IDBI capital

Tata Steel HOLD

India margins strong; Europe continues to struggle

Summary

Tata Steel's Q3FY24 EBITDA was ahead of our and street forecast as India operations reported stronger than expected margins. India sales volumes increased by only 3% QoQ at 4.88 mn tonnes; nevertheless, EBITDA/t jumped 25% QoQ to Rs16,903. However, European operations profitability continued to remain weak and it remains Tata Steel's biggest concerns. UK reported EBITDA loss of Rs26,063/t in Q3FY24 vs. loss of Rs18,802/t in Q2FY24 as demand remained weak in Europe. The company is now undertaking restructuring of the UK business to transition it to being economically and environmentally sustainable. Broadly, we maintain our FY24-25 estimates and introduce FY26 forecasts in this report. We revise our SOTP-based target price to Rs138 (earlier Rs110) and maintain our HOLD rating on the stock.

Key Highlights and Investment Rationale

- **Restructuring of European operations:** Tata Steel aims to transform its UK business from blast furnaces to electric arc furnaces. The company will invest EUR1.25 bn, the investment is supported by the UK govt which has committed EUR500 mn investment in the project. This transformation will affect upto 2,800 employees in coming 18 months.

- **Project updates:** During Q3FY24, the company commenced production of FHCR coil which are receiving approvals from automotive OEMs. The company plans to nearly double its India capacity from 21 MTPA to 40 MTPA over time. This will bring India's (high-margin) capacity share to 75% from 62% currently. The company will now start work on phase II 5 MTPA capacity expansion at Kalinganagar plant followed by capacity expansion of Meramandali plant and Neelachal Ispat Nigam plants.

TP	Rs138
CMP	**Rs134**
Potential upside/downside	3%
Previous Rating	HOLD

Price Performance (%)

	-1m	-3m	-12m
Absolute	(2.6)	11.5	10.8
Rel to Sensex	(0.7)	0.6	(8.4)

Key Stock Data

Bloomberg / Reuters	TATA IN / TISC.BO
Sector	Metal & Mining
Shares o/s (mn)	12,384
Market cap. (Rs mn)	1,655,089
3-m daily average value (Rs mn)	357.2
52-week high / low	Rs142 / 102
Sensex / Nifty	70,701 / 21,353

V/s Consensus

EBITDA (Rs bn)	FY25E	FY26E
IDBI Capital	362	399
Consensus	353	397
% difference	*2.5*	*0.5*

Shareholding Pattern (%)

Promoters	33.7
FII	20.0
DII	21.0
Public	25.3

Financial snapshot **(Rs bn)**

Year	FY22	FY23	FY24E	FY25E	FY26E
Revenue	2,440	2,434	2,283	1,962	2,043
Change (yoy, %)	*56*	*(0)*	*(6)*	*(14)*	*4*
EBITDA	635	323	232	362	399
Change (yoy, %)	*108*	*(49)*	*(28)*	*56*	*10*
EBITDA Margin(%)	*26.0*	*13.3*	*10.2*	*18.4*	*19.5*
Adj.PAT	419	80	46	145	171
EPS (Rs)	34	7	4	12	14
Change (yoy, %)	*344.9*	*(81.0)*	*(42.4)*	*216*	*18*
PE(x)	3.9	20.7	35.9	11	10
Dividend Yield (%)	4.0	2.7	3.0	3	5
EV/EBITDA (x)	3.1	6.5	9.5	5.7	5.0
RoE (%)	44.4	7.3	4.6	14	15
RoCE (%)	29.4	11.9	7	14	15

Source: IDBI Capital Research

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Exhibit 1: Quarterly Snapshot

(Rs mn)

Financial snapshot	Q3FY24	Q2FY24	*QoQ (%)*	Q3FY23	*YoY (%)*
Net Sales	**5,53,119**	**5,56,819**	***(0.7)***	**5,70,836**	***(3.1)***
Total expenditure	4,90,483	5,14,141	*(4.6)*	5,30,357	*(7.5)*
EBITDA	**62,636**	**42,678**	***46.8***	**40,478**	***54.7***
EBITDA margin (%)	*11.3%*	*7.7%*	*366bps*	*7.1%*	*423bps*
Interest	18,808	19,594	*(4.0)*	17,679	*6.4*
Depreciation	24,220	24,799	*(2.3)*	23,684	*2.3*
PBT	**19,279**	**568**	***3,293.6***	**4,030**	***378.4***
Tax	14,058	(2,280)	*(716.5)*	29,049	*(51.6)*
PAT	**5,221**	**(65,112)**	***(108.0)***	**(25,020)**	***(120.9)***
Diluted EPS	0.4	(5.3)	*(108.0)*	(2.0)	*(120.9)*

Source: Company; IDBI Capital Research

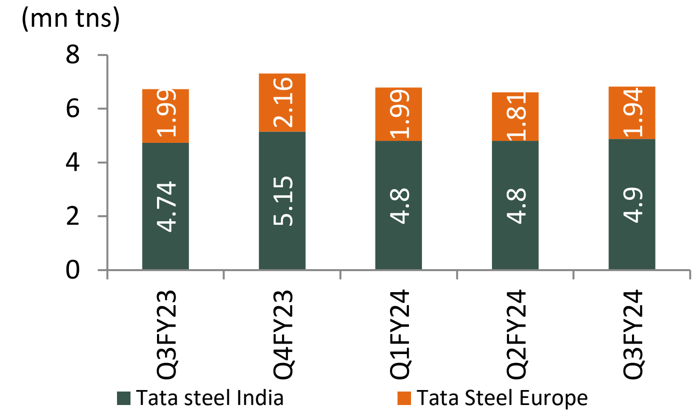
Exhibit 2: Actual vs estimates

(Rs mn)

	Q3FY24E	Q3FY23A	*% Variance*
Net sales	5,67,956	5,53,119	*(2.6)*
EBTIDA	46,977	62,636	*33.3*
Margin (%)	*8.3*	*11.3*	*305bps*
PAT	**4,106**	**5,221**	***27.2***
Dil. EPS	0.3	0.4	*27.2*

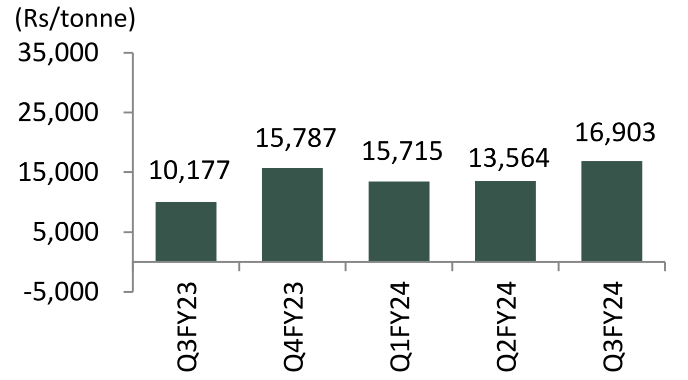
Source: Company; IDBI Capital Research

Exhibit 3: Geographical sales mix



Source: Company; IDBI Capital Research

Exhibit 4: Standalone EBIDTA/tonne up by 25% QoQ



Source: Company; IDBI Capital Research

Exhibit 5: Change in estimates

	FY24E			FY25E			FY26E
	Old	New	*(%) Chg*	Old	New	*(%) Chg*	
Revenue (Rs bn)	2,143	2,283	*6.5*	1,962	1,962	-	2,043
EBITDA (Rs bn)	223	232	*4.1*	363	362	*(0.4)*	399
EBITDA margin (%)	*10.4*	*10.2*	*-24bps*	*18.5*	*18.4*	*-8bps*	*19.5*
Adj. Net profit (Rs bn)	46	46	*0.8*	75	73	*(2.9)*	171
Adj. EPS (Rs)	3.7	3.8	*0.8*	12.2	11.9	*(2.9)*	14.0

Source: Company; IDBI Capital Research

Conference call highlights

- Tata Steel Netherland revenue were at EUR1,239 mn remained flat QoQ. Liquid steel production were at 1.19 mn tons(-21% YoY) due to reline of one of the blast furnaces.
- The company expects the relining of the blast furnaces to be completed by the end of this month and the furnace will be operational from the first week of February, 2024. The company also expects EBITDA/tn to be lower in Q4FY24, however EBITDA/tn will be positive in Q1FY25.
- During the quarter, the company has incurred capex of Rs47 bn.
- In UK operations deliveries stood at 0.64 mn tons(-12% QoQ) due to subdued demand in the UK market. However, the company is going for the restructuring of the UK business to be economically sustainable.
- The company will shut down its first blast furnace in UK operations by the end of Q1FY25 and second blast furnace by the end of Q3FY25.
- The employees in the UK operations will be laid off in a phased manner. Also, the company will pay Rs138 mn commission to the employees.
- During the quarter EBITDA/tn of Indian operation was higher due to inventory movement.
- The company has guided that in Q4FY24 domestic steel prices will be lower by Rs1,000/tn.
- The company plans to increase capacity of Neelachal plant from 1MNTPA to 5MNTPA, Meramandali plant from 5MTPA to 6.5MTPA. Also, commence Kalinganagar phase II expansion from 8MTPA to 11MTPA by the end of FY27.

Exhibit 6: SOTP-based valuation

	FY26E EBITDA	Multiple	(Rs bn)
India operations	389	4.5	1,751
TSE	10	3.0	29
Other operations	4	3.0	13
CWIP @ 50%			127
Derived enterprise value			**1,920**
Less: Net debt			337
Derived equity value			1,583
Target price (Rs/share)			**138**

Source: Company; IDBI Capital Research

Financial Summary

Profit & Loss Account

(Rs bn)

Year-end: March	FY21	FY22	FY23	FY24E	FY25E	FY26E
Net sales	**1,563**	**2,440**	**2,434**	**2,283**	**1,962**	**2,043**
Change (yoy, %)	*4.9*	*56*	*(0)*	*(6)*	*(14)*	*4*
Operating expenses	(1,258)	(1,805)	(2,111)	(2,051)	(1,600)	(1,644)
EBITDA	**305**	**635**	**323**	**232**	**362**	**399**
Change (yoy, %)	*71.1*	*108*	*(49)*	*(28)*	*56*	*10*
Margin (%)	*19.5*	*26.0*	*13.3*	*10.2*	*18.4*	*19.5*
Depreciation	(92)	(91)	(93)	(98)	(99)	(100)
EBIT	**213**	**544**	**230**	**135**	**263**	**299**
Interest paid	(76)	(55)	(63)	(75)	(74)	(73)
Other income	9	8	10	19	19	19
Pre-tax profit	**135**	**496**	**178**	**6**	**208**	**245**
Tax	(57)	(85)	(102)	(32)	(62)	(74)
Effective tax rate (%)	*41.8*	*17.1*	*57.0*	*563.0*	*30.0*	*30.0*
Minority Interest	3.3	6.5	4.2	0.1	(0.2)	(0.2)
Net profit	**82**	**417**	**81**	**(26)**	**145**	**171**
Exceptional items	(10)	(1)	1	(72)	-	-
Adjusted net profit	**92**	**419**	**80**	**46**	**145**	**171**
Change (yoy, %)	*51.3*	*354*	*(81)*	*(42)*	*216*	*18*
EPS	7.7	34.3	6.5	3.8	11.9	14.0
Dividend per share	21.0	5.4	3.6	4.0	4.2	6.3
Dividend Payout %	*272.7*	*15.8*	*55.3*	*107*	*35*	*45*

Balance Sheet (Rs bn)

Year-end: March	FY21	FY22	FY23	FY24E	FY25E	FY26E
Shareholders' funds	**742**	**1,144**	**1,031**	**955**	**1,049**	**1,143**
Share capital	12	12	12	12	12	12
Reserves & surplus	730	1,132	1,019	943	1,037	1,131
Total Debt	**724**	**505**	**573**	**563**	**513**	**463**
Other liabilities	247	273	283	296	310	787
Curr Liab & prov	**709**	**906**	**973**	**1,077**	**1,008**	**1,107**
Current liabilities	661	878	934	1,039	969	1,069
Provisions	47	28	39	39	39	39
Total liabilities	**1,680**	**1,683**	**1,828**	**1,936**	**1,830**	**1,856**
Total equity & liabilities	**2,455**	**2,854**	**2,880**	**2,912**	**2,900**	**3,020**
Net fixed assets	**1,548**	**1,553**	**1,778**	**1,801**	**1,822**	**1,843**
Investments	35	46	48	48	48	48
Other non-curr assets	270	329	187	207	228	253
Current assets	**602**	**926**	**867**	**856**	**802**	**877**
Inventories	333	488	544	618	484	504
Sundry Debtors	95	122	83	115	98	103
Cash and Bank	58	159	134	6	88	125
Other current assets	116	156	106	118	131	145
Total assets	**2,455**	**2,854**	**2,880**	**2,912**	**2,900**	**3,020**

Cash Flow Statement (Rs bn)

Year-end: March	FY21	FY22	FY23	FY24E	FY25E	FY26E
Pre-tax profit	135	496	178	6	208	245
Depreciation	92	91	93	98	99	100
Tax paid	(60)	(68)	(80)	(32)	(62)	(74)
Chg in working capital	245	15	51	(1)	81	37
Other operating activities	60	-	-	-	-	-
Cash flow from operations (a)	**473**	**533**	**243**	**70**	**325**	**308**
Capital expenditure	(100)	(97)	(318)	(120)	(120)	(120)
Chg in investments	7	(12)	(2)	-	-	-
Other investing activities	-	-	-	-	-	-
Cash flow from investing (b)	**(93)**	**(108)**	**(320)**	**(120)**	**(120)**	**(120)**
Equity raised/(repaid)	1	0	0	-	-	-
Debt raised/(repaid)	(409)	(219)	68	(10)	(50)	(50)
Dividend (incl. tax)	(252)	(66)	(44)	(49)	(51)	(77)
Chg in monorities	10	0	(1)	0	(0)	(0)
Other financing activities	-	-	-	-	-	-
Cash flow from financing (c)	**(650)**	**(285)**	**23**	**(59)**	**(102)**	**(127)**
Net chg in cash (a+b+c)	**(270)**	**140**	**(55)**	**(109)**	**103**	**60**

Financial Ratios

Year-end: March	FY21	FY22	FY23	FY24E	FY25E	FY26E
Book Value (Rs)	62.0	94	84	78	86	94
Adj EPS (Rs)	*7.7*	*34.3*	*6.5*	*3.8*	*11.9*	*14.0*
Adj EPS growth (%)	*44.7*	*345*	*-81*	*-42*	*216*	*18*
EBITDA margin (%)	*19.5*	*26.0*	*13.3*	*10.2*	*18.4*	*19.5*
Pre-tax margin (%)	*8.6*	*20.3*	*7.3*	*0.2*	*10.6*	*12.0*
Net Debt/Equity (x)	*0.9*	*0.3*	*0.4*	*0.6*	*0.4*	*0.3*
ROCE (%)	*11.1*	*29*	*12*	*7*	*14*	*15*
ROE (%)	*12.5*	*44*	*7*	*5*	*14*	*15*
DuPont Analysis						
Asset turnover (x)	0.6	0.9	0.8	0.8	0.7	0.7
Leverage factor (x)	3.4	2.8	2.6	2.9	2.9	2.6
Net margin (%)	*5.9*	*17.2*	*3.3*	*2.0*	*7.4*	*8.4*
Working Capital & Liquidity ratio						
Inventory days	78	73	82	99	90	90
Receivable days	22	18	12	18	18	18
Payable days	103	123	111	128	141	143

Valuations

Year-end: March	FY21	FY22	FY23	FY24E	FY25E	FY26E
PER (x)	17.5	3.9	20.7	35.9	11.4	9.6
Price/Book value (x)	2.2	1.4	1.6	1.7	1.6	1.4
EV/Net sales (x)	1.5	0.8	0.9	1.0	1.1	1.0
EV/EBITDA (x)	7.5	3.1	6.5	9.5	5.7	5.0
Dividend Yield (%)	*15.6*	*4.0*	*2.7*	*3.0*	*3.1*	*4.7*

Source: Company; IDBI Capital Research

Notes

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Key to Ratings Stocks:

BUY: 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.

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