

TATA STEEL

METALS / MINING

03 OCT 2017

Event Update

BUY

Target Price: Rs 765

JV with ThyssenKrupp – a positive

Tata Steel and ThyssenKrupp AG have signed MOU to form 50:50 joint venture of their European operations. Tata Steel expects commencement of JV by March 2019, post clearance of various regulatory approvals.

Impact: The JV is **Positive** for Tata Steel as the company can now focus on Indian growth opportunity. Tata Steel would now likely look to expand Kalinganagar (Odisha) capacity. Expansion would be value accretive, given (a) strong steel demand/supply dynamics in India and (b) lower capex cost being a brownfield expansion. While we await details about complete financial arrangements, we raise our target EV/EBITDA multiple for Tata Steel Europe by 1x and maintain **BUY** rating on the stock with revised target price of Rs 765 (Rs 690 earlier).

CMP : Rs 688
Potential Upside : 11%

MARKET DATA

No. of Shares : 971 mn
Free Float : 69%
Market Cap : Rs 668 bn
52-week High / Low : Rs 692 / Rs 359
Avg. Daily vol. (6mth) : 6.3 mn shares
Bloomberg Code : TATA IB Equity
Promoters Holding : 31%
FII / DII : 14% / 30%

Key highlights

- ♦ **Combined entity:** ThyssenKrupp Tata Steel will become the second largest steelmaker in Europe with 21 mnt annual shipment of flat steel (from 10 mnt in FY17 for Tata Steel Europe). Annual turnover of Euro 15 bn vs. Euro 7 bn in FY17 for Tata Steel Europe. Management expects Euro 400-600 mn synergies through integration of commercial, R&D and supporting activities and the entity to be free cash flow positive. Tata Steel will transfer its Euro 2.5 bn debt to the JV book. ThyssenKrupp will transfer its Euro 3.5 bn pension liability and "other steel legacy liabilities" of Euro 0.4 bn in the JV books. Transfer of liabilities will be done in a manner that eventually both partners hold equal stake in the combined entity
- ♦ **Steps ahead:** The process will now move to the next phase in the transaction with due diligence and negotiations on the definitive detailed agreements. The combination is subject to obtaining all corporate authorizations, including Board and shareholder approvals. Completion would be conditional to obtaining requisite competition approvals

Financial summary (Consolidated)

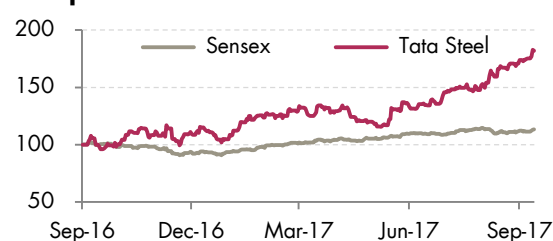
Y/E March	FY16	FY17	FY18E	FY19E
Sales (Rs bn)	1,013	1,116	1,195	1,237
EBITDA (Rs bn)	80	170	174	196
Adj PAT (Rs bn)	(18)	39	50	66
Con. EPS* (Rs)	-	-	65	73
EPS (Rs)	(19)	41	51	68
Change YOY (%)	(271)	(315)	26	33
P/E (x)	(36)	17	13	10
RoE (%)	(7)	11	14	16
EV/E (x)	18	8	8	7
DPS (Rs)	8	8	4	4

Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

	FY17	FY18E	FY19E
Domestic volumes (mnt)	11.0	12.0	12.0
Intl. ops' volumes (mnt)	12.9	13.2	13.4
Domestic EBITDA/ton (Rs)	10,800	10,600	11,600
Intl. ops' EBITDA/t (USD)	59	53	62

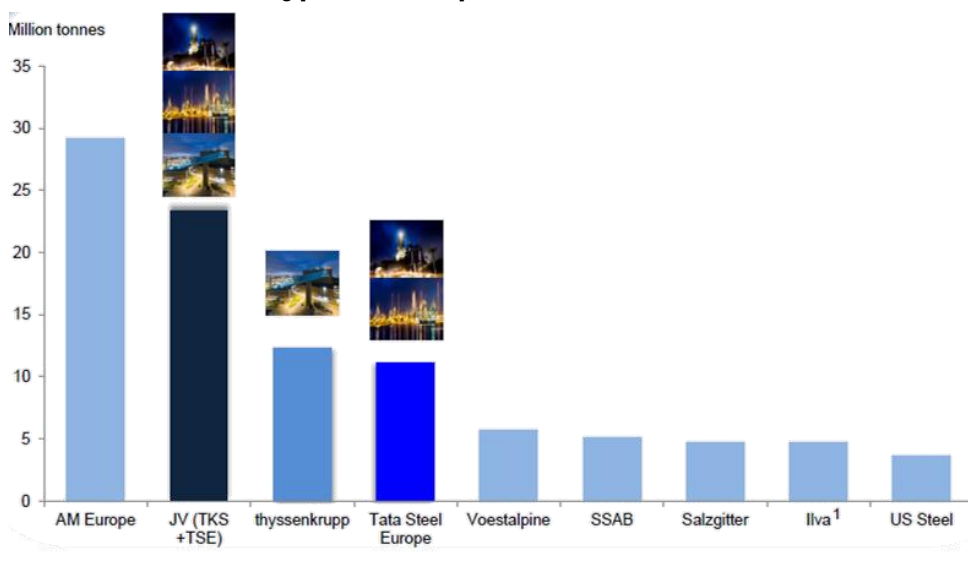
Price performance



Conference call takeaways

- ♦ **India capacity expansion:** Tata Steel will target to double its India capacity in 5 years which will be done through organic (both through Kalinganagar and Jamshedpur facilities) and inorganic route
- ♦ **India focus management:** Tata Steel India is unlikely to spend much time on dealing with Tata Steel Europe. ThyssenKrupp Tata Steel will have a two tier management structure with the Supervisory Board focusing on shareholders' interest and Management Board focusing on day to day operations
- ♦ **Job cuts** to be ~4,000; to be shared equally by the two companies
- ♦ **Debt transfer:** Total net debt in consolidated books is Rs 740 bn. India business has Rs 400 bn, Rs 170 bn will be transferred to the JV and balance Rs 170 bn will be serviced through the dividends received from the JV
- ♦ **ThyssenKrupp's pension liability:** The pension liability of Euro 3.6 bn may have the actual liability of 60% as computed by the rating agencies. However, for the purpose of JV, gross value has been taken
- ♦ **Capex:** Currently, annual capex is Euro 350 mn for Tata Steel and Euro 400 mn for ThyssenKrupp. Of the total, the combined entity will have some synergies on capex avoidance

Exhibit 1: Market standing post JV in Europe



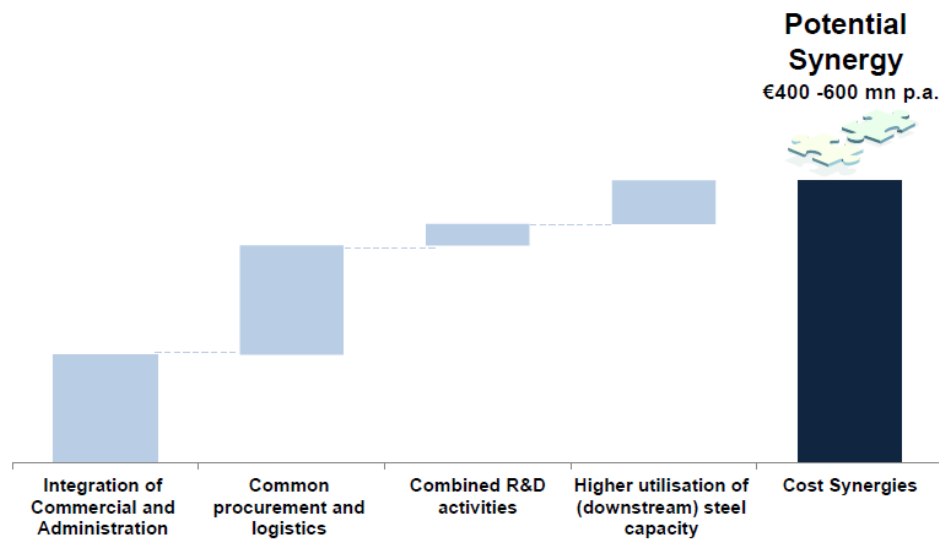
Source: Company

Note: Flat Steel production in Europe (2015),

1 Ilva's acquisition by ArcelorMittal yet to be legally finalized

AM Europe is ArcelorMittal Europe

Exhibit 2: Estimated areas of cost synergies on a steady state basis



Source: Company

Exhibit 3: JV Proforma financials (in Euro mn)

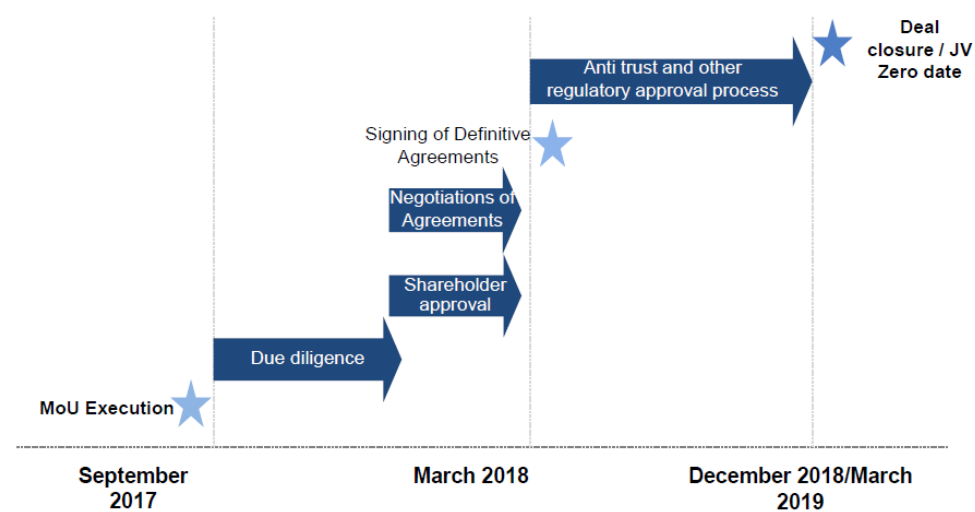
Tata Steel Europe		Jun'17 (LTM)
Deliveries (in million tons)		9.8
Turnover		7,381
EBITDA		699

thyssenkrupp Steel Europe		Jun'17 (LTM)
Deliveries (in million tons)		11.5
Turnover		8,585
EBITDA		866

JV Proforma (Indicative)		
Deliveries (in million tons) ¹		21.3
Turnover ¹		15,966
EBITDA ¹		1,565
Term Debt		2,500

Source: Company

Exhibit 4: Indicative timelines



Source: Company

Financial summary (Consolidated)

Profit & loss (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	1,013	1,116	1,195	1,237
Other operating income	7	7	5	6
Total operating income	1,020	1,123	1,201	1,243
Cost of goods sold	(556)	(543)	(554)	(568)
Gross profit	464	580	647	674
<i>Gross margin (%)</i>	<i>45.8</i>	<i>52.0</i>	<i>54.1</i>	<i>54.5</i>
Total operating expenses	(384)	(410)	(473)	(478)
EBITDA	80	170	174	196
<i>EBITDA margin (%)</i>	<i>7.9</i>	<i>15.2</i>	<i>14.6</i>	<i>15.9</i>
Depreciation	(53)	(57)	(59)	(61)
EBIT	27	113	116	135
Net interest	(42)	(51)	(48)	(44)
Other income	4	5	6	6
Profit before tax	(11)	68	74	98
Total taxation	(7)	(28)	(24)	(31)
<i>Tax rate (%)</i>	<i>(60.1)</i>	<i>40.9</i>	<i>31.9</i>	<i>31.8</i>
Profit after tax	(18)	40	50	67
Minorities	1	(1)	(1)	(1)
Profit/ Loss associate co(s)	(1)	-	-	-
Adjusted net profit	(18)	39	50	66
<i>Adj. PAT margin (%)</i>	<i>(1.8)</i>	<i>3.5</i>	<i>4.1</i>	<i>5.4</i>
Net non-recurring items	15	(82)	28	-
Reported net profit	(4)	(42)	78	66

Balance sheet (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Paid-up capital	10	10	10	10
Reserves & surplus	364	311	385	447
Net worth	374	320	394	457
Borrowing	843	853	803	753
Other non-current liabilities	4	102	102	102
Total liabilities	1,228	1,291	1,316	1,329
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	257	262
Debtors	121	116	118	123
Cash & bank	108	106	83	83
Loans & advances	73	84	95	98
Current liabilities	385	381	354	347
Net current assets	117	173	200	219
Other non-current assets	-	-	-	-
Total assets	1,228	1,291	1,316	1,329

Source: Company, Axis Capital

Cash flow (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	(11)	68	74	98
Depreciation & Amortisation	53	57	59	61
<i>Chg in working capital</i>	<i>86</i>	<i>(48)</i>	<i>(50)</i>	<i>(18)</i>
Cash flow from operations	205	216	107	153
<i>Capital expenditure</i>	<i>(102)</i>	<i>(77)</i>	<i>(60)</i>	<i>(55)</i>
Cash flow from investing	(128)	(166)	(28)	(55)
<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>(50)</i>	<i>(50)</i>
<i>Dividend paid</i>	<i>(9)</i>	<i>(12)</i>	<i>(4)</i>	<i>(4)</i>
Cash flow from financing	(70)	(52)	(102)	(98)
Net chg in cash	7	(3)	(23)	-

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
OPERATIONAL				
FDEPS (Rs)	(19)	41	51	68
CEPS (Rs)	51	15	140	131
DPS (Rs)	8	8	4	4
Dividend payout ratio (%)	(203)	(18)	5	6
GROWTH				
Net sales (%)	(26)	10	7	3
EBITDA (%)	(41)	113	2	13
Adj net profit (%)	(271)	(315)	26	33
FDEPS (%)	(271)	(315)	26	33
PERFORMANCE				
RoE (%)	(7)	11	14	16
RoCE (%)	3	9	9	11
EFFICIENCY				
Asset turnover (x)	1.0	1.0	1.1	1.1
Sales/ total assets (x)	0.7	0.7	0.7	0.7
Working capital/ sales (x)	0.1	-	0.1	0.1
Receivable days	43	38	36	36
Inventory days	78	95	91	91
Payable days	150	146	126	121
FINANCIAL STABILITY				
Total debt/ equity (x)	2.9	2.4	2.1	1.7
Net debt/ equity (x)	2.5	2.1	1.9	1.5
Current ratio (x)	1.3	1.5	1.6	1.6
Interest cover (x)	0.6	2.2	2.4	3.1
VALUATION				
PE (x)	(36)	17	13	10
EV/ EBITDA (x)	17.6	8.3	8.0	6.8
EV/ Net sales (x)	1.4	1.3	1.2	1.1
PB (x)	2	2	2	1
Dividend yield (%)	1	1	1	1
Free cash flow yield (%)	18	8	11	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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