

Tata Sponge Iron Ltd.

₹ 265

Sister's Concern**Buy**

May 18, 2012

Company Background

Tata Sponge Iron Limited (TSIL) was incorporated in 1982 and is based in Bilaipada, India. TSIL engages in the production and sale of sponge iron in India. Its sponge iron is used by secondary steel producers for producing steel. The origins of TSIL can be traced to a groundbreaking effort by Tata Steel to industrialise a backward area of Orissa. Tata Steel proposed to do this by introducing an innovative technology for making sponge iron - Tisco Direct Reduction (TDR), developed by its Research and Development Division. As the first Indian Sponge Iron Company to be accredited with ISO 9002 certification, TSIL produces premium & consistent quality sponge iron for its valued customers. The Company has emerged as one of the leaders among coal-based sponge iron suppliers in India, while winning customer compliments for consistency in supply and product quality.

Investment Rationale

- ➔ TSIL has a total production capacity of 390,000 TPA from 3 kilns. The Company is self sufficient in power with own captive power plants - producing 26 MW of power from 2 power plants. The company plans to expand its captive power plant capacity by 26MW to 51MW over a period of 2-3 years.
- ➔ TSIL gets 100% supplies of iron ore from Tata Steel at subsidised rates. TSIL has a long-term supply agreement with Tata Steel for assured supply of iron ore for uninterrupted production. Tata Steel supplies iron ore from its Khondbond mine in Orissa, at a 20-25% discount from the market price, leading to at least 5% higher operating margin from other non-integrated sponge players.
- ➔ TSIL operates at a capacity utilization of 88% compared to the industry average of 66% which makes it most efficient in terms of maintaining its costs which also contributes to its EBITDA margins being higher compared to peers.
- ➔ The work in connection with development of coal block at Radhikapur (E) and Utkal-F in Talcher coalfields was started in 2006-07. TSIL made significant progress in land acquisition & has deposited requisite money with Government of Orissa for 1st phase of land requirement. Depending upon the money needed, the financial tie-up for the coal block will be completed in next few months. The coal block is expected to become operational from 2013.

Key Financials

Year Ended 31 st	Mar 09	Mar 10	Mar 11
Revenue (INR mn)	6298.9	5419.1	6944.5
Rev. growth (%)	30.70	(13.97)	28.15
EBITDA (INR mn)	2045.1	1458.7	(25.5)
Net profit (INR mn)	1206.7	845.2	1013.4
Shares outstanding (mn)	15.4	15.4	15.4
EPS (INR)	78.4	54.9	65.8
EPS growth (%)	26.32	(29.96)	19.90
P/E (x)	1.6	6.8	5.2
ROCE (%)	35.61	21.95	21.86

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Info Codes

Reuters	: TTSP.BO
Bloomberg	: TTSP@IN
NSE	: TATASPONGE
BSE	: 513010

Previous Report

Date	: Nov 14, 2008
Recommendation	: Accumulate
Price	: ₹ 110
High Reached	: ₹ 288

Market Data

52 Wk Range (₹)	: 233 / 373
Shares in Issue (mn)	: 15.4
Mkt. Cap (₹ bn)	: 4.07
BSE 2 Wk Avg Vol	: 2316

Share Holding Pattern (%)

Promoters	: 43.24
DII's	: 8.11
FII's	: 6.48
Others	: 42.17

Investment Theme

TSIL has a 45% stake in Talcher coal block in Orissa, which has estimated reserves of 120 mn tn for captive consumption, in which forest clearance is pending. TSIL sources ~ 60% of its raw material from Coal India & imports the remaining from Africa. TSIL has received environmental clearance for the coal block and, in FY 10, deposited Rs. 97 Cr with the Government of Orissa for acquisition of part of the land. Management expects the coal block to be operational by FY2014E end. Progress on forest clearance could be a potential trigger for the stock.

A Block can even help growth!

Financial Statements

Income Statement

(₹ mn)

Year end	Mar 09	Mar 10	% Chg	Mar 11	% Chg
Total Sales + Excise	6760.6	5577.0	(17.51)	7352.7	31.84
Other Income	205.4	220.1	7.16	193.4	(12.13)
Change in Stocks	(5.6)	(25.5)	355.36	49.8	(295.29)
Raw Material Con.	3479.1	3219.4	(7.46)	4473.3	38.95
Employee Exp.	199.3	203.9	2.31	199.7	(2.06)
Indirect Taxes	732.4	435.7	(40.51)	669.9	53.75
Other Exp.	504.5	453.9	(10.03)	565.0	24.48
Operating Exp.	4920.9	4338.4	(11.84)	5858.1	35.03
Operating Profit	1839.7	1238.6	(32.67)	1494.6	20.67
Total Interest	46.4	2.5	(94.61)	0.0	(100.00)
Gross Profit	1998.7	1456.2	(27.14)	1688.0	15.92
Net Dep.	183.1	194.0	5.95	185.2	(4.54)
Total Taxation	608.9	417.0	(31.52)	489.4	17.36
Net Profit/Loss	1206.7	845.2	(29.96)	1013.4	19.90

4 Years Balance Sheet

(₹ mn)

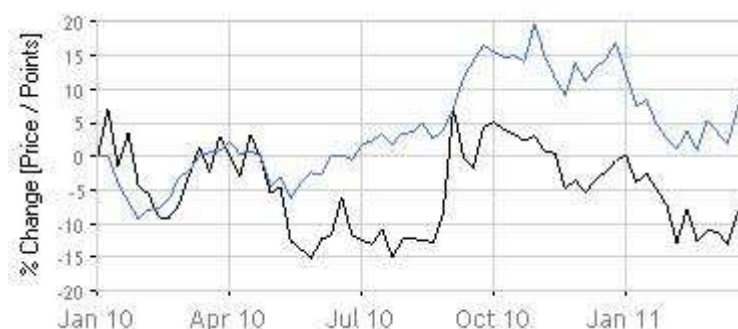
Balance Sheet as on 31 st	Mar 08	Mar 09	Mar 10	Mar 11
SOURCES OF FUNDS	3278.5	3498.2	4202.2	5070.9
Equity Share capital	154.0	154.0	154.0	154.0
Share Application Money	0.0	0.0	0.0	0.0
Preference Share Capital	0.0	0.0	0.0	0.0
Reserves & Surplus	2280.6	3343.1	4046.7	4916.9
Secured Loans	843.9	1.1	1.5	0.0
Unsecured Loans	0.0	0.0	0.0	0.0
USES OF FUNDS	3278.5	3498.2	4202.2	5070.9
Gross Block	3689.3	3591.6	3592.6	3598.5
Less : Revaluation Reserves	0.0	0.0	0.0	0.0
Less : Accumulated Depreciation	1178.4	1357.3	1535.9	1711.1
Net Block	2510.9	2234.3	2056.7	1887.4
Capital Work in Progress	143.9	212.8	1217.4	1290.5
Investments	8.0	8.0	8.0	343.5
Current Assets	2370.5	3014.4	3444.5	4648.8
Less : Current Liabilities	1754.8	1971.3	2524.4	3099.3
Total Net Current Assets	615.7	1043.1	920.1	1549.5
Misc. Expenses not written	0.0	0.0	0.0	0.0
NOTE				
Bk Val Unquoted Investments	8.0	8.0	8.0	8.0
Mkt Val. Quoted Investments	0.0	0.0	0.0	335.5
Contingent Liabilities	112.1	57.1	53.6	351.0
Dividend (%)	70	80	80	80

Quarterly Income Sheets

(₹ mn)

Quarter Ended	Jun 11	Sep 11	Dec 11	Mar 12
Net Sales	1456.90	1737.20	1307.60	1837.70
Cost Of Sales	1126.00	1438.60	1061.90	1583.00
Operating Profit	330.90	298.60	245.70	254.70
Recurring Income	44.80	62.20	57.20	65.70
Adjusted PBDIT	375.70	360.80	302.90	320.40
Financial Expenses	0.00	0.60	0.80	53.90
Depreciation	45.60	46.20	46.20	45.80
Other Write Offs	0.00	0.00	0.00	0.00
Adjusted PBT	330.10	314.00	255.90	220.70
Tax Charges	104.90	96.70	88.00	74.20
Adjusted PAT	225.20	217.30	167.90	146.50
Non Recurring Items	0.00	0.00	0.00	0.00
Other Non Cash Adjust	0.00	0.00	0.00	0.00
Net Profit	225.20	217.30	167.90	146.50

52 Week Index Relative Percentage Appreciation



TSIL vs SENSEX

Risks Associated

Iron ore and coal are the major raw materials used to manufacture sponge iron. Coal prices have witnessed an uptrend recently due to demand supply gap. Iron ore prices have also been escalating due to mining ban in Karnataka. Raw material constitutes about 65% of TSIL's total expenditure and, hence, volatility in raw-material prices would affect the company's EBITDA margin.

Radhikapur's Talcher coal block operations have been delayed due to hindrance in clearances. The block is stuck for final stage of forest clearance and is expected to be operational by FY2014E. Any delay or non-approval of forest clearance may be a negative for the company.

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.

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

Tata Sponge In a Nutshell

Tata Sponge Iron Ltd. (TSIL) is located at Bilaipada near Joda in the Keonjhar district of Orissa. TSIL is an associate company of Tata Steel, which holds a 39.7% stake in the company. TSIL is a leading manufacturer of sponge iron, which is used as a raw material in steel manufacturing, with an installed capacity of 3,90,000 mtpa and a 26MW captive power plant. The company gets 100% supplies of iron ore from Tata Steel with a 20-25% discount from market prices, thus leading to at least 5% higher margins from other non-integrated sponge iron players. TSIL has a 45% stake in Talcher coal block in Orissa with estimated reserves of 120mn tonnes for captive consumption. The company has deposited money for the first phase of land acquisition with the Government of Orissa. Forest clearance for the block is pending. The sooner the block is allocated the earlier will growth be seen.

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Rating Interpretation

Buy	: Expected to appreciate 20% or more over 12-months	Reduce	: Expected to depreciate up to 10% over 12-months
Accumulate	: Expected to appreciate 10% to 20% over 12-months	Sell	: Expected to depreciate 10% or more over 12-months
Trade Buy	: Expected to appreciate more than 10% over 45-days	Trade Sell	: Expected to depreciate more than 10% over 45-days

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