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Sandur Manganese and Iron Ores Ltd.

1.What does Sandur do?

Sandur Manganese is a 60+ year old company, the fifth-largest iron ore miner in Karnataka and the third largest miner of manganese ore in India. It has two mining leases valid up to Dec 2033 over an area of 2000 hectares with estimated reserves of 17MT of Manganese Ore and 105MT of Iron ore. It has majorly three business segments:

I. Mining of Manganese and Iron Ore (~37% revenue, ~52% profits)

- Of the two segments, Iron Ore mining contributed ~31% revenue and Manganese Ore mining contributed 6% in FY22
- Iron Ore 1.6 Million MTPA (100% utilization in FY22)
- Manganese Ore 0.28 Million MTPA - partly used for captive purposes (~26% in FY22) in ferro alloys and rest (~74%) is sold in the open market
- Sandur mainly has low to medium grade Iron Ore and Mn Ore fines and lumps

II. Coke and Waste Heat Recovery (~43% revenue, 28% profits)

- 0.5 MTPA Coke capacity 32 MW Waste Heat Recovery Boilers (WHRB)
- Coke Oven Batteries got commercialized in Jan '21 and has been operating at >100% utilization
- The steam generated from the Coke Oven Plant is recovered using WHRB to generate power for captive consumption in the Ferro Alloy Operations

III. Ferro alloys and power (~20% revenue, ~20% profits)

- Ferro alloys 95-125K TPA of silico manganese (primary product) and ferro manganese (used in production of steel)
- Thermal Based Captive Power generation of 32 MW

In the **Mining** business, ores are sold through e-auctions. Whereas, for the non-mining business of Coke and Ferro Alloy, 50% of the current Coke production is sold on a cost plus basis to one customer and the rest is sold in the open market.

2.How has the business evolved?

- Sandur is transforming itself from a pure-play miner to **an integrated commodity player, focused on value-added end-products.**
- By the end of FY 24- the company is expected to have 4 major segments
  - Iron and Manganese mining
  - Ferro Alloys Manufacturing
  - Power and Coke
  - **Pig Iron and DI Pipe manufacturing (new- starting Mid 2024)**

- Before FY20, Mining was the main activity that contributed ~72% revenue and ~98% profits, whereas in FY22 Mining contributed only ~37% to revenue and ~52% to profits, with rest of the profits contributed by Ferroalloys (20%) and Coke & Energy (28%)

- Revival of the ferro alloys business: The management has turned around the ferro alloys segment by reducing the cost of power by executing Coke oven and WHRB based power generation and now runs one of the most operationally efficient and profitable set of Ferroalloy operations in the country.
  - With the expansion of the ferro alloys capacity from 48,000/66,000 MTPA (SiMn/FeMn) to 95,000/125,000 MTPA the increased power consumption demand is planned to be met by Solar energy through PPA with Renew Power (43 MWp)
- Pig Iron and DI pipe - A forward integration with the objective of
  - Ensuring they have downstream steel operations keeping in mind the 2033 lease renewal < hypothesis being that manufacturers will be given preference in lease renewal>
  - Venturing into a high growth segment and creating perhaps the most integrated value chain in the DI Pipes market in India

3. Characteristics of the business?

- **Iron ore mining:** Fully-automated operation, generating superior margins
  - Used in the production of steel and pig iron (intermediary product in the production of steel, formed by blasting iron ore in a furnace)
  - India produced 217 Million MTPA in FY22 (demand in India has been growing at 6-7% YoY)
  - Government’s focus on infrastructure should bode well for steel and iron ore demand
- **Manganese ore mining:** Semi-automated, labor-intensive operation (lower margins)
  - Manganese ore is extensively used in the production of steel and is also used in lithium-ion batteries used in electric vehicles
  - India produced 2.4 Million MTPA in FY22; still continues to be a net importer
- **Ferroalloys:** Power-intensive operation

    - Critical input used in the manufacture of alloys and special steel
    - Change of power source from the expensive thermal coal route to save 40-70cr per year
- **Coke & Energy:**
    - Coke prices have witnessed extremes globally in the past few years, due to volatility in supply and demand
    - India remains a net importer of Coke and accounted for 11% of global imports in 2020, with a value of ~$600M
- **Ductile Iron (DI) pipes**
    - Finds application in public infra for potable water distribution, irrigation, mining, sewage, etc.
    - Demand majorly driven by municipal bodies and infra agencies
    - Private players (Tata Metaliks, Kalahasthi) are aggressively adding capacities in this space

4. A highly misunderstood business?

A business that is hated by a majority of market participants for a very long time is usually available at very low valuations. In some cases it can be a very good entry point for an investment.
Sandur is seen as a typical commodity business < like the steel manufacturing business>
However, we believe that this understanding is not based on facts. A steel manufacturing business < Ex. Tata Steel, SAIL etc> has the following characteristics

- **Cyclicity of margins** - Dependant on the gap between the demand and supply in the marketplace
    - Tata Steel, for instance, in the last 10 years has had its operating margins fluctuate from -1% to 26% < see comparison between Tata Steel and NMDC> The mining business has far more stable margins and even in 2015 and 2016, which were terrible years for the steel market, NMDC was doing very robust margins

Op. Margin %	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Tata Steel	3%	11%	2%	-1%	12%	17%	19%	12%	19%	26%
NMDC	69%	64%	63%	42%	41%	50%	57%	51%	57%	49%

On analyzing Iron Ore data from Sandur, the following observations can be made regarding average price realizations of Iron Ore:

- Excluding FY22 (when realizations were abnormally high due to commodity boom), 5-yr avg realization is Rs 2159/ton and 10-yr avg is Rs.2392/ton

- Realizations suffered in 2016, which was an extremely bad year for the steel industry

In July 2011, iron ore operations were banned in Karnataka following allegations of abuse of mining limits and were resumed in late 2013; Sandur came out clean, however the business took a hit. There was a production cap put up after the ban from 2014-16.

Iron Ore	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Production (Lakh Tons)	15.8	3.0	1.6	7.1	5.2	7.4	11.5	15.8	15.8	15.9	15.9	15.7
Sales (Lakh Tons)	11.1	5.1	2.3	9.1	5.7	8.8	11.9	13.3	14.9	15.5	16.0	16.0
Salvaged from dumps					4.1	0.8						
Sales value (cr)	192	118	77	172	145	126	225	305	319	335	371	635
Realization (Rs.)	1730	2284	3289	1889	2554	1425	1884	2287	2138	2171	2319	3967

- **Capital Intensity of the business:** A 1 Million Ton Steel plant costs about $1 Billion to set up while an increase in capacity of 1 Million ton for a miner costs less than $20 Million in incremental capital. **Essentially Mining is an extremely capital light business and has exceptional ROCE and generates a lot of free cash flow through cycles < unlike a deep cyclical like Steel manufacturing>**
    - Sandur is investing the high free cash flows it is generating to become an integrated player - and is likely to have pretty stable margins going forward

5. Industry/ competitive landscape

- India is the 4th largest Iron ore producer in the world, production in FY21 stood at 204MT, growing at 6-7% YoY, in line with GDP
- India's finished steel consumption expected to be 230MT in FY31, compared to 133MT in FY22, i.e., CAGR of 6-7%
- All major steel players such as SAIL, JSW Steel, Tata Steel have announced major capacity additions
- NMDC is the only direct competitor and has a major chunk of the market, helping it dictate prices in the country; other steel players also have captive capacity of Iron Ore

6. Management history

- Was the only mining lessee to be awarded 5-star rating in Karnataka and one of the only three of 5-star rated lessee in India
- In 1994, during the 2nd renewal of mining lease, Sandur had surrendered 1500 hectares of forest area for forest conservation. This was well appreciated during the Supreme Court judgment related to the Karnataka Mining Scam in 2011
- No major related party transactions
- The management takes good care of its employees, spending money to subsidize food, health checkups, etc.
- **Promoter shareholding has always been healthy, at 70-75%**
- One of the first few companies to get a clean chit in Karnataka illegal mining case

7. Financials at a glance

INR Cr.	FY17	FY18	FY19	FY20	FY21	FY22	1H 23
Sales	434	608	702	592	747	2,249	1,130
Sales Growth % (YoY)	95%	40%	15%	-16%	26%	201%	
Expenses	343	442	477	396	470	1,275	1,040
Operating Profit	91	166	225	195	276	974	91
OPM %	21%	27%	32%	33%	37%	43%	8%
Net Profit	56	107	147	147	154	675	56
NPM %	13%	18%	21%	25%	21%	30%	5%

Performance in Q1-Q2 FY23 has majorly been impacted because of cooling of commodity prices and changes in guidelines by Govt. of Karnataka regarding buying procedure of Iron ore that created confusion among buyers; the management is confident of selling most of the inventory by Q3, and the remaining by Q4

Quick financials	10 years	5 years	3 years	1 year
Sales growth (CAGR)	29%	39%	47%	54%
Profit growth (CAGR)	58%	64%	67%	-5%
ROE	23%	30%	32%	50%

- Addition of ~600 cr in cash and bank balances, reserves jumping from ~1000 cr in FY21 to ~1650 cr in FY22
- Massive increase in net block in FY21 from ~300cr to ~800cr
- Average trade receivable days are less than 20, quite healthy
- Of ~978 cr profit in FY22, ~873 cr was Cash from Operations

8.Valuations and why it is a screaming buy

Market cap ~2300 cr
~890cr of cash and investments
~280cr debt
EV ~1700cr

Segment	Current volume	Future volume	Price per ton	Sales (cr)*	EBITDA %	EBITDA (cr)
Iron Ore	1.6M	4M	2,000-2,500	720-900	45-55%	320-500
Mn Ore	0.28M	0.46M	5,000-6,000	210-250	40-50%	80-120
Coke	0.4M	0.5M	18,000-22,000	800-1000	18-20%	150-200
Ferro Alloy	0.112M	0.22M	55,000-70,000	1100-1400	15-20%	160-280
Total ex DIP				**2800-3500**		**700-1100**
DI Pipe	-	0.3M	50,000-60,000	1350-1620	15-20%	200-320

(*Calculations are done assuming **90% capacity utilization** only; most numbers are rounded; prices and EBITDA % are based on past 5 yr avg and competitor data, wherever applicable)

Excluding DI Pipe, **Sandur is trading at 2.5x EV/EBITDA FY24** taking lower end of absolute EBITDA (1.5x if we take higher end of projections), which is at **~50% discount compared to its long-term average of 5x EV/EBITDA**

Base case: At 900 cr EBITDA and 3.5x EV/ EBITDA (5-yr median), **Sandur's market cap will be ~3150 cr, implying an upside of ~50% from CMP by FY24**

Bull case: At 1100 cr EBITDA and 5x EV/EBITDA (10-yr median), Sandur's market cap will be ~5500 cr market cap, implying an upside of ~140%

Bear case: At 700cr EBITDA and 2.5x EV/ EBITDA (current valuations), Sandur's market cap will be ~1750 cr, implying a downside of ~20%

DI Pipes business segment is a bonus that can generate ~1500 cr sales and ~250 cr in EBITDA, increasing Sandur's valuation further

Valuations	Sandur (current)	Sandur (5-yr median)	Sandur (10-yr median)	NMDC (current)	NMDC (5-yr median)	NMDC (10-yr median)
P/E	5	5.4	7.6	5.8	5.8	6.6
P/S	0.8	1.2	1.6	1.8	2	2.9
EV/ EBITDA	2.5	3.5	5.4	3.3	2.8	2.8

Sum of Parts: Post the expansion there would be no comparable peer to Sandur in the market but each of the segments does have multiple players.

Segment	**Player**	**Capacity**	**Mcap of Peer (Cr.)**	**Mkt. Cap /Unit capacity**
Iron Ore	NMDC	52 Million Tons	36,647	~7K
Manganese Ore	MOIL	1.23 Million Tons	3,379	~27K
Ferro Alloys (SiMn/FeMn)	Maithan Alloys	283K tons	3,136	~110k
DI Pipe + Pig Iron	Tata Metaliks	600K tons	2,606	~43K

Segment	**Sandur-present capacity**	**Sandur-future capacity**	**Sandur- current mkt cap (Cr.)**	**Sandur- future mkt cap potential (Cr.)**
Iron ore	1.6M Ton	4.5M Ton	~1100	~3200
Manganese ore	280K Ton	460K Ton	~800	~1200
Ferro alloys	112K Ton	220K Ton	~1200	~2400
DI Pipes	0	300K Ton	0	~1300
			~3100	**~8100**

*The above does not include Coke energy segment

Based on SOTP valuation, Sandur's current market cap is at a ~30% discount and in the future (including DI pipes segment), can trade at 8000+ cr market cap, implying multifold potential

9. Growth and Scalability

Going forward, Sandur has become quite aggressive in announcing Capex plans (1000 cr+ in the past 2-3 years, of which ~600cr has been commissioned for ~400K coke oven plant and for increasing capacity of Ferro Alloys segment; this excludes the ~2000 cr+ capex for DI pipes):

- Iron Ore: Applied for 4.5MTPA, compared to 1.6 MTPA currently, along with a 7 MTPA beneficiation unit (to increase the quality of Iron ore, which should also lead to better margins)
    - 2.8x increase in volumes, can lead to revenue growth of 3-4x in this segment
- Manganese Ore: Applied for 0.46 MTPA capacity, compared to 0.28MTPA currently
    - 1.6x increase in volumes
- It aims to build a 0.4 MTPA hot metal plant, along with a 0.3 MTPA production facility of DI pipes (DI pipes India market ~2.5MTPA, growing at 10-12%); the facility will be fully integrated, using captive Iron Ore and in-house Coke
- Increase in coke production from 400K MTPA to 500K MTPA
- ~2x ferro alloy operations
- 2200 cr capex for DI pipes + Pig Iron (3L MTPA for DI Pipes and 2L MTPA for Pig Iron, max combined output = 4L MTPA)
    - Potentially a 1x asset-turn opportunity, with 1500-1800 cr from DI Pipes at Rs 50-60k/ton and 200-300cr from 1L MTPA Pig Iron at 20-30k/ ton
    - EBITDA margins for DI Pipes should be within 15-20% range, with a potential upside due to backward integration for Sandur (Tata metaliks has long-term average of 20% EBITDA margins)

10. Risks/ overhang

- Delay/ rejection in EC approval for Iron Ore expansion
- The company operates in a highly regulated industry, that was also marred by mining bans in Karnataka in 2011; any export related policies will have an impact on Sandur
- The lease of current mines are valid till 2033, post which re-auction will happen wherein there are chances that Sandur has to give up control
    - In recent re-auction of a few mines in 2020, companies paid premium of as high as 100-120%
- Will always be affected by commodity prices of Iron, Manganese, Coke, etc.
- Sector apathy (a lot of bad elements operate in this space and the industry might not be considered very “investor friendly”)
- MD is quite young (has been part of Sandur since 2015 in various roles, was appointed MD in 2020)
- Large contingent liabilities because of disputed income tax and forest development tax claims (Paid 113 cr. to forest department in 2005)