

## Tata Steel

HOLD

Profitability weak; Downgrade to HOLD

## Summary

Tata Steel's Q2FY23 profitability was below our expectations. Although India sales volumes grew by 22% QoQ to 4.76 mn tonnes, EBITDA/t fell by 59% QoQ to Rs10,117 due to fall in steel realization and higher raw material cost (mainly coking coal). European operations profitability was also hit by lower sales volume and weak realizations. EBITDA/t fell by 66% QoQ to Rs9,540. Consolidated net debt increased by Rs202 bn QoQ to Rs717 bn led by acquisition of Nilanchal Ispat, dividend payout and capital expenditure. We cut our FY23 EBITDA estimate by 17% to factor lower than expected EBITDA reported in Q2FY23 but broadly maintain our estimates for FY24. We revise our SOTP-based target price to Rs105 (earlier Rs112). The recent rise in stock price discounts the positives; hence, we downgrade the stock to a HOLD from a BUY.

## Key Highlights and Investment Rationale

- Projects update:** During the quarter, company spent Rs190 bn towards the acquisition of Neelachal Ispat Nigam Ltd (NINL), dividend payout and re-line up of blast furnace in Netherland. The 6 mn tonnes pellet plant will be commissioned in 3QFY23 which will drive cost savings. This will be followed by the Cold Roll Mill complex of 5 MTPA. The NINL blast furnace was commenced in October 2022. Going ahead, company aims to increase its capacity to 10 mtpa from the current level of 1.1 mtpa.
- Weak performance by subsidiaries:** Coking coal and energy cost were elevated during Q2FY23. Thus, European EBITDA fell by 66% QoQ to Rs9,540 mn due to lower steel realizations and higher coking coal cost. Tata Steel Thailand's EBITDA fell by 80% QoQ to Rs0.3 bn (EBITDA/t of Rs1,005). Tata Steel Long Products reported loss of Rs2.2 bn at an EBITDA level due to lower sales volume and higher other expenses.

TP	Rs105
<b>CMP</b>	<b>Rs101</b>
Potential upside/downside	4%
Previous Rating	BUY

## Price Performance (%)

	-1m	-3m	-12m
Absolute	1.9	(6.0)	(23.1)
Rel to Sensex	(4.5)	(12.2)	(26.2)

## V/s Consensus

EBITDA (Rs bn)	FY23E	FY24E
IDBI Capital	371	418
Consensus	424	386
% difference	(12.5)	8.3

## Key Stock Data

Bloomberg / Reuters	TATA IN / TISC.BO
Sector	Metal & Mining
Shares o/s (mn)	12,223
Market cap. (Rs mn)	1,237,006
3-m daily average value (Rs mn)	519.5
52-week high / low	Rs139 / 83
Sensex / Nifty	61,121 / 18,145

## Shareholding Pattern (%)

Promoters	33.9
FII	22.0
DII	18.9
Public	25.2

## Financial snapshot

Year	FY20	FY21	FY22	FY23E	FY24E
Revenue	1,490	1,563	2,440	2,137	1,814
Change (yoy, %)	(6)	5	56	(12)	(15)
EBITDA	178	305	635	371	418
Change (yoy, %)	(39)	71	108	(41)	13
EBITDA Margin(%)	12.0	19.5	26.0	17.4	23.1
Adj.PAT	61	92	419	171	204
EPS (Rs)	5.3	7.7	34.3	14.0	16.7
Change (yoy, %)	(34)	45	345	(59)	20
PE(x)	20.2	14.0	3.1	7.7	6.4
Dividend Yield (%)	1.2	2.0	4.7	2.2	2.2
EV/EBITDA (x)	12.8	6.4	2.6	4.5	3.8
RoE (%)	8.6	12.5	44.4	14.9	16.6
RoCE (%)	4.7	11.1	29.4	14.5	16.9

Source: IDBI Capital Research

**Exhibit 1: Quarterly Snapshot**

(Rs mn)

Financial snapshot	Q2FY23	Q1FY23	QoQ (%)	Q2FY22	YoY (%)
<b>Net Sales</b>	<b>598,775</b>	<b>634,301</b>	<b>(5.6)</b>	<b>602,828</b>	<b>(0.7)</b>
Total expenditure	538,172	484,573	11.1	438,267	22.8
<b>EBITDA</b>	<b>60,603</b>	<b>149,728</b>	<b>(59.5)</b>	<b>164,561</b>	<b>(63.2)</b>
<i>EBITDA margin (%)</i>	<i>10.1</i>	<i>23.6</i>	<i>(1348bps)</i>	<i>27.3</i>	<i>(1718bps)</i>
Interest	15,191	12,181	24.7	10,198	49.0
Depreciation	23,478	22,368	5.0	22,889	2.6
<b>PBT</b>	<b>26,051</b>	<b>117,860</b>	<b>(77.9)</b>	<b>141,196</b>	<b>(81.5)</b>
Tax	13,081	41,923	(68.8)	15,719	(16.8)
<b>PAT</b>	<b>12,970</b>	<b>77,140</b>	<b>(83.2)</b>	<b>125,477</b>	<b>(89.7)</b>
<b>Diluted EPS</b>	<b>1.1</b>	<b>6.3</b>	<b>(83.2)</b>	<b>10.3</b>	<b>(89.7)</b>

Source: Company; IDBI Capital Research

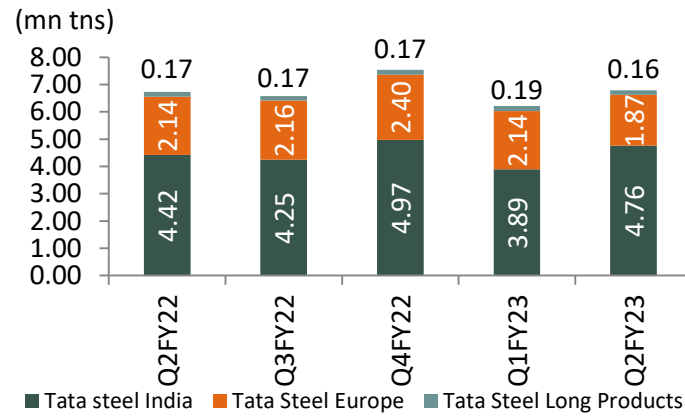
**Exhibit 2: Actual vs estimates**

(Rs mn)

	Q2FY23E	Q2FY23A	% Variance
Net sales	602,586	598,775	(0.6)
EBTIDA	104,257	60,603	(41.9)
<i>Margin (%)</i>	<i>17.3</i>	<i>10.1</i>	<i>(718bps)</i>
PAT	77,140	12,970	(83.2)
Dil. EPS	6.3	1.1	(83.2)

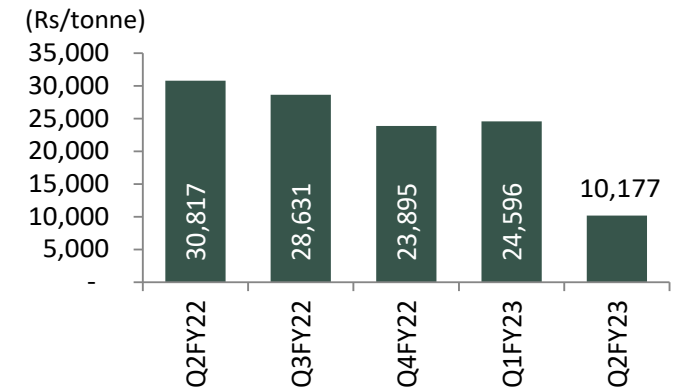
Source: Company; IDBI Capital Research

**Exhibit 3: Geographical sales mix**



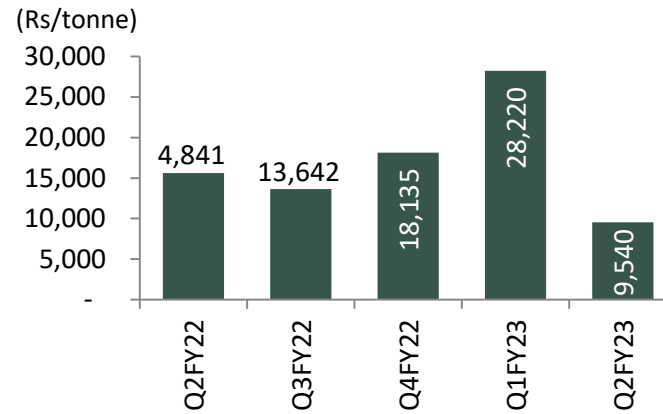
Source: Company; IDBI Capital Research

**Exhibit 4: Standalone EBIDTA/tonne fell by 59% flat QoQ**



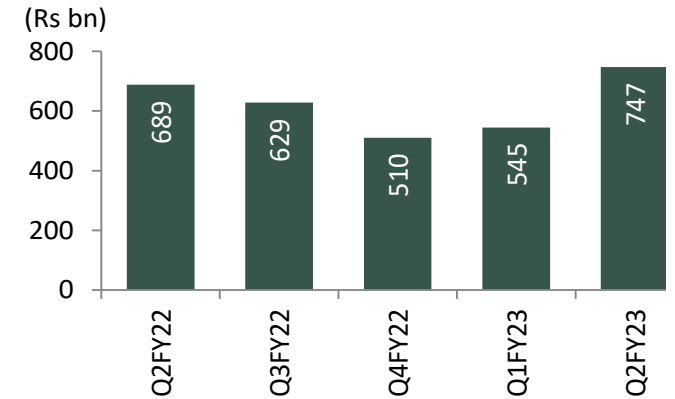
Source: Company; IDBI Capital Research

**Exhibit 5: Tata Steel Europe EBITDA/tonne fell sharply**



Source: Company; IDBI Capital Research

**Exhibit 6: Net debt increased by 37% QoQ**



Source: Company; IDBI Capital Research

**Exhibit 7: Change in estimates**

	FY23E			FY24E		
	Old	New	(%) Chg	Old	New	(%) Chg
Revenue (Rs bn)	2,007	2,137	6.5	1,811	1,814	0.2
EBITDA (Rs bn)	447	371	(16.9)	433	418	(3.4)
EBITDA margin (%)	22.3	17.4	(490bps)	23.9	23.1	(84bps)
Net profit (Rs bn)	223	171	(23.5)	214	204	(4.6)
EPS (Rs)	18	14	(23.6)	18	17	(5.0)

Source: Company; IDBI Capital Research

### Conference call highlights

- On a consolidated basis, Tata steel revenue fell by 6% QoQ on account of drop in steel realization across geographies and lower sales volume (13% QoQ) in Europe due to weak demand.
- Coking coal and Iron ore prices fell by 15-20% during the quarter. However, company is witnessing the coking coal consumption to increase by \$80/tonne for Indian operations and £100/tonne for Europe in Q2FY23.
- For European operations, sales volumes are likely to increase in Q3FY23 led by long term contracts at higher price. However, rising energy costs will keep a check on margins.
- Capex of Rs190 bn in Q2FY23 were spent for the acquisition of Neelachal Ispat Nigam Ltd (NINL), dividend payout and re-line up of blast furnace in Netherland. Therefore, this led to increase in net debt by Rs202 bn to Rs717 bn. The company will begin the deleveraging from FY24.
- In H2FY23, Tata Steel remains confident for its European business to deliver decent performance on the back of cost hedging strategy for carbon and energy for Netherland and UK operations. Moreover, the recent drop in gas prices and energy cost bodes well.
- Indian operations are expected to remain robust on account of stability in steel prices, automotive demand and favorable climatic conditions.
- The NINL blast furnace was commenced in October. Tata steel aims to increase its capacity from 1.1 mn tonnes to 5 mn tonnes over next 3 years with a capex of Rs4-5 bn. This plant will be further scaled up to 10 mn tonnes in coming years.
- The 6 mn tonnes Pellet plant at Kalinganagar will be commissioned in 3QFY23 which will be followed by cold roll mill complex. This will reduce the cost substantially. Also, the 5 mn tonnes expansion at Kalinganagar plant will be commissioned by FY24.
- Going ahead, company remains confident on achieving higher volumes from FY24 onwards led by expansion of Kalinganagar, Neelachal Nigam and Tata steel BSL plants respectively.

**Exhibit 7: SOTP-based valuation**

	FY24 EBITDA	Multiple	(Rs bn)
India operations	336	4.0	1,343
TSE	38	3.0	114
Other operations	4	3.0	13
CWIP @ 70%			106
<b>Derived enterprise value</b>			<b>1,577</b>
Less: Net debt			372
Derived equity value			1,204
<b>Target price (Rs/share)</b>			<b>105</b>

Source: Company; IDBI Capital Research

## Financial Summary

### Profit & Loss Account

(Rs bn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
<b>Net sales</b>	<b>1,577</b>	<b>1,490</b>	<b>1,563</b>	<b>2,440</b>	<b>2,137</b>	<b>1,814</b>
<i>Change (yoy, %)</i>	27	(6)	5	56	(12)	(15)
Operating expenses	(1,283)	(1,311)	(1,258)	(1,805)	(1,765)	(1,396)
<b>EBITDA</b>	<b>294</b>	<b>178</b>	<b>305</b>	<b>635</b>	<b>371</b>	<b>418</b>
<i>Change (yoy, %)</i>	37	(39)	71	108	(41)	13
<i>Margin (%)</i>	18.6	12.0	19.5	26.0	17.4	23.1
Depreciation	(73)	(87)	(92)	(91)	(92)	(93)
<b>EBIT</b>	<b>220</b>	<b>91</b>	<b>213</b>	<b>544</b>	<b>280</b>	<b>325</b>
Interest paid	(77)	(76)	(76)	(55)	(54)	(53)
Other income	14	18	9	8	8	8
<b>Pre-tax profit</b>	<b>157</b>	<b>(16)</b>	<b>135</b>	<b>496</b>	<b>234</b>	<b>280</b>
Tax	(67)	26	(57)	(85)	(70)	(84)
<i>Effective tax rate (%)</i>	43	163	42	17	30	30
Minority Interest	2	2	3	6	7	8
<b>Net profit</b>	<b>92</b>	<b>12</b>	<b>82</b>	<b>417</b>	<b>171</b>	<b>204</b>
Exceptional items	(1)	(49)	(10)	(1)	-	-
<b>Adjusted net profit</b>	<b>93</b>	<b>61</b>	<b>92</b>	<b>419</b>	<b>171</b>	<b>204</b>
<i>Change (yoy, %)</i>	17	(34)	51	354	(59)	20
EPS	8	5	8	34	14	17
Dividend per share	1	1	2	5	2	2
<i>Dividend Payout %</i>	15	29	27	15	17	14

**Balance Sheet**

(Rs bn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
<b>Shareholders' funds</b>	<b>689</b>	<b>736</b>	<b>742</b>	<b>1,144</b>	<b>1,144</b>	<b>1,320</b>
Share capital	11	11	12	12	12	12
Reserves & surplus	678	724	730	1,132	1,132	1,308
<b>Total Debt</b>	<b>911</b>	<b>1,133</b>	<b>724</b>	<b>505</b>	<b>445</b>	<b>295</b>
Other liabilities	209	185	247	273	286	301
<b>Curr Liab &amp; prov</b>	<b>502</b>	<b>425</b>	<b>709</b>	<b>906</b>	<b>1,021</b>	<b>926</b>
Current liabilities	490	408	661	878	994	898
Provisions	12	17	47	28	28	28
<b>Total liabilities</b>	<b>1,623</b>	<b>1,743</b>	<b>1,680</b>	<b>1,683</b>	<b>1,752</b>	<b>1,522</b>
<b>Total equity &amp; liabilities</b>	<b>2,336</b>	<b>2,504</b>	<b>2,455</b>	<b>2,854</b>	<b>2,923</b>	<b>2,868</b>
<b>Net fixed assets</b>	<b>1,431</b>	<b>1,540</b>	<b>1,548</b>	<b>1,553</b>	<b>1,581</b>	<b>1,609</b>
Investments	64	41	35	46	46	46
Other non-curr assets	276	370	270	329	365	406
<b>Current assets</b>	<b>565</b>	<b>553</b>	<b>602</b>	<b>926</b>	<b>930</b>	<b>808</b>
Inventories	317	311	333	488	578	491
Sundry Debtors	118	79	95	122	107	91
Cash and Bank	33	81	58	159	72	34
Other current assets	97	83	116	156	173	192
<b>Total assets</b>	<b>2,336</b>	<b>2,504</b>	<b>2,455</b>	<b>2,854</b>	<b>2,923</b>	<b>2,868</b>



**Cash Flow Statement**

(Rs bn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Pre-tax profit	157	(16)	135	496	234	280
Depreciation	47	87	92	91	92	93
Tax paid	(46)	(11)	(60)	(68)	(70)	(84)
Chg in working capital	110	(32)	245	15	41	8
Other operating activities	-	(15)	60	-	-	-
<b>Cash flow from operations (a)</b>	<b>267</b>	<b>13</b>	<b>473</b>	<b>533</b>	<b>296</b>	<b>297</b>
Capital expenditure	(350)	(197)	(100)	(97)	(120)	(120)
Chg in investments	115	23	7	(12)	-	-
Other investing activities	-	-	-	-	-	-
<b>Cash flow from investing (b)</b>	<b>(236)</b>	<b>(174)</b>	<b>(93)</b>	<b>(108)</b>	<b>(120)</b>	<b>(120)</b>
Equity raised/(repaid)	(0)	-	1	0	-	-
Debt raised/(repaid)	(7)	221	(409)	(219)	(60)	(150)
Dividend (incl. tax)	(14)	(18)	(25)	(62)	(29)	(29)
Chg in minorities	17	4	10	0	7	8
Other financing activities	-	-	-	-	-	-
<b>Cash flow from financing (c)</b>	<b>(5)</b>	<b>208</b>	<b>(423)</b>	<b>(281)</b>	<b>(81)</b>	<b>(171)</b>
<b>Net chg in cash (a+b+c)</b>	<b>27</b>	<b>47</b>	<b>(43)</b>	<b>144</b>	<b>95</b>	<b>6</b>

### Financial Ratios

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Book Value (Rs)	60	64	62	94	94	108
Adj EPS (Rs)	8	5	8	34	14	17
Adj EPS growth (%)	16.9	(34)	44.7	344.9	(59.2)	19.6
EBITDA margin (%)	18.6	12.0	19.5	26.0	17.4	23.1
Pre-tax margin (%)	9.9	(1.1)	8.6	20.3	10.9	15.5
Net Debt/Equity (x)	1.3	1.4	0.9	0.3	0.3	0.2
ROCE (%)	12.4	4.7	11.1	29.4	14.5	16.9
ROE (%)	14.3	8.6	12.5	44.4	14.9	16.6
<b>DuPont Analysis</b>						
Asset turnover (x)	0.7	0.6	0.6	0.9	0.7	0.6
Leverage factor (x)	3.4	3.4	3.4	2.8	2.5	2.4
Net margin (%)	5.9	4.1	5.9	17.2	8.0	11.3
<b>Working Capital &amp; Liquidity ratio</b>						
Inventory days	73	76	78	73	99	99
Receivable days	27	19	22	18	18	18
Payable days	62	60	103	123	144	149

### Valuations

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
PER (x)	13.3	20.2	14.0	3.1	7.7	6.4
Price/Book value (x)	1.8	1.7	1.7	1.1	1.1	1.0
EV/Net sales (x)	1.3	1.5	1.3	0.7	0.8	0.9
EV/EBITDA (x)	7.2	12.8	6.4	2.6	4.5	3.8
Dividend Yield (%)	0.9	1.2	2.0	4.7	2.2	2.2

Source: Company; IDBI Capital Research



# Notes

Dealing	(91-22) 6836 1111	dealing@idbicapital.com
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**Key to Ratings Stocks:**

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

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