

Cost pressures pull margins down

November 11, 2011

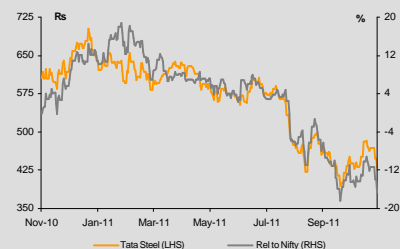
Reco	Previous Reco
Buy	Buy
CMP	Target Price
Rs 430	Rs 503
EPS change FY11E/12E (%)	NA / -9
Target Price change (%)	-25%
Nifty	5,169
Sensex	17,193

Price Performance

(%)	1M	3M	6M	12M
Absolute	(3)	(11)	(28)	(32)
Rel. to Nifty	(4)	(12)	(22)	(18)

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	Metals & Mining
Bloomberg	TATA@IN
Equity Capital (Rs mn)	9592
Face Value(Rs)	10
No of shares o/s (mn)	959
52 Week H/L	714/391
Market Cap (Rs bn/USD mn)	412/8,206
Daily Avg Volume (No of sh)	5576687
Daily Avg Turnover (US\$m)	50.6

Shareholding Pattern (%)

	Sep-11	Jun-11	Mar-11
Promoters	30.7	30.6	30.6
FII/NRI	17.2	19.7	20.0
Institutions	27.7	26.3	26.0
Private Corp	3.2	2.9	3.0
Public	21.2	20.5	20.4

Source: Capitaline

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- **Consolidated topline at Rs 328 bn, up 15% YoY and down 1% QoQ as the steel realizations (Rs 51727/ tonne) in INR term and volume remained flat QoQ**
- **EBITDA at Rs 28 bn, down 25% YoY and 38% QoQ primarily due higher raw material costs. EBITDA/ tonne in Europe and India declined to US\$30 and US\$342 (Rs 16786) respectively**
- **While the standalone APAT stood at Rs 15 bn, weaker performance at other subsidiaries and inter-company tax adjustments dragged the consol. APAT down to US\$2.1 bn**
- **Revising FY12 and FY13 EPS to Rs 70 and Rs 72 respectively; we cut our target price to Rs 503 valuing the company on SOTP basis. Maintain Buy**

Overseas operations responsible for underperformance

Tata Steel Europe EBITDA stood at US\$ 103 as against US\$ 389 in Q1FY12. Sales volume remained flat at 3.48 mt marginally ahead of our expectation of 3.4 mt. Realizations declined 2.5% from US\$ 1,176/ton in Q1FY12 to US\$ 1,148/ton in Q2FY12 on a comparable basis. EBITDA/ tonne for TSE declined over 60% on QoQ from US\$78/ tonne in Q1FY12 to US\$30/ tonne in Q2FY12. Performance at South East Asian operations declined sharply with US\$7/ tonne EBITDA during the quarter due to concerns in Thailand. Overall RM costs for the consolidated business increased by 440 bps to 49.5% in Q2FY12 and pulled the EBITDA down from 13% in Q1FY12 to 8% in the quarter. During the quarter, APAT for standalone business stood at Rs 15 bn (down 12% QoQ) but due to weaker performance of other subsidiaries and inter-company tax adjustments, the consolidated APAT came at US\$2.1 bn (down 96% QoQ).

Performance at Tata Steel India remains weak despite strong realizations

Realization for Tata Steel India grew by 2% from Rs 45631/ tonne in Q1FY12 to Rs 46345/ tonne in Q2FY12. EBITDA/ tonne for the standalone business on the other hand declined 14% from Rs 19395 (US\$ 396 comparable basis) in Q1FY12 to Rs 16786 (US\$342) in Q2FY12. This was due to higher RM costs and INR depreciation. Domestic sales volume stood at 1.65 mt in line with our estimates of 1.63 mt.

Outlook for the next few quarters looks gloomy

The raw material costs haven't peaked yet with more impact likely during Q3FY12 despite fall in spot iron ore and coking coal prices. This coupled with fall in realizations due to demand slow down mainly in Europe, would continue to put pressure on margins going forward. EBITDA at domestic operation is thus expected to be in the range of US\$350/ tonne. The company is focusing primarily on volume in Europe, to manage fixed costs in a depressed pricing scenario. Other subsidiaries are likely to continue their underperformance.

Valuations: maintain Buy

At the CMP of Rs 430, the stock is trading at 6x its FY13EPS and 5x FY13 EV/ EBITDA. As a result of bleak scenario the valuation multiple across the globe has contracted. Looking at that we value the domestic operation at 6x EV/ EBITDA and overseas subsidiaries at 4x EV/ EBITDA. We revise our target price to Rs 503/ share. Maintain BUY.

Financials

(Rs bn)

YE-	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/ EBITDA	P/BV
Mar										
FY10	1,017.6	80.4	7.9	-20.1	-22.6	NA	-8.5	-19.0	9.8	4.6
FY11	1,171.5	160.0	13.7	89.8	93.7	NA	24.5	4.6	5.2	1.9
FY12E	1,230.0	117.1	9.5	68.2	70.3	-25.0	16.1	6.1	7.2	1.5
FY13E	1,369.1	172.2	12.6	69.7	71.8	2.1	14.4	6.0	5.0	1.3

Key Financials – Quarterly (Consolidated)

(Rs mn)	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)	H1FY12	H1FY11	YoY (%)
Revenue	286,462	290,895	338,227	330,002	327,979	14.5	(0.6)	657,981	558,410	17.8
Expenditure	(249,739)	(256,648)	(293,566)	(285,773)	(300,479)	20.3	5.1	(586,252)	(477,361)	22.8
as % of sales	87.2	88.2	86.8	86.6	91.6			89.1	85.5	
Consumption of RM	(124,064)	(138,887)	(159,354)	(148,944)	(162,202)	30.7	8.9	(311,146)	(227,545)	36.7
as % of sales	43.3	47.7	47.1	45.1	49.5			47.3	40.7	
Employee Cost	(38,275)	(36,087)	(40,751)	(42,316)	(39,811)	4.0	(5.9)	(82,127)	(76,046)	8.0
as % of sales	13.4	12.4	12.0	12.8	12.1			12.5	13.6	
Other expenditure	(87,400)	(81,675)	(93,461)	(94,514)	(98,466)	12.7	4.2	(192,979)	(173,770)	11.1
as % of sales	30.5	28.1	27.6	28.6	30.0			29.3	31.1	
EBITDA	36,723	34,246	44,661	44,229	27,500	(25.1)	(37.8)	71,729	81,049	(11.5)
Depreciation	(10,781)	(11,264)	(11,664)	(11,508)	(11,088)	2.8	(3.7)	(22,596)	(21,220)	6.5
EBIT	25,942	22,982	32,997	32,721	16,412	(36.7)	(49.8)	49,133	59,829	(17.9)
Other Income	8,143	(1,043)	2,116	(369)	1,204	(85.2)	426.8	836	8,737	(90.4)
Interest	(6,637)	(7,432)	(7,655)	(7,377)	(7,161)	7.9	(2.9)	(14,538)	(12,613)	15.3
PBT	21,178	14,506	27,458	24,976	10,456	(50.6)	(58.1)	35,431	55,953	(36.7)
Total Tax	(7,450)	(6,240)	(8,764)	(11,230)	(9,065)	21.7	(19.3)	(20,295)	(17,454)	16.3
Adjusted PAT	13,728	8,266	18,694	13,746	1,390	(89.9)	(89.9)	15,136	38,499	(60.7)
(Profit)/loss from JV's/Ass/MI	106	541	269	529	734	593.8	38.8	1,263	457	176.6
Adj.PAT after MI	13,834	8,807	18,962	14,274	2,124	(84.6)	(85.1)	16,399	38,955	(57.9)
Extra ordinary items	(316)	1,223	22,794	39,191	-	(100.0)	(100.0)	39,191	(915)	(4,385.1)
Reported PAT	19,788	10,030	41,756	53,466	2,124	(89.3)	(96.0)	55,590	38,041	46.1
Reported EPS	20.6	10.5	13.4	55.4	2.2	(89.2)	(96.0)	57.6	39.7	45.2

Margins (%)						(bps)	(bps)			(bps)
EBIDTA	12.8	11.8	13.2	13.4	8.4	(443)	(502)	10.9	14.5	(361)
EBIT	9.1	7.9	9.8	9.9	5.0	(405)	(491)	7.5	10.7	(325)
EBT	7.4	5.0	8.1	7.6	3.2	(420)	(438)	5.4	10.0	(464)
PAT	4.8	2.8	5.5	4.2	0.4	(437)	(374)	2.3	6.9	(459)
Effective Tax rate	35.2	43.0	31.9	45.0	86.7	5,153	4,174	57.3	31.2	2,609

Source: Company, Emkay Research

Key Financials – Quarterly (Standalone)

(Rs mn)	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)	H1FY12	H1FY11	YoY (%)
Revenue	71,071	73,974	83,405	78,603	82,119	15.5	4.5	160,722	136,585	17.7
Expenditure	(44,777)	(45,768)	(52,739)	(47,571)	(54,422)	21.5	14.4	(101,993)	(81,128)	25.7
<i>as % of sales</i>	63.0	61.9	63.2	60.5	66.3			63.5	59.4	
Consumption of RM	(15,637)	(17,586)	(19,634)	(15,729)	(18,938)	21.1	20.4	(34,666)	(25,285)	37.1
<i>as % of sales</i>	22.0	23.8	23.5	20.0	23.1			21.6	18.5	
Employee Cost	(6,837)	(5,985)	(7,594)	(6,870)	(6,908)	1.0	0.6	(13,778)	(12,619)	9.2
<i>as % of sales</i>	9.6	8.1	9.1	8.7	8.4			8.6	9.2	
Other expenditure	(22,303)	(22,198)	(25,511)	(24,972)	(28,576)	28.1	14.4	(53,549)	(43,223)	23.9
<i>as % of sales</i>	31.4	30.0	30.6	31.8	34.8			33.3	31.6	
EBITDA	26,293	28,205	30,666	31,032	27,698	5.3	(10.7)	58,729	55,458	5.9
Depreciation	(2,815)	(2,864)	(2,982)	(2,853)	(2,871)	2.0	0.6	(5,724)	(5,617)	1.9
EBIT	23,479	25,342	27,684	28,179	24,827	5.7	(11.9)	53,005	49,841	6.3
Other Income	7,327	113	(17)	411	236	(96.8)	(42.7)	647	7,811	(91.7)
Interest	(3,425)	(3,354)	(2,949)	(2,273)	(2,343)	(31.6)	3.1	(4,615)	(6,702)	(31.1)
PBT	21,111	22,100	24,718	26,317	22,720	7.6	(13.7)	49,037	50,951	(3.8)
Total Tax	(6,726)	(6,966)	(7,644)	(9,233)	(7,767)	15.5	(15.9)	(17,000)	(14,502)	17.2
Adjusted PAT	14,384	15,135	17,074	17,084	14,952	3.9	(12.5)	32,036	36,448	(12.1)
(Profit)/loss from JV's/Ass/MI	-	-	-	-	-	-	-	-	-	-
Adj.PAT after MI	14,384	15,135	17,074	17,084	14,952	3.9	(12.5)	32,036	36,448	(12.1)
Extra ordinary items	-	-	-	5,110	-	-	-	5,110	-	-
Reported PAT	20,654	15,135	17,074	22,194	14,952	(27.6)	(32.6)	37,147	36,448	1.9
Reported DEPS	21.5	15.8	17.8	22.7	15.1	(29.8)	(33.5)	37.9	38.0	(0.4)

Margins (%)						(bps)	(bps)			(bps)
EBIDTA	37.0	38.1	36.8	39.5	33.7	(327)	(575)	36.5	40.6	(406)
EBIT	33.0	34.3	33.2	35.8	30.2	(280)	(562)	33.0	36.5	(351)
EBT	29.7	29.9	29.6	33.5	27.7	(204)	(581)	30.5	37.3	(679)
PAT	20.2	20.5	20.5	21.7	18.2	(203)	(353)	19.9	26.7	(675)
Effective Tax rate	31.9	31.5	30.9	35.1	34.2	233	(90)	34.7	28.5	621

Source: Company, Emkay Research

Sales volume rose in India and Europe

	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)
Tata Steel India	1.66	1.64	1.72	1.60	1.65	-1	3
Tata Steel Europe	3.53	3.47	4.13	3.5	3.48	-1	-1
Tata Steel South East Asia	0.79	0.78	0.78	0.8	0.78	-1	-3
Total	5.98	5.89	6.63	6.10	6.06	1	-1

Performance snapshot in different geographies

Particulars (USD mn)	Tata Steel - India	Tata Steel - Europe	Tata Steel South East Asia	Tata Steel - Group
Deliveries (mt)	1.65	3.48	0.78	6.11
Turnover	1677	4321	637	6698
EBITDA (adjusted)	570	103	5	601
EBITDA Margin (%)	34	2	1	9
EBITDA/ tonne (US\$)	346	30	7	98

Key takeaways from conference call

- The management believes that EBITDA/ tonne for next quarter would be in the range of US\$350 for the domestic business, while further margin contraction is likely to be in European business
- Management feels that the fall in prices during the next quarter may be higher than fall in raw material prices and may hence affect EBITDA for the company
- Peak cost for company is yet to come and may be seen in Q3FY12
- The company is focusing primarily on volume in Europe, to manage fixed costs in a depressed pricing scenario
- SE Asian operations are likely to be a laggard due to issues persisting in Thailand
- Some of the subsidiaries of the company like South African Ferro Chrome operations, Dhamra Port (just commissioned), etc. are likely to continue making losses and eat into the company EBITDA
- During the quarter, because of the weaker performance at other subsidiaries and due to inter-company tax adjustments, overall consolidated tax rate zoomed to 87%
- Consolidated net debt rose to US\$ 8.4 bn (with forward cover of US\$ 789 mn) primarily due to higher working capital borrowings of ~US\$611 mn and exchange adjustment of US\$572 mn
- During the quarter the company in its standalone results has adjusted forex loss of Rs 1.5 bn on account of its unhedged convertible bond. As per the management another ~Rs250 has been amortized in the balance sheet
- 2.9 mt brownfield expansion at Jamshedpur is likely to be commissioned during March 2012

Revising down estimates on concerns of higher costs and weak demand

During the quarter, the overseas subsidiaries of the company reported poor set of numbers on account of higher costs and fall in realizations. Despite Tata Steel Europe (TSE) posted a positive EBITDA of US\$30/ tonne concerns are looming large on the overall outlook for the region. Prices have started correcting sharply recently due to demand slow down, while the peak cost is yet to be seen. This we believe would put significant pressure on the company margins going forward. Back home the domestic operation also saw margin pressure, higher than expected. Also, due to the seasonal nature of business, demand is expected to be weaker during the next quarter.

Factoring these concerns we have revised our estimates. We cut FY13 adjusted EPS by 9% to Rs 72. For FY12 after taking into consideration the exceptional gain during Q1 our EPS stands at Rs 70.

Valuation: maintain Buy

At the CMP of Rs 430, the stock is trading at 6x its FY13EPS and 5x FY13 EV/ EBITDA. As a result of bleak scenario the valuation multiple across the globe has contracted. Looking at that we value the domestic operation at 6x EV/ EBITDA and overseas subsidiaries at 4x EV/ EBITDA. We revise our target price to Rs 503/ share. Maintain Buy

Financials (consolidated)

Income Statement

Y/E, Mar (Rs. mn)	FY10	FY11P	FY12E	FY13E
Net Sales	1,017,578	1,171,498	1,230,027	1,369,140
<i>Growth (%)</i>	-30.2	15.1	5.0	11.3
Expenditure	943,505	1,027,575	1,128,218	1,213,907
Raw Materials	310,045	380,441	413,578	450,625
Freight & handling	55,491	63,896	61,358	68,263
Employee Cost	164,630	152,884	161,182	176,580
Other Exp	72338.34	81079.47	90567.8	96906.36
EBITDA	80,427	159,956	117,082	172,233
<i>Growth (%)</i>	-55.6	98.9	-26.8	47.1
EBITDA margin (%)	7.9	13.7	9.5	12.6
Depreciation	44917	44148	45046	47251
EBIT	35,509	115,808	72,037	124,983
EBIT margin (%)	3.5	9.9	5.9	9.1
Other Income	11858.5	9809.8	2647	6500
Interest expenses	30220.6	27700.4	29120.5	28061.32
PBT	17,147	97,917	45,563	103,421
Tax	21518.4	32459	17906	34907
<i>Effective tax rate (%)</i>	125.5	33.1	39.3	33.8
Adjusted PAT	-4,371	65,458	27,657	68,515
(Profit)/loss from JV's/Ass/MI	1116.2	1266.4	1400	1200
Adjusted PAT after MI	-3,255	66,725	29,057	69,715
<i>Growth (%)</i>	PL	LP	-56.5	139.9
Net Margin (%)	14.1	14.3	15.1	15.1
E/O items	-16837.2	23102.1	39191.1	0
Reported PAT*	-20,092	89,827	68,248	69,715
<i>Growth (%)</i>	PL	LP	-24.0	2.1

Cash Flow

Y/E, Mar (Rs. mn)	FY10	FY11P	FY12E	FY13E
PBT (Ex-Other income)	-11,549	111,210	82,107	96,921
Depreciation	44,917	44,148	45,046	47,251
Interest Provided	30,221	27,700	29,120	28,061
Other Non-Cash items	8,300	10,500	11,217	11,217
Chg in working cap	104,019	-80,451	-11,580	-20,664
Tax paid	-21,518	-32,459	-17,906	-34,907
Operating Cashflow	-21,163	117,565	123,959	133,809
Capital expenditure	-17,803	73,771	92,000	91,000
Free Cash Flow	-3,359	-9,142	34,787	25,663
Other income	11,859	9,810	2,647	6,500
Investments	-7,060	2,481	-14	0
Investing Cashflow	4,798	12,291	2,633	6,500
Equity Capital Raised	25,919	52,320	-1,710	0
Loans Taken / (Repaid)	-68,001	75,840	-48,867	6,500
Interest Paid	-30,221	-27,700	-29,120	-28,061
Dividend paid (incl tax)	-8,300	-10,500	-11,217	-11,217
Income from investments	0	0	0	0
Financing Cashflow	-72,303	100,460	-79,698	-21,561
Net chg in cash	6,667	40,779	-59,459	584
Opening cash position	61,484	68,151	108,930	42,421
Closing cash position	68,151	108,930	49,471	50,056

*Adjusted nos for FY12E and FY13E

Balance Sheet

Y/E, Mar (Rs. mn)	FY10	FY11P	FY12E	FY13E
Equity share capital	8867.4	9587.4	9707.4	9707.4
Reserves & surplus	228,387	357,484	414,374	472,872
Net worth	237,254	367,071	424,082	482,579
Minority Interest	8840.7	8889	8840.7	8840.7
Secured Loans	280,593	286,044	272,971	264,471
Unsecured Loans	250,410	320,799	285,005	300,005
Loan Funds	531,004	606,843	557,976	564,476
Net deferred tax liability	16541	20126.2	16541.1	16541.1
Total Liabilities	794,336	1,015,466	1,017,251	1,082,249
Gross Block	972,890	981,014	1,021,014	1,079,014
Less: Depreciation	608,126	615,922	658,262	705,512
Net block	364,764	365,092	362,752	373,502
CWIP	93194	158841.7	210841.7	243841.7
Investment	54,178	78,473	78,473	78,473
Current Assets	370,218	497,740	472,648	505,273
Inventories	186,866	240,552	268,061	282,570
Sundry debtors	115,124	148,163	155,017	172,549
Cash & bank balance	68,151	108,926	49,471	50,056
Loans & advances	68,499	99,947	110,702	123,223
Other current assets	0	0	0	0
Current lia & Prov	299,867	337,610	371,148	395,046
Current liabilities	233,925	266,711	300,249	324,146
Provisions	65,942	70,899	70,899	70,899
Net current assets	138,851	260,077	212,202	233,450
Total Assets	794,336	1,015,466	1,017,251	1,082,249

Key Ratios

Y/E, Mar	FY10	FY11P	FY12E	FY13E
Profitability (%)				
EBITDA Margin	7.9	13.7	9.5	12.6
Net Margin	-2.0	7.7	5.5	5.1
ROCE	5.6	14.1	7.4	12.6
ROE	-8.0	30.2	17.3	15.4
RoIC	5.7	18.9	10.9	18.3
Per Share Data (Rs)				
EPS*	-22.7	93.7	70.3	71.8
CEPS	28.0	139.7	116.7	120.5
BVPS	93.3	227.0	279.3	339.5
DPS	7.4	9.4	9.9	9.9
Valuations (x)				
PER	-19.0	4.6	6.1	6.0
P/CEPS	15.4	3.1	3.7	3.6
P/BV	4.6	1.9	1.5	1.3
EV / Sales	0.8	0.7	0.7	0.6
EV / EBITDA	9.8	5.2	7.2	5.0
Gearing Ratio (x)				
Net Debt/ Equity	2.0	1.3	1.2	1.1
Net Debt/EBITDA	5.8	3.1	4.3	3.0

Recommendation History: Tata Steel – TATA IN

Date	Reports	Reco	CMP	Target
12/08/2011	Tata Steel Q1FY12 Result Update	Buy	476	670
26/05/2011	Tata Steel Q4FY11 Result Update	Accumulate	573	670
06/04/2011	Tata Steel Management Meet Update	Accumulate	634	695
16/02/2011	Tata Steel Q3FY11 Result Update	Accumulate	617	684

Recent Research Reports

Date	Reports	Reco	CMP	Target
08/11/2011	HEG Q2FY12 Result Update	Accumulate	209	224
25/10/2011	Sesa Goa Q2FY12 Result Update	Hold	211	239
24/10/2011	Sterlite Industries Q2FY12 Result Update	Accumulate	116	162
19/10/2011	Hindustan Zinc Q2FY12 Result Update	Buy	121	159

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