

Pressure mounting on domestic business

November 09, 2012

Rating	Previous Reco
Reduce	Reduce
CMP	Target Price
Rs391	Rs349
EPS Chg FY13E/FY14E (%)	-1.5/ Na
Target Price change (%)	Na
Nifty	5,686
Sensex	18,684

Price Performance (%)	1M	3M	6M	12M
Absolute	-5	-4	-6	-13
Rel. to Nifty	-5	-10	-17	-19

Source: Bloomberg

Relative price chart



Source: Bloomberg

Stock Details

Sector	Metals & Mining
Bloomberg	TATA IB
Equity Capital (Rs mn)	9,712
Face Value(Rs)	10
No of shares o/s (mn)	971
52 Week H/L	501/ 332
Market Cap (Rs bn/USD mn)	379/ 6,940
Daily Avg Volume (No of sh)	4,931,242
Daily Avg Turnover (US\$mn)	35.7

Shareholding Pattern (%)

	S'12	J'12	M'12
Promoters	31.4	31.4	31.4
FII/NRI	16.6	15.8	16.2
Institutions	27.3	28.7	28.3
Private Corp	3.0	3.1	3.0
Public	21.8	21.0	21.1

Source: Capitaline

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- Performance below expectations with negative surprise in domestic business, as EBITDA/ tonne shrank to Rs 14545 (US\$264); Europe EBITDA/ tonne stood at US\$2.3
- Standalone APAT at Rs 13.4bn, down 10% YoY and flat QoQ; EBITDA stood at Rs 25.2 bn, down 9% each on YoY and QoQ on 6% fall in realizations to Rs 48459/ tonne and high costs
- Europe volume came higher at 3.42 mt raising consol topline by 4% YoY to Rs 341 bn; Realizations fell to US\$1123/ tonne; TSH volume stood at 0.77 mt with EBITDA/ tonne at US\$5
- Believe, pain in European operation to continue, while domestic business also should see lower margins; Maintain our FY14 estimates; Retain Reduce with TP of Rs 349/ share

Domestic EBITDA/ tonne lowest in past 11 quarters

The Q2FY13 performance of the company came below expectations primarily due to weakness observed in Indian operations. The EBITDA/ tonne in the Indian business fell to Rs 14545 (US\$263), lowest since Q3FY10. The main reason behind this is 6% fall in realizations on a sequential basis to Rs 48549/ tonne. The quantum of drop in realizations remained higher than the peers as far as Q2FY13 is concerned. The company also purchased coke during the quarter, which also added to the cost pressure, as the RM costs as a percentage to sales rose by 350 bpd on QoQ to 25%. Power costs as percentage to sales also has gone up by 100 bps on QoQ to 7% due to higher power tariffs. EBITDA margin for the standalone business stood at 27.5% for the quarter, down 620 bps YoY and 370 bps QoQ. The company has indicated that purchase of coke would continue till at least January'13. Looking at the spread between coking coal and coke and along with subdued steel prices we believe, this would continue to put pressure on the margins. Also, despite the management still guiding for 1 mt incremental sale volume over FY12 figure of 6.6 mt, we believe, this would be challenging considering lower demand and building up of inventory in the system.

European operations: performance broadly in line

Tata Steel Europe has performed in line with the expectations as the EBITDA/ tonne stood at -US\$2.3 against our estimate of -US\$4. Volume however, has been higher than expected at 3.42 mt for the quarter against 3.21 mt in Q1FY13. Average realizations dropped by ~2% on QoQ to US\$1124/ tonne. This we believe has not yet reflected the drop in steel prices during this period. Also, as steel prices continue to correct further (6% in October over average prices in July- September period, CIS fob Black Sea HR) to US\$510/ tonne. Seasonal weakness is also expected in Q3. Thus, we believe European operations to remain under pressure in near future.

Valuation

At the CMP of Rs 391, the stock trades at 9.6x FY14 EPS and 6x FY14 EV/ EBITDA. We continue to value Indian operation at 6X and European operation at 4X FY14 EV/ EBITDA to arrive at a target price of Rs 349/ share. Maintain Reduce.

Financial Snapshot (Consolidated)

(Rsbn)

YE-	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/ EBITDA	P/BV
Mar										
FY11A	1,188	160	13.5	67	69.6	0.0	22.3	5.6	5.5	1.0
FY12A	1,329	124	9.3	20	20.9	-70.0	4.9	18.7	6.3	0.8
FY13E	1,369	131	9.5	19	20.0	-4.3	4.2	19.6	7.0	0.8
FY14E	1,455	161	11.1	40	40.8	104.2	8.4	9.6	6.0	0.8

Exhibit 1: Quarterly results (Consolidated)

Rs mn	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13	YoY (%)	QoQ (%)	H1FY13	H1FY12	YoY (%)
Revenue	327,979	331,031	339,986	338,212	341,327	4.1	0.9	679,539	657,981	3.3
Expenditure	(300,479)	(313,858)	(308,197)	(304,179)	(318,227)	5.9	4.6	(622,406)	(586,252)	6.2
as % of sales	91.6	94.8	90.7	89.9	93.2			91.6	89.1	
Consumption of RM	(162,202)	(175,116)	(165,645)	(150,498)	(164,972)	1.7	9.6	(315,469)	(311,146)	1.4
as % of sales	49.5	52.9	48.7	44.5	48.3			46.4	47.3	
Employee Cost	(39,811)	(42,938)	(47,221)	(47,825)	(45,393)	14.0	(5.1)	(93,218)	(82,127)	13.5
as % of sales	12.1	13.0	13.9	14.1	13.3			13.7	12.5	
Other expenditure	(98,466)	(95,803)	(95,332)	(105,857)	(107,862)	9.5	1.9	(213,718)	(192,979)	10.7
as % of sales	30.0	28.9	28.0	31.3	31.6			31.5	29.3	
EBITDA	27,500	17,173	31,788	34,033	23,101	(16.0)	(32.1)	57,134	71,729	(20.3)
Depreciation	(11,088)	(11,640)	(10,931)	(13,080)	(13,349)	20.4	2.1	(26,429)	(22,596)	17.0
EBIT	16,412	5,533	20,858	20,953	9,751	(40.6)	(53.5)	30,704	49,133	(37.5)
Other Income	1,204	1,383	2,220	2,894	2,018	67.5	(30.3)	4,912	836	487.6
Interest	(7,161)	(7,069)	(11,280)	(9,690)	(9,721)	35.7	0.3	(19,411)	(14,538)	33.5
PBT	10,456	(153)	11,798	14,157	2,048	(80.4)	(85.5)	16,205	35,431	(54.3)
Total Tax	(9,065)	(6,720)	(9,766)	(8,986)	(6,608)	(27.1)	(26.5)	(15,594)	(20,295)	(23.2)
Adjusted PAT	1,390	(6,874)	2,032	5,170	(4,559)	(428.0)	(188.2)	611	15,136	(96.0)
(Profit)/loss from JV's/Ass/MI	734	847	2,303	808	493	(32.8)	(39.0)	1,301.8	1,263	-
Adj.PAT after MI	2,124	(6,027)	4,335	5,979	(4,066)	(291.4)	(168.0)	1,913	16,399	(88.3)
Extra ordinary items	-	-	-	-	427	-	-	427	39,191	-
Reported PAT	2,124	(6,027)	4,335	5,979	(3,639)	(271.3)	(160.9)	2,340	55,590	(95.8)
Reported EPS	1.8	(6.8)	4.0	5.7	(4.2)	(340.6)	(174.0)	1	57.1	(97.4)

Margins (%)						(bps)	(bps)			(bps)
EBIDTA	8.4	5.2	9.3	10.1	6.8	(162)	(329)	8.4	10.9	(249)
EBIT	5.0	1.7	6.1	6.2	2.9	(215)	(334)	4.5	7.5	(295)
EBT	3.2	(0.0)	3.5	4.2	0.6	(259)	(359)	2.4	5.4	(300)
PAT	0.4	(2.1)	0.6	1.5	(1.3)	(176)	(286)	0.1	2.3	(221)
Effective Tax rate	86.7	(4,383.8)	82.8	63.5	322.6	23,593	25,915	96.2	57.3	3,895

Source: Company, Emkay Research

Exhibit 2: Quarterly results (Standalone)

(Rs mn)	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13	YoY (%)	QoQ (%)	H1FY13	H1FY12	YoY (%)
Revenue	82,119	83,819	94,794	89,080	91,506	11.4	2.7	180,586	160,722	12.4
Expenditure	(54,422)	(57,513)	(64,878)	(61,282)	(66,343)	21.9	8.3	(127,626)	(101,993)	25.1
as % of sales	66.3	68.6	68.4	68.8	72.5			70.7	63.5	
Consumption of RM	(18,488)	(20,748)	(23,345)	(19,261)	(22,960)	24.2	19.2	(42,221)	(34,216)	23.4
as % of sales	22.5	24.8	24.6	21.6	25.1			23.4	21.3	
Employee Cost	(6,908)	(7,332)	(9,363)	(8,591)	(8,300)	20.2	(3.4)	(16,891)	(13,778)	22.6
as % of sales	8.4	8.7	9.9	9.6	9.1			9.4	8.6	
Other expenditure	(29,026)	(29,433)	(32,170)	(33,430)	(35,084)	20.9	4.9	(68,514)	(53,999)	26.9
as % of sales	35.3	35.1	33.9	37.5	38.3			37.9	33.6	
EBITDA	27,698	26,306	29,916	27,798	25,162	(9.2)	(9.5)	52,960	58,729	(9.8)
Depreciation	(2,871)	(2,891)	(2,900)	(3,544)	(3,913)	36.3	10.4	(7,457)	(5,724)	30.3
EBIT	24,827	23,415	27,016	24,254	21,249	(14.4)	(12.4)	45,504	53,005	(14.2)
Other Income	236	(263)	1,829	1,519	2,397	916.9	57.8	3,916	647	505.2
Interest	(2,343)	(2,020)	(5,140)	(4,544)	(4,539)	93.8	(0.1)	(9,084)	(4,615)	96.8
PBT	22,720	21,133	23,706	21,229	19,107	(15.9)	(10.0)	40,336	49,037	(17.7)
Total Tax	(7,767)	(6,920)	(8,101)	(7,663)	(5,695)	(26.7)	(25.7)	(13,358)	(17,000)	(21.4)
Adjusted PAT	14,952	14,213	15,605	13,566	13,412	(10.3)	(1.1)	26,978	32,036	(15.8)
(Profit)/loss from JV's/Ass/MI	-	-	-	-	-	-	-	-	-	-
Adj.PAT after MI	14,952	14,213	15,605	13,566	13,412	(10.3)	(1.1)	26,978	32,036	(15.8)
Extra ordinary items	-	-	-	-	96	NA	NA	96	5,110	Na
Reported PAT	14,952	14,213	15,605	13,566	13,508	(9.7)	(0.4)	27,074	37,147	(27.1)
Reported EPS	15.6	14.8	15.7	13.5	13.4	(13.9)	(0.7)	27	38.3	(29.7)

Margins (%)						(bps)	(bps)			(bps)
EBIDTA	33.7	31.4	31.6	31.2	27.5	(623)	(371)	29.3	36.5	(721)
EBIT	30.2	27.9	28.5	27.2	23.2	(701)	(401)	25.2	33.0	(778)
EBT	27.7	25.2	25.0	23.8	20.9	(679)	(295)	22.3	30.5	(817)
PAT	18.2	17.0	16.5	15.2	14.7	(355)	(57)	14.9	19.9	(499)
Effective Tax rate	34.2	32.7	34.2	36.1	29.8	(438)	(629)	33.1	34.7	(155)

Source: Company, Emkay Research

Exhibit 3: Sales volumes across geographies (mt)

	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13	YoY (%)	QoQ (%)
Tata Steel India	1.65	1.62	1.77	1.59	1.73	5	9
Tata Steel Europe	3.48	3.35	3.55	3.21	3.42	-2	7
Tata Steel South East Asia	0.78	0.66	0.72	0.72	0.77	-1	7
Total	6.10	5.84	6.22	5.70	6.07	0	6

Source: Company, Emkay Research

Exhibit 4: Performance snapshot in different geographies

Particulars (USD mn)	Tata Steel			
	Tata Steel - India	Tata Steel - Europe	South East Asia	Tata Steel - Group
Deliveries (mt)	1.73	3.42	0.77	6.07
Turnover	1,731	3,843	663	6,458
EBITDA (adjusted)	456	-8	4	464
EBITDA Margin (%)	26%	0%	1%	7%
EBITDA/ tonne (US\$)	264	-2	5	76

Source: Company, Emkay Research; *EBITDA adjusted as per standalone numbers

Key takeaways from analyst meet

- Indian operations
 - Long products and flat products realizations on average basis fell to US\$740/tonne
 - Current run rate of the partly commissioned new capacity (2.9 mt) has been 70,000 tonne per month
 - The company has been purchasing coke from the market, which is likely to be over post commissioning of coke over battery- 10 during January'13
 - Company is going ahead with Orissa phase- I greenfield project and don't see any substantial problem with regards to ongoing penalty issue on iron ore mining in Orissa
- SE Asia operations
 - Vietnam operations started to stabilize with better margins
 - Rationalization of assets under process
- European operations
 - Economic situation continues to be worrisome with Eurofer further raising its forecast for contraction in steel demand to 9%
 - Price fall has been sharper in the end of Q2FY13
 - BF- 4 in Port Talbot likely to come on stream in Q4FY13
 - Focus on deliveries intact in a challenging scenario
 - Net deficit in pension fund stands at GBP 500 mn, which is agreed to paid in 15 years
- Balance sheet
 - Net debt increased to Rs 551.7 bn (US\$10.44 bn) during the quarter from Rs 540.7 bn (US\$9.71 bn). Company aims to use more liquidity in the business to keep gross debt intact
 - Capex plans intact

Revising estimates:

We have kept our estimates broadly unchanged for both FY13 and FY14. Some minor refinements however were made for quarterly adjustments.

Exhibit 5: Revised estimates

(Rs bn)	FY13E		FY14E	
	Earlier	Revised	Earlier	Revised
Revenue	1,335	1,369	1,454	1,454
EBITDA	131	131	161	161
APAT	20	19	40	40
EPS (Rs)	20.3	20	40.7	40.7

Source: Company, Emkay Research

Valuation

At the CMP of Rs 391, the stock trades at 9.6x FY14 EPS and 6x FY14 EV/ EBITDA. We continue to value Indian operation at 6X and European operation at 4X FY14 EV/ EBITDA. Don't see any meaningful improvement in the near term. In fact domestic business would be under scanner, as higher costs and lower realizations can continue to play spoilsport. Maintain Reduce with target price of Rs 349/ share.

Key Financials (Consolidated)

Income Statement

Y/E Mar (Rsbn)	FY11A	FY12A	FY13E	FY14E
Net Sales	1,188	1,329	1,369	1,454
<i>Growth (%)</i>	15.1	12.8	2.4	6.3
Expenditure	1,028	1,205	1,238	1,294
Raw Materials	526	657	643	683
Employee Cost	153	172	176	178
Other Exp	245	259	297	308
EBITDA	160	124	131	161
<i>Growth (%)</i>	98.9	-22.4	5.1	23.2
EBITDA margin (%)	13.5	9.3	9.5	11.1
Depreciation	44	45	53	57
EBIT	116	79	78	104
EBIT margin (%)	9.8	5.9	5.7	7.1
Other Income	10	16	9	8
Interest expenses	28	43	39	40
PBT	98	52	48	72
Tax	32	36	31	35
<i>Effective tax rate (%)</i>	33.1	69.6	64.9	48.9
Adjusted PAT	65	16	17	37
<i>Growth (%)</i>	0.0	-75.8	5.2	120.5
Net Margin (%)	5.5	1.2	1.2	2.5
(Profit)/loss from JVs/Ass/MI	-1	-2	-2	-2
Adj. PAT After JVs/Ass/MI	67	20	19	40
E/O items	23	34	0	0
Reported PAT	90	54	19	40
PAT after MI	67	20	19	40
<i>Growth (%)</i>	0.0	-69.6	-4.3	104.2

Balance Sheet

Y/E Mar (Rsbn)	FY11A	FY12A	FY13E	FY14E
Equity share capital	11	10	10	10
Reserves & surplus	359	444	450	476
Net worth	371	453	460	486
Minority Interest	9	11	11	11
Secured Loans	286	252	329	385
Unsecured Loans	321	255	270	285
Loan Funds	607	507	599	670
Net deferred tax liability	20	24	24	24
Total Liabilities	1,015	1,004	1,102	1,199
Gross Block	1,134	1,311	1,397	1,487
Less: Depreciation	616	712	765	822
Net block	518	599	632	665
Capital work in progress	159	200	233	273
Investment	78	40	40	40
Current Assets	598	632	639	687
Inventories	241	256	282	299
Sundry debtors	148	149	167	177
Cash & bank balance	109	108	68	81
Loans & advances	100	119	122	130
Other current assets	0	0	0	0
Current lia & Prov	338	468	443	466
Current liabilities	267	395	370	393
Provisions	71	73	73	73
Net current assets	260	164	196	221
Misc. exp	0	0	0	0
Total Assets	1,015	1,004	1,102	1,199

Cash Flow

Y/E Mar (Rsbn)	FY11A	FY12A	FY13E	FY14E
PBT (Ex-Other income)	121	86	48	72
Depreciation	5	92	53	57
Interest Provided	28	43	39	40
Other Non-Cash items	7	11	3	3
Chg in working cap	-80	95	-72	-11
Tax paid	-32	-36	-31	-35
Operating Cashflow	48	291	39	125
Capital expenditure	-74	-194	-123	-130
Free Cash Flow	-26	97	-84	-5
Other income	0	0	0	0
Investments	-32	17	0	0
Investing Cashflow	-85	-139	-123	-130
Equity Capital Raised	44	7	0	0
Loans Taken / (Repaid)	76	-99	92	72
Interest Paid	-28	-43	-39	-40
Dividend paid (incl tax)	-1	-1	-1	-1
Income from investments	0	0	0	0
Others	0	0	0	0
Financing Cashflow	91	-136	51	30
Net chg in cash	54	15	-32	26
Opening cash position	68	109	108	68
Closing cash position	109	108	68	81

Key Ratios

Y/E Mar	FY11A	FY12A	FY13E	FY14E
Profitability (%)				
EBITDA Margin	13.5	9.3	9.5	11.1
Net Margin	5.5	1.2	1.2	2.5
ROCE	14.0	9.5	8.3	9.8
ROE	22.3	4.9	4.2	8.4
RoIC	18.6	11.9	11.0	13.3
Per Share Data (Rs)				
EPS	69.6	20.9	20.0	40.8
CEPS	115.6	67.4	74.5	99.5
BVPS	386.8	466.7	473.2	500.1
DPS	9.4	12.0	12.0	12.0
Valuations (x)				
PER	5.6	18.7	19.6	9.6
P/CEPS	3.4	5.8	5.2	3.9
P/BV	1.0	0.8	0.8	0.8
EV / Sales	0.7	0.6	0.7	0.7
EV / EBITDA	5.5	6.3	7.0	6.0
Dividend Yield (%)	2.4	3.1	3.1	3.1
Gearing Ratio (x)				
Net Debt/ Equity	1.3	0.9	1.2	1.2
Net Debt/EBITDA	3.1	3.2	4.1	3.7
Working Cap Cycle (days)	46.5	15.5	34.3	35.0

Recommendation History: Tata Steel – TATA IN

Date	Reports	Reco	CMP	Target
08/10/2012	Tata Steel Management Meet Update	Reduce	411	349
14/08/2012	Tata Steel Q1FY13 Result Update	Hold	395	416
21/05/2012	Tata Steel Q4FY12 Result Update	Accumulate	400	451
10/02/2012	Tata Steel Q3FY12 Result Update	Hold	475	422

Recent Research Reports

Date	Reports	Reco	CMP	Target
06/09/2012	Metals and Mining Sector Report			
08/11/2012	SAIL Q2FY13 Result Update	Hold	83	82
06/11/2012	Hindalco Q2FY13 Result Update	Buy	113	134
05/11/2012	Godawari Power Q2FY13 Result Update	Buy	122	143

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