

Tata Sponge Iron

BSE SENSEX 17,481
S&P CNX 5,258

CMP:INR329

TP:INR440

Buy

Bloomberg TTSPIN
Equity Shares (m) 15.4
52-Week Range (INR) 405/291
1,6,12 Rel. Perf. (%) 5/4/0
M.Cap. (INR b) 5.1
M.Cap. (USD b) 0.1

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BY	ROE	ROCE	EV/	EV/
END	(INR M)	(INR M)	(INR)	GR. (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/10A	5,200	845	54.9	-30.0	6.0	1.2	22.0	29.2	0.8	3.3
3/11A	6,758	1,013	65.8	19.9	5.0	1.0	21.9	29.7	0.5	2.1
3/12E	6,861	902	58.6	-11.0	5.6	0.9	16.5	23.0	0.4	2.1
3/13E	8,150	1,080	70.1	19.7	4.7	0.7	17.1	24.1	0.2	1.2

Consolidated

- Adjusted PAT for 2QFY12 declined 4% QoQ (6% YoY) to INR217m, below our estimate of INR224m on account of lower sponge iron production. Sponge iron production was down 1% QoQ (30% YoY) to 71,000 tons, as iron ore supply was impacted by local issues.
- Net sales grew 19% QoQ (down 1% YoY) to INR1.74b while realizations increased 23% QoQ to INR22,397/ton.
- EBITDA decreased 10% QoQ (13% YoY) to INR299m while EBITDA/ton declined 8% QoQ to INR4,206.
- Despite significantly lower production and sales volumes, strong sponge iron realizations are supporting both revenue and margins. Current sponge iron prices are at a 3-year high in the domestic market. Mining ban in Karnataka and regulatory rigor in the Barbil region has affected supply of iron ore to the industry.
- We expect sponge iron production to be significantly lower at 300kt (v/s 383kt in FY11) due to iron supply issues. We have cut our FY12 volume estimate from 355kt to 300kt, reducing our FY12 EPS estimate by 4%.
- Radhikapur (East) coal block is on track. Coal production is likely to start in 2013.
- The stock trades at an attractive EV of 2.1x FY12E EBITDA and 5.6x FY12E EPS. Maintain **Buy**.

Quarterly Performance (Consolidated)

(INR Million)

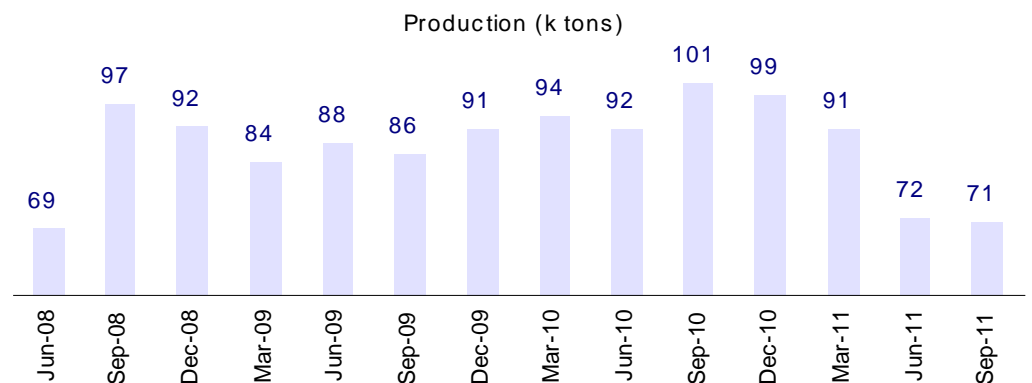
Y/E March	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Sales (tons)	85,000	108,000	91,500	95,500	72,000	71,000	76,000	81,000	380,000	300,000
Change (YoY %)	3.6	23.3	3.2	-7.1	-15.3	-34.3	-16.9	-15.2	5.2	-21.1
Realization (Rs per ton)	15,453	14,842	17,200	19,683	18,138	22,397	22,000	21,000	16,763	20,897
Change (YoY %)	18.5	25.4	34.1	28.9	17.4	50.9	27.9	6.7	25.8	24.7
Net Sales	1,414	1,759	1,704	1,954	1,457	1,737	1,819	1,848	6,758	6,861
Change (%)	17.8	53.0	31.4	14.3	3.0	-1.2	6.8	-5.4	30.0	1.5
EBITDA	421	341	349	459	331	299	335	341	1,497	1,305
Change (YoY %)	53.9	38.4	1.1	-13.2	-21.5	-12.5	-4.0	-25.8	20.8	-12.8
As % of Net Sales	29.8	19.4	20.5	23.5	22.7	17.2	18.4	18.4	22.2	19.0
EBITDA per ton	4,956	3,160	3,810	4,809	4,596	4,206	4,406	4,206	3,940	4,350
Interest						1			0	1
Depreciation	47	46	46	45	46	46	46	46	185	184
Other Income	14	33	29	41	45	62	59	60	191	226
PBT (before EO Inc.)	388	328	331	456	330	314	348	354	1,503	1,346
EO Income(exp)		-180		180					0	
PBT (after EO Inc.)	388	148	331	636	330	314	348	354	1,503	1,346
Total Tax	129	44	109	207	105	97	115	117	489	433
% Tax	33.3	29.7	33.0	32.6	31.8	30.8	33.0	33.0	32.6	32.2
Reported PAT	259	104	222	428	225	217	233	237	1,013	913
Adjusted PAT	259	231	222	307	225	217	233	237	1,013	913
Change (YoY %)	59.4	58.1	9.2	-7.9	-13.1	-5.8	4.9	-22.6	19.9	-9.9

E: MOSL Estimates

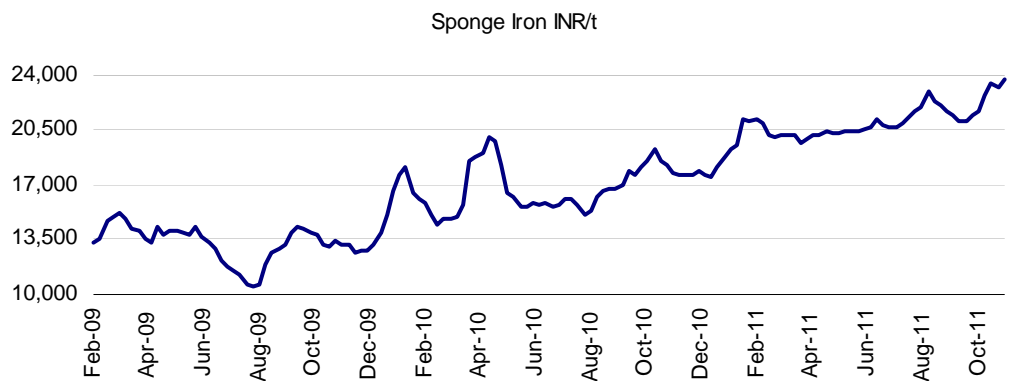
Cutting FY12 volume estimate by 15% to 300kt; maintain Buy

- Despite significantly lower production and sales volumes, strong sponge iron realizations are supporting both revenue and margins. Current sponge iron prices are at a 3-year high in the domestic market. Mining ban in Karnataka and regulatory rigor in the Barbil region has affected supply of iron ore to the industry.
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Production declining on disruption in iron ore supply



Sponge iron prices at three-year high



Source: Company/MOSL

Tata Sponge Iron: an investment profile

Company description

Tata Sponge (TTSP) is located at Bilaipada near Joda in the Keonjhar district of Orissa. It has a production capacity of 390,000tpa of sponge iron. The company has also set up 26MW of captive power plants to gain from the waste hot gases released from its kilns in phases.

Key investment arguments

- Located close to iron ore mines (25km from plants), which saves transport cost. TTSP has a strategic tie-up with Tata Steel, wherein it has leased equipment to Tata Steel to operate the Khondbond iron ore mine and it receives iron ore at significantly lower cost.
- TTSP is one of the best managed sponge iron plants in the country, with a wide service offering profile and domain depth.

Key investment risks

- Earnings are highly leveraged to sponge iron prices.
- Lacking growth triggers, as there are no major capacity expansion plans in the near future.

Recent developments

- The company had a net cash surplus of ~INR1.7b as on 30 September 2011.

Valuation and view

- The stock trades at an EV of 2.1x FY12E EBITDA and 5.6x FY12E EPS. Maintain **Buy**.

Sector view

- The mining ban in Karnataka and regulatory rigor in Barbil region has affected supply of iron ore to the sponge iron industry. Marginal sponge iron producers are forced either to operate at lower capacity or incur high iron ore cost. This has resulted in strong sponge iron prices shooting up to a 3-year high in the domestic market. Prices are likely to remain strong in the near term, as iron ore availability will remain a concern.

Comparative valuations

		Tata Sponge Iron	Godawari Power	Monnet Ispat
P/E (x)	FY12E	5.0	2.4	12.3
	FY13E	5.6	2.1	8.2
P/BV (x)	FY12E	1.0	0.5	1.3
	FY13E	0.9	0.4	1.1
EV/Sales (x)	FY12E	0.5	0.6	3.2
	FY13E	0.4	0.7	2.1
EV/EBITDA (x)	FY12E	2.1	3.0	14.0
	FY13E	2.1	3.5	9.4

EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	58.6	61.6	-4.9
FY13	70.1	70.7	-0.8

Target Price and Recommendation

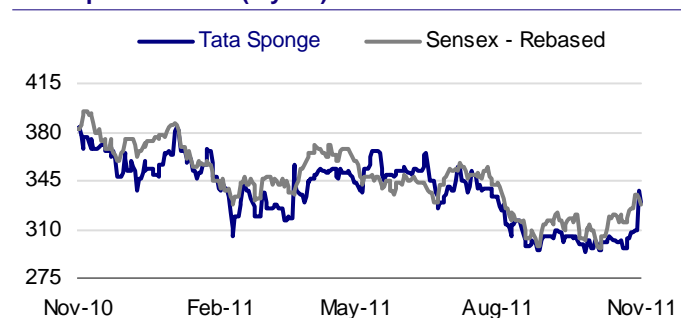
Current Price (Rs)	Target * Price (Rs)	Upside (%)	Reco.
329	440	33.7	Buy

Basis: 2x P/B FY12

Shareholding pattern (%)

	Sep-11	Jun-11	Sep-10
Promoter	43.7	43.7	43.7
Domestic Inst	7.3	7.3	6.8
Foreign	6.8	6.7	6.2
Others	42.2	42.3	43.3

Stock performance (1 year)



Financials and Valuation

Income Statement (Consolidated)			(INR Million)		
Y/E March	2009	2010	2011	2012E	2013E
Net sales	6,081	5,200	6,758	6,861	8,150
Change (%)	33.2	-14.5	30.0	1.5	18.8
Total Expenses	4,242	3,961	5,261	5,556	6,671
EBITDA	1,840	1,239	1,497	1,305	1,479
% of Net Sales	30.3	23.8	22.2	19.0	18.1
Depn. & Amortization	183	194	185	184	209
EBIT	1,657	1,045	1,312	1,121	1,270
Net Interest	46	2	0		
Other income	201	219	191	226	342
PBT before EO	1,812	1,262	1,503	1,347	1,612
EO income					
PBT after EO	1,812	1,262	1,503	1,347	1,612
Tax	605	417	489	433	532
Rate (%)	33.4	33.0	32.6	33.0	33.0
Reported PAT	1,207	845	1,013	913	1,080
Adjusted PAT	1,207	845	1,013	902	1,080
Change (%)	26.3	-30.0	19.9	-11.0	19.7

Balance Sheet			(INR Million)		
Y/E March	2009	2010	2011	2012E	2013E
Share Capital	154	154	154	154	154
Reserves	3,343	4,047	4,917	5,686	6,622
Share holders fund	3,497	4,201	5,071	5,840	6,776
Loans	1	1			
Deferred tax liability (503	459	393	393	393
Capital Employed	4,002	4,661	5,464	6,233	7,169
Gross Block	3,591	3,592	3,598	3,598	3,598
Less: Accum. Deprn.	1,357	1,536	1,711	1,895	2,104
Net Fixed Assets	2,234	2,057	1,887	1,703	1,494
Capital WMP	213	1,217	1,290	1,590	1,740
Investments	8	8	344	344	344
Curr. Assets	2,096	2,155	2,875	3,679	4,735
Inventories	508	683	627	846	893
Sundry Debtors	199	375	223	376	447
Cash and Bank	1,146	933	1,881	2,313	3,251
Loans and Advan	243	164	144	144	144
Curr. Liability & Pro	549	775	933	1,083	1,144
Sundry Creditors	286	401	413	564	625
Other Liabilities & prov	263	375	519	519	519
Net Current Assets	1,546	1,379	1,942	2,596	3,590
Application of Fund	4,002	4,661	5,464	6,233	7,169

E: MOSL Estimates; Consolidated

Ratios					
Y/E March	2009	2010	2011	2012E	2013E
Basic (IIR)					
EPS	78.4	54.9	65.8	58.6	70.1
Cash EPS	90.2	67.5	77.8	70.6	83.7
BV/Share	227.1	272.8	329.3	379.2	440.0
DPS	8.0	8.0	8.0	8.0	8.0
Payout (%)	11.9	17.1	14.2	15.8	13.3
Valuation (x)					
P/E	4.2	6.0	5.0	5.6	4.7
Cash P/E	3.6	4.9	4.2	4.7	3.9
P/BV	1.4	1.2	1.0	0.9	0.7
EV/Sales	0.6	0.8	0.5	0.4	0.2
EV/EBITDA	2.1	3.3	2.1	2.1	1.2
Dividend Yield (%)	2.4	2.4	2.4	2.4	2.4
Return Ratios (%)					
EBITDA Margins	30.3	23.8	22.2	19.0	18.1
Net Profit Margins	19.8	16.3	15.0	13.2	13.3
RoE	40.7	22.0	21.9	16.5	17.1
RoCE	47.6	29.2	29.7	23.0	24.1
RoIC	62.3	40.7	58.9	57.0	66.5
Working Capital Rat					
Fixed Asset Turnover	1.7	1.4	1.9	1.9	2.3
Asset Turnover (x)	1.5	1.1	1.2	1.1	1.1
Debtor (Days)	12	26	24	20	20
Inventory (Days)	30	48	45	45	40
Creditors (Days)	17	28	30	30	28
Leverage Ratio (x)					
Current Ratio	3.8	2.8	3.1	3.4	4.1
Interest Cover Ratio	35.7	-	-	-	-
Debt/Equity	-0.3	-0.2	-0.4	-0.4	-0.5

Cash Flow Statement					
Y/E March	2009	2010	2011	2012E	2013E
Pre-tax Profit	1,812	1,262	1,503	1,347	1,612
Depreciation	179	179	175	184	209
(Inc)/Dec in Wkg. Cap	-227	-46	385	-221	-57
Tax paid	-631	-461	-556	-433	-532
Other Operating Activ		2	1		
CF from Op. Activity	1,132	937	1,508	876	1,232
(Inc)/Dec in FA + CWIF	29	-1,006	-79	-300	-150
CF from Inv. Activity	29	-1,006	-415	-300	-150
Debt Raised/(Repaid)	-843	0	-1		
Dividend (incl. tax)	-144	-144	-144	-144	-144
Other Financing Activi					
CF from Fin. Activity	-987	-144	-146	-144	-144
(Inc)/Dec in Cash	174	-213	947	432	938
Add: Opening Balance	972	1,146	933	1,881	2,313
Closing Balance	1,146	933	1,881	2,313	3,251

N O T E S

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Tata Sponge Iron

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2. Group/Directors ownership of the stock	No
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