

BUY

TP: Rs 125 | ▲ 24%

TATA STEEL

| Metals & Mining

| 01 November 2022

Integrated Indian operations to weather downturn

- **Weak Q2 results as cost adjustments lagged prices; European operations saw a sharper pullback from a stronger Q1**
- **We cut FY23/FY24 EBITDA by 31%/10% factoring in margin uncertainty in Europe and slower recovery in India operations**
- **TP lowered to Rs 125 (vs. Rs 140); maintain BUY as we expect TATA to weather the downturn and deliver on earnings-accretive growth**

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Weak Q2: TATA's consolidated Q2FY23 EBITDA at Rs 58bn fell 60% QoQ and was 22% below consensus. EBITDA/t declined by 59% QoQ to Rs 8.7k/t in standalone operations and by 67% to US\$ 120/t in Europe. Net debt rose 31% HoH to Rs 718bn.

Estimates cut: We cut our FY23/FY24 EBITDA estimates by 31%/10% to reflect our outlook of margin compression in Europe in H2FY23, slower recovery in Indian operations to mid-cycle margin levels by FY24 and higher net debt. While we cut FY23/FY24 EBITDA/t by 37%/29% to US\$ 129/US\$ 72 for European operations, we broadly maintain our forecasts at Rs 15.4k/Rs 17.3k for India.

Near-term uncertainty...: With Chinese domestic prices declining through October and Indian steel at a 5-7% premium to landed prices, we now look for prices to stabilise over FY24 post the lunar holidays in China. European operations are also exposed to margin uncertainty with the reset of annual contracts ahead of CY23 and energy-related volatility through winter.

...discounted in stock price: We estimate that TATA's stock price is currently discounting EBITDA/t of Rs 13.3-14.3k for standalone operations based on 5Y/10Y multiples. This is well below the mid-cycle margin of Rs 17.3k/t that we expect TATA to deliver from its integrated operations, assuming China gross margins settle at the historical average of US\$ 250/t.

Look to medium-term growth: We believe TATA is well positioned to weather this downturn and deliver on its earnings-accretive projects, namely the 6mtpa pellet plant, 2mtpa cold rolling mill, 5mtpa TSK expansion and 5mtpa NINL expansion over FY23-FY26.

Maintain BUY: We lower our TP to Rs 125 from Rs 140 as we bake in uncertainty in European operations by scaling back estimates, while maintaining our target FY24E EV/EBITDA multiple at 5.5x which reflects global uncertainty. Given 24% upside potential, we maintain BUY.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	TATA IN/Rs 101
Market cap	US\$ 14.8bn
Free float	66%
3M ADV	US\$ 72.0mn
52wk high/low	Rs 139/Rs 83
Promoter/FPI/DII	34%/22%/18%

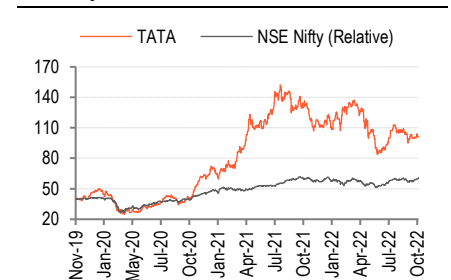
Source: NSE | Price as of 1 Nov 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	2,423	2,160	1,997
EBITDA (Rs mn)	635	358	375
Adj. net profit (Rs mn)	402	173	166
Adj. EPS (Rs)	33.2	14.3	13.7
Consensus EPS (Rs)	33.2	17.7	15.0
Adj. ROAE (%)	42.6	14.2	12.2
Adj. P/E (x)	3.0	7.1	7.4
EV/EBITDA (x)	3.3	5.2	4.7
Adj. EPS growth (%)	436.1	(56.9)	(3.9)

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Weak Q2 results

TATA reported disappointing Q2FY23 EBITDA at Rs 58.2bn, well below Bloomberg consensus of Rs 74.9bn. Consolidated EBITDA plunged 60% QoQ as standalone operations slipped 50% and Europe slumped 70%.

- Standalone EBITDA fell 50% QoQ with a 60% decline in EBITDA/t to Rs 8.7k, partially offset by a 22% increase in deliveries.
- Europe EBITDA dropped 70% QoQ with a 67% decline in EBITDA/t to US\$120/t and a 12.6% fall in deliveries.
- Long products reported an EBITDA loss of Rs 0.5bn excluding Neelachal Ispat Nigam (NINL) and a Rs 2.3bn loss including NINL.

Net debt increased to Rs 718bn from Rs 545bn at year-end on account of NINL payment, dividend outgo and insufficient operating cash flow to cover capex.

Margin recovery in India, margin compression in Europe

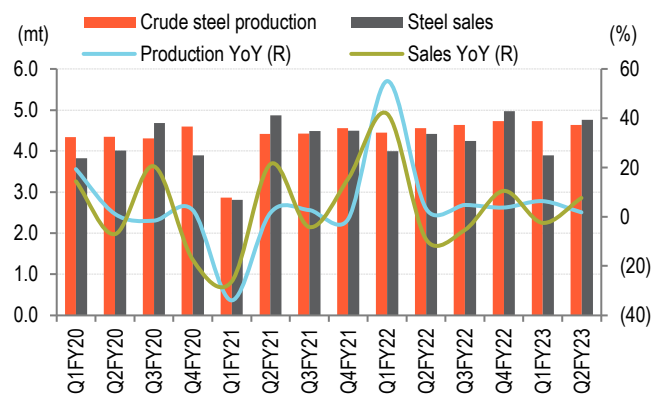
- We expect Indian operations to see gradual margin recovery primarily driven by a US\$ 80/t reduction in coking coal consumption cost in Q3FY23. The company still guides for a Rs 800/t fall in realisation as contract prices adjust to lower spot prices. Overall, we believe this could translate into margin improvement of Rs 5-6k/t over Rs 8.7k/t in Q2.
- Europe appears headed for margin contraction in H2FY23. While management expects coking coal and iron ore consumption costs to fall by US\$ 100/t and US\$ 15/t respectively in Q3, lower realisation and higher energy cost are likely to weigh on margins. Though annual contracts (30% of volumes as per previous guidance) provide some insulation in Q3, the reset of these contracts may eat into Q4 realisations. Despite margin compression, management does not expect EBITDA loss in H2. The company also highlights that its Netherlands operations (70% of European volumes) are more resilient during a downturn and have significantly lower exposure to natural gas. However, its UK operations may face cash burn during this downturn.

Fig 1 – Quarterly performance

(Rs bn)	Q2FY23	Q1FY23	QoQ (%)	Q2FY22	YoY (%)	H1FY23	H1FY22	YoY (%)
Consolidated P&L								
Revenue from operations	599	634	(5.6)	604	(0.8)	1,233	1,138	8.4
Adj. EBITDA	58	143	(59.5)	178	(67.3)	202	337	(40.2)
EBIT	37	127	(70.9)	142	(73.8)	164	280	(41.2)
PBT before exceptionals	26	119	(78.0)	136	(80.7)	146	259	(43.7)
PAT	13	77	(83.2)	125	(89.7)	90	223	(59.6)
Net income to owners	15	78	(80.5)	119	(87.3)	93	208	(55.4)
EPS (Rs)	1	6	(80.5)	10	(87.5)	8	17	(56.1)
Effective tax rate (%)	49.8	35.1	-	11.6	-	37.8	15.0	151.6
Adj. EBITDA break-up								
Standalone (incl BSL)	42	83	(49.9)	136	(69.4)	125	266	(53.2)
Europe	18	60	(70.4)	33	(46.5)	78	49	60.6
Long Products	(2)	0	(573.5)	3	(175.8)	(3)	9	(130.7)
SEA	0	2	(80.0)	0	NA	-	-	-
Others	1	(1)	164.2	6	(88.2)	-	-	-
Consolidated	58	143	(59.5)	178	(67.3)	202	337	(40.2)
Standalone operational parameters								
Production (mt)	4.6	4.7	(1.9)	4.6	1.8	9.4	9.0	4.0
Sales (mt)	4.8	3.9	22.4	4.4	7.7	8.7	8.4	2.9
Apparent realisation (Rs'000/t)	67.7	82.3	(17.7)	74.0	(8.4)	74.3	71.7	3.6
EBITDA (Rs'000/t)	8.7	21.3	(59.1)	30.7	(71.6)	14.4	31.6	(54.5)
Europe operational parameters								
Production (mt)	2.4	2.4	(1.6)	2.6	(6.3)	4.8	5.2	(7.5)
Sales (mt)	1.9	2.1	(12.6)	2.1	(12.6)	4.0	4.5	(10.3)
Apparent realisation (Rs'000/t)	115.3	121.3	(5.0)	100.1	15.2	118.5	91.4	29.6
EBITDA (Rs'000/t)	9.6	28.2	(66.1)	15.6	(38.7)	19.5	10.9	79.0
EBITDA (US\$/t)	120	365	(67.2)	211	(43.1)	248	148	68.4
Consolidated operational parameters								
Production (mt)	7.6	7.7	(2.3)	7.8	(2.7)	15.3	15.7	(2.2)
Sales (mt)	7.2	6.6	9.2	7.4	(2.2)	13.9	14.5	(4.5)
Apparent realisation (Rs'000/t)	82.8	95.8	(13.6)	81.7	1.4	89.0	78.5	13.5
EBITDA (Rs'000/t)	8.0	21.7	(62.9)	24.1	(66.6)	14.6	23.2	(37.4)

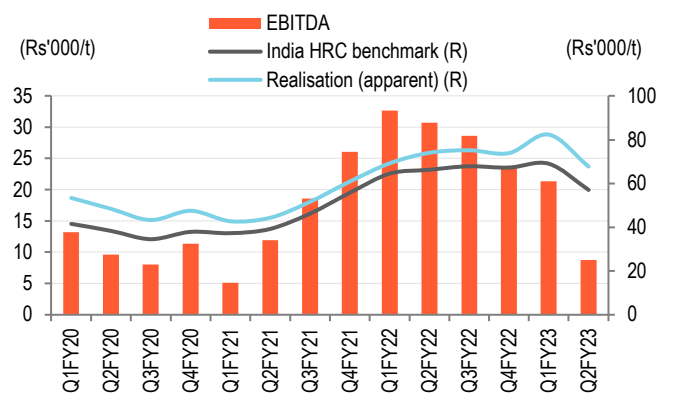
Source: Company, BOBCAPS Research

Fig 2 – Standalone sales recovered from Q1 lows...



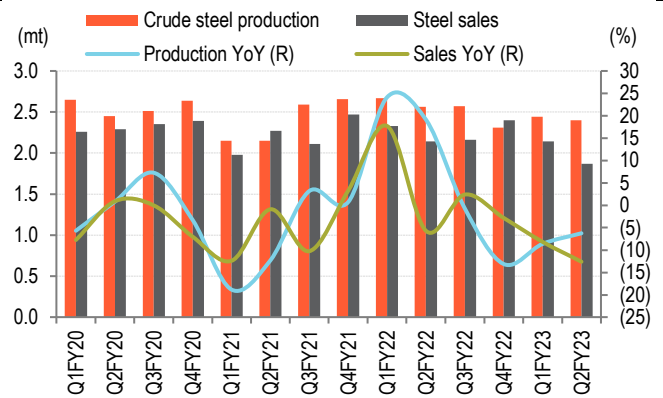
Source: Company, BOBCAPS Research

Fig 3 – ...but EBITDA margin declined sharply



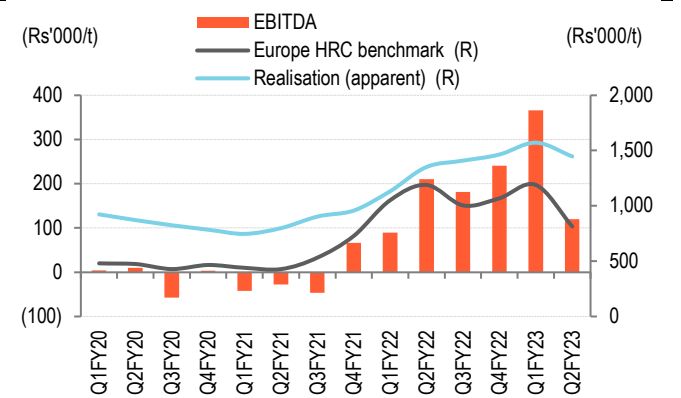
Source: Company, BOBCAPS Research

Fig 4 – Europe sales faced a seasonal decline...



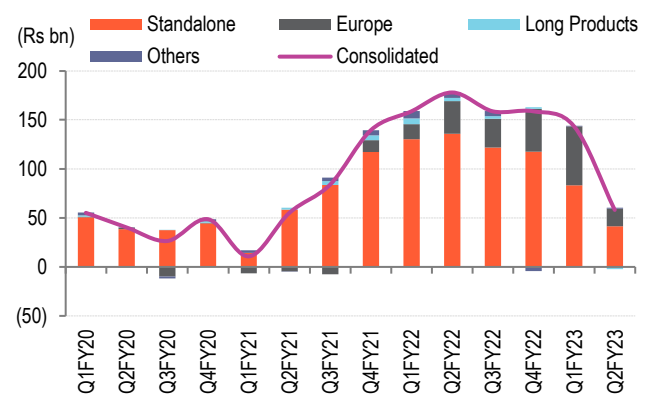
Source: Company, BOBCAPS Research

Fig 5 – ...along with sharp pullback in margin



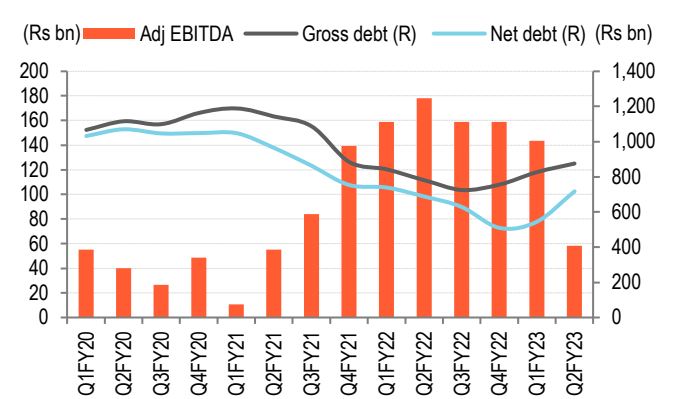
Source: Company, BOBCAPS Research

Fig 6 – Total EBITDA slumped with weakness in both India and Europe operations



Source: Company, BOBCAPS Research

Fig 7 – Net debt increased with acquisition of NINL, dividend payout and capex



Source: Company, BOBCAPS Research

Other takeaways from earnings call

- **Projects on track:** TATA is aiming to start its 6mtpa pellet plant and 2mtpa PLTCM (pickling line tandem cold mill) in Oct'22, in line with its guidance of start-up in FY23. Management reaffirmed gradual start-up of the galvanising and annealing lines over FY24, ramp-up of its NINL blast furnace to the exit rate of 1mtpa by end-FY23 and completion of the 5mtpa Tata Steel Kalinganagar (TSK) expansion by FY24.
- **UK operations will not face cash demand from Pension Scheme:** Management confirmed that its UK employee pension plan remains in surplus and the company has been successful in insuring 30% of its liabilities with British financial services firm Legal & General.
- **Tax rate:** The Netherlands operations will now face tax at a marginal rate of 25% having absorbed past tax losses.
- **Decarbonisation investment:** TATA's Europe operations are seeking UK government support for 50% of capex and part of opex to decarbonise operations. For its Netherlands operations, while TATA aims to build up a corpus, it is also discussing 50% capex support with the government to maintain a level playing field with other steel plants in Europe.

Valuation methodology

Forecast changes

Accounting for the steep underperformance in Q2FY23, our outlook of margin compression in European operations during H2FY23, slower recovery in Indian operations to mid-cycle margins by FY24 and higher net debt than previously expected, we cut our FY23 EBITDA and net income forecasts by 31% and 38% respectively.

We also scale back our FY24 EBITDA and net income estimates by 10% and 17% respectively, lowering our European EBITDA margin forecast to US\$ 72 to account for significant economic and energy-related unpredictability in the region and higher net debt.

Fig 8 – Revised estimates

(Rs bn)	Actual	New			Old			Change (%)		
	FY22	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	2,423	2,160	1,997	2,008	2,313	2,029	2,022	(6.6)	(1.6)	(0.7)
EBITDA	635	358	375	403	517	419	421	(30.8)	(10.4)	(4.3)
EBITDA growth (%)	108	(44)	5	7	(19)	(19)	1	-	-	-
Net income	402	173	166	182	280	200	198	(38.3)	(17.2)	(8.1)

Source: Company, BOBCAPS Research

Fig 9 – Key assumptions

Parameter	FY22	FY23E	FY24E	FY25E
Sales India (mt)	17.9	18.1	18.1	18.8
Sales Europe (mt)	9.0	8.6	9.1	9.1
India HRC price (US\$/t)	891	741	641	611
EBITDA/t Standalone (Rs'000/t)	28.6	15.4	17.3	17.2
EBITDA/t Europe (US\$/t)	180	129	72	89

Source: Company, BOBCAPS Research

Maintain BUY, TP lowered to Rs 125

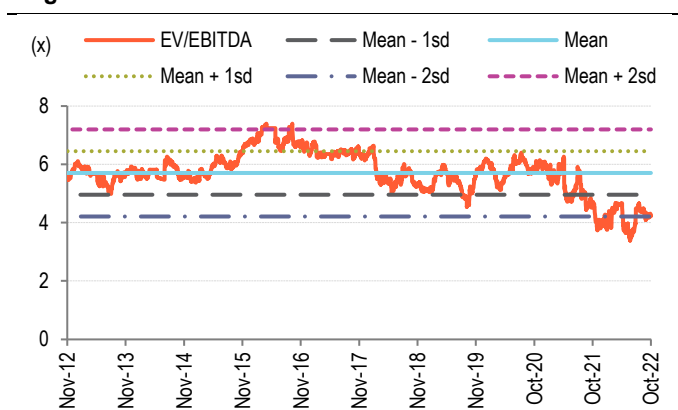
We lower our TP to Rs 125 (from Rs 140) given the reduced growth forecasts even as we maintain our target one-year forward EV/EBITDA multiple at 5.5x. Despite TATA's healthy margin and growth profile for India operations, we value the stock below our target 6x mid-cycle multiple for the Indian steel sector to reflect higher economic uncertainty. Our target multiple is also below the stock's historical trading average of 5.6x/6.2x over the past five/ten-year period. Maintain BUY as we remain confident of TATA's ability to weather the downturn and deliver on earnings-accretive growth.

Fig 10 – Valuation summary

(Rs bn)	Value
FY24E EBITDA	375
Target EV/EBITDA multiple (x)	5.5
EV	2,065
FY23E Net debt	571
Equity value	1,494
Fair value (Rs)	124
Target price Mar'23 (rounded to nearest Rs 5)	125

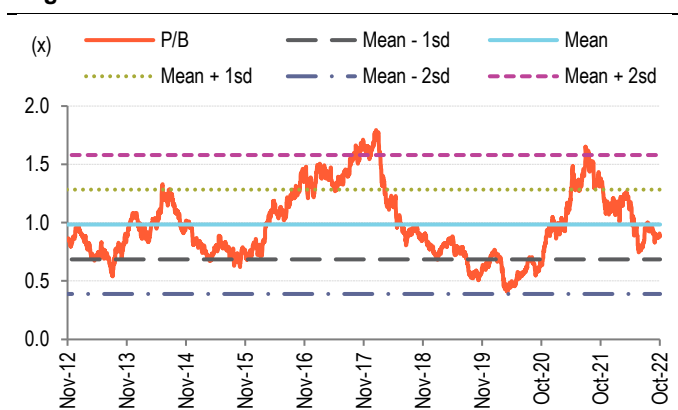
Source: BOBCAPS Research

Fig 11 – TATA EV/EBITDA 2Y forward



Source: Bloomberg, BOBCAPS Research

Fig 12 – TATA P/B 1Y forward



Source: Bloomberg, BOBCAPS Research

Fig 13 – Peer comparison

Ticker	CMP (Rs)	Rating	Target price (Rs)	Upside (%)	EV/Sales (x)		EV/EBITDA (x)		Net income (Rs bn)		P/B (x)		P/E (x)	
					FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
TATA IN	101	BUY	125	23.5	0.8	0.8	5.0	4.5	221	190	1.1	0.9	7.1	7.4
JSTL IN	686	HOLD	650	(5.3)	1.4	1.4	10.0	6.0	74	173	2.5	1.9	22.4	9.6
SAIL IN	80	HOLD	90	12.5	0.5	0.5	4.3	3.3	49	67	0.6	0.5	6.7	5.0

Source: 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 delay 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 rolled mill at Kalinganagar plant in FY23 and annealing and galvanising lines in FY24. It is also expanding Kalinganagar capacity by 5mtpa to raise total India capacity to 25mt by FY24.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
JSW Steel	JSTL IN	20.1	686	650	HOLD
SAIL	SAIL IN	4.0	80	90	HOLD
Tata Steel	TATA IN	14.8	101	125	BUY

Source: BOBCAPS Research, NSE | Price as of 1 Nov 2022

Financials

Income Statement

Y/E 31 Mar (Rs bn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	1,547	2,423	2,160	1,997	2,008
EBITDA	305	635	358	375	403
Depreciation	(92)	(91)	(97)	(102)	(106)
EBIT	213	544	261	273	298
Net interest inc./(exp.)	(76)	(55)	(57)	(51)	(45)
Other inc./(exp.)	9	8	29	11	11
Exceptional items	(10)	(1)	0	0	0
EBT	138	502	240	240	270
Income taxes	(57)	(85)	(60)	(67)	(81)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	3	6	6	6	6
Reported net profit	75	402	173	166	182
Adjustments	0	0	0	0	0
Adjusted net profit	75	402	173	166	182

Balance Sheet

Y/E 31 Mar (Rs bn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	260	368	370	333	330
Other current liabilities	241	260	229	212	213
Provisions	47	28	28	28	28
Debt funds	885	756	756	676	596
Other liabilities	247	273	247	232	233
Equity capital	12	12	12	12	12
Reserves & surplus	730	1,132	1,280	1,418	1,571
Shareholders' fund	775	1,171	1,325	1,470	1,631
Total liab. and equities	2,455	2,854	2,955	2,950	3,029
Cash and cash eq.	130	244	184	206	233
Accounts receivables	95	122	118	109	110
Inventories	333	488	435	378	374
Other current assets	44	71	63	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	370	415
Intangible assets	168	171	174	176	178
Deferred tax assets, net	0	0	0	0	0
Other assets	305	376	376	376	376
Total assets	2,455	2,854	2,955	2,950	3,029

Cash Flows

Y/E 31 Mar (Rs bn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	369	455	341	329	330
Capital expenditures	(100)	(97)	(322)	(145)	(161)
Change in investments	(9)	(23)	0	0	0
Other investing cash flows	89	(40)	29	11	11
Cash flow from investing	(19)	(159)	(293)	(135)	(150)
Equities issued/Others	1	0	0	0	0
Debt raised/repaid	(248)	(129)	0	(80)	(80)
Interest expenses	(76)	(55)	(57)	(51)	(45)
Dividends paid	(30)	(62)	(32)	(34)	(36)
Other financing cash flows	19	64	(19)	(8)	8
Cash flow from financing	(335)	(181)	(108)	(173)	(152)
Chg in cash & cash eq.	15	114	(60)	22	27
Closing cash & cash eq.	130	244	184	206	233

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	6.2	33.2	14.3	13.7	15.1
Adjusted EPS	6.2	33.2	14.3	13.7	15.1
Dividend per share	2.5	5.1	2.7	2.8	3.0
Book value per share	61.4	94.7	106.9	118.4	131.1

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	1.4	0.9	0.9	0.9	0.9
EV/EBITDA	7.1	3.3	5.2	4.7	4.3
Adjusted P/E	16.3	3.0	7.1	7.4	6.7
P/BV	1.6	1.1	0.9	0.9	0.8

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	91.9	87.7	90.8
EBIT margin (EBIT/Revenue)	13.7	22.4	12.1	13.7	14.8
Asset turnover (Rev./Avg TA)	62.4	91.3	74.4	67.6	67.2
Leverage (Avg TA/Avg Equity)	3.4	2.8	2.4	2.2	2.0
Adjusted ROAE	10.1	42.6	14.2	12.2	12.1

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	5.9	56.6	(10.9)	(7.6)	0.6
EBITDA	71.1	108.1	(43.7)	5.0	7.4
Adjusted EPS	356.4	436.1	(56.9)	(3.9)	9.5
Profitability & Return ratios (%)					
EBITDA margin	19.7	26.2	16.6	18.8	20.1
EBIT margin	13.7	22.4	12.1	13.7	14.8
Adjusted profit margin	4.8	16.6	8.0	8.3	9.1
Adjusted ROAE	10.1	42.6	14.2	12.2	12.1
ROCE	11.1	26.9	12.8	12.1	12.7
Working capital days (days)					
Receivables	23	18	20	20	20
Inventory	79	74	73	69	68
Payables	75	74	75	75	75
Ratios (x)					
Gross asset turnover	0.6	0.9	0.7	0.7	0.7
Current ratio	0.8	1.0	0.9	0.9	0.9
Net interest coverage ratio	2.8	10.0	4.6	5.4	6.7
Adjusted debt/equity	1.0	0.4	0.4	0.3	0.2

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

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

BUY – Expected return >+15%

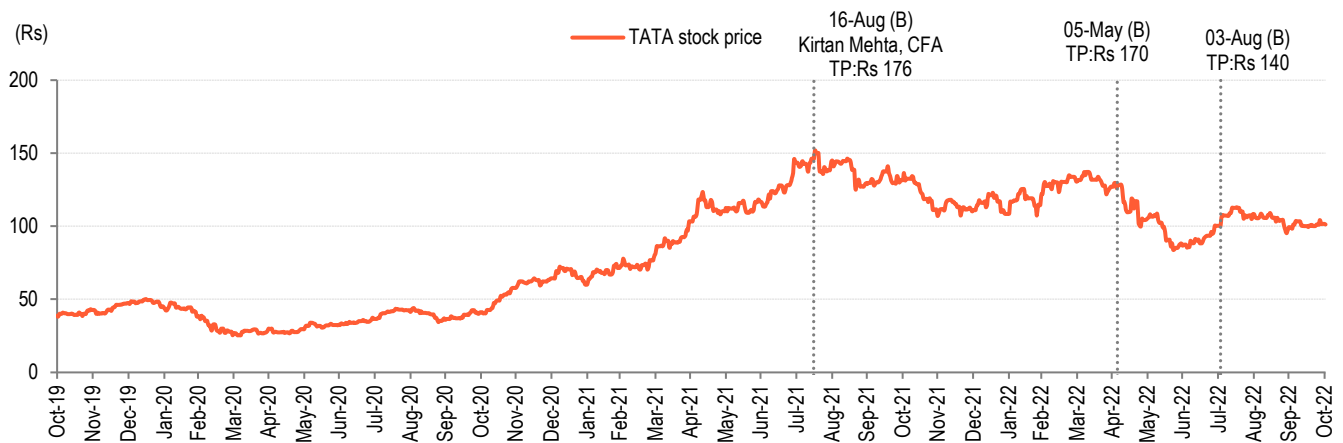
HOLD – Expected return from -6% to +15%

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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