

Result Update

Stock Details

Market cap (Rs mn)	:	14665
52-wk Hi/Lo (Rs)	:	1249 / 768
Face Value (Rs)	:	10
3M Avg. daily volume	:	190,755
Shares o/s (m)	:	15

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenue	8,005	8,457	8,456
Growth (%)	43.6	5.6	(0.0)
EBITDA	1,827	1,848	1,837
EBITDA margin (%)	22.8	21.8	21.7
PAT	1,409	1,517	1,521
EPS	91.5	98.5	98.7
EPS Growth (%)	140.1	7.6	0.3
BV (Rs/share)	640	714	789
Dividend/share (Rs)	20.0	20.0	20.0
ROE (%)	14.3	13.8	12.5
ROCE (%)	14.3	13.8	12.5
P/E (x)	10.4	9.7	9.7
EV/EBITDA (x)	4.3	3.8	3.2
P/BV (x)	1.5	1.3	1.2

Source: Company

Shareholding Pattern (%)

(%)	Jun-18	Mar-18	Dec-17
Promoters	54.5	54.5	54.5
FII	8.5	8.7	8.4
DII	0.9	0.9	0.9
Others	36.2	35.9	36.2

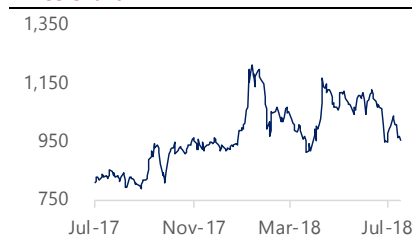
Source: Company

Price Performance (%)

(%)	1M	3M	6M
Tata Sponge Iron	(12.7)	(15.0)	(16.4)
Nifty	1.7	4.3	1.5

Source: Bloomberg

Price chart



Source: Bloomberg

Jatin Damania

Jatin.damania@kotak.com
+91 22 6218 6440

TATA SPONGE IRON LTD

PRICE RS. 955

TARGET RS.1,055

ACCUMULATE

Tata Sponge (TTSP) Q1FY19 reported numbers were in-line with estimates. Higher realisation and improvement in operating leverage led to a 56.1% YoY jump in EBITDA to Rs603 mn (down 2.2% QoQ), with an EBITDA margin of 23.1% (below estimates). TTSP's spread in sponge iron segment continued to remain strong, however, we feel the sustainability of the same for the long term is difficult.

Key Highlights

- Sponge iron sales volume during the quarter grew 16.8%/6.5% YoY/QoQ to 115KT (production during the quarter stood at 116KT, highest ever), the realisation was largely flat QoQ (up 31.3% YoY) to Rs21,384/tonne.
- TTSP reported PAT of Rs456mn, in-line with estimates
- Management expects to operate the facility at rated capacity and is targeting 425KT of volume in FY19. At the same time, management is applying for the fresh Environmental Clearance to further enhance its capacity. We are building in 420KT and 425KT of volume for FY19E and FY20E, respectively.

Valuation & outlook

- We continue to remain positive on TTSP's strong business model, but foresee current valuation as fair, as the sustainability of spreads in the sponge iron business is difficult and expectation of deployment of surplus cash for the forward integration (Steel plant). Besides this, strengthening of Dollar index and trade war is weighing on valuation multiples across the metal sector. The stock has corrected since our last recommendation (Reduce at CMP Rs.1130), factoring this, we upgrade our stock to Accumulate, with a revised target price of Rs1,055, valuing it at 4x FY20 EBITDA (earlier 5x). We have not assigned any value to the investment of Rs1.8bn made by the company on the coal block, as the company's coal block is yet to put in the auction.

Quarterly performance table

Particulars (Rs Mn)	1QFY19	1QFY18	% YoY	4QFY18	% QoQ
Net Sales	2,609	1,750	49.1	2,435	7.2
Raw Materials	1,709	1,054		1,463	
% to sales	65.5	60.2		60.1	
Other Expenses	298	310		357	
% to sales	11.4	17.7		14.6	
Total Expenditure	2,007	1,364	47.1	1,819	10.3
EBITDA	603	386	56.1	616	(2.2)
EBITDA Margin (%)	23.1	22.1		25.3	
Depreciation	29	32		30	
Interest	3	5		3	
EBT	571	350		583	
Other Income	119	103		117	
PBT	690	452		700	
Tax	234	147		233	
ETR (%)	34.0	32.4		33.3	
PAT (reported)	456	306	49.1	467	(2.4)
NPM (%)	17.5	17.5		19.2	

Source: Company, Kotak Securities – Private Client Research

Higher volume led to increase in profitability

TTSP operated all its kilns at the rated capacity during the quarter, as against industry average of 60%-65%. Volume during the quarter stood at 115kt, 16.8%/6.5% YoY/QoQ, which was above expectations. Realisation during the quarter stood at Rs21,384/tonne, flat QoQ, as domestic sponge iron prices remained firm. Given the seasonally weak quarter 2QFY19, we expect sponge iron prices to correct due to lack of infrastructure activities, which would impact its profitability in the next quarter.

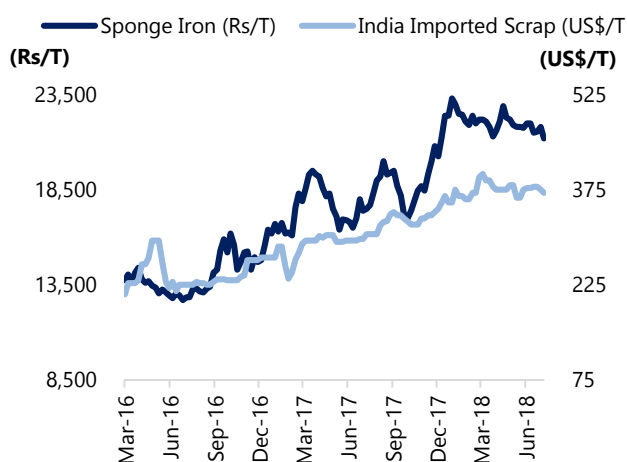
Operational Parameters

	1QFY19	1QFY18	% YoY	4QFY18	% QoQ
Volume					
Sponge Iron (Tonnes)	115	98.5	16.8	108	6.5
Power (Kwh)	38	38	0.0	37	2.7
Realisation					
Sponge Iron (Rs/T)	21,384	16,282	31.3	21,263	0.6
Power (Rs/u)	4.0	3.9	2.6	3.7	5.5
Raw Materials (Rs/T)					
Iron Ore	3,593	2,261	58.9	2,835	26.7
Coal	9,562	7,692	24.3	8,887	7.6
Dolomite	1,885	1,472	28.1	1,679	12.3

Source: Company

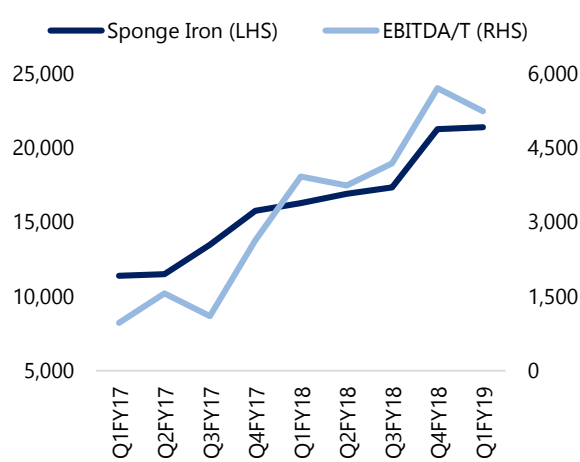
The benefit of higher volume and firm realisation was impacted by increase in input costs, thereby resulting in 220bps QoQ decline in EBITDA margin to 23.1%. The increase in input costs is largely attributed to increase in the coal costs, as the coal situation remained tight in 1QFY19 and global coal prices were higher. The raw material costs during the quarter increased by Rs840/tonne to Rs14,638/tonne. Coal costs during the quarter increased to Rs9,562/tonne from Rs8,887/tonne in 4QFY18 and iron ore cost increased to Rs3,593/tonne from Rs2,900/tonne.

Sponge iron prices and imported scrap (US\$/t)



Source: Bloomberg, Industry data, Company

Sponge iron prices and EBITDA/T (Rs/T)

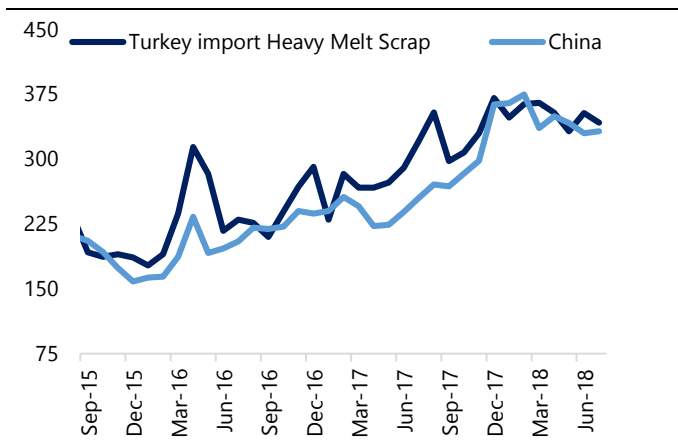


Source: Bloomberg, Industry data, Company

Domestic sponge iron & global scrap prices outlook

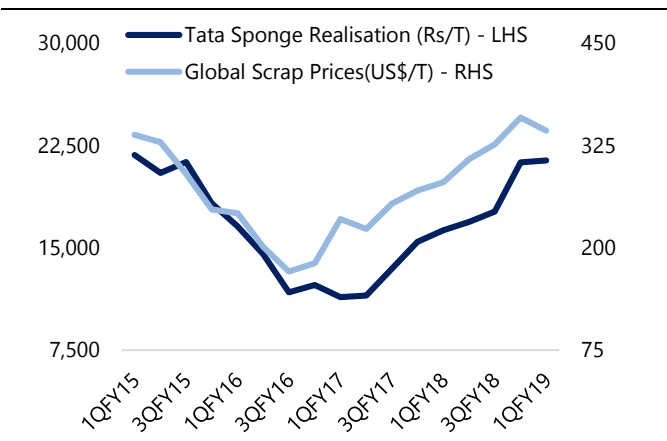
Domestic sponge iron prices remained firm, supported by better demand-supply and an increase in prices of other substitute products like scrap and pig iron. Besides this, global scrap price has also remained strong due to increase in EAF based steel production compared to BF based, as the latter has seen a sharp increase in the cost of production. We expect domestic demand for long products to remain subdued in 2QFY19 (seasonally low quarter) due to lack of infrastructure activities, but is expected to pick-up from 3QFY19 led by an increase in infrastructure spend.

Global scrap price trend (US\$/T)



Source: Bloomberg

Tata Sponge Realisation vs scrap prices



Source: Bloomberg, Company

Forward integration

TheBoD has in-principle approved the setting of 1.5MT steel plant in phases at Beleipada, Odisha, subject to the evaluation of financial viability of the project. Management indicated that, this would be a brownfield project and most likely route for this plant would be BF-BOF combination with forwards integration into long products. Tata Sponge has a strong and debt-free balance sheet with cash and cash equivalent of ~Rs8.2bn at the end of FY18. In addition, the recovery of its investment in Radhikapur East Coal Block (deallocated) would further increase the cash balance by ~Rs1.8bn. TSIL, is in good position to deploy cash, but setting up a steel plant, would lead to raising of debts in the years to come. We have not factor in any impact of the capex on steel plant, as final details are yet to be disclosed by the management.

Recommend Accumulate

We continue to remain positive on TTSP’s strong business model, but foresee current valuation as fair, as the sustainability of spreads in the sponge iron business is difficult and expectation of deployment of surplus cash for the forward integration (Steel plant). Besides this, strengthening of Dollar index and trade war is weighing on valuation multiples across the metal sector. The stock has corrected since our last recommendation (Reduce), factoring this, we upgrade our stock to Accumulate, with a revised target price of Rs1,055, valuing it at 4x FY20 EBITDA (earlier 5x). At CMP, the stock is trading at 9.7x both in FY19E and FY20E earnings and on EV/EBITDA, it trades at 3.8x/3.2x FY19E/FY20E EBITDA.

Company Background

Tata Sponge is a subsidiary of Tata Steel and has sponge iron production capacity of 4.25 lakh tonne in Orissa with 26 MW of waste heat recovery based captive power. The company has impressive track record and maintains consistent quality. Tata Sponge produce and market sponge iron, which is a single end use (steel making) and a single grade product. The company generate power through Waste Heat Recovery Boilers (WHRB), a non-conventional source of 'green' power, which has helped the company to shift their dependence on thermal power. The company export surplus power to their holding company.

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Net sales	5,573	8,005	8,457	8,456
growth (%)	(2.8)	43.6	5.6	(0.0)
Operating expenses	4,958	6,178	6,609	6,618
EBITDA	615	1,827	1,848	1,837
growth (%)	162.4	196.9	1.1	(0.6)
Depreciation & amortisation	128	123	130	136
EBIT	488	1,704	1,717	1,701
Other income	371	431	452	475
Interest paid	24	32	33	34
PBT	834	2,102	2,136	2,142
Tax	247	693	619	621
Effective tax rate (%)	32.0	33.8	29.0	29.0
Net profit	587	1,409	1,517	1,521
Minority interest	0	0	0	0
Reported Net profit	587	1,409	1,517	1,521
Adjusted Net profit	587	1,409	1,517	1,521
growth (%)	84	140	8	0

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement

(Year-end March)	FY17	FY18	FY19E	FY20E
Pre-tax profit	834	2,102	2,136	2,142
Depreciation	128	123	130	136
Chg in working capital	(248)	(213)	(214)	(7)
Total tax paid	(272)	(715)	(624)	(626)
Other operating activities	233	193	33	34
Operating CF	675	1,491	1,462	1,679
Capital expenditure	(39)	(61)	(127)	(177)
Chg in investments	118	112	376	(250)
Other investing activities	30	0	0	0
Investing CF	109	51	248	(427)
Equity raised/(repaid)	0	0	0	0
Debt raised/(repaid)	54	24	32	33
Dividend (incl. tax)	185	371	371	371
Other financing activities	0	0	0	0
Financing CF	239	396	404	405
Net chg in cash & bank bal.	545	1,146	1,307	847
Closing cash & bank bal	3,068	4,216	5,525	6,374

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Cash & Bank balances	3,068	4,216	5,525	6,374
Other Current assets	3,052	3,756	3,824	3,832
Investments	2,736	2,623	2,248	2,498
Net fixed assets	1,603	1,548	1,547	1,590
Other non-current assets	0	0	0	0
Total assets	10,459	12,144	13,143	14,294
Current liabilities	1,619	2,109	1,963	1,965
Borrowings	0	0	0	0
Other non-current liabilities	191	180	180	180
Total liabilities	1,809	2,289	2,143	2,145
Share capital	154	154	154	154
Reserves & surplus	8,494	9,700	10,845	11,995
Shareholders' funds	8,648	9,854	10,999	12,149
Minority interest	0	0	0	0
Total equity & liabilities	10,459	12,144	13,143	14,294

Source: Company, Kotak Securities – Private Client Research;

Ratio Analysis

(Year-end March)	FY17	FY18	FY19E	FY20E
Profitability and return ratios (%)				
EBITDAM	11.0	22.8	21.8	21.7
EBITM	8.8	21.3	20.3	20.1
NPM	10.5	17.6	17.9	18.0
RoE	6.8	14.3	13.8	12.5
RoCE	6.8	14.3	13.8	12.5
Per share data (Rs)				
EPS	38.1	91.5	98.5	98.7
FDEPS	38.1	91.5	98.5	98.7
CEPS	46.4	99.5	106.9	107.6
BV	568.0	639.9	714.3	788.9
DPS	11.0	20.0	20.0	20.0
Valuation ratios (x)				
PE	25.1	10.4	9.7	9.7
P/BV	1.7	1.5	1.3	1.2
EV/EBITDA	14.5	4.3	3.8	3.2
EV/Sales	1.6	1.0	0.8	0.7
P/CEPS	20.6	9.6	8.9	8.9
Other key ratios				
DSO (days)	23.4	26.8	27.0	27.0

Source: Company, Kotak Securities – Private Client Research

RATING SCALE

Definitions of ratings

- BUY** – We expect the stock to deliver more than 12% returns over the next 12 months
- ACCUMULATE** – We expect the stock to deliver 5% - 12% returns over the next 12 months
- REDUCE** – We expect the stock to deliver 0% - 5% returns over the next 12 months
- SELL** – We expect the stock to deliver negative returns over the next 12 months
- NR** – **Not Rated.** Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
- SUBSCRIBE** – We advise investor to subscribe to the IPO.
- RS** – **Rating Suspended.** Kotak Securities has suspended the investment rating and price target for this stock, either because there is not a Sufficient fundamental basis for determining, or there are legal, regulatory or policy constraints around publishing, an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.
- NA** – **Not Available or Not Applicable.** The information is not available for display or is not applicable
- NM** – **Not Meaningful.** The information is not meaningful and is therefore excluded.
- NOTE** – Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark.

FUNDAMENTAL RESEARCH TEAM

Rusmik Oza Head of Research rusmik.oza@kotak.com +91 22 6218 6441	Arun Agarwal Auto & Auto Ancillary arun.agarwal@kotak.com +91 22 6218 6443	Amit Agarwal Transportation, Paints, FMCG agarwal.amit@kotak.com +91 22 6218 6439	Nipun Gupta Information Tech, Midcap nipun.gupta@kotak.com +91 22 6218 6433	Krishna Nain Special Situations krishna.nain@kotak.com +91 22 6218 7907
Sanjeev Zarbade Cap. Goods & Cons. Durables sanjeev.zarbade@kotak.com +91 22 6218 6424	Ruchir Khare Cap. Goods & Cons. Durables ruchir.khare@kotak.com +91 22 6218 6431	Jatin Damania Metals & Mining, Midcap jatin.damania@kotak.com +91 22 6218 6440	Cyndrella Carvalho Pharmaceuticals cyndrella.carvalho@kotak.com +91 22 6218 6426	K. Kathirvelu Production k.kathirvelu@kotak.com +91 22 6218 6427
Teena Virmani Construction, Cement, Building Mat teena.virmani@kotak.com +91 22 6218 6432	Sumit Pokharna Oil and Gas, Information Tech sumit.pokharna@kotak.com +91 22 6218 6438	Pankaj Kumar Midcap pankajr.kumar@kotak.com +91 22 6218 6434	Jayesh Kumar Economy kumar.jayesh@kotak.com +91 22 6218 5373	

TECHNICAL RESEARCH TEAM

Shrikant Chouhan shrikant.chouhan@kotak.com +91 22 6218 5408	Amol Athawale amol.athawale@kotak.com +91 20 6620 3350
---	---

DERIVATIVES RESEARCH TEAM

Sahaj Agrawal sahaj.agrawal@kotak.com +91 79 6607 2231	Malay Gandhi malay.gandhi@kotak.com +91 22 6218 6420	Prashanth Lalu prashanth.lalu@kotak.com +91 22 6218 5497	Prasenjit Biswas, CMT, CFTe prasenjit.biswas@kotak.com +91 33 6625 9810
---	---	---	--

Disclosure/Disclaimer

Kotak Securities Limited established in 1994, is a subsidiary of Kotak Mahindra Bank Limited. Kotak Securities is one of India's largest brokerage and distribution house. Kotak Securities Limited is a corporate trading and clearing member of Bombay Stock Exchange Limited (BSE), National Stock Exchange of India Limited (NSE), Metropolitan Stock Exchange of India Limited (MSE). Our businesses include stock broking, services rendered in connection with distribution of primary market issues and financial products like mutual funds and fixed deposits, depository services and Portfolio Management.

Kotak Securities Limited is also a depository participant with National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL). Kotak Securities Limited is also registered with Insurance Regulatory and Development Authority as Corporate Agent for Kotak Mahindra Old Mutual Life Insurance Limited and is also a Mutual Fund Advisor registered with Association of Mutual Funds in India (AMFI). We are registered as a Research Analyst under SEBI (Research Analyst) Regulations, 2014.

We hereby declare that our activities were neither suspended nor we have defaulted with any stock exchange authority with whom we are registered in last five years. However SEBI, Exchanges and Depositories have conducted the routine inspection and based on their observations have issued advise/warning/deficiency letters/ or levied minor penalty on KSL for certain operational deviations. We have not been debarred from doing business by any Stock Exchange / SEBI or any other authorities; nor has our certificate of registration been cancelled by SEBI at any point of time.

We offer our research services to clients as well as our prospects.

This document is not for public distribution and has been furnished to you solely for your information and must not be reproduced or redistributed to any other person. Persons into whose possession this document may come are required to observe these restrictions.

This material is for the personal information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It is for the general information of clients of Kotak Securities Ltd. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients.

We have reviewed the report, and in so far as it includes current or historical information, it is believed to be reliable though its accuracy or completeness cannot be guaranteed. Neither Kotak Securities Limited, nor any person connected with it, accepts any liability arising from the use of this document. The recipients of this material should rely on their own investigations and take their own professional advice. Price and value of the investments referred to in this material may go up or down. Past performance is not a guide for future performance. Certain transactions -including those involving futures, options and other derivatives as well as non-investment grade securities - involve substantial risk and are not suitable for all investors. Reports based on technical analysis centers on studying charts of a stock's price movement and trading volume, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals.

Opinions expressed are our current opinions as of the date appearing on this material only. While we endeavor to update on a reasonable basis the information discussed in this material, there may be regulatory, compliance or other reasons that prevent us from doing so. Prospective investors and others are cautioned that any forward-looking statements are not predictions and may be subject to change without notice. Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

Kotak Securities Limited has two independent equity research groups: Institutional Equities and Private Client Group. This report has been prepared by the Private Client Group. The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating, target price of the Institutional Equities Research Group of Kotak Securities Limited.

We and our affiliates/associates, officers, directors, and employees, Research Analyst(including relatives) worldwide may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the subject company/company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) or have other potential/material conflict of interest with respect to any recommendation and related information and opinions at the time of publication of Research Report or at the time of public appearance. Kotak Securities Limited (KSL) may have proprietary long/short position in the above mentioned scrip(s) and therefore may be considered as interested. The views provided herein are general in nature and does not consider risk appetite or investment objective of particular investor; readers are requested to take independent professional advice before investing. This should not be construed as invitation or solicitation to do business with KSL. Kotak Securities Limited is also a Portfolio Manager. Portfolio Management Team (PMS) takes its investment decisions independent of the PCG research and accordingly PMS may have positions contrary to the PCG research recommendation. Kotak Securities Limited does not provide any promise or assurance of favourable view for a particular industry or sector or business group in any manner. The investor is requested to take into consideration all the risk factors including their financial condition, suitability to risk return profile and take professional advice before investing.

The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report. No part of this material may be duplicated in any form and/or redistributed without Kotak Securities' prior written consent.

Details of Associates are available on our website ie www.kotak.com

Research Analyst has served as an officer, director or employee of subject company(ies): No

We or our associates may have received compensation from the subject company(ies) in the past 12 months.

We or our associates have managed or co-managed public offering of securities for the subject company(ies) in the past 12 months: No

We or our associates may have received compensation for investment banking or merchant banking or brokerage services from the subject company(ies) in the past 12 months. We or our associates may have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company(ies) in the past 12 months. We or our associates may have received compensation or other benefits from the subject company(ies) or third party in connection with the research report. Our associates may have financial interest in the subject company(ies).

Research Analyst or his/her relative's financial interest in the subject company(ies): No

Kotak Securities Limited has financial interest in the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: No

Our associates may have actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report.

Research Analyst or his/her relatives has actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: No.

Kotak Securities Limited has actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: No

Subject company(ies) may have been client during twelve months preceding the date of distribution of the research report.

"A graph of daily closing prices of securities is available at www.nseindia.com and <http://economictimes.indiatimes.com/markets/stocks/stock-quotes>. (Choose a company from the list on the browser and select the "three years" icon in the price chart)."

Kotak Securities Limited. Registered Office: 27 BKC, C 27, G Block, Bandra Kurla Complex, Bandra (E), Mumbai 400051. CIN: U99999MH1994PLC134051, Telephone No.: +22 43360000, Fax No.: +22 67132430. Website: www.kotak.com/www.kotaksecurities.com. Correspondence Address: Infinity IT Park, Bldg. No 21, Opp. Film City Road, A K Vaidya Marg, Malad (East), Mumbai 400097. Telephone No: 42856825. SEBI Registration No: NSE INB/INF/INE 230808130, BSE INB 010808153/INF 011133230, MSE INE 260808130/INB 260808135/INF 260808135, AMFI ARN 0164, PMS INP000000258 and Research Analyst INH000000586. NSDL/CDSL: IN-DP-NSDL-23-97. Our research should not be considered as an advertisement or advice, professional or otherwise. The investor is requested to take into consideration all the risk factors including their financial condition, suitability to risk return profile and the like and take professional advice before investing. Investments in securities market are subject to market risks, read all the related documents carefully before investing. Derivatives are a sophisticated investment device. The investor is requested to take into consideration all the risk factors before actually trading in derivative contracts. Compliance Officer Details: Mr. Manoj Agarwal. Call: 022 - 4285 8484, or Email: ks.compliance@kotak.com. In case you require any clarification or have any concern, kindly write to us at below email ids:

- **Level 1:** For Trading related queries, contact our customer service at 'service.securities@kotak.com' and for demat account related queries contact us at ks.demat@kotak.com or call us on: Toll free numbers 18002099191 / 1800222299, Offline Customers - 18002099292
- **Level 2:** If you do not receive a satisfactory response at Level 1 within 3 working days, you may write to us at ks.escalation@kotak.com or call us on 022-42858445 and if you feel you are still unheard, write to our customer service HOD at ks.servicehead@kotak.com or call us on 022-42858208.
- **Level 3:** If you still have not received a satisfactory response at Level 2 within 3 working days, you may contact our Compliance Officer (Mr. Manoj Agarwal) at ks.compliance@kotak.com or call on 91- (022) 4285 8484.
- **Level 4:** If you have not received a satisfactory response at Level 3 within 7 working days, you may also approach CEO (Mr. Kamlesh Rao) at ceo.ks@kotak.com or call on 91- (022) 4285 8301.