

# Tata Steel

11 November 2011

Reuters: TISCO.BO; Bloomberg: TATA IN

## Still No Light At The End Of The Tunnel

Tata Steel's consolidated 2QFY12 results were below expectations, as it reported 13%/15% lower EBITDA compared to our/consensus estimates, respectively (adjusted EBITDA is 6%/9% below estimates). This was primarily because of disappointment in domestic operations, as standalone EBITDA was 10% below our estimate due to 25% QoQ rise in other expenses despite flat production. A negative forex impact of Rs2,200mn and higher royalty expenses led to a sharp sequential jump in other expenses. We have revised our earnings estimates by 14% and 0.3% for FY12 and FY13, respectively. We retain our Sell rating on Tata Steel with a revised TP of Rs358 (down 4% against previous TP of Rs 371), which is 20% below the CMP.

**Domestic EBITDA/tonne drops sharply on sequential basis:** Despite a marginal increase in blended realisation QoQ, the company reported a 14% QoQ drop in EBITDA/tonne to Rs16,685/tonne because of the reasons mentioned above. Total blended costs increased 7% compared to our estimate. Volume during the quarter stood at 1.66mt, flat YoY but up 4% QoQ.

**Europe volume was stronger than expectation:** Tata Steel Europe reported a 7% higher volume compared to our estimate, at 3.48mt, but this was partially offset by a marginal 4% decline in expected realisation. EBITDA/tonne for the quarter stood at US\$30/tonne, compared to our expectation of US\$3/tonne.

**South-East Asian operations update:** Tata Steel reported almost flat volume of South-East Asian arms in 2QFY12, but EBITDA fell drastically to US\$5mn from US\$29mn in 2QFY11 and US\$20mn in 1QFY12.

**Other highlights:** The Benga project is expected to commence operations in 2HFY12 and produce run-of-mine output of 5.3mt in FY13. Tata Steel group had net debt of US\$8,412mn at the end of 2QFY12 compared to US\$8,337mn at the end of 1QFY12. It incurred a capex of US\$557mn during 2QFY12. Pension balance continues to remain in surplus, but net surplus dropped from US\$350mn at the end of 1QFY12 to US\$106mn. The effective tax rate of 87% is due to higher taxes paid by profit-making arms, which cannot be fully set off against the loss-making ones.

## SELL

**Sector:** Steel

**CMP:** Rs447

**Target Price:** Rs358

**Downside:** 20%

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### Key Data

Current Shares O/S (mn)	959.2
Mkt Cap (Rsbn/US\$b)	430.5/8.6
52 Wk H / L (Rs)	737/390
Daily Vol. (3M NSE Avg.)	5,575,243

### Price Performance (%)

	1 M	6 M	1 Yr
Tata Steel	(17.0)	(20.2)	(8.7)
Nifty Index	(8.2)	(4.5)	(6.3)

Source: Bloomberg

Y/E March (Rsmn)	2QFY11	1QFY12	2QFY12	Chg (YoY) %	Chg (QoQ) %	1HFY11	1HFY12	Chg (YoY) %
<b>Net sales</b>	<b>286,462</b>	<b>330,002</b>	<b>327,979</b>	<b>14.5</b>	<b>(0.6)</b>	<b>558,410</b>	<b>657,981</b>	<b>17.8</b>
Raw material costs	134,031	161,037	174,009	29.8	8.1	247,226	335,045	35.5
% of sales	46.8	48.8	53.1			44.3	50.9	
Employee costs	38,275	42,316	39,811	4.0	(5.9)	76,046	82,127	8.0
% of sales	13.4	12.8	12.1			13.6	12.5	
Other operating expenses	77,432	82,421	86,659	11.9	5.1	154,089	169,079	9.7
% of sales	27.0	25.0	26.4			27.6	25.7	
<b>Operating profit</b>	<b>36,723</b>	<b>44,229</b>	<b>27,500</b>	<b>(25.1)</b>	<b>(37.8)</b>	<b>81,049</b>	<b>71,729</b>	<b>(11.5)</b>
OPM (%)	12.8	13.4	8.4	(4.4)	(5.0)	14.5	10.9	
Depreciation	10,781	11,508	11,088	2.8	(3.7)	21,220	22,596	6.5
Interest costs	6,637	7,377	7,161	7.9	(2.9)	12,613	14,538	15.3
Other income	8,143	38,823	1,204	(85.2)	(96.9)	8,737	40,027	358.1
<b>PBT</b>	<b>27,448</b>	<b>64,167</b>	<b>10,456</b>	<b>(61.9)</b>	<b>(83.7)</b>	<b>55,953</b>	<b>74,622</b>	<b>33.4</b>
Provision for tax	7,450	11,230	9,065	21.7	(19.3)	17,454	20,295	16.3
Effective tax rate	27.1	17.5	86.7			31.2	27.2	
Exceptional item	(316)	-	-			(915)	-	-
<b>PAT before MI</b>	<b>19,682</b>	<b>52,937</b>	<b>1,390</b>	<b>(92.9)</b>	<b>(97.4)</b>	<b>37,584</b>	<b>54,327</b>	<b>44.5</b>
MI and Profit of Associates	(106)	(529)	(734)			(457)	(1,263)	176.6
<b>PAT after MI</b>	<b>19,788</b>	<b>53,466</b>	<b>2,124</b>	<b>(89.3)</b>	<b>(96.0)</b>	<b>38,041</b>	<b>55,590</b>	<b>46.1</b>
NPM (%)	6.9	16.2	0.6			6.8	8.4	
<b>EPS (Rs)</b>	<b>21.9</b>	<b>55.7</b>	<b>2.2</b>	<b>(89.9)</b>	<b>(96.0)</b>	<b>42.5</b>	<b>57.9</b>	<b>36.2</b>

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 1: Financial summary

Y/E March (Rsmn)	FY09	FY10	FY11	FY12E	FY13E
Revenue	1,473,293	1,023,931	1,187,531	1,303,736	1,327,023
YoY (%)	12.0	(30.5)	16.0	9.8	1.8
EBITDA	184,962	80,427	159,956	133,946	164,846
EBITDA margin (%)	12.6	7.9	13.5	10.3	12.4
PAT	40,728	(20,092)	66,725#	32,173*	57,911
EPS (Rs)	55.7	(22.7)	69.5#	33.1*	59.7
YoY (%)	(67.0)	(140.7)	(406.9)#	(64.6)*	(18.4)
RoE (%)	33.9	(1.4)	18.0#	8.2*	12.2
RoCE (%)	10.9	4.2	8.7#	4.8*	8.0
P/E (x)	8.0	(19.8)	6.4#	13.5*	7.5
EV/ EBITDA (x)	4.7	10.7	5.8	6.7	5.5

# adjusted for gains in Teesside Cast Plant (TCP), \* adjusted for gains in Riversdale Mining, Tata Refractories and settlement fees in TCP

Source: Company, Nirmal Bang Institutional Research

## Exhibit 2: Our estimates vs actuals

Description	2QFY11	1QFY12	2QFY12	YoY(%)	QoQ(%)	2QFY12E	Devi. (%)	2QFY12 BBE	Devi(%)
<b>Domestic performance</b>									
Production (mt)	1.61	1.75	1.75	8.7	0.0	1.75	0.0		
Sales (mt)	1.66	1.59	1.66	0.0	4.2	1.66	0.0		
Realisation (Rs/tonne)	42,812	49,342	49,469	15.6	0.3	49,202	0.5		
Costs (Rs/tonne)	26,974	29,862	32,784	21.5	9.8	30,634	7.0		
EBITDA (Rs/tonne)	15,837	19,480	16,685	5.4	(14.3)	18,568	(10.1)		
<b>Std Financials (Rsmn)</b>									
Revenue	70,381	77,922	81,422	15.7	4.5	80,676	0.9	80,018	1.8
EBITDA	26,290	31,032	27,698	5.4	(10.7)	30,823	(10.1)	28,900	(4.2)
PAT	20,651	22,194	14,952	(27.6)	(32.6)	16,380	(8.7)	14,999	(0.3)
<b>Tata Steel Europe</b>									
Sales volume (mt)	3.56	3.50	3.48	(2.2)	(0.6)	3.25	7.1		
Realisation (US\$/tonne)	1,148.9	1,312.6	1,241.4	8.1	(5.4)	1,297.6	(4.3)		
EBITDA (US\$/tonne)	55.3	78.0	29.6	(46.5)	(62.1)	3.3	790.6		
<b>Consol. financials (Rsmn)</b>									
Revenue	280,909	328,399	325,075	15.7	(1.0)	320,750	1.3	308,200	5.5
EBITDA	36,723	44,229	27,500	(25.1)	(37.8)	31,684	(13.2)	32,512	(15.4)
PAT	19,788	53,466	2,124	(89.3)	(96.0)	6,959	(69.5)	8,737	(75.7)

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 3: Change in financials

Financials (Rsmn)	Earlier assumption		New assumption		Change (%)	
	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
Net sales	1,317,554	1,341,525	1,303,736	1,327,023	(1.0)	(1.1)
EBITDA	146,047	165,147	133,946	164,846	(8.3)	(0.2)
PAT after MI	82,486	58,077	70,996	57,911	(13.9)	(0.3)

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 4: Standalone financial performance

Y/E March (Rsmn)	2QFY11	1QFY12	2QFY12	Chg (YoY) %	Chg (QoQ)%	1HFY11	1HFY12	Chg (YoY)%
<b>Net sales</b>	<b>71,068</b>	<b>78,603</b>	<b>82,119</b>	<b>15.6</b>	<b>4.5</b>	<b>135,780</b>	<b>160,722</b>	<b>18.4</b>
Raw material costs	19,252	20,322	23,258	20.8	14.4	32,449	43,580	34.3
% of sales	0.27	25.9	28.3	4.6	9.5	23.9	27.1	
Employee costs	6,837	6,870	6,908	1.0	0.6	12,619	13,778	9.2
% of sales	9.6	8.7	8.4	(12.6)	(3.8)	9.3	8.6	
Other operating expenses	18,688	20,379	24,256	29.8	19.0	36,060	44,635	23.8
% of sales	26.3	25.9	29.5	12.3	13.9	26.6	27.8	
<b>Operating profit</b>	<b>26,290</b>	<b>31,032</b>	<b>27,698</b>	<b>5.4</b>	<b>(10.7)</b>	<b>54,653</b>	<b>58,729</b>	<b>7.5</b>
OPM (%)	37.0	39.5	33.7	(8.8)	(14.6)	40.3	36.5	
Depreciation	2,815	2,853	2,871	2.0	0.6	5,617	5,724	1.9
Interest costs	3,425	2,273	2,343	(31.6)	3.1	6,702	4,615	(31.1)
Other income	7,327	5,526	236	(96.8)	(95.7)	7,811	5,762	(26.2)
<b>PBT</b>	<b>27,378</b>	<b>31,432</b>	<b>22,720</b>	<b>(17.0)</b>	<b>(27.7)</b>	<b>50,145</b>	<b>54,152</b>	<b>8.0</b>
Provision for tax	6,726	9,238	7,767	15.5	(15.9)	14,502	17,005	17.3
Effective tax rate	24.6	29.4	34.2	39.2	16.3	28.9	31.4	
<b>PAT</b>	<b>20,651</b>	<b>22,194</b>	<b>14,952</b>	<b>(27.6)</b>	<b>(32.6)</b>	<b>35,643</b>	<b>37,147</b>	<b>4.2</b>
NPM (%)	29.1	28.2	18.2			26.3	23.1	
EPS (Rs)	22.9	23.1	15.6	(31.9)	(32.6)	40.7	38.7	(4.9)

Source: Company, Nirmal Bang Institutional Equities Research

## Ratings track

Date	Rating	CMP (Rs)	Target price (Rs)
24 June 2011	Buy	557	756
16 August 2011	Sell	475	458
7 October 2011	Sell	400	371

## Disclaimer

### Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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