Tata Chemicals Ltd.

EQUITY REPORT

November 21st, 2014

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Tata Chemicals Ltd, founded in 1939, is a part of +USD 100 bn Tata group. The company is engaged in manufacturing of products in the Industrial Chemicals, Agri business and Consumer Products space. Tata Chemicals is a pioneer and a market leader in India's branded Iodised salt segment. The company is also a leading manufacturer of urea and phosphatic fertilisers and has a strong position in crop protection business. Currently, Tata Chemicals is the world's second largest producer of soda ash with manufacturing facilities in Asia, Europe, Africa and North America.

Investment Rationale

Robust performance in Q2FY14: Tata Chemicals showcased a growth of 10.6% YoY in its consolidated total income at ₹48,031.5 mn in Q2FY15 supported by better volumes from the North American business and higher revenue from its fertilisers business, which posted a 66.3% YoY increase in revenue at ₹19,759.5 mn in Q2FY15. EBITDA margin grew marginally by 40bps YoY to 13.6% in Q2FY15 as against 13.2% in Q2FY14 due to a 10.1% YoY increase in operating expenses. Further, the company reported a massive rise of 91.2% in its consolidated net profit at ₹2,570.1 mn, during the quarter.

We remain positive for FY15 on the back of sustained growth in all of its business lines, long term earnings viability of the business post the restructuring of its UK and Kenya operations and benefits from the new urea policy. We estimate ~11.9% and ~13.3% YoY growth in revenue in FY15E and FY16E, respectively, while we expect the company to post a profit of ~₹4,211.7 mn in FY15E and the profit to further grow by ~68.8% in FY16E.

Full benefits of restructuring to be visible from FY16: The company has restructured operations at two of its plants, one in UK and the another in Kenya. Restructuring of operations in Kenya is almost complete and operations have started, showing early signs of improvement with full benefits of restructuring of both the UK and Kenya operations expected to be visible in FY16.

Focus on non-bulk agri business and consumer business to drive growth: The company aims at clocking revenues of ₹7.5 bn in FY15 from the non-bulk agri business and aims to increase the same to ₹10 bn in FY16. On the consumer business front, the company plans to drive growth for the pulses business by increasing store penetration. The management aims to increase presence of its pulses business from 55,000 retail points currently to 100,000 retail points by end of FY15 with an ultimate aim of increasing the presence to ~500,000 retail points in the long run. The company has launched a number of products in Q2FY15 thereby plugging the portfolio gaps.

Committed on reducing leverage in the medium term: The management continues to remain committed on reducing its debt-burden. The management has maintained its guidance of reduction in debt from ₹81 bn at the end of H1FY15 to ₹40 bn in the next 5 years by gradually paring down debt.

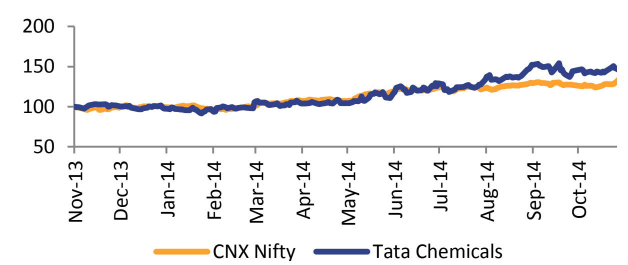
Market Data

Rating	**BUY**
CMP (₹)	425.7
Target (₹)	**512**
Potential Upside	~20%
Duration	Long Term
Face Value (₹)	10.0
52 week H/L (₹)	435.4/244.2
Adj. all time High (₹)	435.4
Decline from 52WH (%)	2.2
Rise from 52WL (%)	74.3
Beta	1.3
Mkt. Cap (₹bn)	108.4
Enterprise Value (₹bn)	181.2

Fiscal Year Ended

Y/E	FY13A	FY14A	FY15E	FY16E
Revenue (₹bn)	147.1	159.0	177.9	201.5
EBITDA (₹bn)	21.6	18.1	20.6	26.0
Net Profit (₹bn)	4.0	(10.3)	4.2	7.1
EPS (₹)	42.0	15.2	16.5	27.9
P/E (x)	10.1	27.9	25.7	15.3
P/BV (x)	1.7	1.9	1.9	1.8
EV/EBITDA (x)	7.6	10.0	9.0	7.1
ROCE (%)	14.6	9.8	10.5	12.5
ROE (%)	16.7	7.0	7.4	11.6

One year Price Chart



Shareholding Pattern	Sep'14	Jun'14	Diff.
Promoters	31.1	31.1	-
FII	21.8	21.9	(0.1)
DII	24.6	23.7	0.9
Others	22.5	23.3	(0.8)

Tata Chemicals Ltd - the world's second largest producer of soda ash

Tata Chemicals operates businesses in the Industrial Chemicals, Agri business and Consumer Products space.

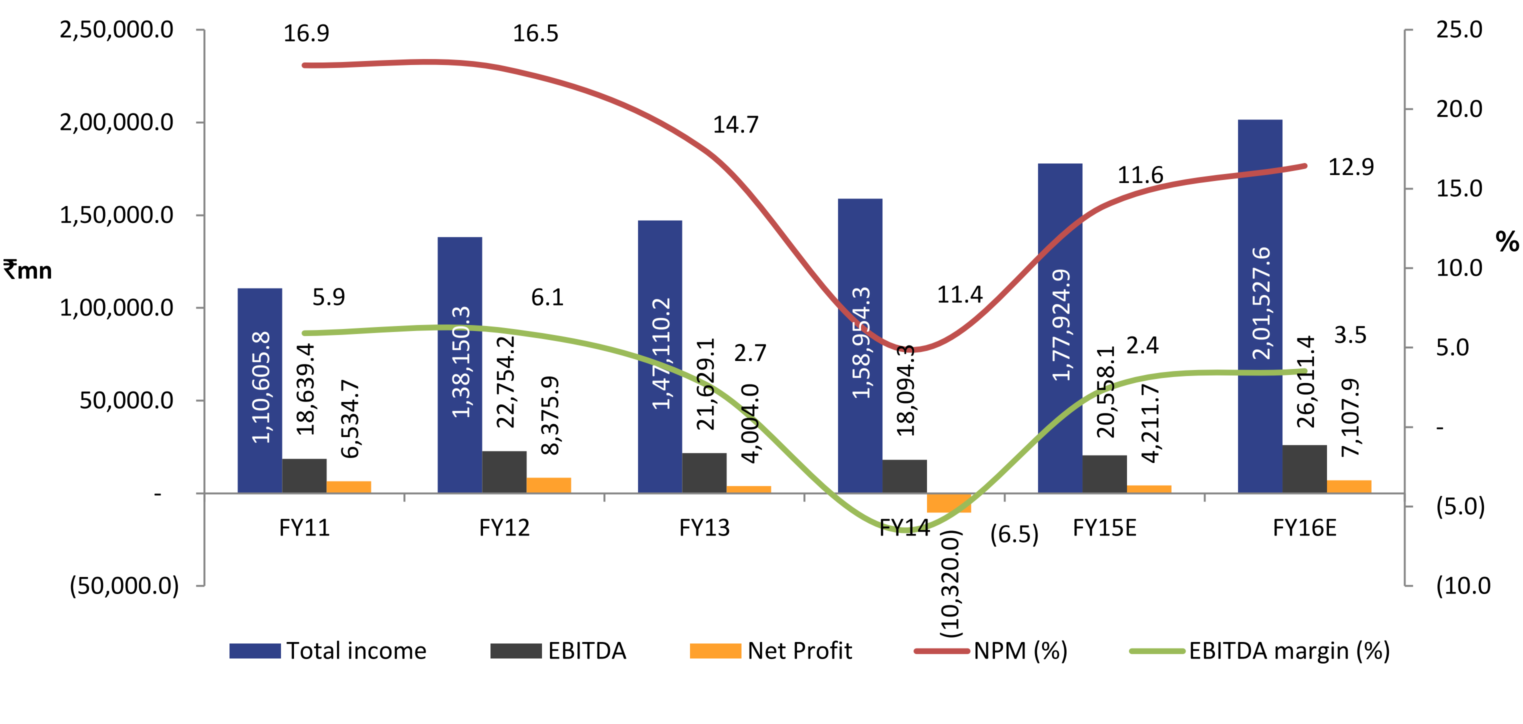
With a market share of ~69% (as in FY14), the company leads the national branded salt market with its premium brands, Tata Salt and I-Shakti Salt.

The company is the world's second largest soda ash manufacturer and the fourth largest manufacturer of sodium bicarbonate.

Established in 1939, Tate Chemicals Ltd is one of the well-known subsidiaries of the Tata Group. The company has interests in businesses that focus on LIFE, i.e. Living (household products), Industrial and Farm essentials (crop nutrition and protection). Tata Chemicals operates businesses in the Industrial Chemicals, Agri business and Consumer Products space. Tata Chemicals is the pioneer and market leader in India's branded Iodised salt segment. With a market share of ~69% (as in FY14), the company leads the national branded salt market with its premium brands, Tata Salt and I-Shakti Salt. With the introduction of an innovative, low-cost, nanotechnology-based water purifier, it is providing affordable, safe drinking water to the masses. The company is the world's second largest soda ash manufacturer and the fourth largest manufacturer of sodium bicarbonate. The company's industry essentials product range provides key ingredients to some of the world's largest manufacturers of glass, detergents and other industrial products. With its farm essentials portfolio the company has carved a niche in India as a crop nutrients provider. Tata Chemicals is a leading manufacturer of urea and phosphatic fertilisers and has a strong position in the crop protection business. Its rural retail Tata Kisan Sansar (TKS) network, agri-brand Paras and its subsidiaries, Rallis India Ltd (Rallis) and Metahelix Life Sciences Limited (Metahelix) are established leaders in the agri space. The company has world-class R&D capabilities in the emerging areas of nanotechnology and biotechnology.

The company has manufacturing capacities spanning across four continents, namely, Asia, Europe, Africa and North America with main subsidiaries, namely, Tata Chemicals Magadi (Africa), Tata Chemicals Europe, British Salt (UK) and Tata Chemicals North America. Other key subsidiaries include Rallies India Ltd and Indo Maroc Phosphore S.A. (IMACID). The company has also entered into a JV with Singapore's Temasek Life Sciences Laboratory (Joil) to develop jatropha seedlings to enable bio fuels capability.

Tata Chemicals' revenue is expected to grow at a CAGR of ~13% from FY14-FY16E



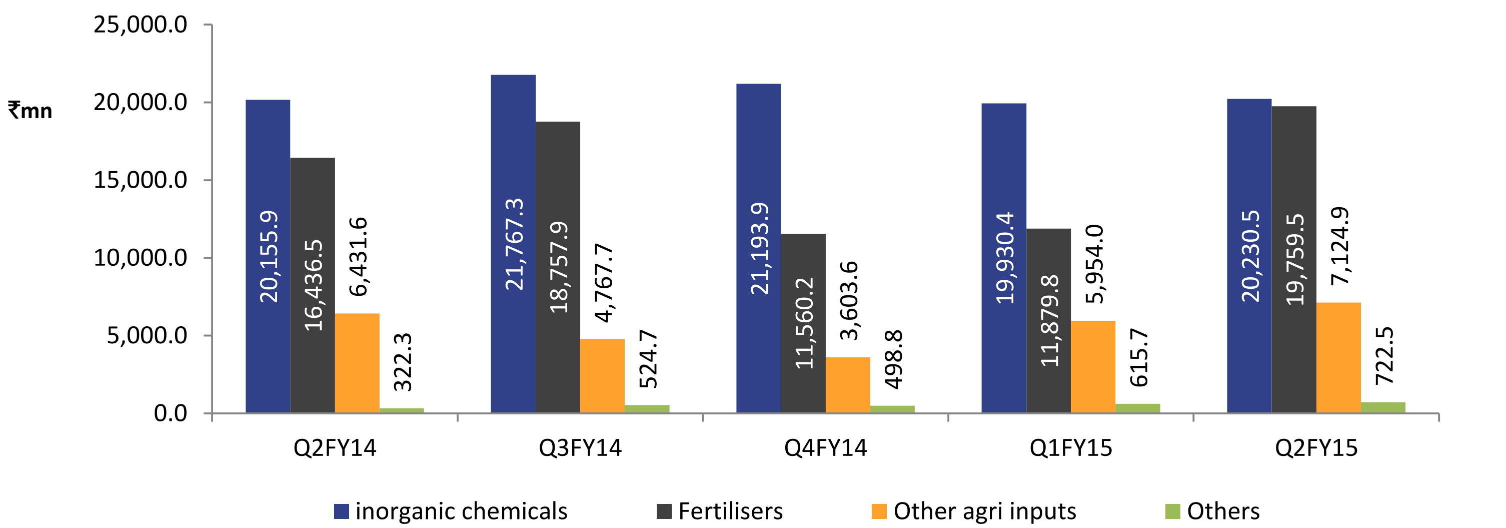
Healthy numbers in Q2FY15

The company's total income grew by 10.6% YoY in Q2FY15 on the back of better volumes from the company's North America based subsidiary, TCNA, and positive performance across all other business lines.

Revenue grew on the back of higher sales volumes from TCNA: Tata Chemicals' performance for Q2FY15 remained encouraging with a growth of 10.6% YoY in consolidated total income at ₹48,031.5 mn as against ₹43,439.7 mn in Q2FY14 driven by positive performance across all businesses. Better realizations at the company's North American subsidiary, Tata Chemicals North America (TCNA) also aid to the growth. Sales volume from TCNA grew sequentially by 6.2% and by 0.7% YoY to arrive at 602,000 tonnes in Q2FY15 and is expected to increase further in the medium term driven by tight demand supply situation. The increase will be visible once new contracts are negotiated at the beginning of CY15.

Growth in revenue was further augmented by higher revenue from Tata Chemicals' fertilisers business, (contributed ~41.7% YoY to the total revenue in Q2FY15), which grew by 66.3% YoY to ₹19,759.5 mn inQ2FY15 as against ₹16,436.5 mn in Q2FY14. Further, revenue from the other agri-inputs (contributed ~15% to the total revenue in Q2FY15) posted a growth of 19.7% YoY at ₹7,124.9 mn compared to ₹6,431.6 mn in Q2FY14. The total income could have grown further, but a flat growth in revenue from inorganic chemicals, which contributed a major part to the total revenue (~42.7%), somewhat capped the growth. The inorganic chemicals business reported a 1.5% YoY rise in revenue at ₹20,230.5 mn, during the quarter.

Tata Chemicals' fertilisers business posted a robust growth of 66.3% YoY in Q2FY15



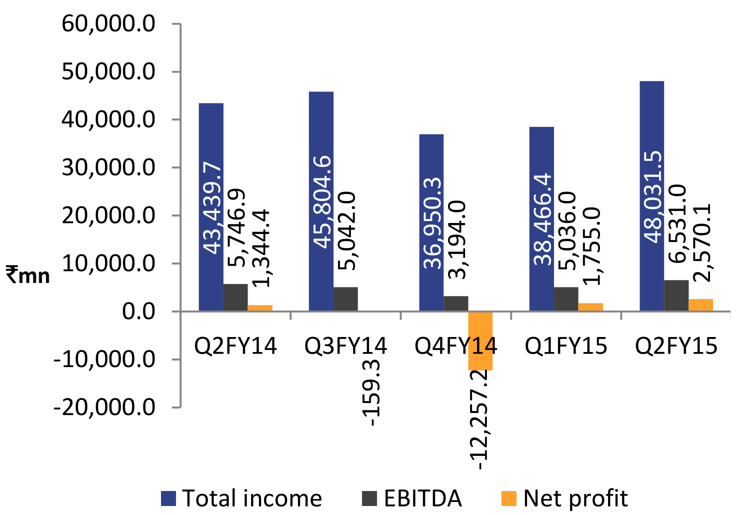
EBITDA margin grew just by 40bps YoY to 13.6% in Q2FY15, against 13.2% in Q2FY14, impacted by an increase in operating expenses by 10.1% YoY to ₹41,500.5 mn.

EBITDA margin expanded by 40bps YoY impacted by higher operating expenses: Tata Chemicals reported a 13.6% increase in its consolidated EBITDA at ₹6,531.0 mn in Q2FY15, as against ₹5,746.9 mn in Q2FY14. EBITDA margin, on the other hand, grew just by 40bps YoY to 13.6% in Q2FY15, against 13.2% in Q2FY14, impacted by an increase in operating expenses by 10.1% YoY to ₹41,500.5 mn in Q2FY15 compared to ₹37,692.8 mn in Q2FY14.

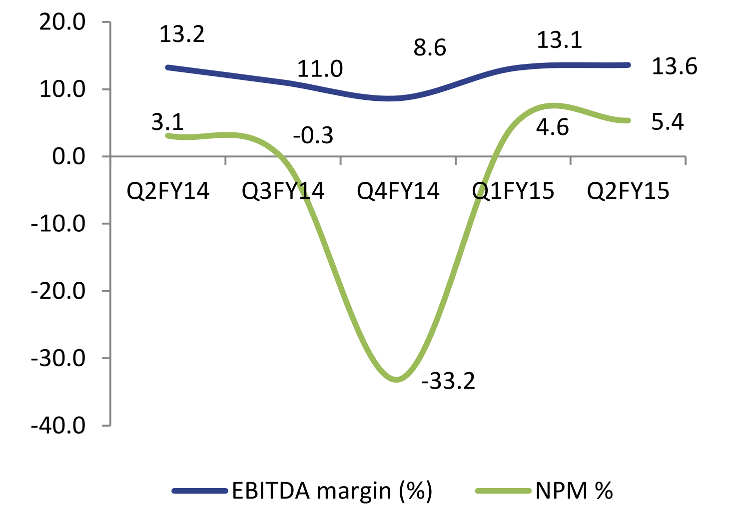
Net profit posted a growth of 91.2% YoY at ₹2,570.1 mn in Q2FY15 driven by a fall in interest and taxation charges.

Decline in interest and taxation led to a substantial rise in net profit: The company showcased a massive rise in consolidated net profit at ₹2,570.1 mn in Q2FY15 as against ₹1,344.4 mn in Q2FY14, marking an uptick by 91.2% YoY. This was on account of a significant decline in interest and taxation cost, down by 30.0% and 12.5% YoY to ₹1,256.0 mn and ₹1,181.1 mn, respectively. As a result, net profit margin also expanded by 226bps YoY to 5.4% in Q2FY15 as against 3.1% in Q2FY15.

Witnessed decent numbers in Q2FY15



Margin Trend



Posted decent numbers in H1FY15: For the half year ended September 2014, the company reported a growth of 13.5% YoY in consolidated revenue at ₹86,497.9 mn, while net profit posted a triple digit growth of 106.3% YoY at ₹4,325.1 mn. EBITDA grew by 17.4% YoY to ₹11,567.0 mn. However, a 12.9% YoY increase in operating expenses capped the growth in margins. EBITDA margins expanded by 45bps YoY to 12.9% in H1FY15 from 13.4% in H1FY14.

Tata Chemicals' substantial cash generation potential, should help the company revive profitability, and improve its return on capital in the quarters to come.

On the back of healthy performance from TCNA and improved revenues across all of its business lines, we expect the company to report better result in the upcoming quarter. Since the outlook for the global soda ash business seems positive, we expect the company's margins to improve in its inorganic chemicals business, where the revenue remained flat in Q2FY15. Also, Tata Chemicals' substantial cash generation potential, should help the company revive profitability, and improve its return on capital in the quarters to come.

TCNA continued to perform better; positive outlook for global soda ash promises improved margins prospect in the years to come

Tight global soda ash market would lead to an increase in pricing power for suppliers in the medium term thereby raising prospects for an improvement in margins for the soda ash business.

The company's subsidiary, TCNA, one of the world's largest producers of high quality soda ash, contributed ~17.9% to the total revenue of the company, in FY14. During the year, the company's soda ash production stood at 23,607,000 tonnes as against the previous year's volume of 23,316,000 tonnes. Sales volume for the year increased to 23,899,000 tonnes as against 23,431,000 tonnes in the previous year, showing a positive volume of 468,000 tonnes. In line with this, TCNA witnessed strong numbers in Q2FY15 with a substantial growth of 139.3% YoY in its net profit at ₹0.67 bn in Q2FY15 as against ₹0.28 bn in the corresponding period a year ago. However, total revenue from operations remained flat at ₹7.37 bn in Q2FY15 compared to ₹7.28 bn in Q2FY14, marginally up by 1.2% YoY. While EBITDA was down by 9.1% YoY at ₹1.70 bn.

We expect TCNA's contribution to the total revenue to grow in FY15 as global soda ash outlook continues to remain positive with no new capacities coming on stream till 2017 thereby leading to a tight global demand supply environment. Tight global soda ash market would lead to an increase in pricing power for suppliers in the medium term thereby raising prospects for an improvement in margins for the soda ash business.

New launches in consumer and agri space is expected to drive growth

On the back of company's continuous efforts to upgrade the existing portfolio with the launch of new improved products, we expect the revenue from the above said business lines to see an improvement in Q3FY15.

Tata Chemicals consumer product portfolio continue to grow consistently at the market place, with Tata salt being a market leader in the national branded edible salt market (~69% market share). During Q2FY15, the company's I-shakti pulses and Tata swach reported healthy volumes and continued to grow steadily with focus on increasing the penetration levels across the India market. In line with its focus on building branded products portfolio, the company's Industrial chemicals business launched GranPlus+ - Speckle grade soda ash in the Indian market in Q2FY15. Farm Essential business also expanded in Tata Paras brand portfolio with the launch of Tata Paras 20:20 for West Bengal and Patna market. Living Essential business expanded Tata Swach portfolio with the launch of Tata Swach Viva (UV+UF) and Tata Swach Nova (RO) variants in September 2014.

All the products launched are well received in the market and the feedback was positive. On the back of company's continuous efforts to upgrade the existing portfolio with the launch of new improved products, we expect the revenue from the above said business lines to see an improvement in Q3FY15.

Tata Chemicals – one of the key beneficiaries of the New Urea policy

Tata chemicals has been waiting for this policy to resume its plans stalled since 2010. If the company's proposal gets accepted by the government, Tata Chemicals will become one of the key beneficiaries of this new urea policy.

We expect Tata Chemicals to get a boost to its performance, following the implementation of the New Urea Policy under which the government will help the private companies to raise their current capacities upto 16 mn tonnes in order to meet the annual demand for the country. Currently, the annual demand of urea in the country is around 30 mn tonnes, whereas the domestic production is around 22 mn tonnes. The rest is met through imports. According to the policy, interested private companies are required to give a bank guarantee of ₹3 bn for every project. The companies will get a subsidy only if the urea production starts in the next 5 years, and it will continue till 8 years after the commencement of production. The fertilizer ministry has invited fresh proposals to 13 companies ***including Tata Chemicals*** for setting up urea plants as well as increasing the capacity of existing ones under the recently notified New Urea Investment Policy.

Tata Chemicals plans to revive a USD 850 mn spending proposal to double its urea capacity after the government said it will guarantee returns on investments. The government has assured new urea units a profit margin of 12% to 20%. Also, the company plans to boost its ability to make the nitrogen-based soil nutrient at its Babrala urea plant in Uttar Pradesh, to 2.5 mn tonnes in the next three years. Tata chemicals has been waiting for this policy to resume its plans stalled since 2010. If the company's proposal gets accepted by the government, Tata Chemicals will become one of the key beneficiaries of this new urea policy.

Restructuring in UK and Kenya operations to start yielding results from FY15 onwards

Tata Chemicals restructured operations at its plans in UK and Kenya. The company's overall plan to restructure these businesses is on the back of losses it suffered from these units back in 2012.

Tata Chemicals restructured operations at its two foreign plants in a move to overcome the high energy cost. While in December 2013, the company closed down one of its plants at Winnington in UK, making soda ash and calcium chloride; it announced the mothballing of its premium ash plant in Magadi, Kenya. Mothballing is referred to as the process of maintaining in good condition a plant not in use so that it may be revived in future. The company's overall plan to restructure these businesses is on the back of losses it suffered from these units back in 2012.

With operations at Kenya showing early signs of improvement, we expect the restructuring process to start yielding results from FY15 onwards with full benefits of restructuring of both the UK and Kenya operations to be visible in FY16.

The debt/Equity ratio for the company has grown from 0.9x in FY12 to 1.5x in FY14, which remains a concern for the company.

With the company's management commitment and efforts towards debt reduction, we remain positive on the company's efforts towards debt reduction.

Restructuring of the UK operations: Tata Chemicals planned to shut its plant at Winnington, UK, when it continued to see low production and made losses. The company planned to close the plant, but it required huge planning. For instance, the Winnington plant had two long-term contracts for securing brine (a solution of salt in water) and power, which it had to take care of. The contracts were eventually renegotiated and that took away a lot of the burden. Further, to reduce finance costs, Tata Chemicals converted a loan from a consortium of five bankers to a single loan from one lender. It also took over a power plant owned by E.ON in September 2013, which it acquired at a very low price. To bring down the cost of power generation from the newly acquired plant, the company bought a steam turbine and also negotiated for a grant from the UK government. It also set up a new 50,000 tonne per annum sodium bicarbonate plant. The result of the restructuring gave the company four revenue streams in the UK – an energy plant, a steam turbine, a sodium bi-carb plant, and the British Salt. All this put together, by the end of the FY16 and will generate sufficient operating margins.

Restructuring of Kenya operations: The company has temporarily halted production at the Magadi (Kenya) plant. The company has two plants at Magadi - a standard ash plant and a pure ash plant. The pure ash plant was an energy-guzzler. So, the company had to take a call to revive the operations at that plant. The management expects its Kenyan operations to turn around from the Q3FY15.

With operations at Kenya showing early signs of improvement, we expect the restructuring process to start yielding results from FY15 onwards with full benefits of restructuring of both the UK and Kenya operations to be visible in FY16.

Debt remains a key concern; a significant reduction is expected over the next five years

For Tata Chemicals, the debt kept on piling over the last few years. The total debt of the company grew by ~16.3% to ₹59 bn in FY12 as against a growth of ~20.4% to ₹84 bn in FY14. The debt/equity ratio for the company has grown from 0.9x in FY12 to 1.5x in FY14, which remains a concern for the company. However, the management continues to remain committed on paring down the debt to ₹40 bn in the next 5 years. Tata chemicals is planning to do so by bring down the debt level in each one of its global subsidiaries over the coming 5 years.

In the US, although the debt is ~USD 315 mn, the cash flows from there are supporting the debt payment. It is a one time payment after 7 years, so while there will not be a reduction in debt and there will be adequate cash generated to be able to pay the debt. As far as UK is concerned, we expect that the restructuring process should be able to bring down the debt from about £120 mn pounds to about £70 mn pounds. Similarly, in Kenya it is expected that the debt may come down from USD 120 mn to ~USD 60 mn dollars over the next 5 years.

Total debt at the end of H1FY15 has reduced to ₹81 bn, down by 3.2% from the fiscal year ended March 2014, driven by reduction in working capital in the standalone business. With the company's management commitment and efforts towards debt reduction, we remain positive on the company's efforts towards debt reduction.

Balance Sheet (Consolidated)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Share Capital	2,548.2	2,548.2	2,548.2	2,548.2
Reserve and surplus	61,587.4	53,106.9	54,363.4	58,516.1
Net Worth	**64,135.6**	**55,655.1**	**56,911.6**	**61,064.3**
Minority Interest	5,361.4	6,552.2	7,207.4	7,928.2
Total debt	69,506.5	83,696.1	91,773.7	101,395.9
Provisions	17,193.5	19,636.0	21,527.3	23,602.6
Deferred tax liability (net)	1,534.5	2,769.2	2,796.9	3,104.6
Other current liabilities	42,034.5	30,845.7	33,996.2	38,002.6
Other long term liabilities	2,624.1	2,949.7	3,215.2	3,568.8
Total equity & liabilities	**202,390.1**	**202,104.0**	**217,428.3**	**238,666.8**
Fixed assets	46,703.3	47,519.6	48,945.2	50,217.8
Goodwill	66,270.2	67,226.1	67,226.1	67,226.1
Investments	5,996.6	4,408.8	4,408.8	4,408.8
Loans & advances	9,650.6	11,615.9	12,689.2	13,934.3
Deferred tax assets	1,590.2	859.2	859.2	859.2
Other current assets	69,876.6	67,852.9	80,678.3	99,399.1
Other long term assets	2,302.6	2,621.5	2,621.5	2,621.5
Total assets	**202,390.1**	**202,104.0**	**217,428.3**	**238,666.8**

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Operating revenue	**147,110.2**	**158,954.3**	**177,924.9**	**201,527.6**
Expenses	125,481.1	140,860.0	157,366.8	175,516.2
EBITDA	**21,629.1**	**18,094.3**	**20,558.1**	**26,011.4**
Other Income	4,177.8	1,424.2	1,424.2	1,424.2
Depreciation	5,338.8	4,712.4	5,089.4	5,445.6
EBIT	**20,468.1**	**14,806.1**	**16,892.9**	**21,990.0**
Interest	4,639.1	5,792.9	6,372.2	7,009.4
Profit Before Tax	**15,829.0**	**9,013.2**	**10,520.7**	**14,980.6**
Tax	3,025.2	2,887.8	3,840.8	5,108.2
Exceptional Items	6698.7	14,202.1	0	0
PAT	**6,105.1**	**(8,076.7)**	**6,680.0**	**9,872.3**
Less: Share of loss in asso.	30.8	33.3	37.3	41.8
Less: MI	2,070.3	2,210	2,431	2,722.7
Net profit	**4,004.0**	**(10,320.0)**	**4,211.7**	**7,107.9**

Key Ratios (Consolidated)

Y/E	FY13A	FY14A	FY15E	FY16E
EBITDA Margin (%)	14.7	11.4	11.6	12.9
EBIT Margin (%)	13.9	9.3	9.5	10.9
NPM (%)	2.7	(6.5)	2.4	3.5
ROCE (%)	14.6	9.8	10.5	12.5
ROE (%)	16.7	7.0	7.4	11.6
Adj. EPS (₹)	42.0	15.2	16.5	27.9
P/E (x)	10.1	27.9	25.7	15.3
BVPS (₹)	251.8	218.5	223.4	239.7
P/BVPS (x)	1.7	1.9	1.9	1.8
EV/Operating Income (x)	1.1	1.1	1.0	0.9
EV/EBITDA (x)	7.6	10.0	9.0	7.1

Valuation and view

Tata chemicals performance in Q2FY15 remained robust with 10.6% and 91.2% growth in its consolidated total income and net profit, respectively. Further, the management's commitment towards driving growth from the non-bulk agri and consumer business augurs well for Tata Chemicals. With operations at Kenya showing early signs of improvement, we expect a boost in profitability in the coming quarters. Further, the management's commitment towards reducing the debt levels make the company's prospects brighter.

At a CMP of ₹425.7, Tata Chemicals is currently trading at EV/EBITDA of 9.0x FY15E and 7.1x FY16E. Considering the company's strong fundamentals, we recommend 'BUY' with a target price of ₹512, which implies potential upside of ~20% to the CMP from 1 year perspective.

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