

Rationale for CRISIL IPO Grading

(One-time assessment)



Resurgere Mines & Minerals India Ltd

CRISIL IPO Grade 1.0/5.0

Bid/Offer opens : *
Bid/Offer closes : *
Shares offered : 4,200,000
As % of post-issue equity : 14.72 per cent
Shares outstanding (Post-issue): 28,541,550

Lead managers:

Motilal Oswal Investment Advisors Pvt Ltd

Registrar to the issue:

Intime Spectrum Registry Limited

Background: Resurgere Mines & Minerals India Limited (RMMIL), erstwhile Exfin Shipping (India) Private Limited, is engaged in the business of extraction and processing of Run of the Mine (RoM) through long-term contracts with leaseholders in Orissa and Jharkhand. Mr. Subhash Sharma, who took over the company in 2003, started the iron ore business. The company primarily sells calibrated lump ore (CLO) in the domestic market and exports iron ore fines to China. It has also applied for iron ore mining lease at Banda in Sindhudurg district of Maharashtra. It plans to venture into bauxite mining through its subsidiary, Warana Minerals Private Limited, at Yelwan Jugai in Maharashtra.

Highlights

Business prospects

- The continuity of the company's business hinges on the renewal of mining leases in favour of current leaseholders. RMMIL is operating on mines where the lease has either already expired or is about to expire shortly.
- The only positive factor for RMMIL's business is the buoyant pricing and demand environment for the medium term, driven by a shortage of iron ore in the global market.
- Competition in the domestic merchant mining industry to intensify post 2009-10, with large-scale integrated plants garnering a greater share of the domestic steel market, leading to shrinking of the sponge iron market, the company's key buyer segment.
- Given RMMIL's strategy to sell in the spot market, the absence of long-term contracts or longstanding business relationships will adversely impact the ability of the company to maintain volumes and prices post 2009-10.

Financial performance

- Revenues of the company have almost doubled in 2006-07 as compared with 2005-06, with a rise in volumes and realisations of iron ore. Its operating margins increased from 15.9 per cent in 2005-06 to 31.2 per cent in 2006-07, with a lower share of traded fines in the sales mix.
- Revenues and profits of the company are expected to witness healthy growth, driven by a rise in volumes and iron ore prices till 2009-10. However, post 2009-10, both revenues and profits are expected to decline from high levels, with the decrease in ore prices and stagnant volumes, at best.

Management capability

- Other than the Managing Director and whole-time director, key management personnel have a limited understanding of the business.
- The company is dependent on third-party consultants for its business plans and financial projections.
- Limited track record in the iron ore business.
- Capability to continue to grow profitably yet to be tested, as the iron ore market has largely been a sellers' market since 2004.

Corporate governance

- Ability to exercise management oversight by the independent directors is limited, as most of them do not have a complete understanding of the business.
- The Board has six directors, of whom three are independent and one a nominee non-executive director (nominee of the Merrill Lynch International).

Other factors

- In November 2007, Merrill Lynch International made a private equity funding for the company's 3 million shares for a total consideration of Rs 630 million.
- In February 2008, the company has made a private placement of total 0.55 million shares to India Business Excellence Fund and India Business Excellence Fund I for a total consideration of Rs. 137.5 million.
- Out of the issue of 4,450,000 shares, the employee reservation shares amount to 250,000, taking the net public issue of shares to 4,200,000.

Resurgere Mines and Minerals Limited aims to raise Rs 1-1.1 billion by this proposed public issue of 4,200,000 equity shares.

Detailed rationale



RMMIL: Shareholding pattern

	Pre-Issue		Post-Issue	
	No. of equity shares	%	No. of equity shares	%
Promoters	8,685,113	36.89	8,685,113	30.43
Promoter group	7,332,450	31.15	7,332,450	25.69
Others	7,523,987	31.96	7,773,987	27.24
Public	-	-	4,750,000	16.64
Total	23,541,550	100.0	28,541,550	100.0

RMMIL: Past financial performance

		2005-06	2006-07
Operating income	Rs Million	850.3	1642.4
Operating margins	Per cent	15.9	31.2
Net profits	Rs Million	81.6	316.4
Net margins	Per cent	9.6	19.3
ROCE	Per cent	100.1	106.1
Return on Equity	Per cent	84.9	77.9
No. of equity shares	Million	4.5	17.5
Net worth	Rs Million	143.3	668.5
Basic Earnings per share	Rs	18.1	18.1
Diluted Earnings per share	Rs	18.1	18.1
Book value	Rs per share	31.9	38.2
Gearing	Times	0.6	0.1

In order to arrive at the overall grade, CRISIL has considered the following broad parameters:

- Business prospects and financial performance
- Management capability
- Corporate governance

CRISIL has assigned a CRISIL IPO Grade '1/5' (pronounced 'one on five') to the proposed initial public offer of Resurgere Mines & Minerals India Limited (RMMIL). This grade indicates that the fundamentals of the issue are poor in relation to other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to issue fundamentals. The grade is not a recommendation to buy/sell or hold the graded instrument, the graded instrument's future market price, or its suitability for a particular investor.

The grading reflects weak management capability of RMMIL and its present uncertain business model, which is based on its entry into agreements with mine leaseholders on the one hand, and sub-contracting actual mining activity to third parties on the other. The tenability of the business model will be particularly tested when competition in the mining industry intensifies over the next 2-3 years. The company's financial returns are also vulnerable to spot price movements of iron ore, as it sells most of its ore through traders in the spot market.

The company management lacks depth since the key management personnel, with the exception of the Managing Director and whole-time director, have a limited understanding of the business. The grading also reflects RMMIL's below-average corporate governance structure, especially with respect to management oversight.

Weak management capability constrained by a limited track record in the iron ore business

The management depicts a limited understanding of the business as reflected in its significant dependence on third-party consultants for making its business plans and financial projections.

Moreover, the management has a limited track record in the iron ore mining business. RMMIL has been into iron ore business only for the past 3 years and has currently a minuscule share (1.3 per cent) in the domestic iron ore market. Its strong performance in the last 2 years has been significantly driven by the buoyant iron ore market conditions in the last few years. We believe that the buoyancy in the iron ore market has not tested the management capability, and it will be truly tested post 2009-10 with the increase in competition in the mining industry.

CRISIL also believes that the management lacks depth of layers. The promoter and the whole-time director take key business decisions; the company continues to depend heavily on them.

Non-renewal of leases, a threat to business continuity

While mining leases of Nuagaon and Tatibha have already expired, that of Maharajpur is due for expiry in April 2009. Currently, the company is operating on these mines under the provisions of Rule 24A (6) of the Mineral Concession Rules, 1960, which allows that if an application for the renewal of a mining lease is made within the time referred to in sub-rule (1), that is, at least 12 months before the date on which the lease is due to expire, is not disposed of by the State Government before the date of expiry of the lease, the period of the lease shall be deemed to have been extended by a further period till the State Government passes order thereon. Although applications for renewal have already been made, or will be made in due course, the possibility of non-renewal of the lease in favour of the existing leaseholder cannot be ignored.

Domestic iron ore market to witness increased competition post 2009-10

CRISIL expects the competition in the domestic iron ore market to intensify post 2009-10, due to the marginalisation of small re-roller and induction furnace-based long-steel manufacturers, using sponge iron as input, by large integrated steel plants using iron ore largely from their captive mines. The same will trigger a shakeout in small-scale steel plants, causing demand for sponge iron to decline. As small sponge iron units are key customers of small-scale merchant iron ore suppliers, it will adversely affect the latter's ability to sell as well as pricing power.

The strategy of selling in spot market is myopic; absence of long-term contracts could prove costly in the long run

RMMIL's selling strategy has been to sell only in the spot market and it sells most of its output to traders. Hence, it currently does not enjoy any long-term relationship with any of its buyers. Post 2009-10, ensuring offtake through the mechanism of long-term contracts and/or having established business relationships directly with the end-user industry will be critical for sustaining competitive pressures on the business. Therefore, in our opinion, the absence of such mechanisms is likely to have an adverse impact on the company's business prospects.

Status of corporate governance is below par

The company has put in place the corporate governance structure only in the recent past. Systems and practices related to this aspect are not yet fully evolved and developed. Independent directors have limited ability to exercise management oversight, as most of them do not have a complete understanding of the company's business.

Business profile

RMMIL is engaged in the business of extraction and processing of Run of the Mine (RoM) through long-term contracts with leaseholders in Orissa and Jharkhand. The company primarily sells CLO in the domestic market and exports iron ore fines to China.

Initially, RMMIL was incorporated under the name of Exfin Shipping (India) Private Limited in March 1987. Mr.Subhash Sharma, who took over the company in 2003, started the iron ore business. In 2004, it entered into long-term raising and purchasing contracts with leaseholders in Orissa and Jharkhand for the extraction and processing of iron ore. In 2006, the company was renamed as Resurgere Mines and Minerals India Limited.

Prior to acquiring RMMIL, Mr.Subhash Sharma was engaged in bulk pharmaceuticals trade.

Currently, Resurgere does not possess the equipment required for mining. Therefore, it has outsourced its machinery requirement to sub-contractors, while it brings the requisite technical expertise for the extraction of ore. The company purchases the extracted ore (RoM) from the leaseholder, and processes the same into CLO and its byproduct, iron ore fines. It also outsources this sizing process to sub-contractors.

RMMIL currently has its operations in the following mines:

- Nuagaon mines in Kendujhargarh district of Orissa (Reserves: 12 million tonnes, equivalent to 10 years of annual production of RMMIL in 2006-07).
- Maharajpur mine in Mayurbhanj district of Orissa (Reserves: 42 million tonnes, equivalent to 35 years of annual production of RMMIL in 2006-07).

- Tatibha mine in West Singhum district of Jharkhand (Reserves: 20 million tonnes, equivalent to 17 years of annual production of RMMIL in 2006-07).

RMMIL sells CLO in the domestic spot market to iron ore traders and exports iron ore fines on a spot basis to traders in China. It has also contracted for trading of iron ore fines from a miner in Madhya Pradesh. Currently, trading in iron ore fines contributes to around 18 per cent of its total revenue.

RMMIL is a recent entrant in the iron ore mining industry. It operates on mines where leases are held by other leaseholders. Its size of operations is much lower as compared with large miners such as NMDC and Sesa Goa Limited. Unlike large players who directly sell a significant portion of their output to steel manufacturers, RMMIL sells most of its output to traders.

RMMIL now plans to cut down its dependence on third parties for its mining and processing operations by purchasing its own machinery. It has applied for iron ore mining lease at Banda in Sindhudurg district of Maharashtra. It has plans to venture into bauxite mining through its subsidiary, Warana Minerals Private Limited.

Financial profile

RMMIL's revenues have grown by about 15 per cent over the past 3 years, with improvement in operating margins to 31.2 per cent in 2006-07 from a meagre 1 per cent in 2003-04. This has mainly been on account of the change in business activities from trading to production, and a buoyant iron ore market. The company's net margins were also on an uptrend, recording around 19 per cent in 2006-07. The debtors' position worsened from about 58 days in 2005-06 to 72 days in 2006-07. The inventory position was also as high as 90 days in 2006-07.

Profile of Management and Board

RMMIL is headed by its promoter Mr. Subhash Sharma. After taking over Exfin Shipping (India) Limited, he started the iron ore business. He is supported by whole-time director Mr. Amit Sharma, who has been associated with him since the take over of the company.

RMMIL's Board consists of six directors: the promoter, whole-time director, three independent directors and one nominee non-executive director. Independent directors Mr. Ishwar Das Agarwal and Mr. Burzin Somandy joined in August 2007, while Mr. Pradeep Bisnoi joined in May 2007. The nominee non-executive director, Mr. Siddharth Bhargava, joined the board in January 2008.

Name of Directors	Designation	Age (years)	Date of Joining	Qualification	Previous Employment	Other directorships held
Mr. Subhash Sharma	Chairman cum Managing director & CEO	40	Director w.e.f August 14, 2007	Bachelor in Science from Mumbai University	Bulk trading in pharmaceuticals	Spear Petroleum Private Limited., Warana Minerals Private Limited
Mr. Amit Sharma	Whole time director	35	Director w.e.f August 14, 2007	Masters in Business Administration from National Institute of Management (Mumbai)	Manager - Commercial in Meta Strips Ltd.	Warana Minerals Private Limited
Mr. Ishwar Das Agarwal	Independent Director	66	August 14, 2007	Post Graduate Diploma in Systems Management from Jammnal Institute of Management Studies and is a Certified Associate of Indian Institute of Bankers	Retired Executive director of the Reserve Bank of India	Raymond Limited, Western India Shipyard Limited
Mr. Pradeep Bishnoi	Independent Director	50	May 14, 2007	Masters degree in Arts	Business in cements under name - Surya Cement Pvt limited and also in iron ore business - Exfin (India) Minerals Ore Company Private Limited	Exfin (India) Minerals Ore Company Private Limited.
Mr. Burzin Somandy	Independent Director	37	August 14, 2007	Bachelor's Degree in Science from Boston College, U.S.A , L.L.B. from Government Law College, Mumbai and is also a qualified solicitor from the incorporated Law Society of United Kingdom	Partner in a Solicitor firm in India	Ladderup Finance Limited, Ladderup Corporate Advisory Pvt. Ltd., Association of the Commerce Block Owners Ltd.
Mr. Siddharth Bhargava	Nominee Non Executive Director	35	January 9, 2008	*	*	Om Logistics Limited
* The nominee director has been appointed post filing of DRHP. The details pertaining to qualification and previous employment of the director are awaited from the company						
Source: Company prospectus						

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