

Strong show led by superlative volumes, maintain Hold

We maintain our Hold rating on Tata Sponge (TSIL) with a revised TP of Rs1135 as we see valuations fair with strong operational performance likely to be maintained and surplus cash on books expected to be deployed as CWIP in the steel plant capex over the next few years. Q1 earnings were strong YoY led by better pricing, solid volumes and tight control on conversion costs. TSIL's spreads in sponge iron business have remained strong but sustenance of the same at current high levels for long periods of time is difficult and hence we continue to build our annual estimates below the current run-rate. Clarity on capex towards the build-up of new steel complex is still elusive.

- Operational performance strong YoY led by robust realisation growth:** TSIL's volumes were best ever at 115kt, up 16.8% YoY. EBITDA rose 56% YoY to Rs603mn. Realisations improved 31% YoY to ~Rs21400 and spreads (gross profit/t) were ~10% higher YoY led by better realisations partially negated by higher coal costs. EBITDA/t stood at Rs5240, up 34% YoY. Management indicated that significant efforts on improving productivity has led to reduction in conversion costs by ~Rs500/t in last few years and this is sustainable in nature.
- Steel plant capex announcement still remains elusive:** TSIL's board had earlier approved the set-up of a steel plant of up to 1.5 mtpa in stages. Management has indicated that this would be a brownfield expansion with a competitive capex cost/t. TSIL would be foraying into long product manufacturing in the steel plant and we expect TSIL to start deploying its existing cash pile and internal accruals into steel plant set-up from H2FY19E.
- Earnings outlook:** TSIL management indicated that they have applied for environment clearance for further production to the tune of 30-40ktpa (vs existing EC of 425ktpa) from existing kilns and expect to receive the clearance before FY19-end. We maintain our volume estimates at 421kt/425kt for FY19E/20E and increase our realization estimates marginally for FY19E/20E given the high volatility in sponge iron prices and recent weakness in long product prices. Coal availability in domestic market remains tight and we have factored in imports/domestic sourcing of 90%/10% for TSIL. We increase our coal price estimates on the higher side and our earnings estimates are revised downwards marginally.
- Valuation and risks – Maintain Hold:** We remain positive on TSIL due to better visibility of volume growth and sustenance of spread. We continue to value the company at 5x FY20E EV/EBITDA and value the surplus cash at 75% as this cash is expected to be deployed as CWIP for the steel plant over next few years. We revise our TP to Rs1135 and maintain Hold. Key downside risks are fall in sponge iron prices and higher coal costs while upside risks are higher volumes and better spread.

Y/E Mar (Rs mn)	Q1FY19	Q1FY18	YoY(%)	Q4FY18	QoQ(%)	Q1FY19E	Var(%)
Net sales	2,609	1,750	49.1	2,435	7.2	2,325	12.2
Raw materials (net)	1,709	1,054	62.2	1,463	16.9	1,385	23.4
Employee costs	102	98	3.9	113	(9.9)	115	(11.5)
Other expenses	196	212	(7.8)	244	(19.6)	220	(11.0)
EBITDA	603	386	56.1	616	(2.2)	605	(0.4)
EBITDA margin (%)	23.1	22.1	103 bps	25.3	(220)bps	26.0	(294)bps
Depreciation	29	32	(9.8)	30	(3.7)	32	(10.6)
Other income	119	103	16.0	117	2.0	130	(8.5)
PBT	690	452	52.5	700	(1.4)	698	(1.2)
Tax	234	147	59.8	233	0.6	230	1.7
PAT	456	306	49.0	467	(2.4)	468	(2.6)

Source: Company, Centrum Research

Y/E Mar (Rs mn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adj. PAT	YoY (%)	EPS	RoE (%)	RoCE (%)	PE (x)	EV/EBITDA(x)
FY16	5,735	(27.4)	240	4.2	319	(65.3)	20.7	3.9	4.2	22.7	4.3
FY17	5,573	(2.8)	616	11.1	588	84.1	38.2	7.0	6.8	15.7	5.4
FY18	8,002	43.6	1,827	22.8	1,409	139.7	91.5	15.2	14.2	10.6	5.2
FY19E	8,712	8.9	1,931	22.2	1,589	12.8	103.2	15.0	14.0	9.4	4.1
FY20E	8,376	(3.9)	1,923	23.0	1,656	4.2	107.5	13.8	12.9	9.0	3.3

Source: Company, Centrum Research Estimates; All ratios based on average mcap for year

In the interest of timeliness, this document is not edited

Centrum Equity Research is available on Bloomberg, Thomson Reuters and FactSet

Target Price	Rs1,135	Key Data	
CMP*	Rs971	Bloomberg Code	TTSP IN
Upside	16.9%	Curr Shares O/S (mn)	15.4
Previous Target	Rs1,130	Diluted Shares O/S(mn)	15.4
Previous Rating	Buy	Mkt Cap (Rsbn/USDmn)	15/217.9
Price Performance (%)*		52 Wk H / L (Rs)	1249/768.3
	1M 6M 1Yr	5 Year H / L (Rs)	1249/217.9
TTSP IN	(11.0) (14.8) 17.9	Daily Vol. (3M NSE Avg.)	190755
Nifty	1.7 1.5 11.7		

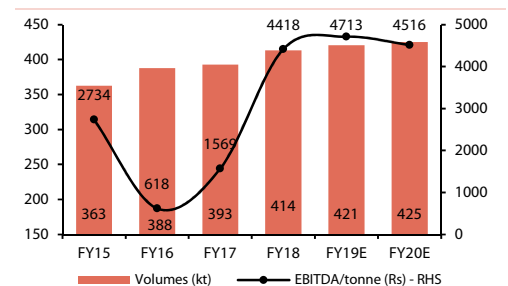
*as on 17 July 2018; Source: Bloomberg, Centrum Research

Shareholding pattern (%)*

	Jun-18	Mar-18	Dec-17	Sep-17
Promoter	54.5	54.5	54.5	54.5
FII's	8.5	8.7	8.4	7.0
Dom. Inst.	0.9	0.9	0.9	0.8
Public & Others	36.2	35.9	36.2	37.7

Source: BSE, *as on 17 July 2018

EBITDA/tonne trend



Source: Company, Centrum Research Estimates

Earnings Revision

Particulars (Rs mn)	FY19E			FY20E		
	New	Old	Chg (%)	New	Old	Chg (%)
Sales	8,712	8,502	2.5	8,376	8,163	2.6
EBITDA	1,931	1,983	(2.6)	1,923	1,919	0.2
EBITDA Margin (%)	22.2	23.3	(116)bps	23.0	23.5	(55)bps
PAT	1,589	1,657	(4.1)	1,656	1,678	(1.3)

Source: Centrum Research Estimates

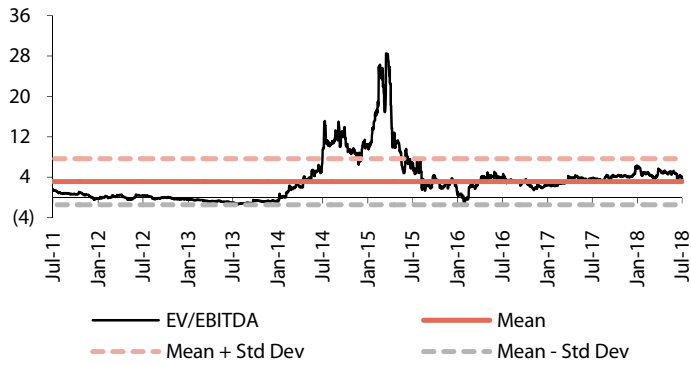
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Exhibit 1: Sensitivity Analysis (FY19E)

Sensitivity to key variables	% change	% impact on EBITDA	% impact on EPS
Sales volume	1	3.6	2.8
Realization	1	4.0	3.2
Iron ore cost increase	1	(1.0)	(0.8)

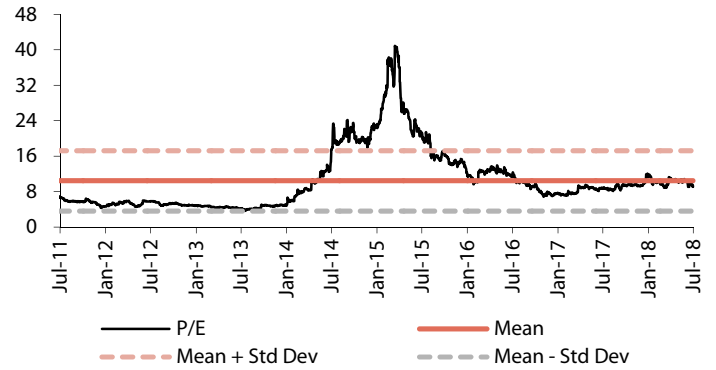
Source: Company, Centrum Research Estimates

Exhibit 2: 1 year forward EV/EBITDA chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 3: 1 year forward P/E chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 4: Valuations

(Rsmn)	Mar'20E
EBITDA	1,923
Justified EV/EBITDA (x)	5.0
EV	9,615
Net Cash	9,286
Add: Net Cash (@75%)	6,965
Add: Coal block investment (@50%)	900
Fair Value Mkt Cap	17,480
No. of Shares (mn)	15.4
Fair value/share (Rs)	1,135

Source: Company, Centrum Research Estimates

Quarterly financials, operating metrics and key performance indicators

Exhibit 5: Quarterly Financials

Particulars (Rs mn)	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19
Net Sales	1,380	1,435	1,672	1,750	1,672	2,145	2,435	2,609
Other operating income	7	1	0	0	0	0	0	0
Total Income	1,387	1,435	1,672	1,750	1,672	2,145	2,435	2,609
(Accretion)/Decretion of stock	48	(4)	85	(209)	62	78	22	(34)
Cost of Raw Materials consumed	897	962	1,025	1,263	1,010	1,292	1,441	1,744
Staff Cost	97	150	114	98	106	101	113	102
Other Operational expenses	175	220	189	212	150	193	244	196
Operating Profit (Core EBITDA)	169	108	258	386	344	481	616	603
Depreciation	33	32	32	32	31	31	30	29
EBIT	137	75	226	354	313	450	586	574
Interest	6	9	5	5	1	23	3	3
Other Revenue/Income	93	86	96	103	95	117	117	119
Other Exceptional Items	0	0	0	0	0	0	0	0
Profit Before Tax	224	153	318	452	407	543	700	690
Tax	63	43	106	147	131	183	233	234
Tax rate (%)	28.2	28.1	33.2	32.4	32.1	33.8	33.3	34.0
Profit After Tax	161	110	212	306	276	360	467	456
Growth (%)								
Net Sales	(8.4)	3.4	19.1	62.6	21.1	49.5	45.7	56.1
EBITDA	1,265.3	362.2	75.1	373.6	103.2	346.7	138.8	75.1
Adj. PAT	182.2	109.4	65.4	190.3	71.9	228.2	120.2	65.0
Margin (%)								
EBITDA	12.2	7.5	15.4	22.1	20.6	22.4	25.3	23.1
EBIT	9.9	5.2	13.5	20.2	18.7	21.0	24.1	22.0
PAT (reported bef minority interest)	11.6	7.6	12.7	17.5	16.5	16.8	19.2	17.5
Key Drivers								
Sponge Iron Sales (kt)	108.5	97.9	101.9	98.5	92.0	115.0	108.0	115.0
Net Sales realizations - Sponge Iron (Rs/t)	11,500	13,470	15,152	16,282	16,895	17,330	21,263	21,384
EBITDA/t (Rs)	1,560	1,100	2,530	3,919	3,739	4,183	5,703	5,239

Source: Company, Centrum Research

Exhibit 6: Key Performance Indicators

	FY15	FY16	FY17	FY18	FY19E	FY20E
Sponge Iron						
Sales Volumes (kt)	363	388	393	414	421	425
YoY %	(3.3)	6.9	1.3	5.3	1.8	1.0
Net Realizations (Rs/t)	19,805	15,046	14,345	18,011	19,500	18,500
YoY%	3.5	(24.0)	(4.7)	25.6	8.3	(5.1)
Power						
Sales Volumes (mn units)	121	113	132	144	137	139
YoY %	(13.8)	(6.7)	16.8	9.1	(4.7)	1.1
Realizations (Rs/unit)	3.8	4.2	3.8	3.8	3.7	3.7
YoY%	19.5	11.2	(10.5)	1.5	(3.9)	0.0

Source: Company, Centrum Research Estimates

Financials

Exhibit 7: Income Statement

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Revenues	5,735	5,573	8,002	8,712	8,376
Materials cost	4,269	3,729	4,958	5,480	5,097
% of revenues	74.4	66.9	62.0	62.9	60.9
Employee cost	340	463	418	460	506
% of revenues	5.9	8.3	5.2	5.3	6.0
Others	887	764	798	842	850
% of revenues	15.5	13.7	10.0	9.7	10.1
EBITDA	240	616	1,827	1,931	1,923
EBITDA margin (%)	4.2	11.1	22.8	22.2	23.0
Depreciation & Amortisation	129	128	123	119	127
EBIT	111	489	1,704	1,812	1,796
Interest expenses	54	24	32	25	25
PBT from operations	57	464	1,671	1,787	1,771
Other income	377	371	431	585	701
PBT	434	835	2,102	2,372	2,472
Taxes	115	247	693	783	816
Effective tax rate (%)	26.4	29.6	33.0	33.0	33.0
Adjusted PAT	319	588	1,409	1,589	1,656

Source: Company, Centrum Research Estimates

Exhibit 8: Key Ratios

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Growth Ratio (%)					
Revenue	(27.4)	(2.8)	43.6	8.9	(3.9)
EBITDA	(75.9)	157.3	196.4	5.7	(0.4)
Adjusted PAT	(65.3)	84.1	139.7	12.8	4.2
Margin Ratios (%)					
EBITDA	4.2	11.1	22.8	22.2	23.0
PBT from operations	1.0	8.3	20.9	20.5	21.1
Adjusted PAT	5.6	10.5	17.6	18.2	19.8
Return Ratios (%)					
ROE	3.9	7.0	15.2	15.0	13.8
ROCE	4.2	6.8	14.2	14.0	12.9
ROIC	3.6	11.7	25.1	27.5	27.6
Turnover Ratios (days)					
Gross block turnover ratio (x)	3.6	3.3	4.6	4.7	4.3
Debtors	19	23	27	25	25
Inventory	21	32	38	35	35
Creditors	26	34	31	30	30
Cash conversion cycle	13	21	35	30	30
Solvency Ratio (x)					
Net debt-equity	(0.8)	(0.7)	(0.6)	(0.6)	(0.7)
Debt-equity	0.0	0.0	0.0	0.0	0.0
Interest coverage ratio	0.5	0.0	0.0	0.0	0.0
Gross debt/EBITDA	0.0	0.0	0.0	0.0	0.0
Current Ratio	4.6	4.5	3.6	4.0	4.8
Per share Ratios (Rs)					
Adjusted EPS	20.7	38.2	91.5	103.2	107.5
BVPS	536.4	561.6	640.6	732.1	828.0
CEPS	29.1	46.5	99.5	110.9	115.7
DPS	10.0	11.0	20.0	10.0	10.0
Dividend payout %	48.2	28.8	21.9	9.7	9.3
Valuation (x)*					
P/E (adjusted)	22.7	15.7	10.6	9.4	9.0
P/BV	0.9	1.1	1.5	1.3	1.2
EV/EBITDA	4.3	5.4	5.2	4.1	3.3
Dividend yield %	2.1	1.8	2.1	1.0	1.0
5 Yr Avg AOCF/EV yield %	58.2	15.5	4.1	5.9	11.6

Source: Company, Centrum Research Estimates; * All ratios based on average mcap for year

Exhibit 9: Balance Sheet

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Equity Share Capital	154	154	154	154	154
Reserves & surplus	8,106	8,495	9,711	11,121	12,597
Shareholders' fund	8,260	8,649	9,865	11,275	12,751
Def tax liab. (net)	217	191	180	180	180
Total Liabilities	8,478	8,840	10,045	11,454	12,932
Gross Block	1,686	1,722	1,782	1,902	2,022
Less: Acc. Depreciation	49	175	292	411	537
Net Block	1,637	1,547	1,490	1,491	1,485
Capital WIP	92	56	58	88	118
Net Fixed Assets	1,730	1,603	1,548	1,579	1,603
Investments	2,854	2,634	1,997	1,997	1,997
Inventories	324	491	841	835	803
Sundry debtors	294	358	588	597	574
Cash	2,521	3,068	4,216	5,754	7,289
Loans & Advances	2,113	2,232	2,790	3,008	2,891
Other assets	39	73	163	72	69
Total Current Asset	5,291	6,222	8,598	10,265	11,626
Trade payables	407	525	669	716	688
Other current Liab.	424	488	798	764	734
Provisions	565	606	631	907	872
Net Current Assets	3,895	4,603	6,500	7,878	9,331
Total Assets	8,478	8,840	10,045	11,454	12,932

Source: Company, Centrum Research Estimates

Exhibit 10: Cash Flow

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Operating profit bef WC	257	631	1,852	1,931	1,923
Changes in working capital	638	(252)	(947)	159	82
Cash flow from operations	771	195	411	1,307	1,189
Adj. OCF (OCF - Interest)	717	170	378	1,282	1,164
Net Capex	172	38	68	150	150
Adj. FCF	545	132	310	1,132	1,014
Cash flow from investments	(584)	536	(2,131)	435	551
Cash flow from financing	(183)	(185)	(202)	(205)	(205)
Net change in cash	3	546	(1,922)	1,537	1,535

Source: Company, Centrum Research Estimates

Appendix A

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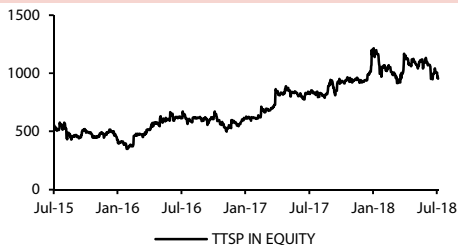
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Tata Sponge price chart



Source: Bloomberg, Centrum Research

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		Tata Sponge
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10	Whether the Research Analyst has been engaged in market making activity of the subject company.	No

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Rating	Market cap < Rs20bn	Market cap > Rs20bn but < 100bn	Market cap > Rs100bn
Buy	Upside > 20%	Upside > 15%	Upside > 10%
Hold	Upside between -20% to +20%	Upside between -15% to +15%	Upside between -10% to +10%
Sell	Downside > 20%	Downside > 15%	Downside > 10%

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