

BUY

TP: Rs 140 | ▲ 34%

TATA STEEL

| Metals & Mining

| 24 September 2022

Merger to simplify group structure

- Proposed merger with 7 group entities will simplify the group structure and enable more efficient funding of NINL and mining expansions
- Announced merger ratios with subsidiaries appear broadly value-neutral for TATA
- Retain estimates pending deal completion; TATA (BUY, TP Rs 140) remains our preferred defensive play in a volatile climate

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Group structure being simplified: TATA has announced the merger of seven of its group entities with itself. The plan excludes Neelachal Ispat Nigam (NINL) where stake dilution is restricted at this stage. The merger will streamline the overall group structure, enable efficient utilisation of group facilities and optimisation of procurement, logistics costs and aid tighter working capital management.

Enables uncomplicated funding for NINL: Importantly, the merger will enable funding of NINL directly on TATA's balance sheet and also avoid the need for complex structures to extend support to long products subsidiary Tata Steel Long Products (TSLP).

Merger value-neutral: We believe the merger is broadly value-neutral at the proposed swap ratios. While it will result in 2.2% dilution of TATA's shares, this would largely be offset by a lower share of minority interest in earnings and modest cost savings of Rs 7bn pre-tax mainly on account of additional royalty that is currently payable by TATA on the sale of captive iron ore to TSLP and Tata Metaliks (TML). Further cost optimisations can improve value. The changes are modest as subsidiary earnings are already accounted for in consolidated earnings.

We remain constructive on India's steel sector: While near-term uncertainty persists owing to the China slowdown, we believe steel margins will stabilise to mid-cycle levels over H2FY23. More importantly, we look forward to earnings growth from Indian steel players over FY23-FY26 as they deliver on the next wave of efficiency and value improvement and expansion projects.

Reiterate BUY: We are not revising estimates at this stage pending completion of the merger. We continue to prefer defensive play TATA (BUY, TP Rs 140) from amongst our steel coverage for its ability to generate sector-leading margins via better integration all the way to iron ore and for its focus on downstream and retail businesses to capture value-add. Our TP is based on a one-year forward EV/EBITDA multiple of 5.5x, which is below our 6x mid-cycle multiple for the Indian steel sector to account for global economic uncertainty.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	TATA IN/Rs 104
Market cap	US\$ 15.6bn
Free float	66%
3M ADV	US\$ 55.0mn
52wk high/low	Rs 143/Rs 83
Promoter/FPI/DII	34%/22%/20%

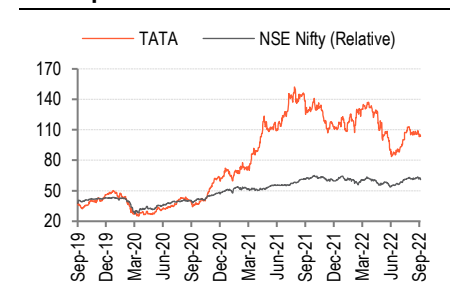
Source: NSE | Price as of 23 Sep 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	2,423	2,278	1,975
EBITDA (Rs mn)	635	432	400
Adj. net profit (Rs mn)	402	221	190
Adj. EPS (Rs)	33.2	18.3	15.7
Consensus EPS (Rs)	33.3	17.6	14.5
Adj. ROAE (%)	42.6	17.8	13.3
Adj. P/E (x)	3.1	5.7	6.6
EV/EBITDA (x)	3.4	4.4	4.4
Adj. EPS growth (%)	436.1	(44.9)	(14.2)

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Decoding the merger

TATA has announced the merger of six of its major subsidiaries and an affiliate TRF with itself. The company has proposed share swap ratios with four of its group entities – Tata Steel Long Products (TSLP), Tinplate Company (TMKN), Tata Metaliks (TML) and TRF. TATA proposes to pay Rs 25.6bn for the merger of Indian Steel & Wire Products. The remaining two subsidiaries – Tata Steel Mining and S & T Mining – are to be merged without any cash or share payments.

Fig 1 – Proposed merger ratios

Company	Price 22-Sep-22 (Rs/sh)	Price arbitrage on Last Close (%)	Proposed merger ratio*	Historical market value ratios over past	
				1M	3M
Tata Steel (TATA)	103.6	-	-	-	-
Tata Steel Long Products (TSLP)	748.6	(7.3)	6.7	6.0	6.1
Tinplate Company (TPC)	338.0	1.1	3.3	3.0	3.2
Tata Metaliks (TML)	800.0	2.3	7.9	7.4	7.3
TRF	375.4	(53.1)	1.7	2.0	1.6

Source: Bloomberg, BOBCAPS Research | *Issue of Tata Steel shares for every share of the subsidiary

The proposed share swap ratios for the listed subsidiaries are broadly in line with their historical one-month and three-month market value ratios. However, the swap ratios imply negative arbitrage of 7.3% and 53.1% for TSLP and TRF shareholders respectively due to the sharp run-up in their stock prices over the last 2-4 weeks.

Restructuring to be broadly value-neutral

As the subsidiaries were already consolidated with TATA, we anticipate only modest changes to earnings following the merger primarily arising out of savings on royalty and a lower share of minority interest. We thus expect the proposed amalgamation to be broadly value-neutral for TATA before accounting for synergy benefits.

Fig 2 – Proposed merger value-neutral at consolidated entity level

(Rs bn)	FY22 earnings	Potential changes due to merger	Change (%)	Proforma earnings post merger
Profit or loss before minority interest	417.5	5.3*	-	422.7
Minority interest	16.0	(3.4)**	-	12.5
Owners' share	401.5	8.7	2.2	410.2
Less: Distribution on hybrid perpetual securities (net of tax)	0.0	-	-	0.0
Profit attributable to ordinary shareholders	401.5	-	-	410.2
Shares (mn)	12.2	0.3	2.2	12.5
EPS (Rs)	32.9	-	(0.1)	32.8

Source: Company, BOBCAPS Research | * Based on 7bn of pre-tax cost savings, **Minority earnings share of three major subsidiaries – TSLP, TPC and TML as a proxy

Valuation methodology

Maintain BUY, TP Rs 140

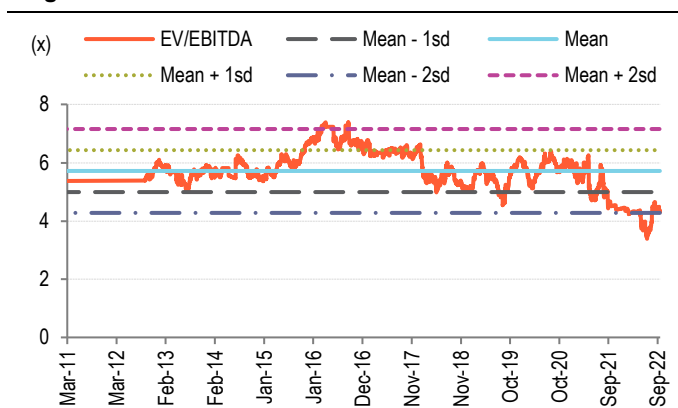
We retain our TP of Rs 140 based on a one-year forward EV/EBITDA multiple of 5.5x. Despite TATA's healthy margin and growth profile, our target multiple for the stock is below our 6x mid-cycle multiple for the Indian steel sector to account for uncertainty due to a slower-than-anticipated recovery in China and risks to global demand from the inflationary impact of the Russia-Ukraine war. The target multiple is also below the stock's historical trading average of 5.7x over the past ten-year period. Maintain BUY.

Fig 3 – Valuation summary

(Rs bn)	Value
FY24E EBITDA	400
Target EV/EBITDA multiple (x)	5.5
EV	2,201
FY23E Net debt	501
Equity value	1,700
Fair value (Rs)	141
Target price Mar'23 (rounded to nearest Rs 5)	140

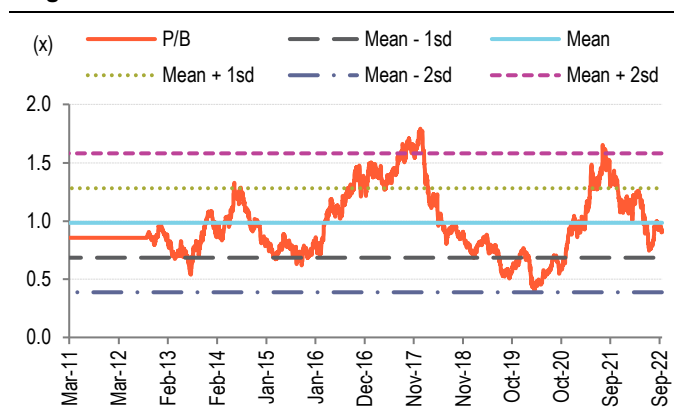
Source: BOBCAPS Research

Fig 4 – EV/EBITDA 2Y forward



Source: Bloomberg, BOBCAPS Research

Fig 5 – P/B 1Y forward



Source: Bloomberg, BOBCAPS Research

Key risks

- Steel producer valuations are highly sensitive to product and raw material prices. Key downside risks to our estimates are unfavourable changes in global demand-supply balance for steel and its raw materials, leading to lower prices and margins than our assumptions
- TATA is exposed to the risk of delays in implementation of its capital investment plan, including expansion, which could impact earnings growth. The company is targeting completion of margin enhancement projects such as the pellet plant and cold roll mill at Kalinaganagar plant by mid-FY24. It is also expanding Kalinaganagar capacity by 5mtpa to raise total India capacity to 25mt by FY25.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Jindal Steel & Power	JSP IN	5.4	426	460	BUY
JSW Steel	JSTL IN	20.0	669	655	HOLD
SAIL	SAIL IN	4.0	78	90	HOLD
Tata Steel	TATA IN	15.6	104	140	BUY

Source: BOBCAPS Research, NSE | Price as of 23 Sep 2022

Financials

Income Statement

Y/E 31 Mar (Rs bn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	1,547	2,423	2,278	1,975	1,988
EBITDA	305	635	432	400	427
Depreciation	(92)	(91)	(96)	(101)	(105)
EBIT	213	544	336	299	322
Net interest inc./(exp.)	(76)	(55)	(47)	(42)	(36)
Other inc./(exp.)	9	8	12	10	11
Exceptional items	(10)	(1)	0	0	0
EBT	138	502	307	274	303
Income taxes	(57)	(85)	(77)	(77)	(91)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	3	6	6	6	6
Reported net profit	75	402	221	190	204
Adjustments	0	0	0	0	0
Adjusted net profit	75	402	221	190	204

Balance Sheet

Y/E 31 Mar (Rs bn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	260	368	354	302	299
Other current liabilities	241	260	241	209	210
Provisions	47	28	28	28	28
Debt funds	885	756	676	596	516
Other liabilities	247	273	258	230	231
Equity capital	12	12	12	12	12
Reserves & surplus	730	1,132	1,332	1,495	1,670
Shareholders' fund	775	1,171	1,380	1,550	1,733
Total liab. and equities	2,455	2,854	2,936	2,914	3,017
Cash and cash eq.	130	244	175	183	208
Accounts receivables	95	122	125	108	109
Inventories	333	488	455	388	385
Other current assets	44	71	66	60	60
Investments	43	66	66	66	66
Net fixed assets	1,190	1,162	1,314	1,275	1,283
CWIP	190	220	290	385	455
Intangible assets	168	171	135	138	141
Deferred tax assets, net	0	0	0	0	0
Other assets	305	376	376	376	376
Total assets	2,455	2,854	2,936	2,914	3,017

Cash Flows

Y/E 31 Mar (Rs bn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	369	455	365	335	344
Capital expenditures	(100)	(97)	(283)	(160)	(185)
Change in investments	(9)	(23)	0	0	0
Other investing cash flows	89	(40)	12	10	11
Cash flow from investing	(19)	(159)	(271)	(150)	(175)
Equities issued/Others	1	0	0	0	0
Debt raised/repaid	(248)	(129)	(80)	(80)	(80)
Interest expenses	(76)	(55)	(47)	(42)	(36)
Dividends paid	(30)	(616)	(30)	(35)	(37)
Other financing cash flows	19	619	(6)	(20)	9
Cash flow from financing	(335)	(181)	(163)	(177)	(144)
Chg in cash & cash eq.	15	114	(70)	9	25
Closing cash & cash eq.	130	244	175	183	208

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	6.2	33.2	18.3	15.7	16.9
Adjusted EPS	6.2	33.2	18.3	15.7	16.9
Dividend per share	2.5	51.0	2.5	2.9	3.0
Book value per share	61.4	94.7	111.3	124.7	139.2

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	1.4	0.9	0.8	0.9	0.9
EV/EBITDA	7.2	3.4	4.4	4.4	4.0
Adjusted P/E	16.8	3.1	5.7	6.6	6.2
P/BV	1.7	1.1	0.9	0.8	0.7

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	50.3	79.7	72.1	69.2	67.3
Interest burden (PBT/EBIT)	70.0	92.6	91.3	91.7	94.1
EBIT margin (EBIT/Revenue)	13.7	22.4	14.8	15.1	16.2
Asset turnover (Rev./Avg TA)	62.4	91.3	78.7	67.5	67.0
Leverage (Avg TA/Avg Equity)	3.4	2.8	2.3	2.1	1.9
Adjusted ROAE	10.1	42.6	17.8	13.3	12.8

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	5.9	56.6	(6.0)	(13.3)	0.6
EBITDA	71.1	108.1	(31.9)	(7.4)	6.6
Adjusted EPS	356.4	436.1	(44.9)	(14.2)	7.3
Profitability & Return ratios (%)					
EBITDA margin	19.7	26.2	19.0	20.3	21.5
EBIT margin	13.7	22.4	14.8	15.1	16.2
Adjusted profit margin	4.8	16.6	9.7	9.6	10.3
Adjusted ROAE	10.1	42.6	17.8	13.3	12.8
ROCE	11.1	26.9	15.4	13.2	13.7
Working capital days (days)					
Receivables	23	18	20	20	20
Inventory	79	74	73	72	71
Payables	75	74	70	70	70
Ratios (x)					
Gross asset turnover	0.6	0.9	0.8	0.7	0.7
Current ratio	0.8	1.0	0.9	0.9	1.0
Net interest coverage ratio	2.8	10.0	7.1	7.2	8.9
Adjusted debt/equity	1.0	0.4	0.4	0.3	0.2

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

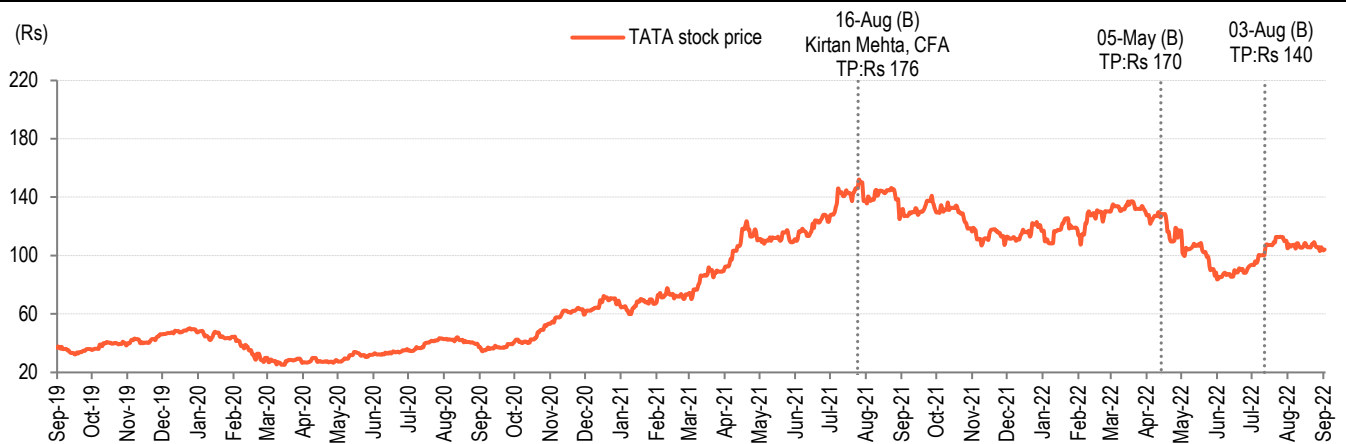
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): TATA STEEL (TATA IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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