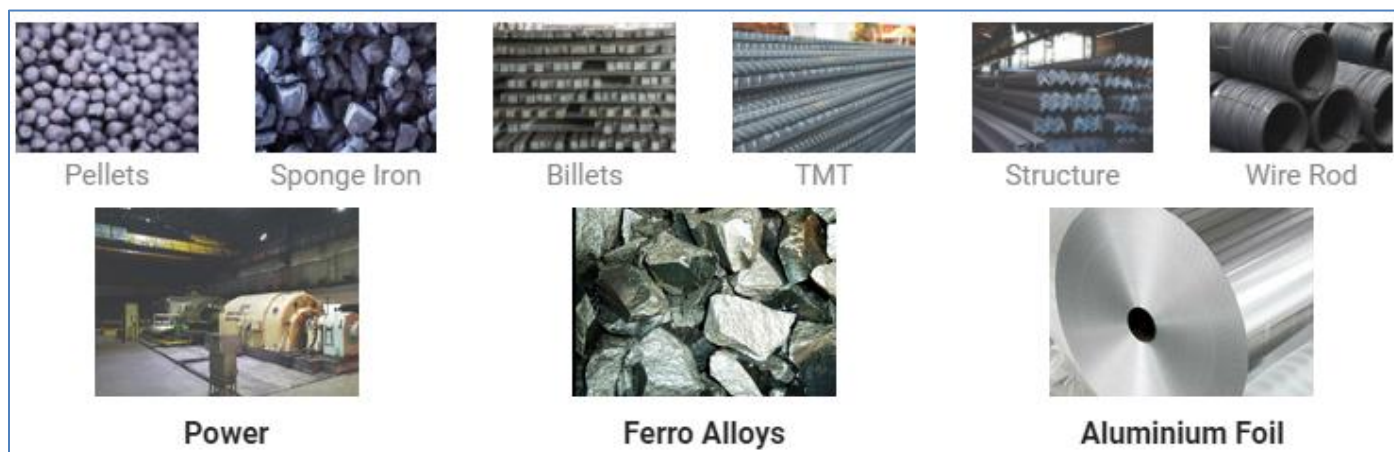


Fig 2a: Manufacturing Plants Capacity / Fig 2b: Fly Ash Bricks / Fig 2c: Products



- Incorporated in 2002, it is headquartered in Kolkata, West Bengal, in East India.
- It has 3 mfg. plants located in Sambalpur in Odisha, and Jamuria and Mangalpur in WB. **See fig 2a.**
- SMEL recently took a step towards the sustainable development of the community by introducing its new initiative called 'Waste to Value' – mfg. of premium quality Fly Ash bricks. **See Fig 2b.**
- It makes long steel products such as iron pellets, sponge iron, steel billets, TMT, structural products, wire rods, and ferro alloys. **See fig 2c, 2d and 2e.** It is among India's largest producers of ferro alloys by installed capacity and the #4 largest player in sponge iron. SMEL is known for TMT bar product.
- SMEL has the ability to sell intermediate and final products across the steel value chain.
- The company has 42 distributors that offer its products across 13 states and 1 UT.
- The mfg. units have an aggregated installed metal capacity of 5.71 m. tonnes per annum.
- SMEL has a workforce of 11,457 including 5,841 permanent and 5,616 contract employees.
- SMEL has a number of subsidiaries - Direct Subsidiaries - Shyam SEL and Power Ltd., Damodar Aluminium Pvt. Ltd., Singhbhum Steel and Power Pvt. Ltd., Renaissance Hydro Power Pvt. Ltd., and Kalinga Infra-Projects Ltd.. Indirect Subsidiaries of SMEL - Harshva Storage and Warehousing Pvt. Ltd., Meadow Housing Pvt. Ltd., Shyam Energy Ltd., Taurus Estates Pvt. Ltd., Whispering Developers Pvt. Ltd., Nirjhar Commodities Pvt. Ltd., and Shree Sikhar Iron & Steel Pvt. Ltd.
- Key leaders and Promoters: Mahabir Prasad Agarwal – Chairman, Brij Bhushan Agarwal – VC & MD and Sanjay Kumar Agarwal – Joint MD.

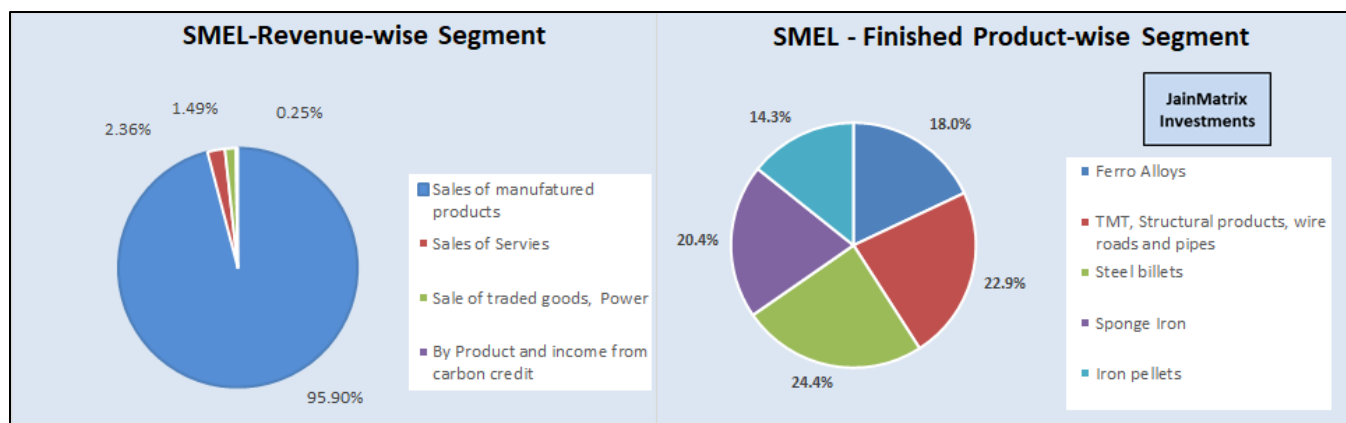


Fig 2d: Revenue Wise Segments and Fig 2e: Finished Product wise Segment

### News, Updates and Strategies

- SMEL on June 11 garnered ₹270 cr. from 22 anchor investors, ahead of its IPO. Marquee investors who participated in the anchor portion included Edelweiss Alternative Investment Opp. Trust, Abakus Growth Fund, Aditya Birla Sun Life, Kotak MF, Integrated Core Strategies, SBI Gen. Insurance, Aurigin Master Fund, IIFL Asset Mgt., Kuber India Fund, Elara India Opp. Fund, Nippon Life, Dovetail India Fund, L&T MF, Saint Capital Fund, and GAM Multistock.
- CARE has upgraded the rating for long term facilities of SMEL to 'CARE AA-; Stable' from 'CARE A+; Stable'. The rating for short-term facilities and commercial paper has been reaffirmed at 'CARE A1+'.
- Jun'21 - SMEL initially planned to raise ₹1,107 cr. from IPO but reduced it to ₹909 cr. (investing.com)
- Nov'20 – SMEL's expansion project of its steel plant project in Pandloi, Sambalpur, from 0.77 mtpa to 2.37 mtpa and rolling mill against an investment of ₹1,205 cr. was also approved. This will create employment opportunities for over 3,270 persons. (Construction week online)
- SMEL has captive railway sidings at 2 of its mfg. units which lowers freight cost given that nearly three tons of raw material is to be transported for every ton of steel produced. Railway freight is more cost effective than road for long distances - above 500 km railway is 20-30% cheaper than road. However there is siding congestion and non-availability of rakes and locomotives for SMEL.
- Sept. 2020 – SMEL introduces a new Product – Wire Rods (SMEL Website)
- SMEL is looking to enter in segments such as pig iron, ductile iron pipes and aluminum foil and is in the process of commissioning an aluminum foil rolling mill at Pakuria in WB with a proposed installed capacity of 0.4 lakh tpa, expected to become operational by FY2022.
- In FY18, 19, 20, and 3QFY21, revenue % from exports was 18.2%, 17.3%, 9.6%, and 11.2%, resp.
- SMEL is involved with around 46 litigations. Out of these, cases against SMEL are 9, cases by SMEL are 9, cases against SMEL subsidiaries (SSPL) are 14, cases against SMEL Promoter is 1, cases by Promoter are 9, cases involving SMEL group company which has a material impact on SMEL are 2, cases against SMEL are 2 and cases against SMEL director are 2. However most of these are payment & cash disputes, a part of dealing with a large number of suppliers, distributors and customers.
- SMEL intends to expand their existing mfg. capacities and also setting up additional plants. It is looking to expand its mfg. capacity from 5.71 MTPA to 11.60 MTPA by 2025. SMEL is guiding for 12-15% annual growth, as achieved in the past, which it will continue in future.

- In order to increase SMEL market share, they aim to selectively acquire established businesses whose operations, resources and capabilities are complementary and/or supplementary to SMEL.

**Steel Industry Outlook in India**

- India is the #2 producer of steel in the world with nearly 6% share of global steel production.
- The Indian steel industry is modern with state-of-the-art steel mills. It has always strived for continuous modernisation of older plants and up-gradation to higher energy efficiency levels.
- India's current steel capacity of is ~140 mtpa and it is expected to rise to 300 mtpa by 2030-31.
- There is an up-cycle in international steel prices in H2FY21 due to increased steel consumption by China due to a stimulus package by the Chinese govt. which is keeping demand for metals high.
- A pick up in domestic demand is also boosting domestic steel prices. Steel prices have crossed pre-covid levels and are currently at a marginal premium to world export prices.



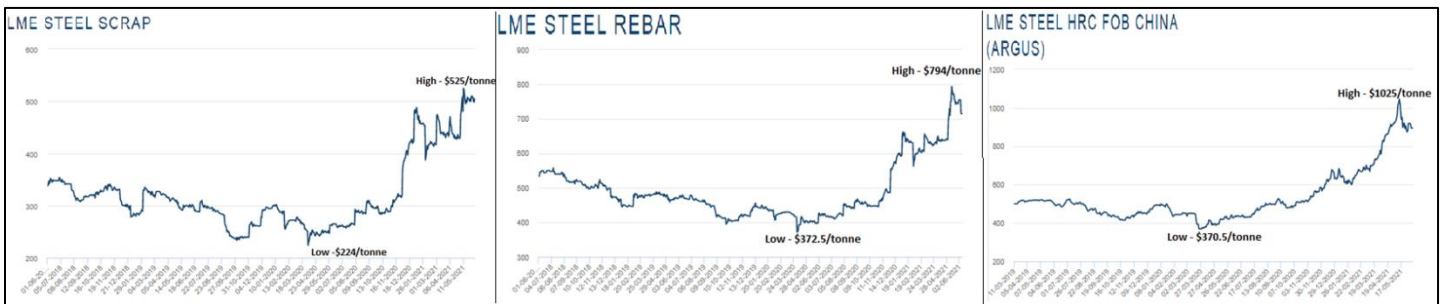
Fig 3a: Market Size (Source IBEF) / Fig 3b: Steel - Form, Composition and End Use



Fig 3c: Consumption & Exports

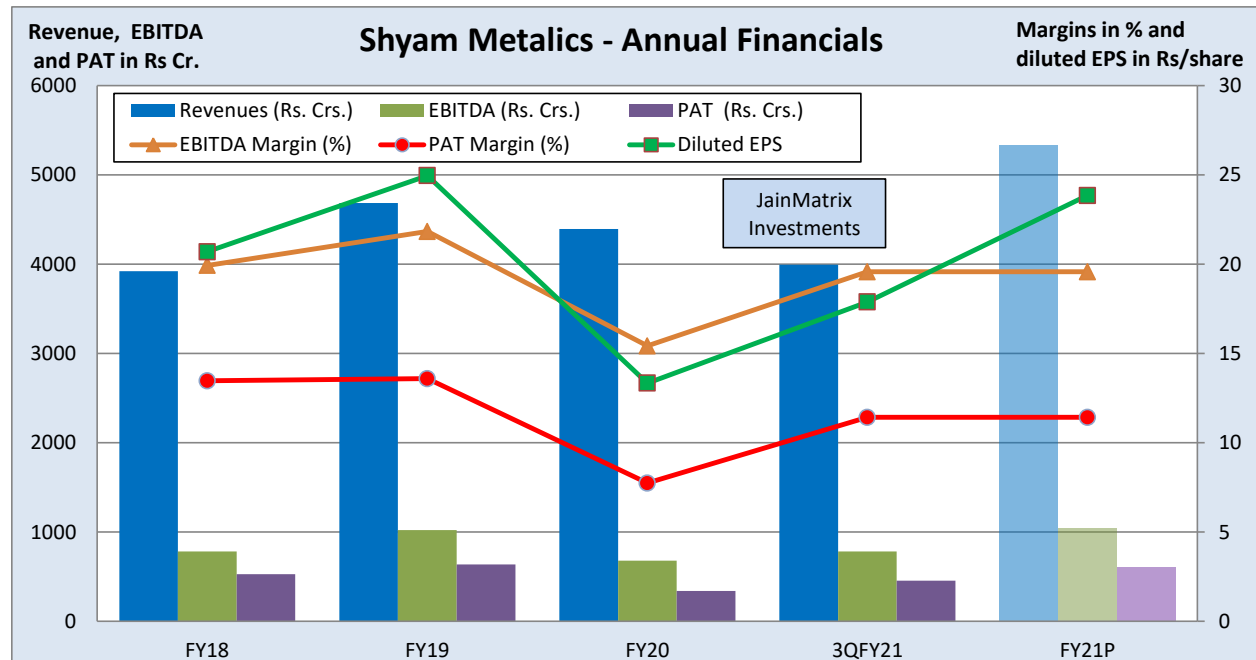
- Export and import of finished steel stood at 8.24 MT and 6.69 MT, respectively, in FY20P.

- India’s finished steel consumption grew during FY16-FY20 at 5.2% CAGR to reach 100 MT. India’s crude steel and finished steel production increased to 108.5 MT and 101.03 MT in FY20. **See fig 3a.**
- The Indian steel sector faced headwinds since 2019 due to general elections, trade tensions, slump in auto sales and slowdown in domestic economy. The Covid-19 pandemic has only added to the sector’s woes. However in Q4FY21 the sector recovered.
- Fig 4d, e and f shows the global price trends of different qualities of steel over last 3 years. We can see that steel prices have risen about 50-100% over this period. **Fig 3d, 3e and 3f – LME Steel Prices**



- CRISIL forecasts steel demand to continue growing at 5-6% CAGR through Fiscal 2025 supported by the GoI led initiatives especially affordable housing and infra projects in metro, road, and urban infra
- GoI focus on infra and restarting road projects is aiding the demand for steel. Also, further likely acceleration in rural economy and infrastructure is expected to lead to growth in demand for steel.
- GoI approved the National Steel Policy 2017, to create a globally competitive steel industry in India. NSP 2017 envisages 300 MT steel-making capacity and 160 kg/capita steel consumption by 2030-31.
- The GoI raised import duty on most steel items twice, each time by 2.5% and imposed measures including anti-dumping and safeguard duties on iron and steel items.

**Financials of BKG**



**Fig 4a – SMEL Financials, including simple FY21 projections based on 3Qs**

- SMEL revenue, EBITDA and profits increased over FY18-21P by 10.8, 10.1 and 4.8% CAGR. **See Fig 4a.**

- Revenue was ₹4,395 cr. and EBITDA ₹678 cr. in FY20. We have also projected FY21 numbers by a simple \*4/3 of 3QFY21 financials. See Fig 5a. The FY20 PAT fell due to Covid, but is now rising.
- EBITDA margin and PAT margins reduced in FY20, but for 3QFY21 margins are increasing.
- During FY20, cashflow from operations was low but cash outflow due to investments was also less. In 3QFY21, cashflows improved. Free Cash Flow (FCF) has been positive except FY19-20. See fig 4b.

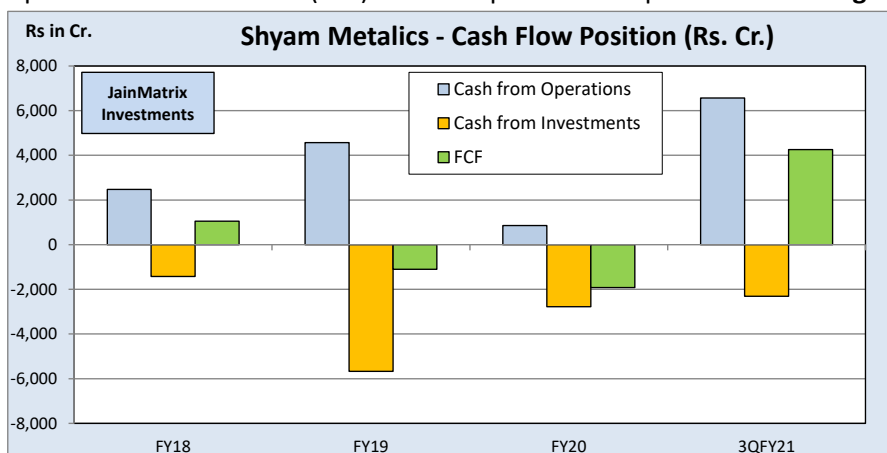


Fig 4b – Free Cash Flow

### Benchmarking

We do a benchmarking exercise of SMEL with its peers in fig 5. We emphasise the smaller steel companies:

- The valuation parameters of PE, PB and EV/EBITDA show it is fair to low, and so it is undervalued.
- Sales and profit growth for SMEL are lesser compared to its peers. D/E ratio is low; EBITDA margin for SMEL is higher compared to peers; profit margins too are good. Return ratios are about average.
- We conclude that SMEL is well managed financially. It is also not aggressively priced in the IPO.

Particulars	SMEL	Kudremukh Iron Ore Co. (KIOCL)	Tata Metaliks Ltd	Tata Steel BSL Ltd	Jindal Steel & Power Ltd	Tata Steel Limited	JSW Steel Limited	SAIL
Sales (₹ in cr's.) (FY20)	4,395	1,938	2,051	18,199	44,376	64,869	73,326	61,664
EBITDA (₹ in cr's.) (FY20)	634	101	301	2,490	7,771	25,176	11,524	10,544
Profits (₹ in cr's.) (FY20)	340	39	166	-735	12	11,319	4,600	2,611
Market Cap (₹ in cr's.)	7,806	17,597	3,435	10,092	41,065	125,265	171,344	52,230
PE (x)	12.80	57.35	14.78	3.88	9.04	16.33	21.18	13.98
PB Price to Book (x)	2.38	5.14	2.09	0.27	1.18	1.22	2.58	0.72
EV/EBIDTA	8.14	85.7	8.68	8.42	8.94	13.52	13.02	8.44
3 Yr CAGR Sales (%)	10.8	30.34	13.3	9.92	27.02	7.59	9.66	11.73
3 Yr CAGR Profit (%)	4.8	-9.74	12.47	na	na	26.61	8.42	na
Debt to equity ratio (x)	0.47	0.03	0.2	0.92	1.19	1.52	1.49	1.22
EBITDA Margin (%)	15.54	5.23	14.68	13.68	17.51	10.43	15.72	17.1
Net Profit Margin (%)	7.8	2.24	8.09	-3.45	-0.25	20.98	5.5	3.44
Return on Equity (%)	12.04	2.02	19.68	11.98	-0.87	13.47	12.58	6.43
RoCE (%)	9.49	3.2	22.87	12.82	5.64	5.17	8.58	7.92

Fig 5 – Benchmarking (note SMEL numbers are annualized for FY21)

### Positives for SMEL and the IPO

- The global economic recovery post covid lockdowns has allowed a recovery in the steel sector. The steel cycle is sharper in India as it is a large producer and prices are lower than global.

- So despite covid, SMEL revenues grew by 19.8% in 3QFY21, partly due to steel prices improvement.
- Management appears financially conservative. SMEL reduce its debt to ₹410 cr. in Mar'20, from ₹600 cr. in Mar'15. It also funded capex largely from internal accrual cash flows rather than debt.
- SMEL is diluting 12% in this IPO. It will need to dilute at least 13% more soon as SEBI mandates at least 25% dilution by promoters in 3 years after IPO. However if market conditions remain good, SMEL may be able to fund future growth through dilution at better valuations.
- SMEL has a consistent track record of operating profitability, and since the start in 2005, they have been EBITDA positive, per management. SMEL is planning for about 12-15% annual growth.
- SMEL's forward and backward integration of Sambalpur & Jamuria mfg. plants has created cost synergies. The mfg. plants are located close to raw material sources, resulting in low transportation costs and simpler supply chains. The integrated operations enables greater control over operating margins & quality, and creation of multiple points of sale across the steel value chain.
- SMEL is backward integrated into power generation, and has a low cost of power generated.
- SMEL is currently in the process of further diversifying their product portfolio by entering into new segments like pig iron, ductile iron pipes and aluminum foil, and also growing capacities.
- Already, a diversified product mix has reduced dependency on any product and de-risked business.
- About 10-18% of sales have been exports in recent times. This is good and perhaps more profitable.

#### Risks and Negatives for SMEL and the IPO

- The steel industry has a cyclical nature resulting in periods of high demand and rising prices followed by low demand and low prices. It's also difficult to see how long the current up cycle will last.
- Steel prices in India have risen sharply in the last year, and customer groups are facing cost pressures. It's possible that Govt may pressurize the Indian steel industry to control prices.
- The COVID-19 outbreak can result in unexpected loss or shutdown of operations at their plants.
- SMEL may be required to pay liquidation damages to suppliers of coal and chrome ore in the event of it not lifting a part of the annual contracted capacity. Disruption of logistics and transport services could impair the ability of SMEL to deliver products to customers and/or increase costs.
- Increase in import tariff may increase expenses for SMEL.
- SFAL and SPSP are subsidiaries engaged primarily in same lines of business of SMEL. Any conflict of interest which may occur between them and SMEL could adversely affect profitability.
- There have been several developments in the Indian steel industry, such as IBC linked revival of several steel assets, M&As and fresh investments by Tatas, Mittals and Jindal groups.
- Restrictions on raw materials import and increase in shipment cost may adversely impact business.
- Global demand for iron ore has pushed up ore prices in India. This can squeeze producer margins.
- High cost of logistics. Weak railway networks and costly trucking services have raised costs.
- There are several direct and indirect subsidiaries that are in unrelated businesses to SMEL.

#### Overall Opinion and Recommendation

- The global steel cycle is on an upswing. Global and domestic demand for steel is rising, and many India based steel plants are running at good capacity utilizations.
- SMEL have a good financial strength, low debt, fair cash and ability to invest in their balance sheet.

- Integrated operations, proximity to RM sources, in house power generation and captive railway sidings build into a low cost operating model, which is good in a commodity industry.
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