

Tata Steel Limited

Bloomberg Code: TATA IN

India Research - Stock Broking

BUY

Tata Steel Limited and Thyssenkrupp AG of Germany had signed definitive agreements in June 2018 to combine their business in Europe to create a 50:50 joint venture company which could have become second largest steel company in the European continent. However, European Commission expressed concerns and objections on automotive steel and packaging steel. The managements of these companies went back to EC with remedies which were found not sufficient. Expecting the deal to be rejected by European Commission, the management of these two companies decided to call off their proposed joint venture on 10th May 2019. With this development, Tata Steel plan to deleverage and de-consolidate business will get adversely impacted. However, the recent growth in company steel production has been led by strong domestic demand ably supported by moderate recovery in European operations. We have valued the stock on EV/EBITDA 6.3x of FY21E EBITDA for the downwardly revised TP of Rs. 618 with potential upside of 28%.

The proposed JV with Thyssenkrupp was part of strategic initiative of restructuring European operations. It was aimed at de-consolidating the European operations and focuses more on profitable business such as India operations. The JV was expected to take significant debt off the book of the two companies and offer cost synergies of Euro 400-600 million per annum. The JV was expected to cut the consolidated debt burden of Tata Steel Limited by about Euro 2.5 Bn and improve leverage levels. The JV would have enabled Tata Steel Limited to create sustainable portfolio in Europe, enabled de-consolidation of Europe business and deleverage balance sheet. JV would also have enabled greater focus on higher value added products, higher investment in R & D and all round growth.

The operational performance of the European business has improved in the last two years. Operations in UK have improved while Netherlands is running stable but profits continued to be under pressure dragging down the margins of consolidated entity. Challenges in Europe business is more due to soft market conditions.

With the postponement of JV, Tata Steel will work towards improving Europe business making the same cash positive. Going forward, stable operations in U.K. and Netherlands to aid European operations growth. The company is working on alternative strategy and will explore all options including JV with another steel manufacturer in Europe preferably from outside Europe to de-consolidate its European operations and deleverage its balance sheet.

Exhibit 1: Valuation Summary

| YE Mar (Rs. Mn) | FY17 | FY18 | FY19 | FY20E | FY21E |
|-------------------|---------|---------|---------|---------|---------|
| Net Sales | 1174199 | 1241097 | 1576690 | 1479063 | 1571518 |
| EBITDA | 170078 | 214332 | 293833 | 275640 | 295473 |
| EBITDA Margin (%) | 14.5 | 17.3 | 18.6 | 18.6 | 18.8 |
| Net Profit | (42408) | 134343 | 79783 | 71627 | 62730 |
| EPS (Rs.) | (43.7) | 117.3 | 69.7 | 62.6 | 54.8 |
| RoE (%) | (10.4) | 27.2 | 12.3 | 9.9 | 8.0 |
| PE (x) | (10.0) | 4.8 | 7.5 | 7.7 | 8.8 |

Source: Company, Karvy Research; *Represents multiples for FY17 - FY19 are based on historic market price

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Recommendation (Rs.)

| | |
|--------------------------|-----|
| CMP (as on May 20, 2019) | 484 |
| Target Price | 618 |
| Previous Target Price | 671 |
| Upside (%) | 28 |

Stock Information

| | |
|------------------------------|---------------|
| Mkt Cap (Rs.mn/US\$ mn) | 549762 / 7884 |
| 52-wk High/Low (Rs.) | 648 / 441 |
| 3M Avg. daily value (Rs. mn) | 30.1 |
| Beta (x) | 1.0 |
| Sensex/Nifty | 39353 / 11828 |
| O/S Shares(mn) | 1126.5 |
| Face Value (Rs.) | 2.0 |

Shareholding Pattern (%)

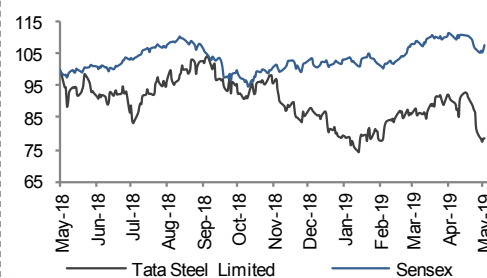
| | |
|-----------|------|
| Promoters | 33.1 |
| FII | 15.0 |
| DII | 29.2 |
| Others | 22.7 |

Stock Performance (%)

| | 1M | 3M | 6M | 12M |
|--------------------|------|------|------|------|
| Absolute | (11) | (1) | (14) | (18) |
| Relative to Sensex | (11) | (10) | (23) | (28) |

Source: Bloomberg

Relative Performance*



Source: Bloomberg; *Index 100

Analyst Contact

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Financials

Exhibit 10: Income Statement

| YE Mar (Rs. Mn) | FY17 | FY18 | FY19 | FY20E | FY21E |
|-----------------------------|---------|---------|---------|---------|---------|
| Revenues | 1174199 | 1241097 | 1576690 | 1479063 | 1571518 |
| Growth (%) | 10.4 | 5.7 | 27.0 | (6.2) | 6.3 |
| Operating Expenses | 1004121 | 1026765 | 1282857 | 1203423 | 1276045 |
| EBITDA | 170078 | 214332 | 293833 | 275640 | 295473 |
| Growth (%) | 113.4 | 26.0 | 37.1 | (6.2) | 7.2 |
| Depreciation & Amortization | 56729 | 57417 | 73418 | 79103 | 98238 |
| EBIT | 113349 | 156915 | 220415 | 196537 | 197235 |
| Other Income | 5275 | 8811 | 14206 | 13326 | 14159 |
| Interest Expenses | 50722 | 54547 | 76601 | 85612 | 99951 |
| PBT | 24736 | 209561 | 159057 | 126359 | 113683 |
| Tax | 27780 | 33923 | 67184 | 44226 | 39789 |
| PAT | (42408) | 134343 | 79783 | 71627 | 62730 |
| Growth (%) | 1,007.9 | (416.8) | (40.6) | (10.2) | (12.4) |

Source: Company, Karvy Research

Exhibit 11: Balance Sheet

| YE Mar (Rs. Mn) | FY17 | FY18 | FY19 | FY20E | FY21E |
|---|----------------|----------------|----------------|----------------|----------------|
| Cash & Cash Equivalents | 49211 | 79379 | 33414 | 26800 | 37572 |
| Trade Receivable | 115868 | 124155 | 118110 | 103483 | 131962 |
| Inventory | 248038 | 283310 | 316561 | 246167 | 349167 |
| Other Financial Assets | 117738 | 304548 | 379526 | 315669 | 335558 |
| Investments | 108632 | 161183 | 38152 | 35790 | 38027 |
| Net Block | 1042960 | 1086199 | 1390865 | 1648349 | 1907737 |
| Miscellaneous | 50887 | 58807 | 59196 | 58005 | 59133 |
| Total Assets | 1733332 | 2097579 | 2335824 | 2434262 | 2859155 |
| Liabilities & Provisions | 531636 | 602132 | 735125 | 661988 | 860136 |
| Debt (LT + ST) | 823504 | 886741 | 911448 | 1018661 | 1189284 |
| Total Liabilities | 1355139 | 1488873 | 1646573 | 1680650 | 2049421 |
| Equity Capital | 9702 | 11450 | 11449 | 11449 | 11449 |
| Reserves & Surplus | 368491 | 597257 | 677801 | 742163 | 798285 |
| Total Networth | 378193 | 608706 | 689251 | 753613 | 809735 |
| Total Networth & Liabilities | 1733332 | 2097579 | 2335824 | 2434262 | 2859155 |

Source: Company, Karvy Research

Exhibit 12: Cash Flow Statement

| YE Mar (Rs. Mn) | FY17 | FY18 | FY19P | FY20E | FY21E |
|--|----------------|-----------------|-----------------|-----------------|-----------------|
| PBT | 24736 | 209561 | 159057 | 126359 | 113683 |
| Depreciation | 56898 | 59617 | 73418 | 79103 | 98238 |
| Interest | 50722 | 55018 | 76601 | 85612 | 99951 |
| Tax Paid | (18427) | (28882) | (67184) | (44226) | (39789) |
| Changes in WC | (49144) | (92755) | 16140 | 87439 | 56816 |
| Others | 82020 | (124445) | (14206) | (13326) | (14159) |
| Cash flow from operating activities | 146805 | 78113 | 243827 | 320960 | 314740 |
| Inc/dec in capital expenditure | (77156) | (74785) | (358803) | (336586) | (357626) |
| Others | (13600) | (45471) | 137236 | 15689 | 11922 |
| Cash flow from investing activities | (90756) | (120256) | (221567) | (320898) | (345704) |
| Inc/dec in borrowings | 194846 | 241614 | 24707 | 107213 | 170623 |
| Dividend paid | (9498) | (11800) | (17772) | (17772) | (17772) |
| Interest paid | (47328) | (51456) | (76601) | (85612) | (99951) |
| Others | (163813) | (111959) | 2190 | (10507) | (11163) |
| Cash flow from financing activities | (25794) | 66399 | (67476) | (6676) | 41737 |
| Net change in cash | 30256 | 24256 | (45216) | (6614) | 10773 |

Source: Company, Karvy Research

Exhibit 13: Key Ratios

| YE Mar | FY17 | FY18 | FY19 | FY20E | FY21E |
|---------------------------|--------|------|------|-------|-------|
| EBITDA Margin (%) | 14.5 | 17.3 | 18.6 | 18.6 | 18.8 |
| EBIT Margin (%) | 9.7 | 12.6 | 14.0 | 13.3 | 12.6 |
| Net Profit Margin (%) | (3.6) | 10.8 | 5.1 | 4.8 | 4.0 |
| Dividend Payout Ratio (%) | 1.8 | 1.8 | 2.5 | 2.7 | 2.7 |
| Net Debt/Equity (x) | 2.0 | 1.3 | 1.3 | 1.3 | 1.4 |
| RoE (%) | (10.4) | 27.2 | 12.3 | 9.9 | 8.0 |
| RoCE (%) | 9.3 | 11.6 | 14.2 | 11.7 | 10.5 |

Source: Company, Karvy Research


Exhibit 14: Valuation Parameters

| YE Mar | FY17 | FY18 | FY19 | FY20E | FY21E |
|---------------|--------|-------|-------|-------|-------|
| EPS (Rs.) | (43.7) | 117.3 | 69.7 | 62.6 | 54.8 |
| DPS (Rs.) | 8.0 | 10.0 | 13.0 | 13.0 | 13.0 |
| BVPS (Rs.) | 389.8 | 531.6 | 602.0 | 658.2 | 707.2 |
| PE (x) | (10.0) | 4.8 | 7.5 | 7.7 | 8.8 |
| P/BV (x) | 1.1 | 1.1 | 0.9 | 0.7 | 0.7 |
| EV/EBITDA (x) | 7.2 | 6.8 | 5.1 | 5.7 | 5.8 |
| EV/Sales (x) | 1.0 | 1.2 | 1.0 | 1.1 | 1.1 |

Source: Company, Karvy Research; *Represents multiples for FY17 - FY19 are based on historic market price

| Stock Ratings | Absolute Returns |
|---------------|------------------|
| Buy | : > 15% |
| Hold | : 5-15% |
| Sell | : < 5% |

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