

# TATA STEEL

METALS / MINING

3 NOV 2017

Quarterly Update

**BUY**

Target Price: Rs 795

## More upside in India margin

Tata Steel's Q2FY18 consolidated EBITDA at Rs 47 bn (up 62% YoY) was lower than consensus and our estimates largely due to lower spread in the European business. Europe business EBITDA/ton declined to Rs 2,900 vs. Rs 5,210 in Q1FY18. India business EBITDA/ton increased to Rs 11,080 vs. Rs 10,620 in Q1FY18.

**Margin outlook:** Domestic steel realization to be higher in Q3, as steel prices hikes happened in end Q2. Management has guided for 12.3 mnt to 12.4 mnt volumes in FY18. India EBITDA/ton to move up over the next 2 quarters. European business margin to remain weak in Q3 due to seasonality, to be followed by a rebound in Q4. Margin outlook for South East business is positive due to increase in rebar to scrap spread.

CMP : Rs 719  
Potential Upside : 11%

### MARKET DATA

No. of Shares : 971 mn  
Free Float : 69%  
Market Cap : Rs 698 bn  
52-week High / Low : Rs 735 / Rs 366  
Avg. Daily vol. (6mth) : 6.3 mn shares  
Bloomberg Code : TATA IB Equity  
Promoters Holding : 31%  
FII / DII : 16% / 30%

## Key highlights

- ◆ **Domestic operations:** Volume growth of 18% YoY at 3.1 mnt in Q2, as Kalinganagar steel plant is close to full ramp-up. Blended EBITDA/ton was Rs 11,080 (vs. Rs 10,620 in Q1FY18). Increase in the margin was mainly due to: (1) lower other expenses (low rates & taxes post GST implementation and less repairs & maintenance expenses); (2) operating leverage due to higher volumes. This was partially offset by lower realization due to low ferro-chrome and long product prices

*(Continued on page 2...)*

## Estimates and valuation

We increase our FY18E/19E EPS to Rs 56/ 72 (vs. Rs 51/ 68 earlier) due to strong domestic volumes and realization. Maintain **BUY** rating with revised target price of Rs 795 (vs. Rs 765 earlier), implying 11% upside from CMP of Rs 719. We value the company at 7x FY19E EV/EBITDA for both India and international operations.

### Financial summary (Consolidated)

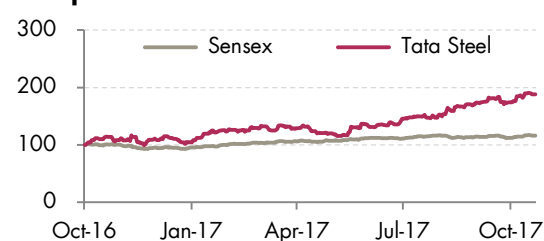
Y/E March	FY16	FY17	FY18E	FY19E
Sales (Rs bn)	1,013	1,116	1,233	1,292
EBITDA (Rs bn)	80	170	191	211
Adj PAT (Rs bn)	(18)	39	54	70
Con. EPS* (Rs)	-	-	65	73
EPS (Rs)	(19)	41	56	72
Change YOY (%)	(271)	(315)	37	29
P/E (x)	(38)	18	13	10
RoE (%)	(7)	11	17	19
EV/E (x)	18	8	8	7
DPS (Rs)	8	8	4	4

Source: \*Consensus broker estimates, Company, Axis Capital

### Key drivers

	FY17	FY18E	FY19E
Domestic volumes (mnt)	11.0	12.5	12.5
Intl. ops' volumes (mnt)	12.9	13.2	13.4
Domestic EBITDA/ton (Rs)	10,800	11,900	12,330
Intl. ops' EBITDA/t (USD)	59	50	64

### Price performance



**Exhibit 1: Results update**

(Rs mn)	Quarter ended					12 months ended		
	Sep-17	Sep-16	% Chg	Jun-17	% Chg	FY18E	FY17	% Chg
<b>Net sales</b>	<b>324,641</b>	<b>263,710</b>	<b>23</b>	<b>295,568</b>	<b>10</b>	<b>1,238,270</b>	<b>1,122,994</b>	<b>10</b>
EBITDA	47,207	29,700	59	49,740	(5)	190,882	137,993	38
Other income	2,532	1,084	134	1,555	63	2,192	5,275	(58)
<b>PBITD</b>	<b>49,739</b>	<b>30,784</b>	<b>62</b>	<b>51,295</b>	<b>(3)</b>	<b>193,074</b>	<b>143,268</b>	<b>35</b>
Depreciation	14,733	14,677	0	15,011	(2)	58,586	56,729	3
Interest	13,499	13,511	(0)	13,437	0	53,846	50,722	6
<b>PBT</b>	<b>21,507</b>	<b>2,597</b>	<b>-</b>	<b>22,846</b>	<b>-</b>	<b>80,643</b>	<b>35,817</b>	<b>125</b>
Tax	11,380	3,634	-	7,405	54	25,916	27,780	(7)
Minority Interest / Associates	(78)	193	(141)	89	(188)	649	646	0
<b>Adjusted PAT after minority</b>	<b>10,205</b>	<b>(1,230)</b>	<b>(930)</b>	<b>15,352</b>	<b>(34)</b>	<b>54,078</b>	<b>7,391</b>	<b>632</b>
Extra ordinary income/ (exp.)	(147)	634	(123)	(6,289)	-	(40,582)	(81,884)	(50)
<b>Reported PAT after minority</b>	<b>10,058</b>	<b>(596)</b>	<b>(1,788)</b>	<b>9,063</b>	<b>11</b>	<b>13,496</b>	<b>(74,493)</b>	<b>(118)</b>
No. of shares (mn)	970	970	-	970	-	971	971	0
EBITDA margin (%)	14.5	11.3	-	16.8	-	15.4	12.3	25
PBITD margin (%)	15.3	11.7	-	17.4	-	15.6	12.8	22
<b>EPS - annualized (Rs)</b>	<b>42.1</b>	<b>(5.1)</b>	<b>(930)</b>	<b>63.3</b>	<b>(34)</b>	<b>55.7</b>	<b>7.6</b>	<b>632</b>

Source: Company, Axis Capital

(...continued from page 1)

### Key highlights

#### ◆ International operations

- **Europe:** Q2FY18 EBITDA/ton was Rs 2,900 vs. Rs 5,210 in Q1FY18 mainly due to lower spread and higher coking coal prices. Volumes were 2.6 mnt (up 15% YoY and 8% QoQ). Profitability will continue to remain under pressure in Q3FY18 as (1) quarter ending December is seasonally weak for Europe and (2) coking coal and other raw material costs will remain elevated. Closure of loss-making plants to support profitability on a YoY basis
- **South East Asia:** EBITDA/ton rebounded to Rs 2,020 vs. Rs 370 in Q1FY18, as steel price spread increased due to decrease in availability of Chinese steel
- **Other downstream subsidiaries/ eliminations:** Total EBITDA was Rs 4.3 bn in Q2FY18 vs. loss of Rs 1 bn in Q1FY18 and Rs 7.5 bn profit in Q2FY17

- ◆ **Debt:** Consolidated net debt rose to Rs 900 bn from Rs 880 bn mainly due to forex impact and BPS (UK unit pension scheme) settlements

## Financial summary (Consolidated)

### Profit & loss (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	1,013	1,116	1,233	1,292
Other operating income	7	7	5	6
<b>Total operating income</b>	<b>1,020</b>	<b>1,123</b>	<b>1,238</b>	<b>1,298</b>
Cost of goods sold	(556)	(543)	(583)	(611)
Gross profit	464	580	656	688
<i>Gross margin (%)</i>	<i>45.8</i>	<i>52.0</i>	<i>53.2</i>	<i>53.2</i>
Total operating expenses	(384)	(410)	(465)	(477)
<b>EBITDA</b>	<b>80</b>	<b>170</b>	<b>191</b>	<b>211</b>
<i>EBITDA margin (%)</i>	<i>7.9</i>	<i>15.2</i>	<i>15.5</i>	<i>16.3</i>
Depreciation	(53)	(57)	(59)	(61)
<b>EBIT</b>	<b>27</b>	<b>113</b>	<b>132</b>	<b>150</b>
Net interest	(42)	(51)	(54)	(50)
Other income	4	5	2	3
<b>Profit before tax</b>	<b>(11)</b>	<b>68</b>	<b>81</b>	<b>104</b>
Total taxation	(7)	(28)	(26)	(33)
<i>Tax rate (%)</i>	<i>(60.1)</i>	<i>40.9</i>	<i>32.1</i>	<i>31.8</i>
Profit after tax	(18)	40	55	71
Minorities	1	(1)	(1)	(1)
Profit/ Loss associate co(s)	(1)	-	-	-
Adjusted net profit	(18)	39	54	70
<i>Adj. PAT margin (%)</i>	<i>(1.8)</i>	<i>3.5</i>	<i>4.4</i>	<i>5.4</i>
Net non-recurring items	15	(82)	(41)	-
Reported net profit	(4)	(42)	13	70

### Balance sheet (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Paid-up capital	10	10	10	10
Reserves & surplus	364	311	321	387
Net worth	374	320	330	396
Borrowing	843	853	813	767
Other non-current liabilities	4	102	102	102
<b>Total liabilities</b>	<b>1,228</b>	<b>1,291</b>	<b>1,261</b>	<b>1,282</b>
Gross fixed assets	1,086	1,266	1,465	1,520
Less: Depreciation	(404)	(380)	(439)	(500)
Net fixed assets	681	885	1,026	1,020
Add: Capital WIP	368	164	25	25
Total fixed assets	1,050	1,049	1,051	1,045
Total Investment	62	69	65	65
Inventory	200	248	266	274
Debtors	121	116	120	128
Cash & bank	108	106	22	29
Loans & advances	73	84	99	103
Current liabilities	385	381	362	361
Net current assets	117	173	146	172
Other non-current assets	-	-	-	-
<b>Total assets</b>	<b>1,228</b>	<b>1,291</b>	<b>1,261</b>	<b>1,282</b>

Source: Company, Axis Capital

### Cash flow (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	(11)	68	81	104
Depreciation & Amortisation	53	57	59	61
<i>Chg in working capital</i>	<i>86</i>	<i>(48)</i>	<i>(56)</i>	<i>(20)</i>
<b>Cash flow from operations</b>	<b>205</b>	<b>216</b>	<b>111</b>	<b>162</b>
<i>Capital expenditure</i>	<i>(102)</i>	<i>(77)</i>	<i>(60)</i>	<i>(55)</i>
<b>Cash flow from investing</b>	<b>(128)</b>	<b>(166)</b>	<b>(97)</b>	<b>(55)</b>
<i>Equity raised/ (repaid)</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>Debt raised/ (repaid)</i>	<i>(18)</i>	<i>10</i>	<i>(40)</i>	<i>(46)</i>
<i>Dividend paid</i>	<i>(9)</i>	<i>(12)</i>	<i>(4)</i>	<i>(4)</i>
<b>Cash flow from financing</b>	<b>(70)</b>	<b>(52)</b>	<b>(98)</b>	<b>(100)</b>
Net chg in cash	7	(3)	(84)	7

### Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
<b>OPERATIONAL</b>				
FDEPS (Rs)	(19)	41	56	72
CEPS (Rs)	51	15	74	135
DPS (Rs)	8	8	4	4
Dividend payout ratio (%)	(203)	(18)	29	6
<b>GROWTH</b>				
Net sales (%)	(26)	10	11	5
EBITDA (%)	(41)	113	12	11
Adj net profit (%)	(271)	(315)	37	29
FDEPS (%)	(271)	(315)	37	29
<b>PERFORMANCE</b>				
RoE (%)	(7)	11	17	19
RoCE (%)	3	9	11	12
<b>EFFICIENCY</b>				
Asset turnover (x)	1.0	1.0	1.1	1.1
Sales/ total assets (x)	0.7	0.7	0.7	0.8
Working capital/ sales (x)	0.1	-	0.1	0.1
Receivable days	43	38	36	36
Inventory days	78	95	93	92
Payable days	150	146	126	121
<b>FINANCIAL STABILITY</b>				
Total debt/ equity (x)	2.9	2.4	2.4	2.0
Net debt/ equity (x)	2.5	2.1	2.3	1.9
Current ratio (x)	1.3	1.5	1.4	1.5
Interest cover (x)	0.6	2.2	2.5	3.0
<b>VALUATION</b>				
PE (x)	(38)	18	13	10
EV/ EBITDA (x)	18.0	8.5	7.8	6.8
EV/ Net sales (x)	1.4	1.3	1.2	1.1
PB (x)	2	2	2	2
Dividend yield (%)	1	1	1	1
Free cash flow yield (%)	17	8	1	15

Source: Company, Axis Capital

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**Research Team**

Sr. No	Name	Designation	E-mail
1	Hiren Trivedi	Research Associate	hiren.trivedi@axissecurities.in
2	Kiran Gawle	Associate	kiran.gawle@axissecurities.in

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