

3QFY08 results inline

1 February 2008

BUY

Price	Target Price
Rs734	Rs1079

Sensex – 17,649

Price Performance

(%)	1M	3M	6M	12M
Absolute	(21)	(19)	30	79
Rel. to Sensex	(10)	(9)	10	43

Source: Bloomberg

Stock Details

Sector	Metals & Mining
Reuters	TISC.BO
Bloomberg	TATA@IN
Equity Capital (Rs mn)	7306
Face Value (Rs)	10
52 Week H/L (Rs)	1049/399
Market Cap (Rs bn)	535.9
Daily Avg Vol (No of shares)	2422469
Daily Avg Turnover (US\$ mn)	51.6

Shareholding Pattern (%)
(31st Dec.'07)

Promoters	33.7
FII/NRI	20.6
Institutions	20.0
Private Corp.	3.1
Public	22.6

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Tata Steel reported their 3QFY08 results. On a standalone basis, for the third quarter, the company reported PAT of Rs10.68bn (yoy up 0.5%, qoq down 10%) and net sales of Rs49.7bn (yoy up 11.3%, qoq up 3.9%). During the quarter, the company reported production of 1.24mt (yoy down 3% and qoq down 3%). However, the company reported higher sales volume at 1.24mt (yoy up 1%, qoq up 2%). During the quarter, the company reported higher than expected interest cost due to delay in completion of CCPS and rights issue. During the 4QFY08, the company expects reduction of interest cost to the tune of Rs1.7bn due to repayment of USD2.2bn of bridge loans. However, the company is mulling further issuance of equity linked securities to the tune of USD0.5mn which, at CMP of Rs773 could lead to a further dilution of 3% on the fully diluted equity. We also attended the analyst meet of Tata Steel. Key highlights of the meet are as under:

EU markets witness mild slowdown, expect re-stocking to push demand again

- European markets have witnessed a slowdown in the third quarter due to excess stock levels at the service centers leading to lower offtake from the producers. Consequently, the third quarter has not witnessed significant price hike by Corus.
- Corus sell almost 70% of its output on spot market mainly to construction, infrastructure sectors. Balance 30% is sold through annual contracts to automotive and packaging industry which have witnessed a slow down and stock pile up during the second quarter of FY08.
- The company expects re-stocking to push demand for steel.
- Exports from China, a major cause of concern for the EU has now been on a downward trend with new export tax norms by China and anti-dumping duties on several Chinese products by EU. This has resulted in reduction in exports from China to EU and hence, increase in demand for domestic producers.

Synergies on target

- Tata Steel consolidated is currently achieving a run rate of 30% of the target synergy of USD450mn which is targeted by the completion of the third year of acquisition.

Expansion projects largely on track

- The 1.8mtpa expansion project at Jamshedpur is on track and target date is maintained at June 2008. The capex for the expansion also remains on targeted Rs45.5bn.
- For the next phase of expansion which will take the capacity of Tata Steel Jamshedpur facility to 10mtpa by 2010 is on track with major equipment orders already placed. The total outlay for the project stands at Rs91.6bn.
- Work has already started on the greenfield project at Orissa for its 6mtpa plant and major equipment orders have been placed. Land acquisition is in progress. The total capex for the new plant is pegged at Rs156.6bn.

Progress on raw material sufficiency

- Tata Steel aims to have a 50% sufficiency over the long term over its raw material and has taken first step towards the same.
- Tata Steel has acquired 30% stake in Riversdale Mining Limited for its coking coal project in Mozambique. The company expects first shipment of coking coal in from CY2010. However, as per the agreement Tata Steel has a offtake arrange of 40% of the output at

market price. This does not lead to any savings on coking coal, but ensures steady supply of coking coal to Corus.

- The company has also signed an agreement with the state owned company of Ivory Coast, Sodembi. Tata Steel will hold 75% stake in the JV. The JV will develop the iron ore mine at Mt, Nimba which has a potential reserve of around 500mt. The JV will setup a pelletization plant and supply pellets to feed its facilities at Corus.
- Tata Steel has also entered into a 70:30 JV with the Al Baheja Group in Oman to develop limestone reserves. The JV will mine metallurgical grade limestone in southern Oman. The mine is expected to start limestone shipments from CY2010. The project is still in the initial phase of exploration and drilling.
- Further, Tata Steel has entered into a JV with SAIL to explore 4 coking coal blocks in Jharkhand to ensure coking coal supplies for the expanded capacities of both Tata Steel Jamshedpur and SAIL. The JV is expected to be formed by March 2008 and start preparatory work on exploration and drilling and securing statutory clearances thereafter.

Valuation

Tata Steel consolidated has reported an FDEPS of Rs40.14 excluding the actuarial gains which are notional profits. Including the actuarial gains the company has reported a FDEPS of Rs63.35 on a consolidated basis as compared to our full year estimates of Rs 110 for FY08. Further, the company has guided to an effective tax rate of 33% as compared to our assumption of 28% although the cash tax rate is likely to be lower. CVRD has proposed a hike of 70% in iron ore contract price for FY09 and coking coal contracts are likely to go up by at least 20-25%. We had factored in a hike of 30% for iron ore in FY09 and a 5% hike in coking coal prices for FY09. We believe Corus will have to hike steel prices by almost 10% as against our assumptions of 5%. We believe the hike is largely possible. However, the management guidance for an effective tax rate of 33% will likely result in lower EPS from Rs116.5 to Rs107.9. We reduce our target price to Rs1079 which is 10x our revised FY09 FDEPS of Rs107.9. We believe that Tata Steel will likely achieve its target synergies and will be able to push a hike of 10% in FY09 due to strong cost push factor.

We maintain a BUY on the stock with a reduced target price of Rs1079 which is 10x FY09 FDEPS of Rs107.9. At our target price the stock will likely trade at an EV/EBITDA of 7.0x and PER of 10x. At CMP of Rs733, the stock trades at 7.2x and EV/EBITDA of 6.1x.

Standalone financials results

	3QFY08	3QFY07	(%) yoy	2QFY08	(%) qoq
Steel production (t)	1,245,926	1,289,822	-3.4%	1,279,672	-2.6%
Steel sales (t)	1,243,500	1,234,404	0.7%	1,218,326	2.1%
Realisation/t	39,999	36,212	10.5%	39,276	1.8%
Net Sales	49,739	44,700	11.3%	47,851	3.9%
Expenditure					
Raw Material Cost	9,309	8,315	11.9%	7,999	16.4%
Trading goods purchased	1,084	1,110	-2.4%	1,072	1.1%
Change in stock	-614	-790	-22.3%	-159	286.6%
Net Raw material cost	9,778	8,635	13.2%	8,911	9.7%
Gross profit	39,962	36,065	10.8%	38,940	2.6%
Gross margin	80.3%	80.7%	-34bps	81.4%	-104bps
Power Cost	2,395	2,261	5.9%	2,387	0.3%
Employee Cost	3,646	3,611	1.0%	3,769	-3.3%
Frieght	2,877	2,856	0.7%	2,800	2.8%
Other Expenses	10,077	9,502	6.1%	9,730	3.6%
Total operating exp	18,996	18,229	4.2%	18,685	1.7%
EBITDA	20,966	17,836	17.5%	20,254	3.5%
Ebitda margin	42.2%	39.9%	225bps	42.3%	-18bps
Depreciation & amortization	2,092	1,991	5.1%	2,050	2.0%
EBIT	18,874	15,846	19.1%	18,204	3.7%
EBIT margin	37.9%	35.4%	250bps	38.0%	-10bps
Interest	3,627	520	597.0%	2,022	79.4%
Other income	670	987	-32.1%	943	-28.9%
Employee separation compensation	650	493	32.0%	563	15.5%
Forex gain (loss)	479	0		903	
PBT	15,746	15,820	-0.5%	17,466	-9.8%
Provision for tax	5,061	5,183	-2.4%	5,558	-8.9%
ETR (%)	32%	33%	-62bps	32%	32bps
PAT	10,686	10,638	0%	11,908	-10.3%
Net margin	21.5%	23.8%	-231bps	24.9%	-340bps
less: Extraordinary Items adjusted for Tax	113	325	-65.3%	-225	-150.3%
Adjusted PAT	10,799	10,963	-1.5%	11,684	-7.6%
Adjusted net margin	21.7%	24.5%	-281bps	29.7%	-804bps
Equity capital	6,092	5,807	4.9%	6,092	0.0%
Diluted capital	8,717	5,807	50.1%	8,717	0.0%
Reported EPS					
- Basic	17.54	18.32	-4.2%	19.55	-10.3%
- Diluted	12.26	18.32	-33.1%	19.55	-37.3%
Adjusted EPS					
- Basic	17.73	18.88	-6.1%	19.18	-7.6%
- Diluted	12.39	18.88	-34.4%	19.18	-35.4%

All fig in Rs mn except per sh data and percentage

Common Size Ratios

	3QFY08	3QFY07	% yoy	2QFY08	% qoq
Net Sales	100%	100%	-	100%	-
Raw material cost	19%	19%	11 bps	17%	200 bps
Trading goods purchased	2%	2%	-30 bps	2%	-6 bps
Change in stock	-1%	-2%	53 bps	0%	-90 bps
Net Raw Material Cost	20%	19%	34 bps	19%	104 bps
Personal expenses	7%	8%	-75 bps	8%	-55 bps
Power cost	5%	5%	-24 bps	5%	-17 bps
Frieght	6%	6%	-61 bps	6%	-7 bps
Other expenses	20%	21%	-100 bps	20%	-7 bps
EBITDA	42%	40%	225 bps	42%	-18 bps
Depreciation	4%	4%	-25 bps	4%	-8 bps
Interest expense	7%	1%	613 bps	4%	307 bps
Other income	1%	2%	-86 bps	2%	-62 bps
PAT	21%	24%	-231 bps	25%	-340 bps

Standalone Segment results

	3QFY08	3QFY07	% yoy	2QFY08	% qoq
Segment Revenue					
Steel Business	43,772	39,787	10.0%	42,983	1.8%
Ferro Alloys and minerals	5,730	4,161	37.7%	4,338	32.1%
Others	3,154	3,241	-2.7%	3,322	-5.1%
Less: Inter Segment Revenue	-2,917	-2,495	16.9%	-2,792	4.5%
Net Sales	52,656	47,190	11.6%	50,643	4.0%
Segment EBIT					
Steel Business	17,027	14,746	15.5%	16,825	1.2%
Ferro Alloys and minerals	2,337	1,344	73.8%	1,762	32.6%
Others	-1	103		-68	
Unallocable income/(Exp)	182	640	-71.5%	970	-81.2%
Less: Interest and finance charges	-3,627	-520	597.0%	-2,022	79.4%
Total	15,918	16,313	-2.4%	17,466	-8.9%
Segment Capital Employed					
Steel Business	116,231	106,308	9.3%	113,018	2.8%
Ferro Alloys and minerals	3,389	2,129	59.2%	2,916	16.2%
Others	3,017	2,797	7.9%	2,875	4.9%
Unallocated	284,748	63,919	345.5%	178,467	59.6%
Total	407,384	175,152	132.6%	297,277	37.0%

All fig in Rs mn except percentage

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