

Tata Sponge Iron

BSE SENSEX	S&P CNX	CMP:INR274	TP:INR428	Buy
17,234	5,205			
Bloomberg	TTSP IN			
Equity Shares (m)	15.4			
52-Week Range (INR)	379/233			
1,6,12 Rel. Perf. (%)	-2/-12/-16			
M.Cap. (INR b)	4.2			
M.Cap. (USD b)	0.1			

Consolidated

- Tata Sponge (TTSP) posted an adjusted PAT of INR168m (v/s our estimate of INR233m) for 3QFY12, down 23% QoQ (and 24% YoY), mainly on account of a volume-driven decline in revenue.
- Net sales declined 25% QoQ (and 23% YoY) to INR1.31b. Both production and sales volumes declined sequentially on lower iron ore availability due to difficulty in getting road permits in Odisha. We expect volumes to remain flat, as the issue of road permits persists. Sponge iron sales volumes declined 23% QoQ to 55k tons. Average realization fell 2% QoQ to INR21,936/ton.
- EBITDA decreased 18% QoQ (and 30% YoY) to INR246m. EBITDA margin improved 160bp QoQ to 18.8%. EBITDA/ton increased 6% QoQ to INR4,467, as raw material cost declined to INR15,982/ton from INR17,646/ton in 2QFY12.
- Despite significantly lower production and sales volumes, strong sponge realization is supporting both revenue and margins. Current sponge iron prices are at a three-year high in the domestic market (at ~INR24,000/ton v/s INR17,970/ton in FY11), as producers suffer shortage of raw material (especially iron ore) post the ban on mining in Karnataka and increased regulatory rigor in Odisha.
- The stock trades at 5.5x FY12E EPS, 0.7x FY12E BV, and at an EV of 1.8x FY12E EBITDA. Maintain **Buy**.

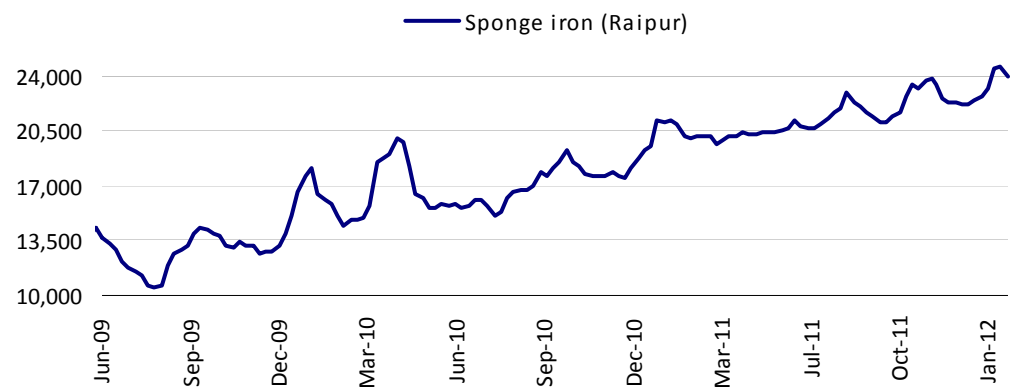
Quarterly Performance	(INR Million)										
	Y/E March	FY11				FY12				FY11	FY12E
		1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Sales (tons)	85,000	108,000	91,500	95,500	72,000	71,000	55,000	55,000	380,000	253,000	
Change (YoY %)	3.6	23.3	3.2	-7.1	-15.3	-34.3	-39.9	-42.4	5.2	-33.4	
Realization (Rs per ton)	15,453	14,842	17,200	19,683	18,138	22,397	21,936	22,336	16,763	21,072	
Change (YoY %)	18.5	25.4	34.1	28.9	17.4	50.9	27.5	13.5	25.8	25.7	
Net Sales	1,414	1,759	1,704	1,954	1,457	1,737	1,308	1,376	6,758	5,877	
Change (%)	17.8	53.0	31.4	14.3	3.0	-1.2	-23.3	-29.6	30.0	-13.0	
EBITDA	421	341	349	459	331	299	246	231	1,497	1,107	
Change (YoY %)	53.9	38.4	1.1	-13.2	-21.5	-12.5	-29.5	-49.6	20.8	-26.1	
As % of Net Sales	29.8	19.4	20.5	23.5	22.7	17.2	18.8	16.8	22.2	18.8	
EBITDA per ton	4,956	3,160	3,810	4,809	4,596	4,206	4,467	4,206	3,940	4,374	
Interest						1	1		0	1	
Depreciation	47	46	46	45	46	46	46	46	185	184	
Other Income	14	33	29	41	45	62	57	60	191	224	
PBT (after EO Inc.)	388	148	331	636	330	314	256	245	1,503	1,145	
Total Tax	129	44	109	207	105	97	88	81	489	370	
% Tax	33.3	29.7	33.0	32.6	31.8	30.8	34.4	33.0	32.6	32.4	
Reported PAT	259	104	222	428	225	217	168	164	1,013	775	
Adjusted PAT	259	231	222	307	225	217	168	164	1,013	775	
Change (YoY %)	59.4	58.1	9.2	-7.9	-13.1	-5.8	-24.4	-46.5	19.9	-23.6	

E: MOSL Estimates

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Sponge iron prices at three-year high



Source: Company/MOSL

Lowering FY12 volumes to 253kt; Valuation attractive

- We are lowering our FY12 sponge iron sales volume to 253kt from earlier estimate of 300kt. We hope that road permits problem will be solved in due course and the iron ore supply will be restored to normal levels by the start of FY13. We are maintaining our FY13 volume estimates of 380kt assuming normal operations.
- Stock trades at attractive FY12 EV/EBITDA of 1.8x, PE of 5.5x and P/BV of 0.7x. Maintain **Buy**.

Tata Sponge Iron: an investment profile

Company description

Tata Sponge 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 in close proximity to iron ore mines (25km from plants), which saves transport cost. The company 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.
- Tata Sponge is one of the best managed sponge iron plants in the country, with a wide service offering profile and domain depth.
- Radhikapur (East) coal block on commencement will lower external dependence for coal.

Key investment risks

- Earnings are highly leveraged to sponge iron prices.

- Lacking growth triggers as no major capacity expansion plans in the near future.
- Iron ore supply concerns due to mining road permits related problems in Odisha

Valuation and view

- Stock trades at attractive FY12 EV/EBITDA of 1.8x, PE of 5.5x and P/BV of 0.7x. Maintain **Buy**.

Sector view

- Current sponge iron prices are at their three high in domestic market (at ~INR24,000/ton v/s INR17,970/ton in FY11) as producers suffers raw material shortage especially iron ore post Karnataka mining ban and increased regulatory rigor in Odisha. Marginal sponge iron ore producers are forced either to operate at lower capacity or incur high iron ore cost. Prices are expected to remain strong in the near term as iron ore availability to the industry will remain a concern as more and more mining regions come under regulator rigor.

Comparative valuations

		Tata Sponge Iron	Godawari Power	Monnet Ispat
P/E (x)	FY12E	4.2	4.0	10.1
	FY13E	5.5	2.4	7.8
P/BV (x)	FY12E	0.8	0.5	1.3
	FY13E	0.7	0.4	1.1
EV/Sales (x)	FY12E	0.3	0.4	3.1
	FY13E	0.3	0.5	2.1
EV/EBITDA (x)	FY12E	1.6	2.8	11.7
	FY13E	1.8	3.3	8.9

EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	49.9	58.8	-15.2
FY13	67.3	66.8	0.7

Target Price and Recommendation

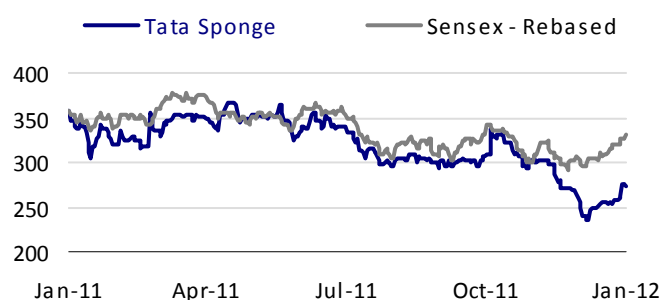
Current Price (INR)	Target * Price (INR)	Upside (%)	Reco.
274	428	56.3	Buy

1x FY13 BV

Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	43.7	43.7	43.7
Domestic Inst	7.3	7.3	7.3
Foreign	6.8	6.8	6.4
Others	42.3	42.2	42.7

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	5,877	8,747
Change (%)	33.2	-14.5	30.0	-13.0	48.8
Total Expenses	4,242	3,961	5,261	4,771	7,265
EBITDA	1,840	1,239	1,497	1,107	1,482
% of Net Sales	30.3	23.8	22.2	18.8	16.9
Depn. & Amortizati	183	194	185	184	185
EBIT	1,657	1,045	1,312	922	1,297
Net Interest	46	2	0		
Other income	201	219	191	224	250
PBT before EO	1,812	1,262	1,503	1,147	1,547
EO income					
PBT after EO	1,812	1,262	1,503	1,147	1,547
Tax	605	417	489	370	511
Rate (%)	33.4	33.0	32.6	33.0	33.0
Reported PAT	1,207	845	1,013	776	1,037
Adjusted PAT	1,207	845	1,013	768	1,037
Change (%)	26.3	-30.0	19.9	-24.2	35.0

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	5,549	6,441
Share holders funds	3,497	4,201	5,071	5,703	6,595
Loans	1	1			
Defferred tax liabil	503	459	393	393	393
Capital Employed	4,002	4,661	5,464	6,095	6,988
Gross Block	3,591	3,592	3,598	3,598	3,598
Less: Accum. Deprn.	1,357	1,536	1,711	1,895	2,080
Net Fixed Assets	2,234	2,057	1,887	1,703	1,518
Capital WIP	213	1,217	1,290	1,590	1,740
Investments	8	8	344	344	344
Curr. Assets	2,096	2,155	2,875	3,460	4,576
Inventories	508	683	627	725	959
Sundry Debtors	199	375	223	322	479
Cash and Bank	1,146	933	1,881	2,270	2,994
Loans and Advai	243	164	144	144	144
Curr. Liability & Prov.	549	775	933	1,002	1,190
Sundry Creditors	286	401	413	483	671
Other Liabilities & l	263	375	519	519	519
Net Current Assets	1,546	1,379	1,942	2,458	3,386
Application of Funds	4,002	4,661	5,464	6,095	6,988

E: MOSL Estimates; Consolidated

Ratios					
Y/E March	2009	2010	2011	2012E	2013E
Basic (INR)					
EPS	78.4	54.9	65.8	49.9	67.3
Cash EPS	90.2	67.5	77.8	61.8	79.3
BV/Share	227.1	272.8	329.3	370.3	428.3
DPS	8.0	8.0	8.0	8.0	8.0
Payout (%)	11.9	17.1	14.2	18.6	13.9
Valuation (x)					
P/E	3.5	5.0	4.2	5.5	4.1
Cash P/E	3.0	4.1	3.5	4.4	3.5
P/BV	1.2	1.0	0.8	0.7	0.6
EV/Sales	0.5	0.6	0.3	0.3	0.1
EV/EBITDA	1.7	2.7	1.6	1.8	0.8
Dividend Yield (%)	2.9	2.9	2.9	2.9	2.9
Return Ratios (%)					
EBITDA Margins	30.3	23.8	22.2	18.8	16.9
Net Profit Margins	19.8	16.3	15.0	13.1	11.9
RoE	40.7	22.0	21.9	14.3	16.9
RoCE	47.6	29.2	29.7	19.8	23.7
RoIC	62.3	40.7	58.9	48.0	68.2
Working Capital Ratios					
Fixed Asset Turnover (x)	1.7	1.4	1.9	1.6	2.4
Asset Turnover (x)	1.5	1.1	1.2	1.0	1.3
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	3.5	3.8
Interest Cover Ratio	35.7	-	-	-	-
Debt/Equity	-0.3	-0.2	-0.4	-0.4	-0.5

Cash Flow Statement					
(INR Million)					
Y/E March	2009	2010	2011	2012E	2013E
Pre-tax Profit	1,812	1,262	1,503	1,147	1,547
Depreciation	179	179	175	184	185
(Inc)/Dec in Wkg. Cap.	-227	-46	385	-127	-203
Tax paid	-631	-461	-556	-370	-511
Other Operating Activiti		2	1		
CF from Op. Activity	1,132	937	1,508	833	1,018
(Inc)/Dec in FA + CWIP	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 Activiti					
CF from Fin. Activity	-987	-144	-146	-144	-144
(Inc)/Dec in Cash	174	-213	947	389	724
Add: Opening Balance	972	1,146	933	1,881	2,270
Closing Balance	1,146	933	1,881	2,270	2,994

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Tata Sponge Iron

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