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20 YEARS

# Initiating Coverage

# Tata Steel Ltd.

26-October-2020

RETAIL RESEARCH

# Tata Steel Ltd

| Industry | LTP | Recommendation | Base Case Fair Value | Bull Case Fair Value | Time Horizon |
|---|---|---|---|---|---|
| Iron & Steel | Rs 423.35 | Buy at LTP and add on dips to Rs. 372-376 band | Rs. 465 | Rs. 510 | 2 quarters |

| | |
|---|---|
| HDFC Scrip Code | TATSTE |
| BSE Code | 500470 |
| NSE Code | TATASTEEL |
| Bloomberg | TATASTL IN |
| CMP October 23, 2020 | 423.35 |
| Equity Capital (Rscr) | 1145 |
| Face Value (Rs) | 10 |
| Equity Share O/S (cr) | 114.5 |
| Market Cap (Rscrs) | 48512 |
| Book Value (Rs) | 643 |
| Avg. 52 Wk Volumes | 16435706 |
| 52 Week High | 505.95 |
| 52 Week Low | 250.90 |

| Share holding Pattern % (Sept., 2020) | |
|---|---|
| Promoters | 33.66 |
| Institutions | 44.35 |
| Non Institutions | 21.99 |
| Total | 100.0 |

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## Our Take:

Tata Steel Group is among the top global steel companies with an annual crude steel capacity of 33 million tonnes per annum (MnTPA). The company's Indian operations enjoy highest EBITDA/t in the industry due to captive iron ore mines and better product mix. India has become world's second largest steel producing country after China with crude steel production of 111.2 million tonnes in 2019. The World Steel Association (WSA) forecasts steel demand to decline 6.4% YoY to 1654 MnT in CY 2020, due to COVID-19 impact, however it has asserted that global steel demand could rebound to 1717 MnT in CY 2021. Going forward, we believe steel demand could improve on the back of revival in the economy post COVID-19, Government's continuous thrust on infrastructure development, revival in the capex cycle One of the designated core industries, steel is the key to the government's focus on driving growth in the infrastructure segment and government has taken many initiatives such as imposing anti-dumping duty, Steel Import Monitoring System (SIMS), imposing export duty on iron ore etc. We believe that going forward the recent price hikes in steel prices are sustainable and Tata Steel India operations is likely to do well as capacity utilization level improves and ramp up of production at Bhushan Steel happens. We expect European operations will continue to face headwinds but it can surprise on the positive side with any news on divestment/ partnership or support from the UK Government.

## Valuations & Recommendation:

Tata Steel's India operations are one of the most profitable in the industry on the back of value-added mix, pricing power and lower raw material costs. The company sources 100% of its iron ore requirements from captive mines which has led to industry leading EBITDA/t for the company. The company with significant operating and financing leverage will benefit post COVID-19 crisis and recovery both in domestic and global demand. Further, given the fact that China is slowly and steadily getting growth back in its economy, the downside in steel prices are limited and the spreads are likely to improve going forward. We believe that the recent rise in steel prices and consequent price hikes by domestic steel makers are sustainable on the back of improvement in domestic demand and strong demand from China. Indian steel makers have been able to latch on opportunities in the exports markets with record exports in the month of July. Going forward, better realization and improved demand is likely to result in higher margins for top steel makers.

The stock is trading at valuation of ~6.8x FY22E EV/EBITDA. We feel investors could buy the stock at LTP (6.8xFY22E EV/EBITDA) and add on dips of Rs. 372-376 band (6.6x FY22E EV/EBITDA) for base case target of Rs. 465 (7.1x FY22E EV/EBITDA) and bull case target of Rs.510 (7.3x FY22E EV/EBITDA).

### Financial Summary

| Rs in Cr | Q1FY21 | Q1FY20 | YoY (%) | Q4FY20 | QoQ (%) | FY19 | FY20 | FY21E | FY22E |
|---|---|---|---|---|---|---|---|---|---|
| Net Revenues | 24289 | 35947 | -32.4 | 33770 | -28.1 | 157669 | 139817 | 138418 | 153645 |
| EBITDA | 506 | 5377 | -90.6 | 4647 | -89.1 | 29383 | 17463 | 13011 | 21818 |
| Depreciation | 2111 | 2071 | 1.9 | 2224 | -5.1 | 7342 | 8441 | 8702 | 8841 |
| Other Income | 193 | 251 | -23.3 | 1316 | -85.4 | 1421 | 1843 | 2076 | 2151 |
| Tax | 1272 | 1124 | 13.1 | -263 | -583.0 | 6718 | -2568 | 1035 | 3015 |
| APAT | -4648 | 714 | -751.0 | -1615 | 187.7 | 9098 | 1172 | -2179 | 4673 |
| EPS (Rs) | -39.01 | 5.88 | | -13.37 | | 79.5 | 10.2 | -19.0 | 40.8 |

*(Source: Company, HDFC sec.)*

### Recent Developments

In Q1FY21, Tata Steel consolidated revenues declined 32% YoY to Rs. 24289 crore while EBITDA declined by 91% YoY to Rs. 506 crore. EBIDTA margins narrowed to 2.1% from 14.9% in the same period year ago. The significant drop in EBITDA was on the back lower profitability in India operations as the nation was hit by COVID-19 and consequent lockdown in the first quarter. Further, the losses in European operations also exacerbated the impact. On a consolidated basis, Tata Steel reported net loss of Rs. 4648 crore in Q1FY21 as compared to profit of Rs. 714 crore in the same period year ago. Tata Steel's Q1FY21 consolidated EBITDA at Rs.506 cr (-91% YoY) was the weakest in the past 10 years.

Q1FY21 sales volumes in India declined by 27% QoQ due to nationwide lockdown amid COVID-19 outbreak; exports were significantly ramped up to 1.46 mn tons by tapping new markets and leveraging supply chain capability.

There was reduction in net debt of Rs. 1677 crore in India, including a reduction of Rs. 577 crore and Rs. 291 crore, respectively at Tata Steel BSL and Tata Steel Long Products. The company doesn't expect loss in its European division to accelerate in the second quarter as it continues to seek support from the European Union and U.K.

In Q2FY21, Tata Steel achieved highest ever quarterly deliveries of 5.05 mn tons (provisional) in India as the company ramped up its steelmaking and downstream operations to the pre-Covid level, with all major sites operating at around full capacity utilization. The growth in domestic deliveries was broad based with growth across all key business verticals. In Europe, recovery is more gradual and total deliveries increased 14% QoQ to 2.26 mn tons (provisional). In Q2FY21, Tata Steel witnessed a lower proportion of exports, down 24% compared with 50% in Q1FY21. This would improve blended realisation.
Recently, Tata Steel subsidiaries Tata Steel Long Products and Tata Steel Bhushan Steel posted robust performance in Q2FY21 which augurs well for the overall performance of Tata Steel.

## Long term Triggers

**Crude steel capacity to increase to 300 million tonnes by 2030-31**

India has set capacity target of 300 million tonnes of crude steel by 2030-31. India has become world's second largest steel producing country after China with crude steel production of 111.2 million tonnes in 2019. As per World Steel Association (WSA), with the expected population growth, emerging new applications for steel and more sophisticated steel applications, the global steel market has a potential to grow further to between 700 to 1000 million tonnes in the next 50 years. India, given its proposed infrastructure spend is expected to be one of the largest consumers of steel and stimulators of steel demand The growth prospects in the India's steel industry with its competitive advantages and the impetus being given by the Government to the steel sector with growth envisaged in key sectors such as, infrastructure, housing, railways, consumer durables and automobile, the demand for Tata Steel's diversified product portfolio would continue and will help in improving its performance in terms of volumes as well as EBITDA margins.

Steel stocks are direct proxies for economic and industrial growth recovery in India, as seen in the last several cycles. Hence if the recovery in the economy sustains, steel stocks could be prime beneficiaries.

**Captive iron ore mines gives edge over competitors**

The Company possesses and operates captive mines that ensure cost-competitiveness and production efficiencies through an uninterrupted supply of raw material. Tata Steel's iron ore mines in Jharkhand and Odisha enable 100% captive iron ore usage and the coal mines in West Bokaro & Jharia ensure ~30% captive coal usage in operations. Tata Steel additionally has a dolomite mine, a chromite mine and manganese mines that ensures steady and cost-efficient supply of raw materials to its ferro alloy plants. Presence across the value chain helps the company achieve higher economic efficiencies and customer satisfaction standards which is one of the best in the industry. These captive iron ore mines give company immunity from any sort of disruption in the iron ore market.

**Export markets to support volumes**

India remained a net exporter of finished steel during FY20, with exports of 8.36 mn t, up 31.4% YoY. Non-alloy HRC was the most exported product at 4.82 mn t, while bars and rods led the non-alloy, non-flat segment exports with 0.51 mn t. Meanwhile, India imported 6.77 mn t of finished steel, down 13.6% YoY, with non-alloy HRC accounting for 34% of the total imports. Imports from Korea accounted for 40% of the total imports. Recently, due to the pandemic and consequent slowdown in the domestic market, export market has been providing huge opportunity to the Indian steel makers. Indian steel mills hit new high in July with record exports of 2.44 mn t. Overall, from Apr-Jul, 2020, steel exports touched 7.8 mn t against 2.89 mn t in the same first four months of 2019-20, a whopping 169% rise YoY. As local demand started to grow, finished steel exports fell sequentially in August. With 69 per cent of semi-finished steel and 28 per cent of finished steel from India heading to China between April and August, India turned net exporter of steel to China for the first time in several years. As per CRISIL, while global steel prices were on a slide from end-February till June, iron ore prices soared, led by supply-side disruptions especially in Brazil and Australia. Iron ore prices zoomed past coking coal prices another first in the past 25 quarters. This prompted port-based capacities in China to import semis and process them further in order to save on increased iron ore costs

**European business could surprise on the positive side**

Ever since the acquisition of the European Steel giant Corus for US$12bn in 2007, the European business has been dragging down the consolidated profitability of Tata Steel. In Europe, Tata Steel is amongst the largest steel producers with a crude steel production capacity of over 12.3 MnTPA. Over the years, management has been making efforts to reduce exposure in Europe and thereby improving overall profitability of the company. However, the JV attempt between the company and Thyssenkrupp was unsuccessful after competition watchdog European Commission blocked it. The company has also launched a transformation programme with the aim of becoming self-sufficient and cash positive. Going forward, any positive update in the European business could significantly improve its profitability. During FY20, Tata Steel Europe steel production was at 10.26 mn tons as compared to 10.31 mn tons in FY19. The transformation programme was launched in order to improve the performance of business, productivity of the business, better product mix and various cost savings initiatives. This transformation initiative delivered over 200 million pounds benefits in FY20. Going forward, we believe that in spite of the various initiatives taken by the management for Tata Steel Europe, it will continue to drag the overall profitability of the company. We believe that the street has discounted the negative impact of European operations, however any sort of positive news for the European business could be big trigger for the company.

**Measures to reduce leverage**

Due to rising uncertainties and high leverage, Tata Steel has scaled-down its capacity target to 25 mn t by FY25 vs 30 mn t. This measn that it will focus on enhancing cost leadership and market share in chosen segments.

Tata Steel will focus on completing the 5mtpa TSK expansion at Kalinganagar to help downstream value addition, increase the long products portfolio, drive synergies across acquisitions and enhance cost leadership under its Shikhar25 programme.

## What could go wrong?

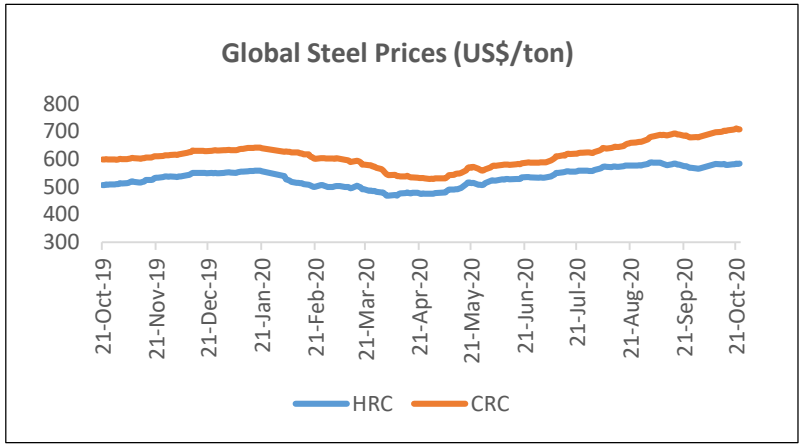
- The steel industry is inherently cyclical in nature and is sensitive to the shifting business cycles. The slowdown in the demand of the steel and over supply from international market at cheaper rates will adversely affect the Indian steel industry.
- The key raw materials for the industry – iron ore and coking coal have been volatile in the recent times. Whilst the company fulfils its iron ore requirements from its captive mines, the coking coal requirement is largely met through imports which has shown volatility in prices impacting company's margins.
- European business continues to drag overall performance of the company, further losses could exacerbate the company problems in the continent.
- Weak profitability over the past few years has hurt operating cash flow and hence deleveraging, with net debt increasing to Rs104bn (5.9x Net Debt/EBITDA). But lengthening of debt maturity gives comfort.

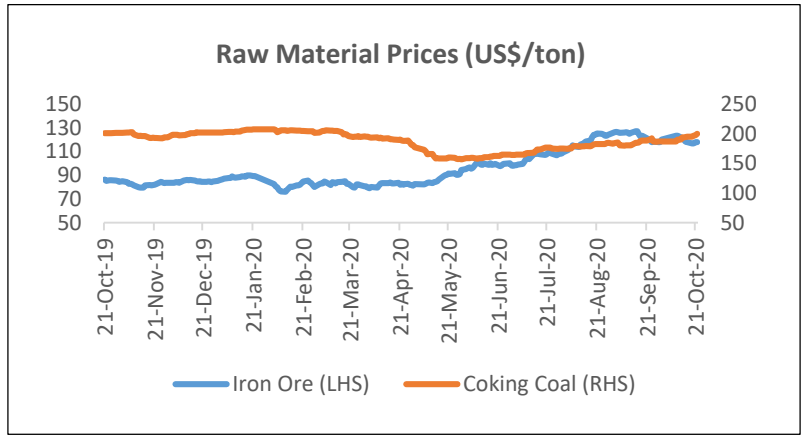
## Company Profile:

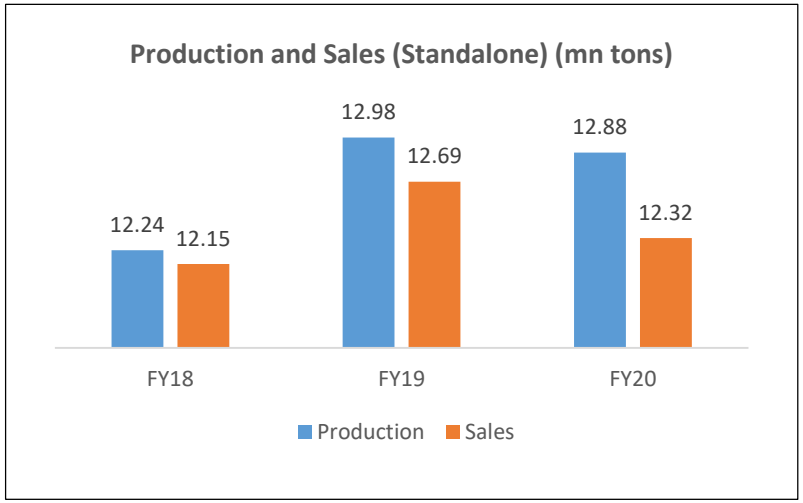
Tata Steel Group is among the top global steel companies with an annual crude steel capacity of 33 million tonnes per annum (MnTPA). It is one of the world's most geographically-diversified steel producers, with operations and commercial presence across the world. It has a 10 mn t plant at Jamshedpur. Its domestic operations are backward integrated (100% for iron ore and 40% for coal). The company has set up greenfield project in the eastern state of Odisha commissioning the first phase (3 MnTPA) of 8 MnTPA of steel capacity in 2016. Tata Steel India remains the lowest cost producer of steel in Asia.

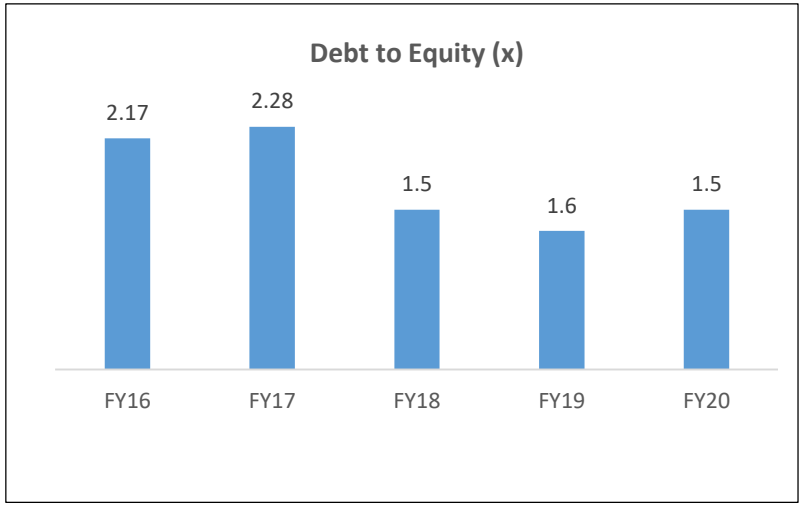
The company acquired NatSteel and Millennium Steel in Southeast Asia and followed it up with the acquisition of the US$13bn European steel major Corus (now Tata Steel Europe) in 2007. Tata Steel recently acquired the 5.6mt Bhushan Steel for Rs352bn, under the NCLT process. Tata Steel is expanding its India capacity to 25mt via brownfield expansion at Kalinganagar. Tata steel is the second largest steel producer in Europe with a crude steel production of over 12.1 MnTPA.

# Tata Steel Ltd




*(Source: Company, HDFC sec.)*

# Tata Steel Ltd

**Financials (Consolidated)**

**Income Statement**

| Particulars | FY19 | FY20 | FY21E | FY22E |
|---|---|---|---|---|
| **Income from operations** | **157669** | **139817** | **138418** | **153645** |
| Material Cost | 60780 | 57475 | 59105 | 60536 |
| Employee Cost | 18759 | 18534 | 19794 | 20742 |
| Other expenses | 48746 | 46345 | 46509 | 50549 |
| Total expenses | 128286 | 122354 | 125407 | 131827 |
| **EBITDA** | **29383** | **17463** | **13011** | **21818** |
| Depreciation | 7342 | 8441 | 8702 | 8841 |
| EBIT | 23462 | 10866 | 6386 | 15128 |
| Other Income | 1421 | 1843 | 2076 | 2151 |
| Interest | 7660 | 7533 | 7680 | 7590 |
| Profit before tax | 15681 | -420 | -1294 | 7538 |
| Tax Expenses | 6718 | -2568 | 1035 | 3015 |
| **Profit After Tax** | **8963** | **2149** | **-2329** | **4523** |
| **Adj. PAT** | **9098** | **1172** | **-2179** | **4673** |
| EPS | 79.5 | 10.2 | -19.0 | 40.8 |

**Balance Sheet**

| Particulars | FY19 | FY20 | FY21E | FY22E |
|---|---|---|---|---|
| **EQUITY AND LIABILITIES** | | | | |
| Share Capital | 1145 | 1145 | 1145 | 1145 |
| Reserves and Surplus | 67779 | 72431 | 70023 | 73551 |
| **Shareholders' Funds** | **68924** | **73576** | **71168** | **74696** |
| Minority Interest | 2364 | 2587 | 2587 | 2587 |
| Long Term borrowings | 80343 | 94105 | 93105 | 90605 |
| Deferred Tax Liabilities (Net) | 10579 | 6732 | 6732 | 6732 |
| Other Long Term Liabilities | 4410 | 4994 | 5537 | 4917 |
| Long Term Provisions | 4046 | 4235 | 4357 | 4171 |
| **Non-current Liabilities** | **99377** | **110066** | **109730** | **106424** |
| Short Term Borrowings | 10802 | 19184 | 22184 | 20684 |
| Trade Payables | 21717 | 21381 | 22754 | 23573 |
| Other Current Liabilities | 26630 | 18822 | 20478 | 20626 |
| Short Term Provisions | 1249 | 1663 | 1711 | 1638 |
| **Current. Liabilities** | **60398** | **61051** | **67128** | **66522** |
| ***TOTAL*** | **231065** | **247280** | **250612** | **250228** |
| **ASSETS** | | | | |
| **Fixed Assets** | | | | |
| Gross Block | 166215 | 173455 | 181285 | 192190 |
| Less: Acc. Depreciation | 47764 | 53951 | 62653 | 71494 |
| **Net Block** | **118451** | **119504** | **118632** | **120696** |
| Intangible Assets | 2679 | 3077 | 2923 | 2777 |
| Goodwill | 3997 | 4055 | 4055 | 4055 |
| Capital work-in-progress | 17957 | 18862 | 16033 | 13628 |
| Non-current Investments | 3213 | 2853 | 2853 | 2853 |
| Long-Term Loans and Advances | 613 | 489 | 554 | 615 |
| Other Non-current Assets | 25298 | 39851 | 44294 | 41484 |
| **Non-current Assets** | **29125** | **43193** | **47701** | **44952** |
| Current Investments | 2525 | 3432 | 3432 | 3432 |
| Inventories | 31656 | 31069 | 31097 | 33255 |
| Trade Receivables | 11811 | 7885 | 7964 | 8419 |
| Cash and Bank Balances | 3341 | 8055 | 10054 | 10597 |
| Short-Term Loans and Advances | 240 | 216 | 379 | 421 |
| Other Current Assets | 9284 | 7934 | 8343 | 7998 |
| **Current Assets** | **58857** | **58590** | **61269** | **64121** |
| ***TOTAL*** | **231065** | **247280** | **250612** | **250228** |



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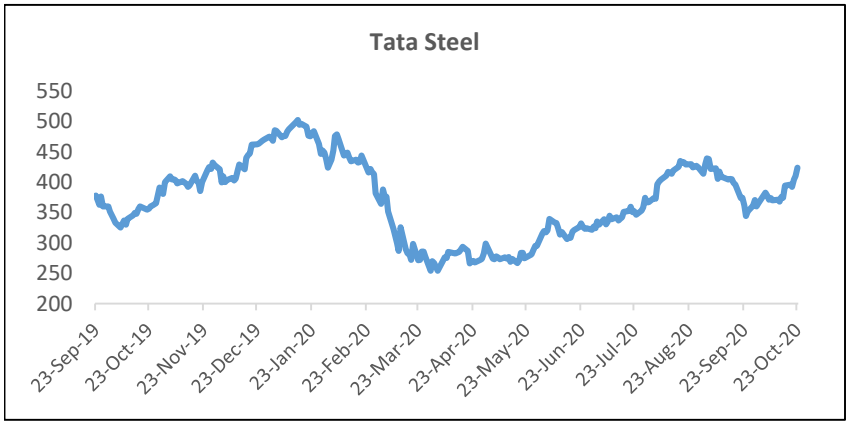
# Tata Steel Ltd

**Cash Flow Analysis**

| Particulars | FY19 | FY20 | FY21E | FY22E |
|---|---|---|---|---|
| Profit Before Tax | 15807.1 | -1380.4 | -1294.1 | 7537.8 |
| Depreciation | 7579.3 | 8707.7 | 8701.7 | 8840.7 |
| Others | 4453.2 | 10751.2 | 3714.6 | 9718.9 |
| Change in working capital | 2590.5 | 4196.2 | 2518.2 | -1601.1 |
| Tax expenses | -5094.2 | -2105.9 | -1035.2 | -3015.1 |
| **CF from Operating activities** | **25336.0** | **20168.7** | **12605.2** | **21481.2** |
| Net Capex | -9091.0 | -10398.0 | -5000.0 | -8500.0 |
| Other investing activities | 13389.4 | -401.5 | 303.5 | 296.0 |
| **CF from Investing activities** | **-29210.9** | **-14530.4** | **-4696.5** | **-8204.0** |
| Proceeds from Eq Cap | -6.0 | 187.5 | 0.0 | 0.0 |
| Borrowings / (Repayments) | 8267.0 | 8636.3 | 2000.0 | -4000.0 |
| Dividends paid | -1423.9 | -1815.2 | -229.0 | -1145.0 |
| Interest paid | -6901.4 | -7419.3 | -7680.0 | -7590.0 |
| **CF from Financing activities** | **-672.7** | **-1694.6** | **-5909.0** | **-12735.0** |
| **Net Cash Flow** | **-4547.7** | **3943.8** | **1999.8** | **542.2** |

**One Year Price Chart.**




**Financial Ratios**

| Particulars | FY19 | FY20 | FY21E | FY22E |
|---|---|---|---|---|
| EPS (Rs) | 79.5 | 10.2 | -19.0 | 40.8 |
| Cash EPS (Rs) | 143.6 | 84.0 | 57.0 | 118.0 |
| BVPS (Rs) | 602.0 | 642.6 | 621.6 | 652.4 |
| | | | | |
| PE (x) | 5.3 | 41.3 | -22.2 | 10.4 |
| P/BV (x) | 0.7 | 0.7 | 0.7 | 0.6 |
| Mcap/Sales (x) | 0.3 | 0.3 | 0.3 | 0.3 |
| EV/EBITDA (x) | 4.6 | 8.8 | 11.8 | 6.8 |
| | | | | |
| EBITDAM (%) | 18.6 | 12.5 | 9.4 | 14.2 |
| EBITM (%) | 14.9 | 7.8 | 4.6 | 9.8 |
| PATM (%) | 5.8 | 0.8 | -1.6 | 3.0 |
| | | | | |
| ROCE (%) | 15.2 | 6.3 | 3.4 | 8.1 |
| RONW (%) | 14.0 | 1.6 | -3.0 | 6.4 |
| | | | | |
| Current Ratio (x) | 1.0 | 1.0 | 0.9 | 1.0 |
| Quick Ratio (x) | 0.5 | 0.5 | 0.4 | 0.5 |
| Debt-Equity (x) | 1.3 | 1.5 | 1.6 | 1.5 |
| | | | | |
| Debtor days | 28 | 26 | 21 | 19 |
| Inventory days | 69 | 82 | 82 | 76 |
| Creditor days | 49 | 56 | 58 | 55 |

*(Source: Company, HDFC sec.)*



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**Disclosure:**

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