

Equities

11 November 2011 | 10 pages

Tata Steel (TISC.BO)

2QFY12: Europe a Wildcard; Subsidiary/JV Losses

- 2QFY12 adj cons PAT down 75% yoy** — Tata Steel's consol. adj PAT came in at Rs3.6bn (reported Rs2.1bn), below estimates. The underperformance is due to \$77m of EBITDA losses – accounted for by subsidiary losses/inter-company adjustments; and higher tax. Some subsidiaries making losses are 1) Tata Steel KZN (90%) - ferro chrome business in S. Africa (FY11 loss of \$11m) hit by low chrome ore availability/high power costs - likely to remain weak; 2) Tata Metaliks (50%), EBITDA loss of \$9m in 2QFY12 – Redi unit sold now; 3) Dhamra Port (50%) recently commissioned; 4) Mothballing impact of mini blast furnace (BF) in Tata Steel Thailand. Standalone tax was higher than consolidated tax despite consolidated PAT being lower.
- 1Q India highlights** — Adj PAT at Rs16.5bn rose 3% yoy, in line with Citi est. EBITDA margin (incl other income) was 36% vs 38% last year (40% in 1QFY12). EBITDA/t was \$365 (adj) vs \$336 in 2QFY11 and \$403 in 1Q. Management expects an EBITDA level of \$350-375/t to sustain. Sales volumes fell marginally to 1.65mt (flats rose 3% yoy). Average steel realizations rose 20% yoy and 2% qoq. Margins declined on higher raw material/power costs and weak performance of the ferro alloys division. EBIT margin fell to 18% vs 33% on lower demand from Japan's stainless steel industry/lower prices.
- Europe EBITDA/t down 42% yoy** — EBITDA/t was \$30 in 2Q (Citi est \$25) vs \$51 last year and \$71 in 1Q. The quarter was impacted by higher raw material prices. Volumes fell marginally to 3.48mt (3.53mt last year). Europe remains a wildcard and management expects EBITDA/t to be weaker in 3Q vs 2Q. They have taken steps to mothball 1mtpa BF capacity in Scunthorpe and close the construction products business in South Wales. Pension surplus was £106m in Sep11 vs £350m in June11.
- Tata Steel Asia EBITDA/t fell 81% yoy** — EBITDA/t was \$6 vs \$34. Volumes were flat yoy at 0.78mt. Asia was impacted by floods in Thailand/weak Australian demand.
- Risks** — There is downside risk to our forecasts. We await further clarity from management on the performance of the subsidiaries/JVs; following which we will review our estimates.

Company Update

Buy	1
Price (09 Nov 11)	Rs430.00
Target price	Rs632.00
Expected share price return	47.0%
Expected dividend yield	2.0%
Expected total return	49.0%
Market Cap	Rs412,462M
	US\$8,252M

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



Figure 1. Tata Steel (Consolidated) – Statistical Abstract

YE 31 Mar	PAT (Rs bn)	PAT growth (%)	EPS (Rs)	EPS growth (%)	P/E (x)	EV/EBITDA (x)	ROE (%)
FY09	79.0	4%	106.3	3%	4.0	3.6	18%
FY10	(3.3)		(4.2)			12.5	-9%
FY11	72.9		76.0		5.7	5.5	25%
FY12E	51.9	-29%	53.4	-30%	8.1	5.9	12%
FY13E	63.6	23%	65.4	23%	6.6	4.9	13%
FY14E	63.4	0%	65.2	0%	6.6	4.9	12%

Source: Company Reports and Citi Investment Research and Analysis estimates. Price as on 11 Nov 2011.

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Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	nm	5.7	8.1	6.6	6.6
EV/EBITDA adjusted (x)	9.9	5.0	5.7	4.7	4.6
P/BV (x)	1.7	1.2	1.0	0.9	0.8
Dividend yield (%)	1.9	2.8	2.0	2.3	2.4
Per Share Data (Rs)					
EPS adjusted	-4.18	76.01	53.39	65.43	65.25
EPS reported	-4.18	76.01	53.39	65.43	65.25
BVPS	257.08	370.69	447.45	499.36	550.50
DPS	8.00	12.00	8.50	10.00	10.50
Profit & Loss (RsM)					
Net sales	1,023,931	1,187,531	1,300,679	1,400,750	1,392,507
Operating expenses	-976,563	-1,061,913	-1,191,552	-1,268,151	-1,260,046
EBIT	47,368	125,618	109,127	132,600	132,462
Net interest expense	-30,221	-27,700	-36,327	-42,643	-42,641
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	17,147	97,917	72,800	89,956	89,820
Tax	-21,518	-26,263	-21,480	-26,987	-26,946
Extraord./Min.Int./Pref.div.	657	1,266	548	590	507
Reported net income	-3,714	72,921	51,868	63,560	63,381
Adjusted earnings	-3,714	72,921	51,868	63,560	63,381
Adjusted EBITDA	92,285	169,766	152,086	183,194	183,550
Growth Rates (%)					
Sales	-30.5	16.0	9.5	7.7	-0.6
EBIT adjusted	-66.5	165.2	-13.1	21.5	-0.1
EBITDA adjusted	-49.8	84.0	-10.4	20.5	0.2
EPS adjusted	-103.9	nm	-29.8	22.5	-0.3
Cash Flow (RsM)					
Operating cash flow	105,022	64,629	101,574	96,477	120,996
Depreciation/amortization	44,917	44,148	42,959	50,594	51,088
Net working capital	49,017	-71,749	6,227	-27,630	419
Investing cash flow	-47,003	-83,785	-57,946	-31,530	-62,381
Capital expenditure	-69,472	-101,636	-93,272	-35,510	-67,824
Acquisitions/disposals	17,530	14,334	0	0	0
Financing cash flow	-51,352	59,931	-115,853	-58,113	-60,235
Borrowings	-26,866	53,092	-71,599	-4,039	-4,458
Dividends paid	-13,209	-7,146	-13,273	-11,431	-13,135
Change in cash	6,668	40,775	-72,226	6,835	-1,619
Balance Sheet (RsM)					
Total assets	1,097,760	1,354,831	1,388,532	1,439,967	1,484,570
Cash & cash equivalent	87,464	140,519	67,698	74,533	72,914
Accounts receivable	115,124	148,163	160,358	172,695	171,679
Net fixed assets	457,958	523,934	605,009	620,747	668,549
Total liabilities	860,780	990,303	945,036	946,137	941,069
Accounts payable	220,239	253,157	283,735	284,468	282,806
Total Debt	531,004	606,843	535,244	531,206	526,748
Shareholders' funds	236,980	364,528	443,497	493,831	543,501
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	9.0	14.3	11.7	13.1	13.2
ROE adjusted	-1.6	25.0	13.1	13.8	12.4
ROIC adjusted	3.4	12.8	9.8	11.1	10.6
Net debt to equity	187.2	127.9	105.4	92.5	83.5
Total debt to capital	69.1	62.5	54.7	51.8	49.2

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2QFY12 Results

Figure 2. Tata Steel - 2QFY12 Standalone Results

(Rs m)	2Q FY12	2Q FY11	% chg
Production (mt)	1.71	1.61	6
Sales (mt)	1.65	1.66	-1
Net sales	82,119	71,068	16
Expenditure	52,922	44,777	18
Operating profit	29,198	26,290	11
Other income	236	1,057	-78
EBITDA (incl other income)	29,433	27,347	8
EBITDA margin (%)	35.8	38.5	
Interest costs	2,343	3,425	-32
Depreciation	2,871	2,815	2
Extraordinary items	-1,500	6,270	
PBT	22,720	27,378	-17
Total tax	7,767	6,726	15
Effective tax rate (%)	34.2	24.6	
PAT (as reported)	14,952	20,651	-28
Adjusted PAT	16,452	15,922	3

Source: Company Reports and Citi Investment Research and Analysis

Figure 3. Tata Steel - 2QFY12 Consolidated Results

(Rs m)	2Q FY12	2Q FY11	% chg
Net sales	327,979	286,462	14
Expenditure	298,979	249,740	20
Operating profit	29,000	36,722	-21
Other income	1,204	886	36
EBITDA (incl other income)	30,205	37,607	-20
EBITDA margin (%)	9.2	13.1	
Interest costs	7,161	6,637	8
Depreciation	11,088	10,781	3
Extraordinary items	-1,500	6,943	
PBT	10,456	27,132	-61
Total tax	9,065	7,450	22
Effective tax rate (%)	86.7	27.5	216
Net profit	1,390	19,682	-93
Share of profits of associates	192	3	
Minority interest	542	103	
Profit after minority interest and share of profits from associates	2,124	19,788	-89
Adjusted profit after minority interest and share of profits from associates	3,624	14,752	-75

Source: Company Reports and Citi Investment Research and Analysis

Figure 4. Tata Steel - 2QFY12 Consolidated Results Summary

	2Q FY12	2Q FY11	% chg
Sales volumes (m tonnes)			
Indian operations	1.65	1.66	-1
Tata Steel Europe	3.48	3.53	-1
SE Asia	0.78	0.79	-1
Total	6.11	6.06	1
Net sales (US\$ m)			
Indian operations	1,677	1,451	16
Tata Steel Europe	4,321	3,632	19
SE Asia	637	549	16
Total	6,698	5,850	14
EBITDA (US\$ m)			
Indian operations*	601	558	8
Tata Steel Europe	103	180	-43
SE Asia	5	27	-81
Total*	632	790	-20
EBITDA margin (%)			
Indian operations*	36%	38%	
Tata Steel Europe	2%	5%	
SE Asia	1%	5%	
EBITDA/t(US\$)			
Indian operations*	365	336	9
Tata Steel Europe	30	51	-42
SE Asia	6	34	-81

Source: Company Reports and Citi Investment Research and Analysis. *Adjusted

Tata Steel

Company description

Tata Steel Ltd (TSL) has a crude-steel capacity of 6.8mtpa, of which ~50% is rolled into flat products and the rest sold as long products. It sells ferro alloys, tubes, bearings and some mineral products. Tata Steel Europe (TSE, earlier called Corus), TSL's 100% subsidiary, is a Northern European Steel long and flat steel producer with 16m tpa of crude steel capacity and production bases in the UK and the Netherlands. TSL has a presence in Asia through NatSteel (100%-owned) and Tata Steel Thailand (67.9%-owned). Adding Asia-based capacities takes its total steel capacity to ~25mtpa. Of this capacity, 27% is in India, 64% in the UK/Europe and the rest in SE Asia. The crude steel capacity in India will likely be hiked by a further 42% to 9.8mtpa by end 2011, taking India's share of total steel capacity to 36%.

Investment strategy

We rate TSL as Buy (1) with a TP of Rs632. TSL India's combination of raw material security, operating efficiencies, high value products, and branding helps it earn EBITDA margins of 34-39%. Most capacity increases are in India where it should maintain raw material security at existing levels (100% iron ore, 50-55% for coking coal) and we expect the Indian business to earn EBITDA/t of US\$340-430 in FY12-14E. In India, volumes are expected to be flat in FY12, but grow 29% in FY13. Our estimates use average steel price of US\$830/t in FY12 and US\$823/t in FY13 and due to our Rs/US\$ trend expectation, assume that average steel prices for TSL India will rise 9% YoY in FY12 and fall 1% in FY13. TSE has continued to report positive EBITDA since 3QFY10 (EBITDA/t of US\$25-94) and we expect EBITDA/t of US\$26/37 during FY12E/13E. In both auto and construction, there is divergence in Europe and the North/South Divide continues. German construction/auto orders/registrations are robust but construction confidence has dipped in UK & EU. Prospects of a deepening of the Euro area sovereign crisis creates risk - again for S. European economies, hence for steel demand too. We are concerned about the demand outlook in Europe, especially near-term, but are positive on a 12-18 month time frame. Consolidated gross debt was US\$13.6bn and net debt was US\$9.1bn at Jun-11. We expect net debt/EBITDA of 3.1x and net D/E of 1.1x as of Mar-12E.

Valuation

We value TSL using SOTP. We use EV/EBITDA as our preferred valuation metric for TSL largely due to its high leverage. For TSL India, we use a target EV/EBITDA of 7.0x on Sep12E earnings, a premium to the average of 6.5x FY12E for the other Indian steel majors to reflect greater integration and relatively higher margins. Tata Steel Europe and its other non-Indian businesses are valued at 4.5x EV/EBITDA, ~10% below the five-year trading average for the European steel sector. Based on the above, we arrive at a target price of Rs632. At our target price, the stock would trade at a consolidated Sep12E EV/EBITDA of 6.5x and P/E of 10.6x.

Risks

Key downside risks to our investment thesis on TSL are: 1) Weaker steel prices; 2) Higher raw material prices; 3) FX trends; 4) Lower volumes than we expect, especially for Tata Steel Europe. Upside risks are: 1) Upside in steel prices in Europe or India, driven by better demand or plant shutdowns; 2) Weaker raw material prices than expected which would benefit Tata Steel Europe. If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our TP. Conversely, if the impact of any of these upside risks is greater than we anticipate, the stock could exceed our TP.

Appendix A-1

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Tata Steel (TISC.BO)

Ratings and Target Price History Fundamental Research

Analyst: Pradeep Mahtani

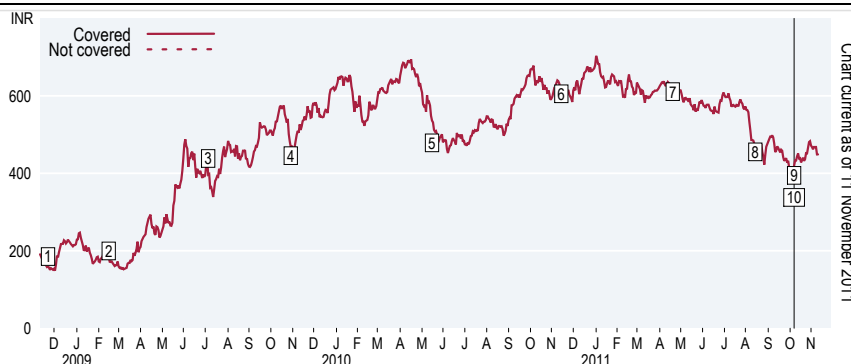


Chart current as of 11 November 2011

	Date	Rating	Target Price	Closing Price
1	21-Nov-08	*3H	*130.00	160.05
2	16-Feb-09	3H	*125.00	184.05
3	6-Jul-09	*2M	*460.00	396.45
4	29-Oct-09	2M	*529.00	468.10

	Date	Rating	Target Price	Closing Price
5	17-May-10	2M	*590.00	536.20
6	15-Nov-10	*1M	*740.00	617.15
7	20-Apr-11	1M	*777.00	625.00
8	14-Aug-11	1M	*632.00	476.35

	Date	Rating	Target Price	Closing Price
9	7-Oct-11	Stock rating system changed		
10	7-Oct-11	*1	632.00	419.60

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Tata Steel (TISC.BO)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Pradeep Mahtani

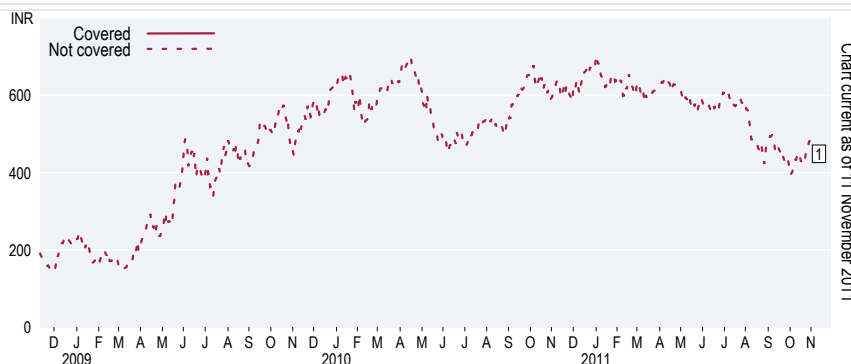


Chart current as of 11 November 2011

	Date	Rating	Target Price	Closing Price
1	11-Nov-11	*ADD MP	-	448.80

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