

Tata Steel | BUY

Operationally in-line; Europe disappoints

Tata Steel reported consolidated EBITDA of INR47.2bn in-line with JMfe. While Indian operations reported an EBITDA in line with estimates, European operations delivered an EBITDA of USD45/ton vs. JMFe of USD73/ton, driven by higher RM costs and lower spreads. Tata's Indian operations have now fully ramped up, with its 3mt green-field steel plant at Kalinganagar operating at close to full utilisation levels. A barrage of duties put in place by the Government has ensured a floor price for imports, limiting any downside to Indian operations profitability. We expect continued focus on the EU turnaround plans for much of the current fiscal year. We factor in Indian operations EBITDA/ton of INR11.3/11.5k for FY18/19E and an EBITDA/ton of USD75 for European business. We escribe a multiple of 7x FY19 EV/EBITDA to Indian business to arrive at SOTP fair value of INR750/sh. Maintain BUY.

- **Indian operations EBITDA in-line with JMFe:** Tata Steel India reported a revenue growth of c.34.1% YoY, driven by 17.4% YoY growth in volumes to 3.08mn tons and c.14.3% increase in realisations YoY. The volume growth was supported by ramp-up at Kalinganagar and volume growth across the verticals. EBITDA increased 76% YoY to INR33.8bn, in-line with JMFe of INR34.3bn.
- **European margins decline on higher RM costs and lower spreads:** Corus EBITDA per ton witnessed moderation at USD45/ton in 2Q as against JMfe expectation of USD73/ton. This is a decline from USD67/ton in 2QFY17 and USD81/ton reported in the previous quarter, driven by decline in gross margin to 53% in 2QFY18. EBITDA declined 24% YoY to USD117mn due to lower spreads and higher raw material cost.
- **South East Asia operations gain on higher volumes and improved spreads:** South East Asian operations reported a significant increase in EBITDA from INR220mn in 1QFY18 to INR1.4bn in 2QFY18 driven by higher deliveries and improved spreads.
- **European business poised for structural turnaround:** Tata Steel Europe witnessed significant positive developments – **a)** Signed a MoU for a 50:50 JV with Thyssenkrupp AG with combined proforma annual shipments of 21mn tons and an EBITDA of USD 2bn+ (including expected synergies of USD 480-72mn), implying a net debt EBITDA of c.3.5, **b)** Tata Steel UK (TSUK) completed the consultation process with employees to close the British Steel Pension Scheme (BSPS) for future accruals for an agreed settlement amount of GDP550mn to BSPS and provision of 33% equity stake in TSUK along with sponsorship of a new scheme with lower future annual increases for the pensioners, **c)** completed sale of 42 inch and 84 inch pipe mills in Hartlepool to Liberty House and **d)** acquired full Intellectual property rights in Hlsarna technology with potential benefits of reduced costs through lower usage of energy and use of lower priced raw material costs.
- **KPO Phase-II capex time away:** The Indian operations may see a capex breather for some time facilitating deleveraging of the balance sheet. However, Tata is likely to embark on the Kalinganagar expansion potentially adding another 3-5mn tons of capacity at a very efficient sub-US\$500/t of capex given accommodative Phase I capex earlier.



Ashutosh Somani

ashutosh.somani@jmfl.com | Tel: (91 22) 66303083

Nitin Agarwala

nitin.agarwala@jmfl.com | Tel: (91 22) 66303125

Recommendation and Price Target

| | |
|----------------------------|------|
| Current Reco. | BUY |
| Previous Reco. | BUY |
| Current Price Target (12M) | 750 |
| Upside/(Downside) | 4.4% |
| Previous Price Target | 750 |
| Change | 0.0% |

Key Data – TATA IN

| | |
|--------------------------|---------------------|
| Current Market Price | INR718 |
| Market cap (bn) | INR697.6/US\$10.8 |
| Free Float | 57% |
| Shares in issue (mn) | 971.4 |
| Diluted share (mn) | 971.4 |
| 3-mon avg daily val (mn) | INR3,417.7/US\$52.7 |
| 52-week range | 735/366 |
| Sensex/Nifty | 33,266/10,364 |
| INR/US\$ | 64.8 |

Price Performance

| % | 1M | 6M | 12M |
|-----------|------|------|------|
| Absolute | 10.1 | 59.9 | 77.5 |
| Relative* | 3.5 | 43.8 | 49.0 |

* To the BSE Sensex

JM Financial Research is also available on:
Bloomberg - JMFR <GO>,
Thomson Publisher & Reuters
S&P Capital IQ and FactSet

Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

| Financial Summary | (INR mn) | | | | |
|------------------------|-----------|-----------|-----------|-----------|-----------|
| Y/E March | FY15A | FY16A | FY17A | FY18E | FY19E |
| Net Sales | 1,395,037 | 1,019,647 | 1,122,994 | 1,370,108 | 1,408,483 |
| Sales Growth (%) | -6.1 | -26.9 | 10.1 | 22.0 | 2.8 |
| EBITDA | 125,358 | 79,683 | 170,078 | 199,524 | 209,372 |
| EBITDA Margin (%) | 9.0 | 7.8 | 15.1 | 14.6 | 14.9 |
| Adjusted Net Profit | 32 | -18,333 | 39,476 | 66,510 | 79,321 |
| Diluted EPS (INR) | 0.0 | -18.9 | 40.6 | 68.5 | 81.7 |
| Diluted EPS Growth (%) | -99.9 | 0.0 | 0.0 | 68.5 | 19.3 |
| ROIC (%) | -0.1 | 3.8 | 5.9 | 8.7 | 9.5 |
| ROE (%) | 0.0 | -4.2 | 10.3 | 17.3 | 17.6 |
| P/E (x) | 22,142.0 | -38.0 | 17.7 | 10.5 | 8.8 |
| P/B (x) | 1.6 | 1.7 | 2.0 | 1.7 | 1.4 |
| EV/EBITDA (x) | 11.8 | 19.4 | 9.3 | 7.4 | 6.8 |
| Dividend Yield (%) | 1.4 | 1.1 | 1.1 | 0.9 | 0.9 |

Source: Company data, JM Financial. Note: Valuations as of 30/Oct/2017

Exhibit 1. Quarterly performance (consolidated) (INR mn)

| | 2QFY18 | 2QFY18E | Var% | 2QFY17 | YoY % | 1QFY18 | QoQ % |
|----------------------|----------------|----------------|------------|----------------|-------------|----------------|-------------|
| Net Sales | 324,641 | 322,887 | 0.5 | 263,710 | 23.1 | 295,568 | 9.8 |
| EBITDA | 47,207 | 47,203 | 0.0 | 29,700 | 58.9 | 49,740 | -5.1 |
| PAT- Adjusted | 10,157 | 16,562 | | -1,425 | | 15,304 | |

Source: Company, JM Financial

Exhibit 2. Quarterly performance (standalone) (INR mn)

| | 2QFY18 | 2QFY18E | Var% | 2QFY17 | YoY % | 1QFY18 | QoQ % |
|-----------------------|----------------|----------------|-------------|----------------|--------------|----------------|--------------|
| Net Sales | 142,209 | 148,828 | -4.4 | 106,018 | 34.1 | 129,706 | 9.6 |
| Volumes (mn tons) | 3.08 | 3.13 | -1.6 | 2.62 | 17.4 | 2.75 | 12.0 |
| Realisation (INR/ton) | 46,172 | 47,549 | -2.9 | 40,403 | 14.3 | 47,166 | -2.1 |
| Expenditure | 108,457 | 114,572 | -5.3 | 86,870 | 24.8 | 100,043 | 8.4 |
| EBITDA | 33,753 | 34,256 | -1.5 | 19,148 | 76.3 | 29,663 | 13.8 |
| EBITDA (%) | 23.7 | 23.0 | | 18.1 | | 22.9 | |
| Blended EBITDA/ton | 10,959 | 10,944 | 0.1 | 7,297 | 50.2 | 10,786 | 1.6 |
| Other Income | 2,495 | 1,800 | | 1,647 | | 1,121 | |
| Depreciation | 9,124 | 10,000 | -8.8 | 9,117 | | 9,664 | |
| EBIT | 27,123 | 26,056 | 4.1 | 11,678 | 132.3 | 21,120 | 28.4 |
| Interest | 7,092 | 7,500 | -5.4 | 7,367 | | 7,001 | |
| PBT | 20,032 | 18,556 | 8.0 | 4,311 | 364.7 | 14,119 | 41.9 |
| Tax | 6,824 | 6,123 | | 1,172 | | 2,886 | |
| Eff. Tax Rate (%) | 34.1 | 33.0 | | 27.2 | | 20.4 | |
| XO Items | -267 | 0 | | -643 | | -6,168 | |
| PAT- Reported | 12,941 | 12,432 | 4.1 | 2,496 | 418.5 | 5,064 | 155.5 |
| PAT- Adjusted | 13,119 | 12,432 | 5.5 | 2,926 | 348.3 | 9,197 | 42.6 |
| EPS (INR) | 13.5 | 12.8 | | 3.0 | | 9.5 | |

Source: Company, JM Financial

Exhibit 3. Quarterly performance – Corus (USD mn)

| | 2QFY18 | 2QFY18E | % Var | 2QFY17 | YoY % |
|-------------------------|--------------|--------------|--------------|--------------|--------------|
| Net Sales | 2,334 | 2,365 | -1.3 | 1,846 | 26.4 |
| Deliveries (mn tons) | 2.6 | 2.6 | | 2.3 | 13% |
| Realisations (US\$/ton) | 898 | 910 | -1.3 | 803 | 11.8 |
| EBITDA | 117 | 190 | -38.3 | 155 | -24.3 |
| EBITDA/ton (US\$/ton) | 45 | 73 | | 67 | |

Source: Company, JM Financial

Exhibit 4. TATA steel India – key assumptions

| | FY18E | FY19E |
|---------------------------|------------|------------|
| Net sales (INR bn) | 548 | 586 |
| Sales volume (mn ton) | 11.9 | 12.6 |
| EBITDA (INR bn) | 134 | 144 |
| EBITDA (INR/ton) | 11,293 | 11,452 |

Source: JM Financial

Exhibit 5. TATA Steel Europe – key assumptions

| | FY18E | FY19E |
|----------------------------|-------------|-------------|
| Net sales (US\$ bn) | 10.7 | 10.7 |
| Sales volume (mn ton) | 11.0 | 11.0 |
| EBITDA (US\$ bn) | 0.8 | 0.8 |
| EBITDA (USD/ton) | 75 | 75 |

Source: JM Financial

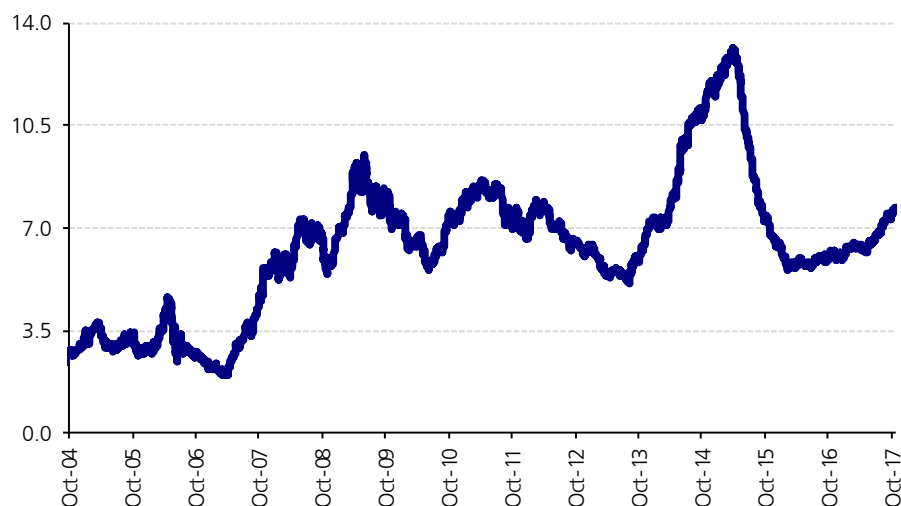
Exhibit 6. SOTP valuation of INR750/share; BUY

(INR bn)

| Companies | FY19 EBITDA (INR bn) | Multiple (x) | Target EV |
|--|----------------------|--------------|------------|
| | 143.8 | 7 | 1,021 |
| Corus | 53.6 | 6 | 322 |
| NAT Steel + Tata steel Thailand + others | 12.0 | 5 | 60 |
| Total EV | | | 1,403 |
| Total Net debt | | | 691 |
| Target MCap | | | 712 |
| No. of shares (mn) | | | 971 |
| Value INR/share | | | 733 |
| Investments (INR/share) | | | 18 |
| Target Price (INR/share) | | | 750 |

Source: JM Financial

Exhibit 7. EV/EBITDA trend - one year forward



5/10 year averages of 1-year forward EV/EBITDA are 7.6x/7.3x respectively

Source: Bloomberg, Company, JM Financial

Exhibit 8. Fair value sensitivity to Corus and India EBITDA/ton

(INR/share)

| | | FY19E EBITDA/ton of TATA Steel India (INR/ton) | | | | |
|---|----|--|--------|--------|--------|--------|
| | | 10,452 | 10,952 | 11,452 | 11,952 | 12,452 |
| FY19E EBITDA/ton of TATA Steel Europe (USD/ton) | 65 | 594 | 646 | 698 | 751 | 803 |
| | 70 | 619 | 672 | 724 | 776 | 829 |
| | 75 | 645 | 697 | 750 | 802 | 854 |
| | 80 | 671 | 723 | 776 | 828 | 880 |
| | 85 | 697 | 749 | 801 | 854 | 906 |

Source: JM Financial

Financial Tables (Consolidated)

| Income Statement (INR mn) | | | | | |
|-----------------------------|------------------|------------------|------------------|------------------|------------------|
| Y/E March | FY15A | FY16A | FY17A | FY18E | FY19E |
| Net Sales | 1,395,037 | 1,019,647 | 1,122,994 | 1,370,108 | 1,408,483 |
| Sales Growth | -6.1% | -26.9% | 10.1% | 22.0% | 2.8% |
| Other Operating Income | 0 | 0 | 0 | 0 | 0 |
| Total Revenue | 1,395,037 | 1,019,647 | 1,122,994 | 1,370,108 | 1,408,483 |
| Cost of Goods Sold/Op. Exp | 556,674 | 406,215 | 393,049 | 610,471 | 623,858 |
| Personnel Cost | 214,076 | 175,876 | 172,522 | 176,902 | 179,778 |
| Other Expenses | 498,929 | 357,873 | 387,345 | 383,210 | 395,475 |
| EBITDA | 125,358 | 79,683 | 170,078 | 199,524 | 209,372 |
| EBITDA Margin | 9.0% | 7.8% | 15.1% | 14.6% | 14.9% |
| EBITDA Growth | -23.6% | -36.4% | 113.4% | 17.3% | 4.9% |
| Depn. & Amort. | 59,436 | 53,064 | 56,729 | 63,553 | 65,518 |
| EBIT | 65,922 | 26,620 | 113,349 | 135,971 | 143,854 |
| Other Income | 7,962 | 4,122 | 5,275 | 5,186 | 5,182 |
| Finance Cost | 48,478 | 42,214 | 50,722 | 46,413 | 40,614 |
| PBT before Excep. & Forex | 25,406 | -11,472 | 67,902 | 94,744 | 108,421 |
| Excep. & Forex Inc./Loss(-) | 0 | 0 | 0 | 0 | 0 |
| PBT | 25,406 | -11,472 | 67,902 | 94,744 | 108,421 |
| Taxes | 25,674 | 6,900 | 27,780 | 27,553 | 28,380 |
| Extraordinary Inc./Loss(-) | -39,287 | 14,505 | -81,884 | 0 | 0 |
| Assoc. Profit/Min. Int.(-) | -300 | -39 | 646 | 682 | 720 |
| Reported Net Profit | -39,255 | -3,828 | -42,408 | 66,510 | 79,321 |
| Adjusted Net Profit | 32 | -18,333 | 39,476 | 66,510 | 79,321 |
| Net Margin | 0.0% | -1.8% | 3.5% | 4.9% | 5.6% |
| Diluted Share Cap. (mn) | 971.4 | 971.4 | 971.4 | 971.4 | 971.4 |
| Diluted EPS (INR) | 0.0 | -18.9 | 40.6 | 68.5 | 81.7 |
| Diluted EPS Growth | -99.9% | 0.0% | 0.0% | 68.5% | 19.3% |
| Total Dividend + Tax | 11,311 | 9,263 | 9,247 | 7,515 | 7,515 |
| Dividend Per Share (INR) | 10.0 | 8.0 | 8.0 | 6.5 | 6.5 |

Source: Company, JM Financial

| Balance Sheet (INR mn) | | | | | |
|-----------------------------------|------------------|------------------|------------------|------------------|------------------|
| Y/E March | FY15A | FY16A | FY17A | FY18E | FY19E |
| Shareholders' Fund | 448,387 | 414,576 | 355,443 | 414,438 | 486,244 |
| Share Capital | 9,714 | 9,702 | 9,702 | 9,702 | 9,702 |
| Reserves & Surplus | 438,672 | 404,873 | 345,741 | 404,736 | 476,542 |
| Preference Share Capital | 0 | 0 | 0 | 0 | 0 |
| Minority Interest | 8,542 | 7,809 | 16,017 | 16,775 | 17,572 |
| Total Loans | 856,489 | 902,254 | 910,497 | 937,087 | 923,717 |
| Def. Tax Liab. / Assets (-) | 125,892 | 118,340 | 119,057 | 119,057 | 119,057 |
| Total - Equity & Liab. | 1,439,310 | 1,442,979 | 1,401,014 | 1,487,358 | 1,546,590 |
| Net Fixed Assets | 1,022,790 | 1,081,959 | 1,077,907 | 1,083,309 | 1,083,668 |
| Gross Fixed Assets | 1,030,532 | 1,085,795 | 1,265,617 | 1,338,572 | 1,384,450 |
| Intangible Assets | 39,609 | 40,676 | 34,947 | 34,947 | 34,947 |
| Less: Depn. & Amort. | 329,165 | 404,473 | 380,498 | 444,052 | 509,570 |
| Capital WIP | 281,814 | 359,961 | 157,841 | 153,841 | 173,841 |
| Investments | 140,930 | 107,137 | 124,571 | 86,745 | 86,745 |
| Current Assets | 566,172 | 579,744 | 521,996 | 670,202 | 734,735 |
| Inventories | 245,934 | 200,133 | 248,038 | 254,435 | 260,218 |
| Sundry Debtors | 135,798 | 120,662 | 115,868 | 141,463 | 142,276 |
| Cash & Bank Balances | 82,485 | 61,863 | 49,211 | 165,425 | 223,362 |
| Loans & Advances | 101,956 | 197,085 | 108,879 | 108,879 | 108,879 |
| Other Current Assets | 0 | 0 | 0 | 0 | 0 |
| Current Liab. & Prov. | 290,582 | 325,861 | 323,460 | 352,899 | 358,558 |
| Current Liabilities | 252,682 | 266,237 | 270,789 | 247,345 | 250,006 |
| Provisions & Others | 37,900 | 59,623 | 52,671 | 105,554 | 108,552 |
| Net Current Assets | 275,590 | 253,884 | 198,536 | 317,304 | 376,177 |
| Total - Assets | 1,439,310 | 1,442,979 | 1,401,014 | 1,487,358 | 1,546,590 |

Source: Company, JM Financial

| Cash Flow Statement (INR mn) | | | | | |
|------------------------------|----------------|-----------------|----------------|----------------|----------------|
| Y/E March | FY15A | FY16A | FY17A | FY18E | FY19E |
| Profit before Tax | 25,706 | -11,433 | 67,256 | 94,062 | 107,701 |
| Depn. & Amort. | 59,436 | 53,064 | 56,729 | 63,553 | 65,518 |
| Net Interest Exp. / Inc. (-) | 0 | 0 | 0 | 0 | 0 |
| Inc (-) / Dec in WCap. | -43,702 | 1,085 | 42,695 | -2,553 | -936 |
| Others | -39,287 | 14,505 | -81,884 | 0 | 0 |
| Taxes Paid | -25,674 | -6,900 | -27,780 | -27,553 | -28,380 |
| Operating Cash Flow | -23,521 | 50,320 | 57,016 | 127,509 | 143,903 |
| Capex | 517,304 | -133,409 | 22,298 | -68,955 | -65,878 |
| Free Cash Flow | 493,783 | -83,089 | 79,314 | 58,554 | 78,025 |
| Inc (-) / Dec in Investments | -89,995 | 33,793 | -17,434 | 37,826 | 0 |
| Others | -403,322 | -7,816 | -73,527 | 758 | 796 |
| Investing Cash Flow | 23,986 | -107,432 | -68,664 | -30,371 | -65,082 |
| Inc / Dec (-) in Capital | 0 | -12 | 0 | 0 | 0 |
| Dividend + Tax thereon | -11,311 | -9,263 | -9,247 | -7,515 | -7,515 |
| Inc / Dec (-) in Loans | 504 | 45,765 | 8,242 | 26,591 | -13,370 |
| Others | 0 | 0 | 0 | 0 | 0 |
| Financing Cash Flow | -10,806 | 36,491 | -1,005 | 19,076 | -20,885 |
| Inc / Dec (-) in Cash | -10,341 | -20,622 | -12,653 | 116,215 | 57,937 |
| Opening Cash Balance | 92,826 | 82,485 | 61,863 | 49,211 | 165,425 |
| Closing Cash Balance | 82,485 | 61,863 | 49,211 | 165,425 | 223,362 |

Source: Company, JM Financial; Note: Significant variation in WCap in FY16/17 due to significant increase in retirement benefit asset in FY16 partially offset by change in inventory

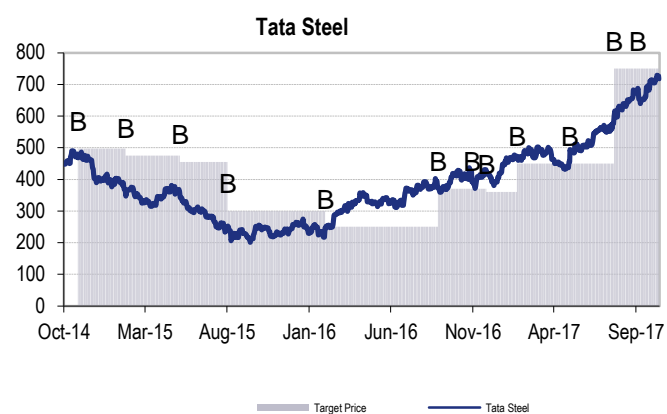
| Dupont Analysis | | | | | |
|---------------------|----------|-------|-------|-------|-------|
| Y/E March | FY15A | FY16A | FY17A | FY18E | FY19E |
| Net Margin | 0.0% | -1.8% | 3.5% | 4.9% | 5.6% |
| Asset Turnover (x) | 1.1 | 0.8 | 0.9 | 1.0 | 1.0 |
| Leverage Factor (x) | 3.0 | 3.1 | 3.4 | 3.4 | 3.1 |
| RoE | 0.0% | -4.2% | 10.3% | 17.3% | 17.6% |
| Key Ratios | | | | | |
| Y/E March | FY15A | FY16A | FY17A | FY18E | FY19E |
| BV/Share (INR) | 461.6 | 426.8 | 365.9 | 426.6 | 500.6 |
| ROIC | -0.1% | 3.8% | 5.9% | 8.7% | 9.5% |
| ROE | 0.0% | -4.2% | 10.3% | 17.3% | 17.6% |
| Net Debt/Equity (x) | 1.7 | 2.0 | 2.4 | 1.9 | 1.4 |
| P/E (x) | 22,142.0 | -38.0 | 17.7 | 10.5 | 8.8 |
| P/B (x) | 1.6 | 1.7 | 2.0 | 1.7 | 1.4 |
| EV/EBITDA (x) | 11.8 | 19.4 | 9.3 | 7.4 | 6.8 |
| EV/Sales (x) | 1.1 | 1.5 | 1.4 | 1.1 | 1.0 |
| Debtor days | 36 | 43 | 38 | 38 | 37 |
| Inventory days | 64 | 72 | 81 | 68 | 67 |
| Creditor days | 73 | 103 | 104 | 77 | 76 |

Source: Company, JM Financial

History of Earnings Estimate and Target Price

| Date | FY18E EPS (INR) | % Chg. | FY19E EPS (INR) | % Chg. | Target Price | % Chg. |
|-----------|--------------------|--------|--------------------|--------|-----------------|--------|
| 12-Nov-14 | | | | | 497 | |
| 9-Feb-15 | | | | | 475 | -4.4 |
| 21-May-15 | | | | | 455 | -4.2 |
| 18-Aug-15 | 21.6 | | | | 300 | -34.1 |
| 16-Feb-16 | 19.6 | -9.3 | | | 250 | -16.7 |
| 13-Sep-16 | 63.2 | 222.4 | | | 370 | 48.0 |
| 15-Nov-16 | 63.2 | 0.0 | 64.8 | | 370 | 0.0 |
| 12-Dec-16 | 61.9 | -2.1 | 64.8 | 0.0 | 360 | -2.7 |
| 7-Feb-17 | 61.9 | 0.0 | 64.9 | 0.2 | 450 | 25.0 |
| 16-May-17 | 62.0 | 0.2 | 64.8 | -0.2 | 450 | 0.0 |
| 7-Aug-17 | 68.5 | 10.5 | 81.7 | 26.1 | 750 | 66.7 |
| 20-Sep-17 | 68.5 | 0.0 | 81.7 | 0.0 | 750 | 0.0 |

Recommendation History



APPENDIX I

JM Financial Institutional Securities Limited

Corporate Identity Number: U65192MH1995PLC092522

Member of BSE Ltd. and National Stock Exchange of India Ltd. and Metropolitan Stock Exchange of India Ltd.

SEBI Registration Nos.: BSE - INZ010012532, NSE - INZ230012536 and MSEI - INZ260012539, Research Analyst – INH000000610

Registered Office: 7th Floor, Cnergy, Appasaheb Marathe Marg, Prabhadevi, Mumbai 400 025, India.

Board: +9122 6630 3030 | Fax: +91 22 6630 3488 | Email: jmfinancial.research@jmfl.com | www.jmfl.com

Compliance Officer: Mr. Sunny Shah | Tel: +91 22 6630 3383 | Email: sunny.shah@jmfl.com

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|-----------------------|--|
| Rating | Meaning |
| Buy | Total expected returns of more than 15%. Total expected return includes dividend yields. |
| Hold | Price expected to move in the range of 10% downside to 15% upside from the current market price. |
| Sell | Price expected to move downwards by more than 10% |

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