

Company Flash

2 March 2009 | 7 pages

Tata Steel (TISC.BO)

Sell: By No Means In The Clear

- 3Q FY09 PAT falls across regions** — Cons adj PAT was Rs10bn, 23% lower yoy but better than estimates on higher than expected EBITDA and cost savings - major part of the savings being on account of hedging gains. EBITDA margins fell 350bps to 8.7% and EBITDA fell 29% to Rs29bn. Revenues rose 4% to Rs332bn despite a 24% fall in volumes (6m tonnes) due to higher realizations.
- Tata Steel India PAT fell 43% yoy** — Adj. PAT at the Indian operations came in at Rs5.9bn. EBITDA margin fell to 31% vs 42% last year on lower steel volumes (-14% yoy), lower ferro alloy margins and higher raw material costs (+80% yoy per tonne). Steel PBIT margin was 31% vs 42% last year. Ferro alloys divisional PBIT fell 39% yoy to Rs1.4bn and PBIT margin was 21% vs 26% in 3Q FY08.
- Asian operations** — NatSteel reported a US\$16m EBITDA loss (margin -5%), while Thailand reported an EBITDA loss of US\$76m, (margin -60%). Volumes fell 43% and 25% yoy respectively at NatSteel and Thailand. Weak demand, inventory write-downs and political turmoil in Thailand impacted operations.
- Corus strong 4QFY09 but outlook bleak** — 3Q EBITDA was 96% ahead of our expectations, likely to be a lag effect in the quarter with negative risks to earnings. Demand continues to be 35-50% down. GBP600m cost savings hinge on hedging gains and plant closures, only the latter is recurring benefit.
- Bearish stance still justified** – Demand visibility remains low with prices continuing to fall in export markets and there is potential for further disappointment.

Sell/High Risk	3H
Price (27 Feb 09)	Rs172.35
Target price	Rs125.00
Expected share price return	-27.5%
Expected dividend yield	5.8%
Expected total return	-21.7%
Market Cap	Rs125,916M US\$2,469M

Price Performance (RIC: TISC.BO, BB: TATA IN)



Figure 1. Tata Steel (Consolidated) – Statistical Abstract

YE 31 Mar	PAT PAT growth		EPS EPS growth		P/E	EV/EBITDA	ROE
	(Rs bn)	(%)	(Rs)	(%)	(x)	(x)	(%)
FY06	37.3	4%	67.5	4%	2.6	1.5	36%
FY07	41.8	12%	71.9	7%	2.4	3.0	29%
FY08	75.1	80%	102.4	42%	1.7	3.6	26%
FY09E	94.6	26%	127.8	25%	1.3	3.4	31%
FY10E	38.3	-60%	45.9	-64%	3.8	4.5	11%
FY11E	30.5	-20%	37.1	-19%	4.6	5.3	8%

Source: Company Reports and Citi Investment Research. Price as on 27 Feb 2009. Note – All figures are on a consolidated basis.

See Appendix A-1 for Analyst Certification and important disclosures.

Pradeep Mahtani¹

+91-22-6631-9882
pradeep.mahtani@citi.com

Thomas P Wrigglesworth²

+852-2501-2747
thomas.wrigglesworth@citi.com

Raashi Chopra¹

raashi.chopra@citi.com

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3Q FY09 Results

Figure 2. Tata Steel 3Q FY09 – Consolidated Results

Rs m	3Q FY09	3Q FY08	% chg
Sales (m tonnes)	6.07	7.94	-24
Net sales	331,910	318,985	4
Expenditure	303,336	280,283	8
Operating Profit	28,574	38,702	-26
Margin (%)	8.6	12.1	
Other income	316	1,758	-82
EBITDA (incl other income)	28,890	40,460	-29
Margin (%)	8.7%	12.7%	
Interest costs	9,114	10,592	-14
Depreciation	10,852	10,038	8
Extraordinary items	(2,007)	448	
PBT	6,917	20,278	-66
Total tax	(405)	7,161	
Effective tax rate (%)	-5.9%	35.3%	
Net profit	7,322	13,118	-44
Reported PAT after MI & profits from associates	8,139	13,251	-39
Adjusted PAT after MI & profits from associates	10,028	12,961	-23

Source: Company Reports and Citi Investment Research

Figure 3. Tata Steel 3Q FY09 – Standalone Results

Rs m	3Q FY09	3Q FY08	% chg
Production (m tones)	1.23	1.25	-1
Sales (m tonnes)	1.07	1.24	-14
Sales (net) - Steel	41,096	40,855	1
Sales (net) - Others	6,925	8,884	-22
Net sales	48,021	49,739	-3
Expenditure	33,242	29,423	13
Operating Profit	14,780	20,316	-27
Margin (%)	30.8%	40.8%	
Other income	85	471	
EBITDA (Incl other income)	14,864	20,786	-28
Margin (%)	31.0%	41.8%	
Interest costs	3,482	3,427	2
Depreciation	2,513	2,092	20
Extraordinary items	-1,268	479	
PBT	7,601	15,747	-52
Total tax	2,939	5,061	
Effective tax rate (%)	38.7%	32.1%	
PAT (as reported)	4,662	10,686	-56
PBT (Excl extraordinary items)	8,869	15,267	-42
Tax on adjusted PBT	2,939	4,907	-40
Tax rate (%)	33.1%	32.1%	
Adjusted PAT	5,930	10,361	-43

Source: Company Reports and Citi Investment Research

Figure 4. 3Q FY09 Consolidated Results

US\$ m	Tata Steel (India)	TSUK (Corus)	NSA	TSTH	Tata Steel Group
Deliveries (m tonnes)	1.1	4.3	0.4	0.3	6.0
Turnover	991	5,381	343	127	6,839
EBITDA	306	358	-16	-76	611
EBITDA margin (%)	31%	7%	-5%	-60%	9%

Source: Company Reports

Tata Steel

Company description

Tata Steel Ltd (TSL) is the world's sixth-largest steel company. In India, it has raised its crude-steel capacity from 5mtpa to 6.8mtpa, of which ~60% is rolled into flat products and the rest sold as long products. It sells ferro alloys, tubes, bearings and some mineral products. Corus, TSL's 100% subsidiary, is a Northern European Steel long and flat steel producer with around 20m tpa of crude steel capacity and production bases in the UK and Holland. TSL has a presence in Asia through NatSteel (100%-owned) and Tata Steel Thailand (67%-owned). Adding the Asia-based capacities takes its total crude-steel capacity to 30mtpa and finishing capacity to 33mtpa. Of its crude steel capacity, 23% is in India, 71% in the UK/Europe and the rest in SE Asia. The crude steel capacity in India will likely be hiked further to 10mtpa by 2011.

Investment strategy

We rate TSL Sell/High Risk (3H) to factor in an extended global slowdown, weaker steel prices in Europe and India, lower volumes and weaker margins. Our earnings estimates for TSL are largely based on our European steel price forecasts. For HRC we expect an average price of US\$740/t, +15% YoY for FY09, but a decline of 26% YoY to US\$550/t for FY10 and 18% YoY to US\$450/t for FY11. India's steel demand growth which was between 11-14% p.a. in the past three years has slowed. Demand ytd (April 2008-January 2009) showed a 3.2% decline yoy. We take into account volume cuts announced by Corus given weakening demand in its key markets of Europe and UK. The sharp price cuts have an adverse impact on TSL's consolidated EBITDA margins, which could fall from 14% in FY08 to 11% in FY10 and 10% in FY11. TSL's more profitable operations in India do not get a proportionate benefit from declining raw material prices as 100% of iron ore and 60% of coking coal is available from captive sources. We expect declining earnings in FY10 and FY11. TSL should end FY09 with a high debt-equity ratio of 1.7x. This is likely to fall to around 1.1x by FY11 as we anticipate debt repayments by Corus due to lower working capital needs. With falling profitability, we expect Tata Steel's interest coverage to fall from 3.6x in FY09 to 1.8x by FY11.

Valuation

We use EV/EBITDA as our preferred valuation metric for TSL largely due to its high leverage. Our target multiple is based on the stock's five year average forward EV/EBITDA of 4x, which incorporates a full steel cycle. As we assume near-trough domestic prices, we no longer apply a 5% discount to the average EV/EBITDA. Our 12-month forward consolidated EV/EBITDA is 4x. At our target price of Rs125, the stock would trade at a consolidated FY10E P/E of 2.7x.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, assigns a High Risk rating to TSL. Key upside risks are: 1) upside in steel prices in Europe or India driven by better demand or plant shutdowns; 2) increase in steel import duties in India; 3) a better global credit outlook; and 4) weaker raw material prices than we expect which would benefit Corus.

Appendix A-1

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Fundamental Research

Analyst: Pradeep Mahtani

Covered since May 30 2008

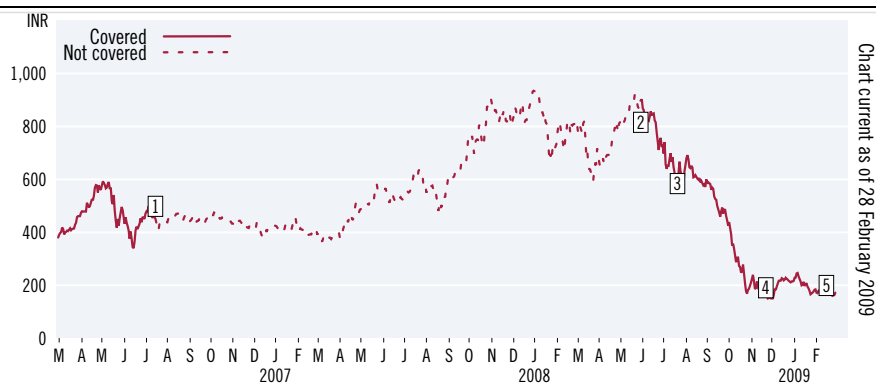


Chart current as of 28 February 2009

Date	Rating	Target Price	Closing Price
1 14-Jul-06	Coverage suspended		
2 29-May-08	*1M	*1,286.00	896.05

Date	Rating	Target Price	Closing Price
3 21-Jul-08	1M	*933.00	598.50
4 21-Nov-08	*3H	*130.00	160.05

Date	Rating	Target Price	Closing Price
5 16-Feb-09	3H	*125.00	184.05

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Tata Steel (TISC.BO)2 March 2009

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