

## TATA STEEL

BUY  
CMP Rs573  
TP Rs723

26 May 2011

### Near term concerns; Future growth triggers intact

Tata Steel's Q4FY11 consol. revenue at Rs338.2bn were up 23% YoY mainly on improved realisations and higher volumes at TSE. However, consol. operating profit declined by 16% YoY to Rs39.9bn due to higher operating costs (blended cost/t increased 33% YoY to USD1,004 on higher RM cost). Adjusted net profit declined 49% YoY to Rs13.8bn with lower non-operating income. However, one-offs (mainly Rs25bn gain on sale of TCP) led to 69% YoY growth in reported PAT to Rs41.4bn.

**Tata Steel India (TSI):** Despite improved realisation (up 15% YoY), EBITDA/t at USD413 grew at a subdued 3% YoY on flat volume (1.7mnt) and higher input cost. Sequentially, EBITDA/t grew 8% aided by improve realisation despite a hike in staff and other expenses.

**Tata Steel Europe:** TSE's adj. EBITDA/t at USD53 (adj. for USD133mn of write-backs) improved 107% QoQ on higher volumes (up 19% QoQ to 4.1mnt due to -0.5mnt of de-stocking) despite flat steel prices.

**South East Asian operations:** EBITDA/t at USD29 (vs USD15 in Q4FY10, EBITDA loss of USD5 in Q3FY11) benefited from improved realisations (up 54% YoY) despite 16% YoY decline in deliveries.

**Balance Sheet:** Consol. debt of Rs581.1bn & cash and equivalent of Rs128.9bn, with net D/E at 1.0x, net D/EBITDA (FY11) at 2.6x.

**Project updates:** 2.9mntpa brownfield expansion, Riversdale and New millennium projects on schedule. Commenced work on 6.0mntpa integrated steel plant at Odisha entailing capex of Rs345bn.

**TSE restructuring:** As a further initiative towards cost-cutting, TSE has announced closure of bloom & billet mill in Scunthorpe and mothballing of Queen Bess blast furnace (~1mntpa), entailing right-sizing of 1,200.

### VALUATIONS AND RECOMMENDATION

*In the near term, we believe that there are a few pain points for TSE: 1) Qtrly sales at >4mnt not sustainable, 2) Despite low cost RM inventory, margin expansion in Q1FY12 is expected to be subdued, as TSE finding it difficult to increase steel prices and 3) Q2FY12 could see a significant contraction in margins as high cost raw material comes through.*

*However, we expect Tata Steel to benefit from improved steel profitability H2FY12 onwards (as RM cost declines on easing supply constraints), rising share of highly profitable Indian ops. with 2.9mntpa expansion and hedging of high RM cost at TSE with commencing of mining at Riversdale (coal) and New Millennium (iron ore). We expect EBITDA, EPS CAGR of 8%, 11% respectively over FY11-FY13E. Maintain 'BUY' with a reduced target price of Rs723 (6.3x FY12E consol. EV/EBITDA).*

### KEY FINANCIALS (CONSOLIDATED)

Rs mn

	FY09	FY10	FY11	FY12E	FY13E
Net Revenue	1,473,293	1,023,931	1,187,531	1,242,602	1,254,432
YoY Gr. (%)	12.0	(30.5)	16.0	4.6	1.0
Op. Profit	181,277	80,427	155,235	156,113	180,661
OPM (%)	12.3	7.9	13.1	12.6	14.4
Adj. Net Profit	90,454	(6,430)	56,869	54,609	70,502
YoY Gr. (%)	50.4	-	-	(4.0)	29.1

### KEY RATIOS

Dil. EPS (Rs)	104.1	(6.8)	55.7	52.8	68.2
ROCE (%)	13.7	(3.2)	8.3	7.3	9.0
RoE (%)	26.4	(2.2)	17.0	13.0	15.0
PER (x)	4.4	-	10.3	10.8	8.4
P/BV (x)	1.3	2.0	1.5	1.3	1.2
EV/EBDITA (x)	4.3	10.7	5.9	5.3	5.1

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### QUARTERLY SNAPSHOT (Rs mn)

Consolidated	Quarter Ended		
	Sep-10	Dec-10	Mar-11
Net Revenue	286,462	290,895	338,227
YoY Gr. (%)	12.8	11.0	23.0
Op.Profit	36,723	34,246	39,940
OPM (%)	12.8	11.8	11.8
Adj.Net Profit	13,815	10,007	13,826
YoY Gr. (%)	-	139.2	(49.4)

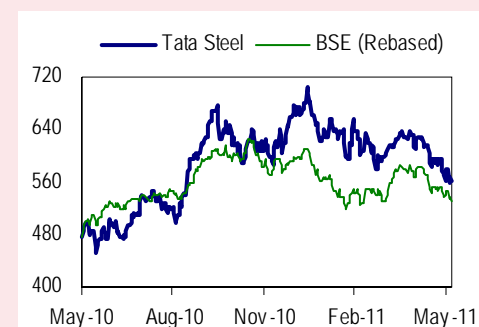
### STOCK DATA

Market Cap	Rs585bn
Book Value per share	Rs388
Shares O/S (F.V. Rs10)	1022mn
Free Float	69.4%
Avg Trade Value (6 months)	Rs3,815mn
52 week High/Low	Rs714/449
Bloomberg Code	TATAIN
Reuters Code	TISC.BO

### PERFORMANCE (%)

	1M	3M	12M
Absolute	(10.5)	(10.1)	17.7
Relative	(1.6)	(7.7)	6.3

### RELATIVE PERFORMANCE



**Exhibit 1 - Q4FY11 Quarterly snapshot - Consolidated**

Rs Mn	Q4FY11	Q4FY10	YOY%	Q3FY11	QoQ %	FY12E	FY11	YOY%
Net Revenue	338,227	275,038	23.0	290,895	16.3	1,242,602	1,187,531	4.6
Operating Profit	39,940	47,501	(15.9)	34,246	16.6	156,113	155,235	0.6
OPM (%)	11.8	17.3		11.8		12.6	13.1	
Other Income	2,116	9,588	(77.9)	157	1,250.2	11,603	4,721	145.8
Depreciation	11,664	10,946	6.6	11,264	3.5	46,740	44,148	5.9
Interest	7,701	11,322	(32.0)	7,432	3.6	34,117	27,746	23.0
PBT	22,691	34,821	(34.8)	15,706	44.5	86,860	88,062	(1.4)
Total Tax	8,764	7,866	11.4	6,240	40.4	34,310	32,459	5.7
Effective tax rate (%)	38.6	22.6		39.7		39.5	36.9	
MI & share of ass.	(101)	374	(127.0)	541	(118.7)	2,059	1,266	62.6
Adjusted Net Profit	13,826	27,329	(49.4)	10,007	38.2	54,609	56,869	(4.0)
Extraordinary items*	27,560	(2,904)		23		-	32,958	
Reported Net Profit	41,386	24,425	69.4	10,030	312.6	54,609	89,827	(39.2)
Adj. EPS (Rs)	13.5	28.8	(53.0)	10.4	30.5	52.8	55.7	(5.1)

Source: Company, PINC Research; \* Q4FY11 - Gain on sale of TCP Rs25bn; Adjustment for one-off gain in TSE Rs6.0bn and excess Rs1.3bn employee cost in Tata Steel India due to provisioning for gratuity

**Exhibit 2 - Q4FY11 Quarterly snapshot - Standalone**

Rs Mn	Q4FY11	Q4FY10	YOY%	Q3FY11	QoQ %	FY12E	FY11	YOY%
Net Revenue	83,408	73,394	13.6	73,974	12.8	324,820	293,964	10.5
Operating Profit	31,969	31,307	2.1	28,205	13.3	126,744	115,629	9.6
OPM (%)	38.3	42.7		38.1		39.0	39.3	
Other Income	(18)	2,303	-	113	-	4,673	1,618	188.9
Depreciation	2,982	3,115	(4.3)	2,864	4.1	12,026	11,462	4.9
Interest	2,949	3,585	(17.7)	3,354	(12.1)	16,073	13,005	23.6
PBT	26,020	26,911	(3.3)	22,100	17.7	103,318	92,780	11.4
Total Tax	7,644	7,663	(0.3)	6,966	9.7	34,095	29,112	17.1
Effective tax rate (%)	29	28.5		31.5		33.0	31.4	
Adjusted Net Profit	18,377	19,248	(4.5)	15,135	21.4	69,223	63,668	8.7
Extraordinary items	(1,300)	2,375		-		-	6,289	
Reported Net Profit	17,077	21,623	(21.0)	15,135	12.8	69,223	69,956	(1.0)
Adj. EPS (Rs)	18.0	20.3	(11.3)	14.8	21.4	66.9	62.3	7.5

Source: Company, PINC Research

**Exhibit 3 - Tata Steel: SOTP Valuation (Based on EV/EBITDA multiple)**

In Rs mn	Target EV/EBITDA	Target EV	CWIP (on BV)	FY12 Net Debt*	Residual Equity	Target Price (Rs)
Tata Steel India	6.5	823,836	120,000	115,951	827,885	801
Corus (TSE)	5.5	137,690	15,573	255,707	(102,444)	(99)
Tata Steel Thailand	5.0	4,116	-	-	4,116	4
Natsteel	5.0	17,556	-	-	17,556	17
<b>Tata Steel consolidated</b>	<b>6.3</b>	<b>983,198</b>	<b>135,573</b>	<b>371,658</b>	<b>747,113</b>	<b>723</b>

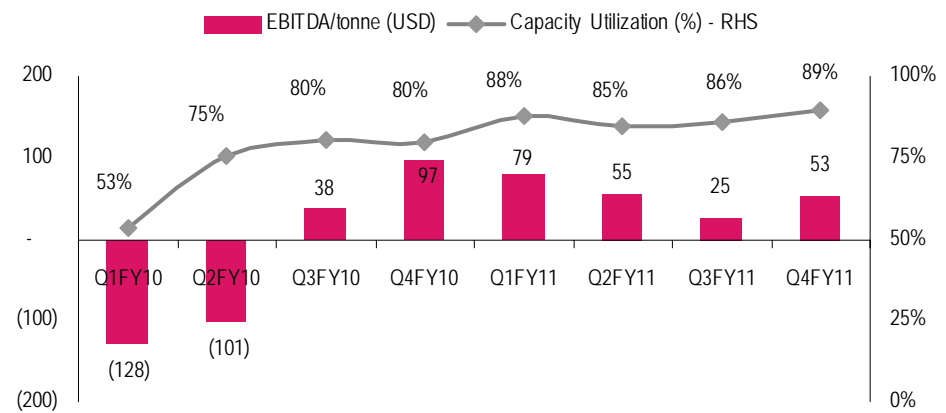
Source: PINC Research \* includes market value of investments at 25% holding discount

**Exhibit 4 - Quarterly performance trend**

(mn tonnes)	Q4FY11	Q4FY10	YOY%	Q3FY11	QoQ %	FY12E	FY11	YOY%
<b>Tata Steel India</b>								
Steel deliveries	1.71	1.70	0.6	1.64	4.5	6.83	6.56	4.1
Net Revenues (USD mn)	1,842	1,598	15.3	1,649	11.7	7,218	6,447	12.0
Net Realisation (USD/tonne)	1,077	940	14.6	1,007	6.9	1,057	983	7.6
EBITDA (USD mn)	706	682	3.6	629	12.3	2,817	2,536	11.1
EBITDA/tonne (USD/tonne)	413	401	3.0	384	7.5	412	387	6.7
<b>Tata Steel Europe</b>								
Steel deliveries	4.13	3.78	9.3	3.47	19.0	14.71	14.87	(1.1)
Net Revenues(USD mn)	4,924	3,833	28.5	4,024	22.4	17,427	17,044	2.2
Net Realisation (USD/tonne)	1,192	1,014	17.6	1,160	2.8	1,185	1,146	3.4
EBITDA (USD mn)	217	366	(40.7)	88	146.6	556	795	(30.0)
EBITDA/tonne (USD/tonne)	53	97	(45.7)	25	107.2	38	53	(29.2)
<b>South East Asian Operations</b>								
Steel deliveries	0.77	0.92	(16.1)	0.62	23.4	3.65	3.31	10.3
Net Revenues(USD mn)	689	533	29.3	653	5.5	2,969	2,539	16.9
Net Realisation (USD/tonne)	895	581	54.2	1,046	(14.5)	814	768	6.0
EBITDA (USD mn)	22	14	57.1	(3)	NA	96	80	20.4
EBITDA/tonne (USD/tonne)	29	15	87.3	(5)	NA	26	24	9.2

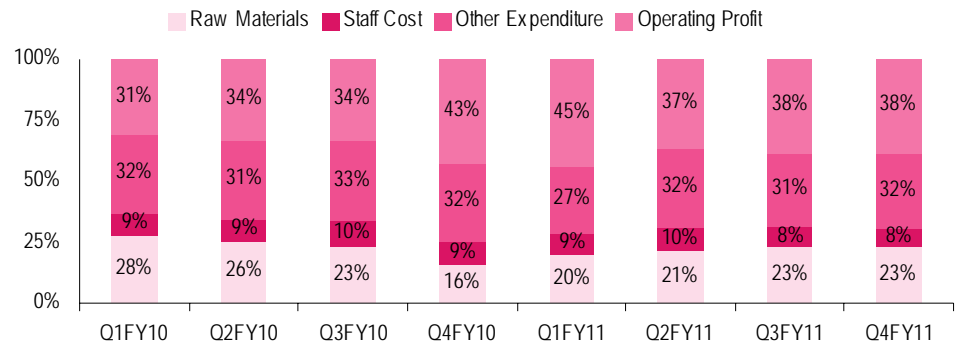
Source: Company, PINC Research

**Exhibit 5 - TSE: EBITDA and CU (at 10-qtr high)**



Source: Company, PINC Research

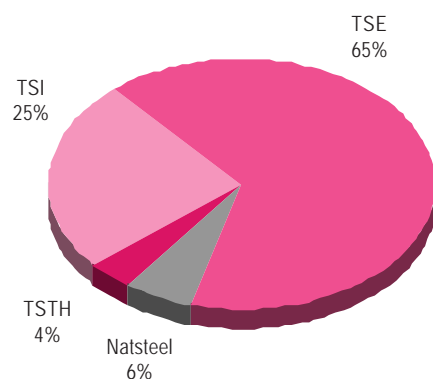
**Exhibit 6 - Tata Steel India cost structure**



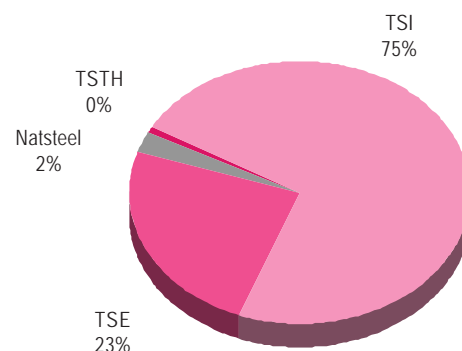
Source: Company, PINC Research

**Exhibit 7 - Share of highly profitable Indian operations to increase**

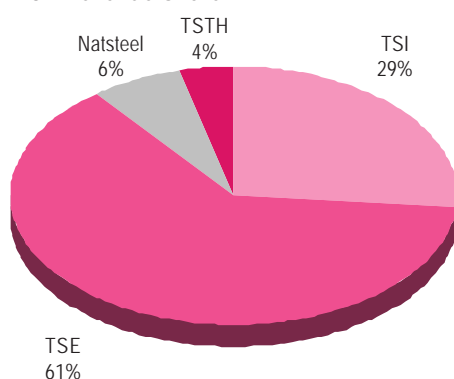
**FY11 Revenue Share**



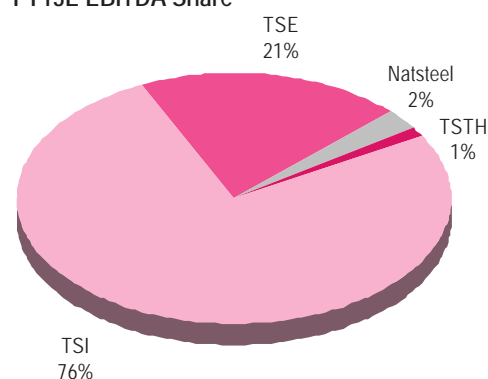
**FY11 EBITDA Share**



**FY13E Revenue Share**



**FY13E EBITDA Share**



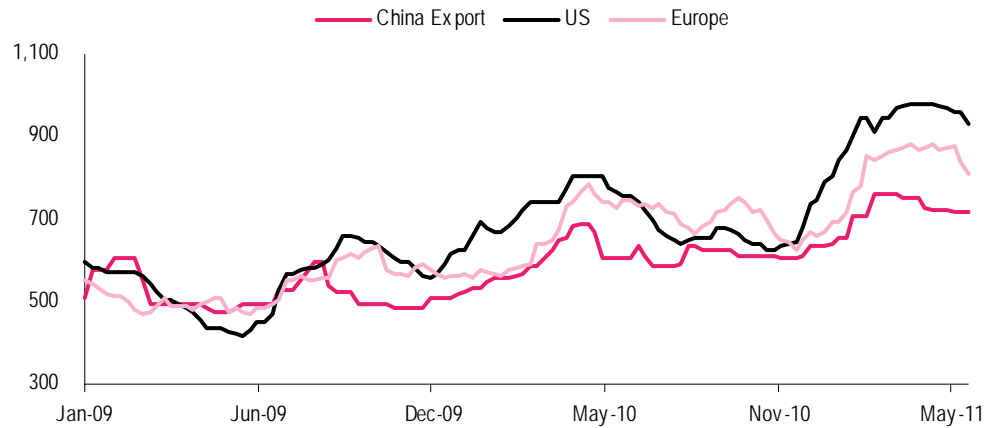
Source: Company, PINC Research

**Exhibit 8: PINC's revised assumptions and estimates**

	FY11	FY12E			FY13E
	Actual	Earlier	Revised	% Chg	Introducing
Benchmark HRC price (USD/t)	715	750	760	1.3	735
Contract coking coal (USD/t)	215	240	280	16.7	250
USD/INR	45.6	45.0	45.0	-	43.5
Sales volume (S) - mnt	6.6	6.8	6.8	0.8	8.4
Sales volume (C) - mnt	24.7	25.0	25.2	0.7	27.2
Revenue (C) - Rs mn	1,187,531	1,200,867	1,242,602	3.5	1,254,432
EBITDA (C) - Rs mn	155,235	161,226	156,113	(3.2)	180,661
- EBITDA (S) - USD/t	353	374	381	1.9	354
- EBITDA (TSE) - USD/t	53	49	38	(22.7)	59
Adj. PAT (C) - Rs mn	56,869	64,050	54,609	(14.7)	70,502
EPS (Rs)	55.7	62.0	52.8	(14.7)	68.2
Target EV/EBITDA (x)		6.1	6.3	2.8	
Target Price (Rs)		817	723	(11.5)	

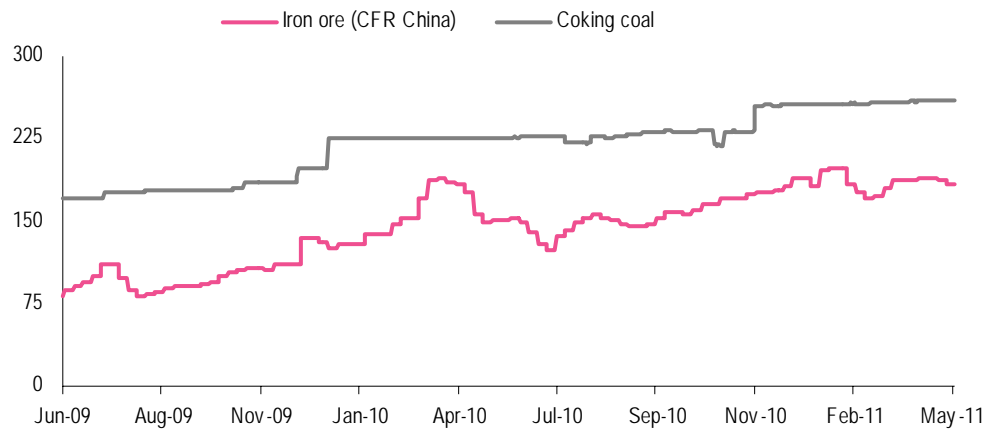
Source: Company, PINC Research

**Exhibit 9 - Global HRC price trends (USD/tonne)**



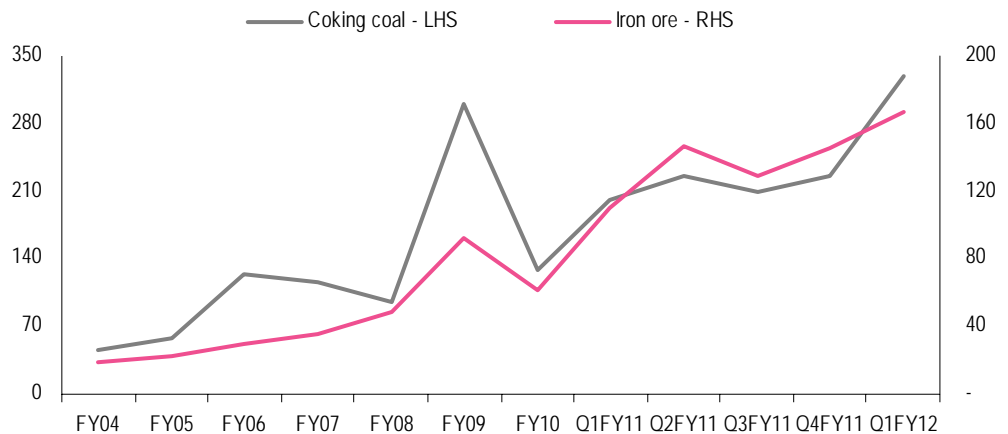
Source: Bloomberg, PINC Research

**Exhibit 10 - Raw material spot prices (USD/tonne)**



Source: Bloomberg, PINC Research; Iron ore price is for 63.5% grade; Coking coal price is domestic spot price in China

**Exhibit 11 - Raw material Contract prices (USD/tonne)**



Source: Industry, PINC Research

**Consolidated**

Year Ended March (Figures in Rs mn)

Income Statement	FY09	FY10	FY11	FY12E	FY13E
Net Revenue	1,473,293	1,023,931	1,187,531	1,242,602	1,254,432
Growth (%)	12.0	(30.5)	16.0	4.6	1.0
Operating Profit	181,277	80,427	155,235	156,113	180,661
Other income	7,662	13,406	4,721	11,603	12,888
<b>EBITDA</b>	<b>188,939</b>	<b>93,833</b>	<b>159,956</b>	<b>167,716</b>	<b>193,549</b>
Growth (%)	1.0	(50.3)	70.5	4.9	15.4
Depreciation	42,654	44,917	44,148	46,740	52,818
<b>EBIT</b>	<b>146,285</b>	<b>48,915</b>	<b>115,807</b>	<b>120,976</b>	<b>140,731</b>
Interest Expense	37,907	34,943	27,746	34,117	37,878
<b>PBT (before E/o items)</b>	<b>108,378</b>	<b>13,972</b>	<b>88,062</b>	<b>86,860</b>	<b>102,853</b>
Tax Provision	18,940	21,518	32,459	34,310	35,999
Minority Interest	1,017	1,116	1,266	2,059	3,648
<b>Adjusted Net Profit</b>	<b>90,454</b>	<b>(6,430)</b>	<b>56,869</b>	<b>54,609</b>	<b>70,502</b>
Growth (%)	50.4	-	-	(4.0)	29.1
E/o (loss)/income	(40,945)	(13,662)	32,958	-	-
<b>Reported Net profit</b>	<b>49,509</b>	<b>(20,092)</b>	<b>89,827</b>	<b>54,609</b>	<b>70,502</b>
<b>Adjusted EPS (Rs)</b>	<b>104.1</b>	<b>(6.8)</b>	<b>55.7</b>	<b>52.8</b>	<b>68.2</b>
EPS Growth (%)	50.4			(5.1)	29.1

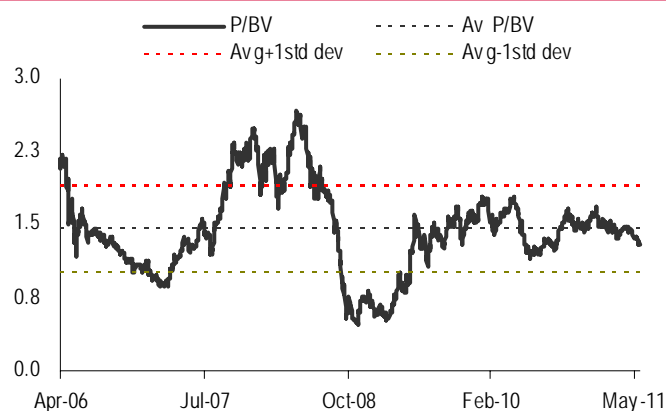
Cash Flow Statement	FY09	FY10	FY11	FY12E	FY13E
Pre-tax profit	67,432	310	88,062	86,860	102,853
Depreciation	42,654	44,917	44,148	46,740	52,818
Total Tax Paid	(33,813)	(24,586)	(32,459)	(34,310)	(35,999)
Chg in working capital	2,848	46,465	(81,100)	47,080	(17,786)
Other operating activities	77,838	37,603	23,025	22,513	24,990
<b>Cash flow from oper (a)</b>	<b>156,959</b>	<b>104,710</b>	<b>41,676</b>	<b>168,884</b>	<b>126,877</b>
Capital Expenditure	(83,611)	(69,498)	(110,124)	(105,500)	(104,800)
Chg in investments	(8,121)	9,951	23,608	-	-
Other investing activities	4,104	(2,072)	(7,744)	11,603	12,888
<b>Cash flow from inv (b)</b>	<b>(87,628)</b>	<b>(61,619)</b>	<b>(94,260)</b>	<b>(93,897)</b>	<b>(91,912)</b>
<b>Free cash flow (a+b)</b>	<b>69,331</b>	<b>43,091</b>	<b>(52,585)</b>	<b>74,987</b>	<b>34,964</b>
Equity raised/(repaid)	145	24,465	45,462	5,346	-
Debt raised/(repaid)	20,514	(26,866)	90,840	(25,000)	(30,000)
Change in minority interest	-	-	-	-	-
Dividend (incl. Tax)	(12,266)	(13,209)	(14,316)	(14,484)	(14,484)
Other financing activities	(35,941)	(35,739)	(27,746)	(34,117)	(37,878)
<b>Cash flow from fin (c)</b>	<b>(27,548)</b>	<b>(51,350)</b>	<b>94,240</b>	<b>(68,254)</b>	<b>(82,362)</b>
<b>Net chg in cash (a+b+c)</b>	<b>41,783</b>	<b>(8,259)</b>	<b>41,656</b>	<b>6,732</b>	<b>(47,397)</b>

Balance Sheet	FY09	FY10	FY11	FY12E	FY13E
Equity Share Capital	8,685	9,496	10,216	10,336	10,336
Reserves & surplus	299,703	261,619	386,329	431,681	487,699
<b>Shareholders' funds</b>	<b>308,388</b>	<b>271,114</b>	<b>396,545</b>	<b>442,017</b>	<b>498,035</b>
Minorities interests	8,949	8,841	8,889	8,489	8,989
Total Debt	563,218	490,272	581,112	556,112	526,112
<b>Capital Employed</b>	<b>880,555</b>	<b>770,227</b>	<b>986,546</b>	<b>1,006,618</b>	<b>1,033,136</b>
Net fixed assets	606,708	603,377	676,916	735,676	787,658
Cash & Cash Eq.	95,529	87,270	128,926	135,658	88,261
Net Other current assets	164,224	61,257	142,357	95,277	113,063
Investments	30,134	34,865	58,473	60,132	64,280
Net Deferred tax Assets	(16,040)	(16,541)	(20,126)	(20,126)	(20,126)
<b>Total Assets</b>	<b>880,555</b>	<b>770,227</b>	<b>986,546</b>	<b>1,006,618</b>	<b>1,033,136</b>

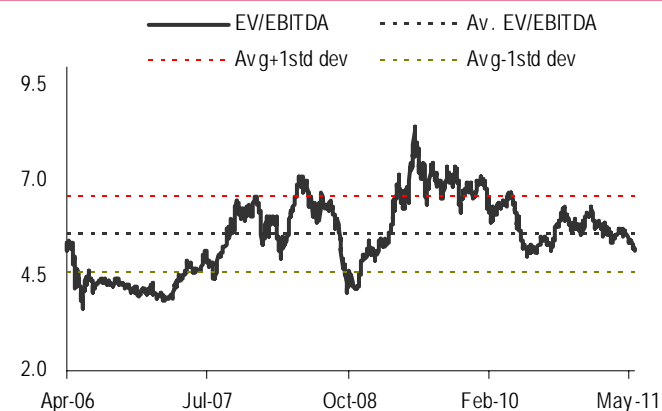
Key Ratios	FY09	FY10	FY11	FY12E	FY13E
OPM (%)	12.3	7.9	13.1	12.6	14.4
Net Margin (%)	6.1	(0.6)	4.8	4.4	5.6
Yield (%)	3.2	1.4	2.1	2.1	2.1
Net debt/Equity (x)	1.4	1.3	1.0	0.8	0.8
Working Capital Days	28	34	36	31	38
RoCE (%)	13.7	(3.2)	8.3	7.3	9.0
RoE (%)	26.4	(2.2)	17.0	13.0	15.0
EV/Net Sales (x)	0.5	0.8	0.8	0.7	0.7
EV/EBITDA (x)	4.3	10.7	5.9	5.3	5.1
PER (x)	4.4	-	10.3	10.8	8.4
PCE (x)	3.0	-	5.8	5.8	4.8
Price/BV (x)	1.3	2.0	1.5	1.3	1.2

Note: TP and EV based valuation multiples calculated valuing CWIP at book value.

1-Year rolling forward P/BV Band



1-Year rolling forward EV/EBITDA Band



## T E A M

### EQUITY DESK

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