

RESULT UPDATE

Setting More Realistic Targets

2QFY11 sees combination of lower realization and higher cost

While net sales was broadly in line with expectation, EBITDA during the quarter was Rs3,034mn, much lower compared with consensus estimates of Rs4,593mn (Bloomberg mean). Adjusted net profit at Rs3,485mn too was below consensus estimates, despite a minimal tax rate of 5%. Ore realisations dropped 19% QoQ to Rs3,380 per tonne from Rs4,157/t, while total operating expenses (excluding depreciation) rose from Rs1,600/t in 1Q to Rs3,046/t in 2Q, led by higher material and transport costs.

Pig iron business to the rescue ... but only at the topline

The Pig Iron segment, led by better sales volume (84kt), added to the topline - segment revenue showed a 55% YoY and 46% QoQ increase. However, operating profit at Rs341mn was largely in keeping with the level of prior quarters, indicating a drop in margins.

Volume guidance of 10% in FY11 is more realistic

The management expects volume growth of ~10% this year. In earlier discussions, they had talked about 20-25% volume growth including volume from acquisitions. We believe that 10% is a more realistic guidance and maintain our forecast of 8% volume growth for FY11E (11% for FY12E).

Long-term growth rate faces hiccups

The outlook on expansion in mining capacity is more muted on account of slower regulatory approvals. Our volume forecast for FY12E (24.6mt) implies full utilization of the current mining capacity (presently 25mt).

Maintain HOLD recommendation, TP revised to Rs380

We maintain our **HOLD** recommendation on the stock, while rolling forward our TP for September 2011 to Rs380 (earlier Rs370 for March 2011). The TP considers the impact of the Cairn deal as well as the government's profit sharing proposal (at 10% compared with the proposal of 26%).

Exhibit 1: Key financials

Y/E Mar (Rs mn)	FY08	FY09	FY10	FY11E	FY12E	FY13E
Net sales (Rs mn)	37,659	49,179	57,978	92,372	114,402	126,306
EBITDA (Rs mn)	23,032	27,062	31,486	45,818	58,732	64,737
Adjusted Net profit (Rs mn)	15,416	21,522	25,072	42,033	42,665	47,409
Adjusted EPS FD (Rs)	19.6	27.3	30.8	48.5	48.9	54.3
P/E Adj (x)	18.6	13.4	11.8	7.5	7.5	6.7
EV/EBITDA (x)	11.6	9.5	8.7	5.3	3.5	2.6

Source: Company, Ambit Capital research

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Recommendation

CMP:	Rs359
Target Price (Sep 2011):	Rs380
Previous TP:	Rs370
Upside (%)	6

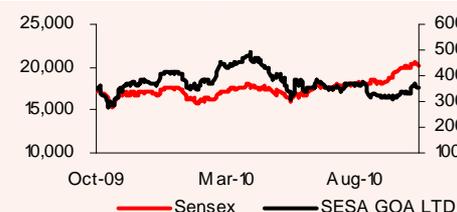
Stock Information

Mkt cap:	Rs320,153mn/US\$7,259mn
52-wk H/L:	Rs495/266
3M Avg. daily vol. (mn):	6
Beta (x):	1.2
BSE Sensex:	20169
Nifty:	6076

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	14.6	8.5	4.0	-9.3
Rel. to Sensex	11.3	-3.4	-10.7	-21.5

Performance (%)



Source: Bloomberg, Ambit Capital research

Exhibit 2: 2QFY11 results

Y/E Mar 31 (Rsmn)	2Q FY10	3Q FY10	4Q FY10	1Q FY11	2Q FY11	YoY%	QoQ%
Net Sales	5,341	18,668	24,035	23,940	9,068	70%	-62%
Other operating income	46	224	154	190	115		
Total operating income	5,387	18,892	24,189	24,131	9,183	70%	-62%
Inc (Dec) in stock-in-trade	(1,566)	814	(639)	(1,392)	(1,387)		
Raw materials consumed	881	883	881	855	871		
Iron ore purchased	557	645	1,621	1,471	1,068		
a). Material costs	(129)	2,342	1,863	934	551	-528%	-41%
b). Stores consumed	526	690	686	737	614	17%	-17%
c). Staff & personnel costs	334	515	447	444	466	40%	5%
d). Transport expenses	2,306	3,276	3,649	3,457	2,677	16%	-23%
e). Export duties	47	175	1,215	1,276	527	n.a.	-59%
f). Other prodn & admin exp	777	1,534	1,300	1,776	1,315	69%	-26%
Total Prod & Admin expenses	3,860	8,531	9,159	8,624	6,150	59%	-29%
EBITDA	1,527	10,360	15,030	15,507	3,034	99%	-80%
Margin	28.6%	55.5%	62.5%	64.8%	33.5%		
Depreciation	202	225	166	191	194	-4%	1%
Operating profit	1,325	10,136	14,864	15,315	2,840	114%	-81%
Other income	893	1,325	1,291	1,609	1,004	13%	-38%
Extraordinary income	0	0	0	(911)	364		
EBIT	2,218	11,461	16,154	16,014	4,208	90%	-74%
Interest & other charges	20	251	227	137	140		
Reported PBT	2,198	11,210	15,928	15,877	4,068	85%	-74%
Tax expense	503	2,906	3,777	2,832	189	-62%	-93%
Reported PAT	1,694	8,304	12,151	13,045	3,879	129%	-70%
(-) Minority Interest	30	29	22	27	30		
Reported Net profit to shareholders	1,665	8,275	12,129	13,018	3,849	131%	-70%
Adjusted Net profit to shareholders	1,665	8,275	12,129	13,928	3,485	109%	-75%
Reported EPS (Diluted)	2.1	9.5	14.6	15.2	4.2	106%	-72%

Source: Company, Ambit Capital research

Exhibit 3: Volume and per tonne figures

	2Q FY10	3Q FY10	4Q FY10	1Q FY11	2Q FY11	YoY%	QoQ%
Iron ore sales (MT)	1.6	6.8	7.4	5.4	2.0	25%	-63%
Pig iron sales (T)	66,880	71,000	70,000	54,000	84,000	26%	56%
Iron ore realisation (Rs/T)	2,389	2,514	3,024	4,157	3,380	41%	-19%
Net sales/T of iron ore	3,299	2,749	3,259	4,433	4,491	36%	1%
EBITDA/T of iron ore sold	943	1,525	2,038	2,872	1,503	59%	-48%

Source: Company, Ambit Capital research

Exhibit 4: Consolidated profit & loss

Y/E Mar (Rs mn)	FY2008	FY2009	FY2010	FY2011E	FY2012E	FY2013E
Net Sales	37,659	49,179	57,978	92,372	113,511	125,346
Total operating costs exc D&A	15,194	22,529	27,097	47,099	56,846	63,455
EBITDA	23,032	27,062	31,486	45,818	57,197	62,455
EBITDA margin %	61.2	55.0	54.3	49.6	50.4	49.8
Depreciation	500	517	745	854	1,065	1,225
Operating profit	22,533	26,545	30,741	44,964	56,131	61,230
FX and exceptional items	0	(1,641)	1,219	0	0	0
Other income	744	2,240	3,041	6,024	7,174	8,403
EBIT	23,277	27,144	35,001	50,988	63,305	69,633
Interest & other charges	28	43	555	824	1,023	1,065
Adjusted PBT	23,249	28,743	33,227	50,164	62,282	68,569
Total exceptional gains (losses)						
Reported PBT	23,249	27,102	34,446	50,164	62,282	68,569
Total taxes	7,760	7,153	8,056	8,026	20,553	22,628
Minority Interest	74	68	99	104	109	115
Adjusted Net profit to shareholders	15,416	21,522	25,072	42,033	41,620	45,826
Reported Net profit to shareholders	15,416	19,881	26,291	42,033	41,620	45,826
Wted no of shares (FD)	787	787	813	888	888	888
Adjusted EPS FD	19.6	27.3	30.8	48.5	47.8	52.5
Reported EPS FD	19.6	25.3	31.6	48.5	47.8	52.5

Source: Company, Ambit Capital research

- The impact of Cairn deal and profit sharing provision are considered in the valuation rather than FY13E financials

Exhibit 5: Key ratios

Y/E Mar (Rs mn)	FY2008	FY2009	FY2010	FY2011E	FY2012E	FY2013E
Total materials cost/Net Sales	12.6%	10.0%	9.2%	11.0%	11.1%	11.4%
Employee cost/ Net Sales	1.8%	2.0%	2.9%	2.0%	1.9%	1.9%
Transport costs/ Net Sales	15.9%	23.3%	20.4%	19.4%	18.9%	19.0%
Royalties & Export duties / Net Sales	4.5%	4.7%	5.3%	10.1%	10.1%	9.8%
Other costs/Net sales	5.5%	5.8%	8.9%	8.4%	8.1%	8.5%
EBITDA margin	61.2%	55.0%	54.3%	49.6%	50.4%	49.8%
Adjusted PBT Margin	61.7%	58.4%	57.3%	54.3%	54.9%	54.7%
Reported PBT Margin	61.7%	55.1%	59.4%	54.3%	54.9%	54.7%
Return on Equity	52.9%	46.0%	31.8%	36.1%	27.1%	23.5%
Return on Capital employed (adj for CWIP)	51.8%	42.2%	24.1%	27.9%	21.8%	19.2%
Gross Debt/ Equity (x)	0.0%	0.0%	24.8%	16.8%	12.7%	10.0%
Net Debt (Cash)/ Equity (x)	-70.4%	-66.6%	-63.1%	-70.9%	-75.7%	-79.2%

Source: Company, Ambit Capital research

Exhibit 6: Consolidated cash flow statement

Y/E Mar (Rs mn)	FY2008	FY2009	FY2010	FY2011E	FY2012E	FY2013E
Reported profit before taxes	23,249	27,102	34,446	50,164	62,282	68,569
+ Depreciation expense	500	517	745	854	1,065	1,225
- Interest & dividend recd (net)	(717)	(2,198)	(1,701)	(2,188)	(2,564)	(3,137)
+/- Other adjustments	10	(12)	(1,924)	0	0	0
Cash flows pre working capital changes	23,042	25,409	31,566	48,830	60,784	66,657
Changes in working capital	(1,707)	3,145	1,791	(1,311)	(522)	(941)
Direct Taxes Paid	(7,475)	(7,210)	(7,644)	(8,026)	(20,553)	(22,628)
Net Cash from Operating Activities	13,861	21,343	25,713	39,493	39,709	43,088
Net capex	(674)	(1,471)	(1,490)	(6,000)	(4,000)	(4,000)
Investments	(11,838)	(9,647)	(37,143)	0	0	0
Acquisitions	0	0	(17,132)	0	0	0
Interest & dividend received	480	1,130	1,824	3,012	3,587	4,201
Others	0	0	0	0	0	0
Net Cash from Investing Activities	(12,033)	(9,989)	(53,941)	(2,988)	(413)	201
Proceeds from Issue of Share Capital	0	0	5,372	0	0	0
Borrowings	0	0	23,576	10	10	10
Interest Paid	(0)	(10)	(63)	(824)	(1,023)	(1,065)
Dividend Paid	(1,836)	(1,380)	(2,064)	(2,701)	(4,269)	(4,162)
Others	0	(10,000)	0	0	0	0
Net Cash from Financing Activities	(1,836)	(11,390)	26,821	(3,515)	(5,281)	(5,217)
Net Increase in Cash & Cash Equivalents	(8)	(35)	(1,407)	32,990	34,014	38,073

Source: Company, Ambit Capital research

Exhibit 7: Consolidated balance sheet

Y/E Mar (Rs mn)	FY2008	FY2009	FY2010	FY2011E	FY2012E	FY2013E
Equity Capital	394	787	831	831	831	831
Reserves & surplus	29,041	46,370	78,346	116,111	153,569	194,813
Minority Interest	266	334	433	537	646	761
Networth	29,701	47,491	79,610	117,479	155,046	196,405
Borrowings	0	19	19,606	19,616	19,626	19,636
Deferred Tax Liability	664	664	750	750	750	750
Capital employed	30,365	48,175	99,966	137,845	175,422	216,790
Net Fixed Assets (inc CWIP)	4,975	5,930	22,557	27,703	30,637	33,413
Investments	20,510	31,252	45,649	45,649	45,649	45,649
Cash and Bank Balances	210	177	23,918	56,909	90,923	128,996
Net current assets	4,880	10,992	31,760	64,494	99,136	137,729
Capital employed	30,365	48,175	99,966	137,845	175,422	216,790

Source: Company, Ambit Capital research

Exhibit 8: Per share figures and valuation ratios (based on CMP)

Y/E Mar (Rs mn)	FY2008	FY2009	FY2010	FY2011E	FY2012E	FY2013E
Adjusted EPS Fully Diluted	19.6	27.3	30.8	48.5	47.8	52.5
Reported EPS Fully Diluted	19.6	25.3	31.6	48.5	47.8	52.5
Net Dividend Per Share	2.3	2.3	3.2	5.0	4.9	5.3
Book Value Per Share	37.1	59.5	88.7	131.2	173.2	219.6
P/E on adjusted basis (x)	18.6	13.4	11.8	7.5	7.6	7.0
P/E on reported basis (x)	18.6	14.5	11.5	7.5	7.6	7.0
P/B (x)	9.9	6.1	4.1	2.8	2.1	1.7
EV/ EBITDA (x)	11.6	9.5	8.7	5.3	3.6	2.7
Dividend yield (%)	0.6	0.6	0.9	1.4	1.3	1.5

Source: Company, Ambit Capital research

Explanation of Investment Rating

Investment Rating	Expected return (over 12-month period from date of initial rating)
Buy	> 15%
Hold	5% to 15%
Sell	< 5%

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