

INDUSTRY	METALS
CMP (as on 20 Sep 17)	Rs 688
Target Price	Rs 818
Nifty	10,141
Sensex	32,401

KEY STOCK DATA

	TATA IN
Bloomberg	
No. of Shares (mn)	971
MCap (Rsbn) / (\$ mn)	668/10,387
6m avg traded value (Rs mn)	3,339

STOCK PERFORMANCE (%)

52 Week high / low	Rs 693 / 359		
	3M	6M	12M
Absolute (%)	31.6	38.5	88.1
Relative (%)	28.1	28.7	74.5

SHAREHOLDING PATTERN (%)

Promoters	31.35
FIs & Local MFs	30.29
FPIs	13.67
Public & Others	24.69

Source : BSE
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JV comes to fruition

Tata Steel Europe (TSE) and thyssenkrupp Steel Europe (TKA-SE) will merge their assets into a 50:50 JV. The resultant entity will be the 2nd largest European steelmaker with vertically integrated operations in Port Talbot (UK), IJmuiden (Netherlands) and Duisburg (Germany), driving significant consolidation. Synergies of EUR 400-600mn are expected by FY20, driven mainly from the optimization of duplicate functions like admin, sales, and procurement, in addition to efficiencies in logistics and bundling of R&D functions.

For Tata Steel, the JV implies significant derisking of its operations from volatility in Europe and reduction in net debt (EUR 2.5bn). thyssenkrupp moves another step towards shedding all its materials/commodity businesses. Further, the valuation of its equity stake in the deal (~EUR 2.0bn in our estimate) is accretive straightaway (invested capital of ~EUR 5bn and liabilities of EUR 4bn shifted off balance sheet)

We value the JV at 6.0x EV/EBITDA (including synergies at the midpoint of the guided range) to arrive at an equity valuation of EUR 3.0bn for the each JV parent. Our SoTP for Tata Steel increases by Rs 131/sh to Rs 818. Of this ~Rs200/sh comes from debt reduction, while valuation of Tata Steel Europe reduces by Rs67/sh due to farm out.

Other key highlights

- The JV is expected to have high dividend payouts, which are expected to sustain the remainder of Tata Steel's foreign debt (~Rs 170bn).
- Headcount reduction of ~4000, equally divided between admin and production and also equally divided between TSE and TKA-SE. The entity will be headquartered in Netherlands.
- Both TKA and Tata Steel have hinted at further synergies post the EUR 400-600mn range, driven by assessment & optimization of upstream production network (liquid phase, hot rolling mills)

View: Significant derisking event for Tata Steel, which has long struggled with its European operations. With lowering of external debt, it can explore both organic and inorganic opportunities domestically. We remain positive.

Financial Summary (Consolidated)

(Rs bn)	FY16	FY17	FY18E	FY19E	FY20E
Net Sales	1,020	1,123	1,201	1,267	1,315
EBITDA	80	170	192	216	230
PAT	(18)	39	64	82	88
Diluted EPS (Rs)	(18.9)	40.6	65.8	84.4	90.8
P/E (x)	N/M	16.6	10.3	8.0	7.5
EV / EBITDA (x)	18.6	8.8	7.5	6.5	5.7
RoE (%)	(4.2)	10.3	16.8	18.6	17.1

Source: Company, HDFC sec Inst Research

We estimate the equity portion of the contribution at EUR 2.0bn each, at assumed multiples of 6.5x EV/EBITDA

We value the JV at 6.0x EV/EBITDA to arrive at an equity valuation of EUR 3.0bn for the each JV parent.

Thyssenkrupp and Tata Steel

EUR mn, LTM	Thyssenkrupp		Tata Steel Europe
Volumes (LTM)	11.50	Volumes (LTM)	9.92
Assumed EBITDA/t	76	Assumed EBITDA/t	70
EBITDA	870	EBITDA	699
EV/EBITDA multiple assumed	6.5	EV/EBITDA multiple assumed	6.5
EV	5,655	EV	4,544
Pension liability transferred	3,600		
Debt transferred to JV	400	Debt transferred to JV	2,500
Implied Equity Contribution	2,055	Implied Equity contribution	2,044

Source: Company, HDFC sec Inst Research

JV – Thyssenkrupp Tata Steel

EUR mn	
EBITDA	1,569
Synergy	500
Total EBITDA	2,069
EV/EBITDA	6.0
Implied EV	12,414
Pension Liabilities	3,600
Debt	2,900
Implied Market cap	5,914
50% attribution	2,957

Source: Company, HDFC sec Inst Research

Our SoTP for Tata Steel increases by Rs 131/sh. Of this ~Rs200/sh comes from debt reduction, while valuation of Tata Steel Europe reduces by Rs67/sh due to farm out.

Sum of the parts valuation (prior to merger)

Valuation Summary	EBITDA	Multiple	Value
Tata Steel India	142,041	7.0	994,284
Tata Steel Europe	48,920	6.0	293,518
Others	1,151	5.0	5,755
EV			1,293,556
Net Debt			626,215
Market Cap			667,341
Target Price			687

Source: Company, HDFC sec Inst Research

Sum of the parts valuation (post-merger)

Valuation Summary	EBITDA	Multiple	Value
Tata Steel India	142,041	7.0	994,284
Others	1,151	5.0	5,755
EV			1,000,038
Net Debt (Reduction of EUR 2.5bn)			433,315
Market Cap			566,724
50% of JV Valuation (EUR: 2.96bn)			228,162
Target Price			818

Source: Company, HDFC sec Inst Research

Key Highlights of the announcements/con-calls

Deal specifics	<ul style="list-style-type: none"> ■ The companies have based deal calculations on LTM nos and detailed due diligence of each other's operations will be done post MoU. ■ Headquarters to be housed in Netherlands. ■ JV to have no recourse to Tata Steel/thyssenkrupp B/S. The JV income will be reported as one line item in both the balance sheet and the PnL for Tata Steel ■ Target to house the debt in Tata Steel Netherlands given higher profitability there, to enjoy interest shields. Current cost of debt at 3.75% with a B- rating, likely to go down in a restructured JV.
BSPS Trustee Stake in Tata Steel UK	<ul style="list-style-type: none"> ■ BSPS Trustees' 33% stake in the Tata Steel UK will become a minority interest for the JV. ■ Given lower profitability in the UK business, the value attribution is likely to be low. The BSPS Trustees stake is purely financial and they do not get any influence on the JV operations.
TKA's pension liabilities	<ul style="list-style-type: none"> ■ In Germany, there is no regulatory requirement for funding the pension plans and such the EUR 3.6bn amount is a pure pension liability. ■ However, pension liabilities on TKA books are significantly derisked. TKA's pension defined benefit pension plans have closed to new members since late 1990s, and they get defined contribution plans only. Of the TKA's EUR 7.95bn outstanding pension liability, ~64% was owed to existing pensioners with an average age of 76 years. ■ Amortization of close to EUR 235mn on EUR3.6bn pension liabilities, making it quasi debt with low interest. The changes in accrued pension liabilities are on account of change in German discount rates and have no impact on the payout to pensioners.
Synergies	<ul style="list-style-type: none"> ■ Expected to accrue from headcount reductions given duplication in functions across the two companies. ■ Finance, corporate, HR, sales, procurement etc could be some of the divisions which have a potential of seeing a lower headcount. ■ There could be significant R&D synergies, given both the groups spend ~EUR 100mn each which can be streamlined.
Dividend payout	<ul style="list-style-type: none"> ■ High dividend payout expected from the JV once operations stabilize. This will help Tata Steel service the ~Rs 170bn ex-India debt, which remains once the EUR 2.5bn is transferred to the JV.

Thyssenkrupp Europe Steel has been a more stable and higher margin business compared to TSE

Historical trends

	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Tata Steel Europe							
Volumes (Deliveries, mT)	3.4	3.6	2.5	2.3	2.4	2.9	2.4
Realisations (US\$/t)	717	683	774	790	778	798	894
EBITDA/T (US\$/t)	(30)	(15)	51	66	38	103	80

Thyssenkrupp Steel Europe

	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Volumes (Deliveries, mT)	2.4	2.8	3.1	2.9	2.7	3.0	2.9
Realisations (US\$/t)	800	747	737	761	756	839	893
EBITDA/T (US\$/t)	72	64	70	81	51	69	128

Source: Company, HDFC sec Inst Research

Note: TKA-SE has a September year end

Key Assumptions

	FY16	FY17	FY18E	FY19E	FY20E
India					
Saleable steel volumes (mT)	9.5	11.0	11.7	12.4	12.6
Realisations (US\$/T)	581	622	673	694	726
Iron ore costs (US\$/t)	28	29	31	32	34
Coking coal (US\$/t)	129	180	180	190	200
Steel Spreads (US\$/t)	408	458	486	503	527
EBITDA/T (US\$)	90	131	157	172	186

Europe

	FY16	FY17	FY18E	FY19E	FY20E
Steel deliveries	11.0	9.9	10.0	10.0	10.0
Steel Spreads (US\$/t)	430	446	510	520	525
EBITDA/T (US\$)	(7)	71	70	75	75

Source: Company, HDFC sec Inst Research

Income Statement

Year ending March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenues	1,019,647	1,122,994	1,200,537	1,267,337	1,314,957
Growth %	(26.9)	10.1	6.9	5.6	3.8
Material Expenses	406,215	393,049	434,750	453,570	467,122
Employee Expenses	175,876	172,522	157,589	162,562	166,220
Other operating expenses	357,873	387,345	415,995	435,256	451,627
Operating profits	79,683	170,078	192,203	215,949	229,988
Operating Profit Margin (%)	7.8	15.1	16.0	17.0	17.5
EBITDA	79,683	170,078	192,203	215,949	229,988
EBITDA %	7.8	15.1	16.0	17.0	17.5
EBITDA Growth %	(36.4)	113.4	13.0	12.4	6.5
Depreciation	53,064	56,729	57,178	59,217	61,359
EBIT	26,620	113,349	135,025	156,732	168,629
Other Income (Including EO Items)	44,026	(37,968)	(629)	5,815	6,106
Interest	42,214	50,722	46,773	42,244	43,496
PBT	28,432	24,660	87,622	120,303	131,240
Tax (Incl Deferred Tax)	6,900	27,780	29,089	37,474	42,148
PAT	21,532	(3,120)	58,533	82,829	89,092
Minority Interest /Associates	39	(646)	(678)	(712)	(748)
EO Loss / Profit (Net of Tax)	39,904	(43,242)	(6,168)	-	-
APAT	(18,333)	39,476	64,023	82,117	88,344
APAT Growth (%)	(53.3)	(315.3)	62.2	28.3	7.6
EPS	(19)	41	66	84	91
EPS Growth (%)	(53.30)	(315.33)	61.77	28.32	7.59

Source: Company, HDFC sec Inst Research, Standalone numbers displayed

Balance Sheet

As at March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
SOURCES OF FUNDS					
Share Capital	9,702	9,702	9,702	9,702	9,702
Reserves	404,873	345,741	394,188	466,889	536,568
Total Shareholders Funds	414,576	355,443	403,890	476,591	546,270
Minority Interest	7,809	16,017	16,017	16,017	16,017
Long Term Debt	671,478	662,973	662,973	662,973	662,973
Short Term Debt	177,308	197,442	164,161	114,161	114,161
Total Debt	848,785	860,415	827,134	777,134	777,134
Deferred Taxes	87,934	91,442	91,442	91,442	91,442
Long Term Provisions & Others	(7,271)	77,662	77,662	77,662	77,662
TOTAL SOURCES OF FUNDS	1,351,833	1,400,979	1,416,145	1,438,846	1,508,525
APPLICATION OF FUNDS					
Net Block	689,747	891,625	889,447	890,230	893,872
CWIP	359,961	157,841	157,841	157,841	157,841
Goodwill	40,676	34,947	34,947	34,947	34,947
Investments	56,706	64,893	64,893	64,893	64,893
LT Loans and Advances	45,240	45,346	45,346	45,346	45,346
Total Non-Current Assets	1,192,329	1,194,654	1,192,476	1,193,259	1,196,900
Inventories	200,133	248,038	232,176	274,758	243,765
Debtors	120,662	115,868	124,239	129,228	130,033
Other Current Assets	28,123	36,124	36,124	36,124	36,124
Cash & Equivalents	112,316	109,015	131,756	128,751	211,244
Total Current Assets	461,235	509,045	524,296	568,862	621,165
Creditors	185,567	185,745	183,651	206,299	192,565
Other Current Liabilities & Provns	116,163	116,975	116,975	116,975	116,975
Total Current Liabilities	301,730	302,720	300,626	323,274	309,540
Net Current Assets	159,505	206,326	223,669	245,588	311,625
TOTAL APPLICATION OF FUNDS	1,351,833	1,400,979	1,416,145	1,438,846	1,508,525

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	21,571	(3,766)	57,694	81,948	78,926
Non-operating & EO items	(4,122)	(5,275)	629	(5,815)	(6,106)
Interest expenses	17,449	(9,041)	58,323	76,133	72,820
Depreciation	42,214	50,722	46,773	42,244	43,496
Working Capital Change	53,064	56,729	57,178	59,217	61,359
Tax Paid	122,767	(94,706)	5,398	(24,924)	16,456
OPERATING CASH FLOW (a)	235,493	3,704	167,672	152,671	194,129
Capex	(132,180)	29,944	(55,000)	(60,000)	(65,000)
Free cash flow (FCF)	103,313	33,647	112,672	92,671	129,129
Investments	68,462	(8,188)	0	0	0
Non-operating Income	4,122	5,275	(629)	5,815	6,106
INVESTING CASH FLOW (b)	(59,596)	27,031	(55,629)	(54,185)	(58,894)
Debt Issuance / (Repaid)	33,473	(38)	0	0	0
Interest expenses	49,960	11,630	(33,281)	(50,000)	0
FCFE	(42,214)	(50,722)	(46,773)	(42,244)	(43,496)
Share Capital Issuance	111,058	(5,445)	32,618	427	85,634
Dividend	(9,263)	(9,247)	(9,247)	(9,247)	(9,247)
FINANCING CASH FLOW (c)	31,956	(48,377)	(89,301)	(101,491)	(52,743)
NET CASH FLOW (a+b+c)	207,853	(17,643)	22,741	(3,005)	82,493
EO Items / Others	(193,794)	14,342			
Closing Cash & Equivalents	112,316	109,016	131,756	128,751	211,244

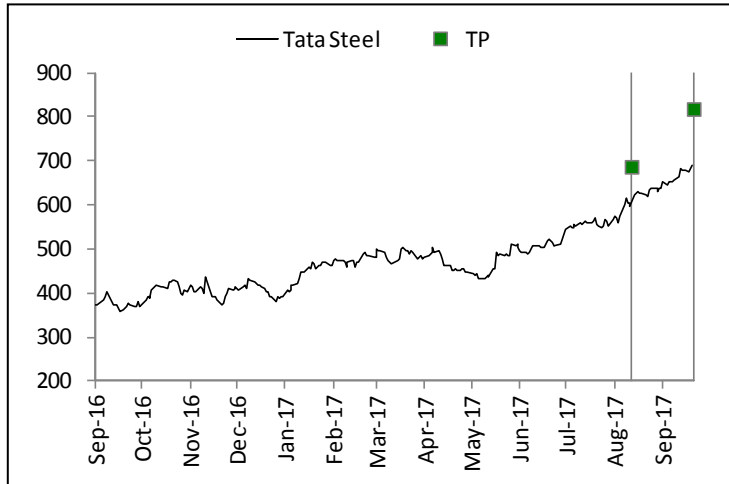
Source: Company, HDFC sec Inst Research

Key Ratios

	FY16	FY17	FY18E	FY19E	FY20E
PROFITABILITY (%)					
EBITDA Margin	7.8	15.1	16.0	17.0	17.5
APAT Margin	(1.8)	3.5	5.3	6.5	6.7
RoE	(4.2)	10.3	16.8	18.6	17.1
Core RoCE	6.3	8.7	13.6	15.1	16.4
RoCE	5.4	7.5	11.6	12.7	12.9
EFFICIENCY					
Tax Rate (%)	(115.2)	25.7	20.0	25.0	25.0
Asset Turnover (x)	0.9	0.9	0.9	0.9	0.9
Inventory (days)	77	70	69	69	69
Debtors (days)	44	37	35	35	35
Payables (days)	63	58	53	53	53
Cash Conversion Cycle (days)	58	49	51	51	51
Debt/EBITDA (x)	10.3	5.0	4.4	3.7	3.4
Net D/E	1.78	2.11	1.72	1.36	1.01
Interest Coverage	0.7	2.3	3.0	3.8	4.0
PER SHARE DATA					
EPS (Rs/sh)	(18.9)	40.6	65.8	84.4	90.8
CEPS (Rs/sh)	35.8	99.1	124.6	145.3	154.0
DPS (Rs/sh)	8.0	8.0	8.0	8.0	8.0
BV (Rs/sh)	426.9	366.0	415.9	490.7	572.0
VALUATION					
P/E	N/M	16.6	10.3	8.0	7.5
P/BV	1.6	1.8	1.6	1.4	1.2
EV/EBITDA	18.6	8.8	7.5	6.5	5.7
OCF/EV (%)	8.3	6.4	12.4	11.7	16.2
FCF/EV (%)	(1.2)	3.2	8.3	7.1	10.9
Dividend Yield (%)	1.2	1.2	1.2	1.2	1.2

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
11-Aug-17	606	BUY	687
21-Sep-17	688	BUY	818

Rating Definitions

- BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
- NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
- SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

INSTITUTIONAL RESEARCH
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