Investment Research | 14th May '07

PPFAS

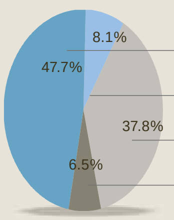
Tata Metaliks Limited

BUY | CMP Rs. 117.0 | Target Rs. 190.0

Stock Codes

Bloomberg	: TML.IN
Reuters	: TMET.BO
BSE Code	: 513434
NSE Code	: TATAMETALI
BSE Group	: B1

Share Holdings
(as on 31st Mar '07)



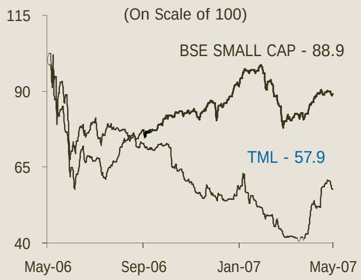
Stock Data

Benchmark	: BSE SM CAP
52 W High Rs.	: 213.9
52 W Low Rs.	: 80.0
Mkt Cap in Rs. Mn.	: 2958.7
Face Value	: Rs. 10.0

Absolute Return

%	1m	3m	6m
TML	23.59	0.09	-20.54
BSE SMCAP	4.43	-3.19	8.16

Price Comparison



Analyst: Abul Fateh
Ph: 2284 6555 | abul@ppfas.com
ppfas@bloomberg.net

TML is the largest foundry grade pig iron producer in India. The company provides its customers with critical support across their entire business cycle – raw material process and end product, helping them emerge as their business partners. It emerged as a one stop shop for raw materials and end products for a large number of customers without adequate bargaining capacity across a multitude of vendors.

Particulars (Rs Mn)	FY06	FY07	FY08E	FY09E
Net Sales	4,415.77	6,811.50	8,333.61	8,726.98
EBIDTA	802.87	693.10	1,402.43	1,465.62
Operating Margin (%)	17.21	7.95	14.83	14.79
PAT	459.08	295.10	747.13	808.36
EPS (Rs)	18.15	11.67	28.93	30.42
P/E (x)	6.44	10.03	4.04	3.85
Market Cap/Sales (x)	0.67	0.43	0.36	0.34
EV/EBIDTA (x)	4.77	5.96E	2.91	2.38
ROCE (%)	32.38	21.43	39.43	40.66
RONW (%)	35.09	20.63	36.78	29.76
Dividend Yield (%)	5.13	5.13	5.13	5.13

Investment Rationale

During 2005-2006 TML has doubled its capacity to 650,000 TPA (tonnes per annum) by the acquisition of the pig iron plant of Usha Ispat Ltd at Redi in Maharashtra. The Plant consists of Three Mini Blast Furnaces taking the total Blast Furnaces of the company to 5. The First Furnace started operations on 10th February 2006. The second started operations in April 2006. The third furnace is expected to start by the end of Q1 FY08.

TML sources iron-ore on long term contract basis and about 40% of the coke requirements is met from its captive coke ovens and the remaining is imported.

The earnings growth would be on the back of strong volume growth. The stock trades at an attractive valuation of 4.04x FY08(E) and 3.85x FY09 (E) earnings. The gearing of the company is low which would protect the margins of the company in the rising interest cost scenario.

TML has paid regular dividends since FY01. The company paid dividends of Rs 6.00 each in FY05 and FY06 and declared a dividend of Rs 6.00 again in FY07 (Ex Dividend Date 06 June, 2007). We expect the company to pay similar dividends in the coming years on the back of strong earnings growth led by strong demand for the foundry grade pig iron.

The healthy cash flows of the company would enable further inorganic and organic growth of the company.

The company is getting into the value added product through a joint venture with Kubota Corporation of Japan to manufacture ductile iron (DI) pipes that are widely used in water supply which would help in reducing the volatility in earnings of the company.

Valuations

On one year forward PE basis TML has traded at an average multiple of 6.5x in the past 12 months which we believe that the stock would at least trade at considering the fact that the earnings would grow by 150% from FY07 to FY08. The mean one year forward PE multiple since April 2002 has been 7.6x. The stock is currently trading at a PE multiple of 4.04x and 3.85x on its estimated earnings for FY08 and FY09 respectively.

On one year forward EV/EBIDTA basis the stock has traded at an average multiple of 5.05x in the past 12 months. The stock is currently trading at an EV/EBIDTA multiple of 2.91x and 2.38x on its estimated EBIDTA for FY08 and FY09 respectively.

In the past twelve months TML has traded in the range of 0.7x-1.1x on market cap/sales parameter. The stock is currently trading at 0.36x and 0.34x on its estimated sales for FY08 and FY09 respectively.

ROCE is expected to improve considerably to around 40% which reflects the strong fundamentals of the business of the company. We expect an appreciation of 62% in the stock price from the current levels by FY08. A dividend yield of around 5.13 % also makes the stock a good buy at these levels.

Recommendation

We recommend a buy on the stock with FY08 target of Rs190 (a decent 62% appreciation from the current price of Rs 117). The downside in the stock seems to be very limited as the stock is already trading at very low valuation multiples. At our one year target price the stock would trade at 6.5x P/E, 4.2x EV/EBIDTA and 0.6x Market Cap/Sales on FY08 estimates.

Concerns

The Pig Iron industry is associated with risks in the volatility of the finished goods prices as well as the rise in the raw material prices. TML has taken the initiative to produce customised products which now form almost 30% of the total sales of the company, this would reduce the volatility in the earnings of TML. TML sources the raw materials like coke and iron ore on long term contract basis which. Around 40 % of the coke requirements are met by captive coke ovens which helps the TML to reduce the volatility in earnings.

Company Overview

TML, promoted by Tata Steel Ltd. and assisted by The West Bengal Industrial Development Corporation, was set up together with Tata Korf Engineering Services as the technology consultant and KTS, Brazil as the technology supplier. The company was incorporated on 10th October 1990 as Tata Korf Metal, West Bengal and the name was changed to Tata Metaliks on 16th January 1992.The company's Promoters and its subsidiaries hold 47.64% stake in company.

Tata Metaliks is engaged in the business of manufacturing and selling Foundry Grade pig iron. Its plant, located at Kharagpur in the state of West Bengal and Redi in Maharashtra , consists of five Mini Blast Furnaces and related facilities including Captive Power Plants. The company commenced production in 1994 with an installed capacity of 90,000 tonnes of hot metal per annum. Since, then the company with the help of regular technological upgradation, increased its installed capacity with the same Mini Blast Furnace (MBF). In the year 2000, the capacity was increased to 140000 tonnes of hot metal per annum and to 163000 tonnes in 2004. In 2005 company has successfully installed its second MBF of similar capacity i.e 162000 tonnes of hot metal per annum, taking the total capacity of the Company to 325000 tonnes of hot metal per annum. At present the company has a production capacity of 650,000 TPA of Pig Iron.

The company programmed the first relining of its Blast Furnace during the year 2000-01 with an estimated cost of the project Rs. 3.43 crores, which was financed from internal accurals. The campaign life of the Blast Furnace has exceeded six years, the highest ever achieved by any Korf Blast Furnace in the country.

The company has an agreement with Tata Korf Engineering Services for technical know-how and consultancy. It installed a power plant using blast furnace gas, to reduce the cost of power.

In June 1999, the Total Productive Maintenance movement, was launched in the company with the objective of improving Overall Equipment Effectiveness and thereby improving machine availability, performance and product quality levels by minimising losses.

The company is certified with ISO 9001-2000 (Quality Management), ISO 14001 (environment management) and OHSAS 18001 (operational activity), OHSAS 18001 : 1999 (Occupational Health and Safety Management System). The company is awarded with Golden Peacock Awards, Environment Management Award 2003, National Quality Award, West Bengal Pollution Control Board Environment Excellence Award 2002, CII-HR Award for the years 2002,2003,2004, Udyog Ratan Award from the Institute of Economic Studies, New Delhi for the years 2003 and 2004, Greentech Environment Award and Pollution Control Award by the Government of West Bengal for the year 2003, Active Promotion Award in Tata Business Excellence Model for the year 2003, Highest Delta Award in Tata Business Excellence Model for the year 2003.During 2005-2006, the Company acquired the pig iron plant of Usha Ispat Ltd at Redi in Maharashtra.

Business Overview

TML manufactures low sulphur and low phosphorus grades pig iron suitable for the manufacture of ductile grades of castings, and it is the only supplier of such grades in the eastern India. The pig iron manufactured by TML is ideally suited for specialised applications such as pressure tight precision casting, automobile engine blocks, crankshafts, gears, rolling mill rolls, motor and generator housings, railway and machine tools. TML also manufactures a wide range of customised pig iron grades which constitute about 30% of total sales. These customised grades are value added for the foundries as they need not do further adjustments in the chemical compositions. The customised grades create customer loyalty which reduces the volatility in realisations. The company covers almost all the foundry belts in India as well as out-locations to Bangladesh, Thailand, Malaysia, Indonesia, Vietnam, Taiwan, Korea, Japan, UAE, Egypt, Turkey, Spain, Italy and Greece.

TML is now looking to become a one-stop-shop for the foundry owners by providing them solutions with regard to material and equipment selection, revamping and capital updates for foundries, equipment improvements, selection of equipment and material suppliers through in-house database. TML has already started its first Helpdesk at Howrah in Kolkata which offers the entire range of services, handle quality related issues on pig iron. TML is foraying into providing marketing support to its customers in selling foundry products. Foundry industry is highly fragmented and has large idle capacities, TML would help these customers to achieve faster ramp-up of production.

Acquisition of Usha Ispat Limited's Assets

During the FY06, TML acquired the immovable and movable assets of Usha Ispat Ltd, located at Redi in Maharashtra, through Stressed Assets Stabilisation Fund (IDBI) for a consideration of Rs 115 Crores and free of liabilities. The acquisition was funded by a combination of debt (Rs 80 Cr) and internal accruals. This acquisition has added another 325,000 TPA pig iron capacity taking the total capacity to 650,000 TPA.

New Projects

110,000 TPA of DI pipes at Kharagpur

Tata Metaliks has forged a Rs 150-crore joint venture with Kubota Corporation of Japan to manufacture ductile iron (DI) pipes that are widely used in water supply. The project cost will be funded through an equal mix of debt and equity. Of the equity portion of Rs 75 crore, Tata Metaliks will pick up 51% and Kubota Corporation 44%, while the balance 5% will be held by Metal One of Japan. The joint venture was approved by the board of Tata Metaliks at its meeting on Thursday. The new company will be a subsidiary of Tata Metaliks. The manufacturing unit will come up on 40 acres in Kharagpur, West Bengal, adjacent to Tata Metaliks' existing facility which produces foundry grade pig iron. The new company will manufacture 1.1 lakh tonnes of DI pipes per annum at Kharagpur. Kubota Corp is a world leader in DI pipes. The new venture will use liquid pig iron from Tata Metaliks and is likely to be operational by the end of 2009.

The domestic market for these DI pipes is pegged at around five lakh tonnes but it is growing at around 20% every year. Other Indian manufacturers of these pipes include Electrosteel Castings and Saw Pipes. While cast iron pipes are pre-dominantly used in water transmission, a growing awareness about better quality and longevity of DI pipes has led to its growth in recent years.

500,000 TPA steel billets making plant

TML has planned a capacity of 500,000 TPA steel billet making plant as a step towards forward integration in order to de-risk its business. However, the company's plan is yet to see any progress due to delay in getting land from the state government. The land requirement is about 350 acres.

We have not factored the benefits of any of the two projects in our valuations.

Pig Iron Industry

Pig iron is raw iron, the immediate product of smelting iron ore with coke and limestone in a blast furnace. It is tapped in the liquid form called Hot Metal, which is an intermediate product used for making steel and other applications. Pig iron in solid form, widely known as Merchant Pig Iron, is an immediate product and has wide range of applications such as Steel making and manufacture of castings.
Pig Iron is mainly categorised into two major types:

a) 'Basic Grade' iron used for steel making

b) 'Foundry Grade' iron for making iron castings which finds applications in industrial and other sectors.

In the developed countries pig iron is also used as a scrap substitute in the charge - mix of Electric Arc Furnaces (EAFs).

Silicon content for foundry grade pig iron as per IS 224/78 ranges from 1.25 to 3.15 percent whereas for making steel the percentage of Silicon has to be preferably between less than 0.5 to 1.5 per cent.

Total global demand of foundry grade pig iron is about 80 million tonnes per annum (MTPA) of which about 50% demand is met by recycling of old castings leaving the demand for primary foundry grade pig iron at 40 MTPA. The global trade is about 13 MTPA. The leading pig iron exporters are:

Exporting Country	Exports (MTPA)	Grade	Major Destination
Brazil	5.80	Basic/Foundry	USA, Taiwan
Russia	4.50	Basic	Europe
China	1.10	Basic/Foundry	S-E Asia
Ukraine	1.00	Basic	Europe
India	0.60	Basic/Foundry	S-E Asia, Middle East

Geographical Distribution of Pig Iron Market

	Market Size (TPA)	TML Sales Distribution (%)
Northern Region	700,000	35.00
Southern Region	600,000	15.00
Western Region	600,000	15.00
Eastern Region	300,000	35.00
Steel Producers	800,000	-

Pig Iron Demand supply forecast

	Demand	Production	Surplus/Deficit
2006-07	3,859,000	3,861,000	2,000
2007-08	4,103,000	4,116,000	13,000
2008-09	4,364,000	4,385,000	21,000
2009-10	4,604,000	4,625,000	21,000
2010-11	4,934,000	4,935,000	1,000

Pig Iron: Growth-rate Forecasts

	2006-07			2007-11		
(%)	Share	Growth Rate	Weighted Growth	Share	Growth Rate	Weighted Growth
Cast Iron Castings	70.0	8.3	5.8	75.0	8.3	6.2
Mini Steel Plants	30.0	9.0	2.7	25.0	0.5	0.1
Total	100.0		8.5	100.0		6.3

Source: Industry

Cast Iron Castings: Growth-rate Forecasts

	2006-07			2007-11	
(%)	Share	Growth Rate	Weighted Growth	Growth Rate	Weighted Growth
Construction & Sanitation	12.6	8.0	1.0	8.0	1.0
Steel Plants	11.2	8.5	1.0	8.0	0.9
Engineering, Govt Departments	26.2	8.0	2.1	8.0	2.1
Railways	7.6	5.0	0.4	5.0	0.4
Automobiles	23.8	12.0	2.9	12.0	2.9
Spun Pipes	12.4	6.0	0.7	6.0	0.7
Post & Telephone	4.5	5.0	0.2	5.0	0.2
Defence	1.7	5.0	0.1	5.0	0.1
Total	100.0		8.3		8.3

Source: Industry and CRISINFAC

Pig Iron production forecasts

(Lakh Tons)	2006-07	2007-08	2008-09	2009-10	2010-11
Main Producers	6.60	6.88	7.19	7.45	7.60
Indian Iron&Steel Co	1.84	1.89	1.96	1.99	2.05
SAIL	1.98	2.16	2.34	2.52	2.55
RINL	2.78	2.84	2.89	2.94	3.00
Secondary Producers	32.01	34.28	36.66	38.79	41.75
Neelachal ispat Nigam Ltd	5.50	6.60	4.00	4.20	4.40
Jayaswals Neco Ltd	3.26	3.00	3.00	3.00	3.00
Tata Metaliks	4.35	5.65	5.65	5.65	5.65
NMDC Ltd	1.50	1.65	1.80	2.00	2.00
Jindal Steel& Power Ltd	1.75	1.75	2.00	2.13	2.13
Jindal Saw Pipes Ltd	1.50	1.60	1.78	1.85	2.00
Kirloskar Ferrous Industries Ltd	1.80	2.03	2.04	2.04	2.05
Kudremukh Iron & Steel Co	1.59	1.59	1.59	1.70	1.75
Visa Industries ltd	1.01	1.35	1.50	1.80	1.90
Sesa industries Ltd	1.87	1.98	1.98	1.98	2.00
Sathavahana Ispat Ltd	1.97	1.97	1.97	2.00	2.00
Others	6.25	6.25	10.00	10.50	12.30
Total	77.56	83.47	88.35	92.54	98.13

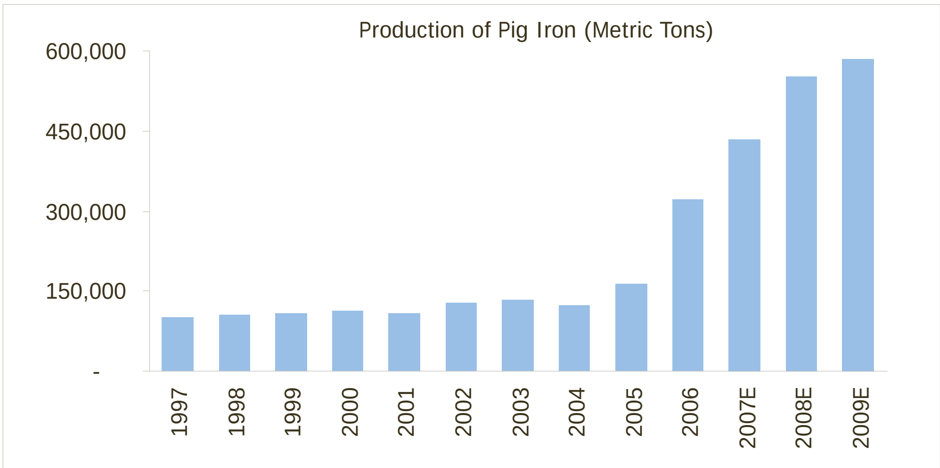
Source: Industry and CRISINFAC

Outlook

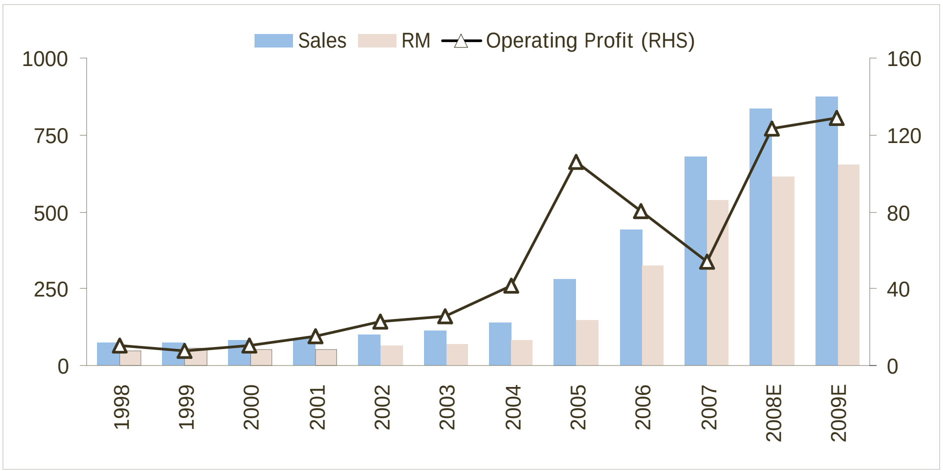
Driven by construction and sanitation, automobile, capital goods and spun pipes, the buoyancy in the castings industry boosts the demand for pig iron. Castings industry is expected to grow at a CAGR of 8.3% . A steady growth in the castings industry would result in the stable growth for pig iron keeping the realisations stable.

Financial Performance

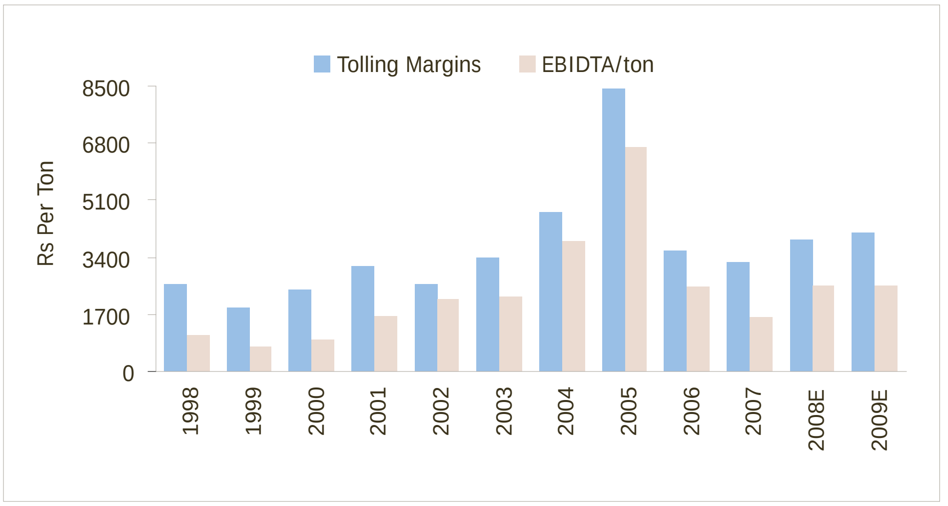
TML has poised a consistent growth in the production of Pig Iron since 1997. A major surge in the production had been seen post Redi acquisition. We expect TML to produce 5.5 Lakh tons of Pig Iron in FY08. This would boost the sales of the company from Rs 6811.50 Million in FY07 to 8333.61 in FY08. The EPS of the company is expected to increase from Rs 11.67 in FY07 to Rs 29.54 in FY08. The EPS slipped from Rs 18.15 in FY06 to Rs 11.67 in FY07 due to a one time expense of Rs 170 Million on account of the relining of one the blast furnaces at Kharagpur.



The sales of the company have been on an increasing trend since 1998. The sales are expected to increase from Rs 6818.5 Million in FY07 to Rs 8333.6 Million in FY08. The Operating Profit of the company has increased continuously from FY1998 to FY2005. FY2005 saw a sharp increase in the realisations of Pig Iron due to which the profit of the company increased significantly in FY2005. Due to a correction in the prices of Pig Iron the profit came back to the normal levels in FY06. The profit came down in FY07 due to a one time cost on account of the relining of a blast furnace.



The tolling margins and EBIDTA per ton of the company increased consistently between FY02 and FY05. However the tolling margins fell down considerably in FY06 due to a fall in realisations and increasing raw material prices (coke and iron ore). FY07 again saw a small dip in the margins due to one time cost of Rs 170 million on account of relining of one of the blast furnaces. The Coke prices have stabilised around $230 per ton and we expect the margins of the company to improve in FY08.



Income Statement (Rs Mn)				
Year End 31 March	FY06	FY07	FY08E	FY09E
Net Sales	4415.8	6811.5	8333.6	8727.0
Growth (%)	56.1	54.3	22.3	4.7
Total Expenditure	3655.9	6270.1	7097.8	7435.9
Raw Materials	3262.0	5386.9	6157.0	6524.5
% of sales	73.9	79.1	73.9	74.8
Operating Profit	759.9	541.4	1235.8	1291.1
Other Income	43.0	151.7	166.7	174.5
EBIDTA	802.9	693.1	1402.4	1465.6
Depriciation	71.7	129.5	145.0	150.0
EBIT	731.2	563.6	1257.4	1315.6
Interest	43.3	141.9	132.0	132.0
PBT	687.9	421.7	1125.4	1183.6
Tax	228.8	126.6	393.9	414.3
PAT	459.1	295.1	731.5	769.4
EPS (Rs)	18.2	11.7	28.9	30.4
Growth (%)	-28.3	-35.7	147.9	5.2
Dividend per share (Rs)	6.0	6.0	6.0	6.0

Ratios				
	FY06	FY07E	FY08E	FY09E
Profitability				
Operating Margin (%)	17.21	7.95	14.83	14.79
NPM (%)	10.40	4.33	8.78	8.82
RONW (%)	35.09	20.63	36.78	29.76
ROCE (%)	32.38	21.43	39.43	40.66
Leverage				
Debt/Equity	0.73	0.84	0.60	0.25
Interest Coverage Ratio	16.88	3.97	9.53	9.97
Valuation				
EV/EBIDTA (x)	4.77	5.94	2.91	2.38
EV/Sales (x)	0.87	0.60	0.49	0.40
Market Cap/Sales (x)	0.67	0.43	0.36	0.34
P/E (x)	6.44	10.03	4.04	3.85
Book Value/Share (Rs)	51.74	56.57	78.65	102.24
P/BV (x)	2.26	2.07	1.49	1.14
Dividend Yield (%)	5.13	5.13	5.13	5.13
Growth Rates (%)				
Net Sales (%)	56.06	54.25	22.35	4.72
EBIDTA (%)	-24.31	-13.67	102.34	4.51
Net Profit (%)	-28.26	-35.72	147.89	5.17
EPS (%)	-28.26	-35.72	147.89	5.17
Efficiency				
Raw Mat(% of net sales)	73.87	79.09	73.88	74.76
Employee Cost (% of net sales)	2.24	2.25	2.50	2.50
Current Ratio	1.07	1.19	1.17	1.21

Balance Sheet (Rs Mn)				
YE 31 March (Rs Mn)	FY06	FY07E	FY08E	FY09E
Share Capital	252.9	252.9	252.9	252.9
Reserve & Surplus	1055.5	1177.6	1736.1	2332.5
Total Shareholder Funds	1308.4	1430.5	1989.0	2585.3
Debt Funds	950.0	1200.0	1200.0	650.0
Deferred Tax Liability	153.7	153.7	153.7	153.7
Total Liabilities	2412.1	2784.2	3342.7	3389.0
Fixed Assets	1905.3	2213.1	2318.1	2268.1
Capital work in progress	362.8	150.0	150.0	150.0
Investments	40.0	40.0	440.0	440.0
Current Assets	1612.9	2438.5	2920.1	3119.8
Inventory	1232.2	1824.2	2125.6	2252.2
Sundry Debtors	245.8	459.8	571.4	598.4
Loans&Advances	53.3	114.9	142.9	149.6
Cash&Bank Balances	81.6	39.6	80.2	119.6
Current Liabilities & Provisions	1508.9	2057.4	2485.5	2588.9
Sundry Creditors	1043.7	1532.6	1904.8	1994.7
Advances Recd From Customers	149.6	153.3	190.5	199.5
Other Current Liabilities	20.7	76.6	95.2	99.7
Provisions	294.9	294.9	294.9	294.9
Net Current Assets	104.0	381.1	434.6	530.9
Total Assets	2412.1	2784.2	3342.7	3389.0

Cash Flow Statement (Rs Mn)				
	FY06	FY07E	FY08E	FY09E
Cash Flow From Operating activities				
PBT	687.9	421.7	1125.4	1183.6
Depriciation	71.7	129.5	145.0	150.0
Other Op CF	7.7	0.0	0.0	0.0
Inc/Dec In WC				
Inc/Dec In Trade & Other Receivables	-180.2	-275.6	-139.6	-33.7
Inc/Dec In Inventories	-524.2	-591.9	-301.4	-126.6
Inc/Dec In Payables & Other Liab	763.6	548.5	428.1	103.4
Net Change In WC	59.2	-319.1	-12.9	-56.9
Tax Paid	-156.4	-126.6	-393.9	-414.3
Net Cash From Op Activities	670.0	105.5	863.6	862.4
Cash Flow From Investing activities				
Capex	-1277.1	-224.5	-250.0	-100.0
Increase/Decrease in Investments	0.0	0.0	-400.0	0.0
Net Cash Used In Investing Activities	-1277.1	-224.5	-650.0	-100.0
Cash Flow From financing activities				
Debt Raised/Repayed	750.0	250.0	0.0	-550.0
Dividends Paid	-146.5	-151.7	-151.7	-151.7
Tax On dividends	-21.3	-21.3	-21.3	-21.3
Net Cash From Financing Activities	582.3	77.0	-173.0	-723.0
Net Cash Flow	-24.8	-42.0	40.6	39.4
Previous Cash Balance	106.2	81.6	39.6	80.2
Net Cash & Cash Equivalents	81.6	39.6	80.2	119.6

Parag Parikh Financial Advisory Services Ltd
130/132,Great Western Building, 1st Floor, S.B.Marg, Near Lion Gate, Fort, Mumbai - 400 023.
Tel : 91-22-2284 6555 Fax : 91-22-2284 6553, e-mail : research-call@ppfas.com | Investment Boutique: Shiv Shakti, Gr.Floor, N.S.Rd. No. 10, Opp. Haveli, Juhu Scheme, Mumbai - 400 049, Tel :91-22- 2623 6555 Fax : 91-22-2623 6553, e-mail : ib@ppfas.com