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India | Equity Research | Company Update

Tata Steel

Metals

Turning over a new leaf

Tata Steel (TSL) has announced deep restructuring of its UK operations (TSUK) with twin objectives of business continuity and sustainability. Key points: 1) Existing blast furnaces to be replaced by 3mtpa Electric Arc Furnace (EAF); 2) 40% of GBP 1.25bn investment to be funded through the grant by the UK government; 3) cost differential of GBP 150-170/te compared to current operations; 4) possible emission reduction to 0.4tCO₂/te from the current level of 2.16 tCO₂/te at UK operations; and 5) setting up of EAF may complement the scrap ecosystem in the UK. In our view, the development assumes significance as support from parent for TSUK operations is likely to reduce in future. As a result, we raise our valuation multiple to 6x (earlier 5.5x), resulting in a revised TP of INR 150 (earlier INR 135). Maintain **ADD**.

Deep restructuring of UK operations

TSL and the UK government have jointly agreed on a proposal to investment in EAF steel making facilities replacing the existing heavy-end facilities (blast furnace and coke ovens) approaching the end of life. Key points: 1) Investment of GBP 1.25bn of which up to GBP 500mn will be through the grant from the UK government; 2) significant decarbonisation potential by reducing direct emissions by 5mtpa; and 3) non-cash impairment of legacy investments and potential elimination of the current cash losses at TSUK would lead to balance sheet restructuring. Management during analyst call indicated that consultation process with various stakeholders is likely to complete within the next 45-60 days and the new EAF may be operational within 36 months of the receipt of relevant regulatory and planning approvals. Besides, the existing sales volume is likely to be unaffected in the interim as downstream facilities would continue to operate uninterrupted through the import of additional steel substrate.

See an incremental value of INR 10-16/share

During the analyst call, management mentioned that the loss at EBITDA level at UK operations was GBP 127mn and GBP 39mn for FY23 and Q1FY24, respectively, with support from parent at GBP 163mn. Further, TSK operations incurred carbon cost of GBP 70mn per annum. Management indicated that there is a cost saving potential of GBP 150-170/te compared to the existing operations and IRR potential of 15-16% from the new investment as upstream.

Financial Summary

Y/E March (INR mn)	FY22A	FY23A	FY24E	FY25E
Net Revenue	24,39,592	24,33,527	24,21,546	24,92,972
EBITDA	6,34,900	3,23,002	3,12,205	4,16,807
EBITDA Margin (%)	26.0	13.3	12.9	16.7
Net Profit	4,02,880	86,440	1,04,513	1,68,686
EPS (Rs)	33.0	7.1	8.6	13.8
EPS % Chg YoY	409.8	(80.7)	34.5	61.5
P/E (x)	3.9	20.0	14.8	9.2
EV/EBITDA (x)	3.3	6.9	7.0	5.1
RoCE (%)	24.9	5.4	7.3	10.6
RoE (%)	44.6	8.7	9.4	14.8

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Market Data

Market Cap (INR)	1,613bn
Market Cap (USD)	19,396mn
Bloomberg Code	TATA IN
Reuters Code	TISC.BO
52-week Range (INR)	134 /95
Free Float (%)	66.0
ADTV-3M (mn) (USD)	54.1

Price Performance (%)	3m	6m	12m
Absolute	19.8	25.4	27.3
Relative to Sensex	8.3	19.0	14.7

ESG Disclosure	2021	2022	Change
ESG score	57.6	58.8	1.2
Environment	60.8	60.8	-
Social	22.2	25.7	3.6
Governance	89.9	89.9	-

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

Previous Reports

26-07-2023: [Q1FY24 results review](#)

04-05-2023: [Q4FY23 results review](#)

facilities are not operating at their optimal state and lower carbon cost. Besides, there could be an additional benefit from the British Industry Supercharger scheme. We peg an incremental value of INR 10-16/share at the steady state based on different scenarios of cost saving potential.

Exhibit 1: Scenarios for incremental value

Scenarios	1	2	3	4
Cost benefit/t (GBP)	100	125	150	175
Sales volume (mnte)	3	3	3	3
Incremental EBITDA (GBP mn)	300	375	450	525
EV/EBITDA (x)	6.5	6.0	5.5	5.0
Incremental EV (GBP mn)	1,950	2,250	2,475	2,625
Initial Investment (GBP mn)	725	725	725	725
Incremental market cap (GBP mn)	1,225	1,525	1,750	1,900
Incremental market cap (INR)	1,26,053	1,56,923	1,80,075	1,95,510
Value per share (INR)	10.3	12.8	14.7	16.0

Source: I-Sec research, Company data

See benefit beyond the numbers

TSL is a major player in the UK steel market with annual consumption of 9mtpa. The company has significant market share in key segments- 50% in automotive, 43% in construction and 62% in packaging. In our view, the development represents an attempt to develop the most optimal solution for the loss-making UK operations, enhancing the business competitiveness and sustainability. Key points: 1) Scrap ecosystem of 9mtpa in the UK may be partially utilised towards value addition within UK; 2) carbon emissions may reduce to 0.4tCO₂/t crude steel (c.s.) production compared to the current level of 2.16 tCO₂/te c.s.; 3) future readiness of UK operations can be significantly enhanced as power supply in the UK would be incrementally from renewable sources, reducing the emissions further; and 4) British Industry supercharger scheme, endeavouring to reduce the cost of electricity and levelling the same with other major economies in the world, is likely to aid EAF-based operations more than blast furnace based operations.

Outlook: Value-accretive development; maintain ADD

In our view, the development around TSUK is likely to ensure the future readiness of the business from both profitability and ESG perspective. We expect both additional restructuring costs and policy support as consultation process picks up. Taking cognisance of better operating prospects of TSUK and reduced support from the parent, we raise our valuation multiple to 6x (earlier 5.5x), resulting in a revised TP of INR 150 (earlier INR 135). Maintain **ADD** rating on TSL stock.

Key risks:

Upside: 1) Better than expected pricing/demand in India; 2) additional support from the UK government for TSUK operations; and 3) higher than expected contract prices in Europe.

Downside: Lower than expected spreads, debt increase, and sustained higher coking coal prices.

Exhibit 2: Shareholding pattern

%	Dec'22	Mar'23	Jun'23
Promoters	33.9	33.9	33.9
Institutional investors	41.1	42.2	40.5
MFs and other	8.2	9.1	8.9
FIs/ Banks	0.3	0.1	0.2
Insurance Cos.	10.0	10.0	10.3
FII	22.6	23.0	21.1
Others	25.0	23.9	25.6

Source: Bloomberg, I-Sec research

Exhibit 3: Price chart



Source: Bloomberg, I-Sec research

Financial Summary

Exhibit 4: Profit & Loss

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Net Sales	24,39,592	24,33,527	24,21,546	24,92,972
Operating Expenses	9,69,905	9,78,142	10,78,307	10,34,945
EBITDA	6,34,900	3,23,002	3,12,205	4,16,807
EBITDA Margin (%)	26.0	13.3	12.9	16.7
Depreciation & Amortization	91,009	93,352	98,386	1,03,918
EBIT	5,43,891	2,29,650	2,13,819	3,12,890
Interest expenditure	54,622	62,987	61,280	56,895
Other Non-operating Income	7,849	10,343	7,963	7,141
Recurring PBT	4,97,118	1,77,006	1,60,502	2,63,135
Profit / (Loss) from Associates	6,492	4,181	4,223	4,265
Less: Taxes	84,776	1,01,598	56,176	92,097
PAT	4,12,342	75,408	1,04,326	1,71,038
Less: Minority Interest	15,954	(6,851)	4,036	6,618
Extraordinaries (Net)	(1,341)	1,133	-	-
Net Income (Reported)	4,17,493	80,722	1,08,549	1,75,303
Net Income (Adjusted)	4,02,880	86,440	1,04,513	1,68,686

Source Company data, I-Sec research

Exhibit 5: Balance sheet

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Total Current Assets	8,40,322	8,30,355	7,66,368	7,25,119
of which cash & cash eqv.	1,58,989	1,33,573	1,12,630	1,00,414
Total Current Liabilities & Provisions	6,54,872	6,96,595	7,03,673	6,50,949
Net Current Assets	1,85,450	1,33,760	62,695	74,170
Investments	1,31,399	84,103	84,103	84,103
Net Fixed Assets	12,45,042	12,79,193	12,80,807	13,26,889
ROU Assets	-	-	-	-
Capital Work-in-Progress	2,12,276	3,03,079	3,63,079	3,78,079
Total Intangible Assets	96,016	1,96,073	1,96,073	1,96,073
Other assets	2,98,438	1,60,508	1,60,508	1,60,508
Deferred Tax assets	30,239	26,260	26,260	26,260
Total Assets	21,99,584	21,83,622	21,74,172	22,46,729
Liabilities				
Borrowings	7,65,613	8,48,931	7,78,931	7,08,931
Deferred Tax Liability	1,23,258	1,41,156	1,41,156	1,41,156
provisions	48,260	4,778	4,778	4,778
other Liabilities	91,469	1,37,005	1,37,005	1,37,005
Equity Share Capital	12,212	12,212	12,212	12,212
Reserves & Surplus	11,32,218	10,18,609	10,79,158	12,21,715
Total Net Worth	11,44,430	10,30,821	10,91,370	12,33,928
Minority Interest	26,554	20,931	20,931	20,931
Total Liabilities	21,99,584	21,83,622	21,74,172	22,46,729

Source Company data, I-Sec research

Exhibit 6: Quarterly trend

(INR mn, year ending March)

	Sep-22	Dec-22	Mar-23	Jun-23
Net Sales	6,03,871	6,07,831	6,93,235	6,34,301
% growth (YOY)	55.1	45.1	38.7	18.8
EBITDA	1,64,561	1,58,937	1,50,296	1,49,728
Margin %	27.3	26.1	21.7	23.6
Other Income	2,709	596	2,922	2,681
Extraordinaries	5,160	(1,934)	(2,743)	(392)
Adjusted Net Profit	1,19,181	95,727	97,562	77,650

Source Company data, I-Sec research

Exhibit 7: Cashflow statement

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Operating Cashflow	4,43,810	2,16,831	3,43,617	2,83,201
Working Capital Changes	(15,269)	13,505	50,122	(23,691)
Capital Commitments	(1,05,222)	(1,41,425)	(1,60,000)	(1,65,000)
Free Cashflow	3,38,588	75,406	1,83,617	1,18,201
Other investing cashflow	(3,590)	(45,374)	-	-
Cashflow from Investing Activities	(1,08,812)	(1,86,798)	(1,60,000)	(1,65,000)
Issue of Share Capital	-	-	-	-
Interest Cost	-	-	-	-
Inc (Dec) in Borrowings	(1,39,207)	15,65,426	(70,000)	(70,000)
Dividend paid	(30,201)	(62,926)	(43,964)	(26,128)
Others	(64,603)	(15,72,306)	(90,597)	(34,288)
Cash flow from Financing Activities	(2,34,011)	(69,807)	(2,04,560)	(1,30,417)
Chg. in Cash & Bank balance	1,00,987	(39,775)	(20,943)	(12,215)
Closing cash & balance	1,58,989	1,33,573	1,12,630	1,00,414

Source Company data, I-Sec research

Exhibit 8: Key ratios

(Year ending March)

	FY22A	FY23A	FY24E	FY25E
Per Share Data (INR)				
Reported EPS	34.2	6.6	8.9	14.4
Adjusted EPS (Diluted)	33.0	7.1	8.6	13.8
Cash EPS	40.4	14.7	16.6	22.3
Dividend per share (DPS)	51.0	3.6	2.1	3.5
Book Value per share (BV)	93.7	84.4	89.4	101.0
Dividend Payout (%)	149.2	54.5	24.1	24.1
Growth (%)				
Net Sales	56.1	(0.2)	(0.5)	2.9
EBITDA	108.1	(49.1)	(3.3)	33.5
EPS (INR)	409.8	(80.7)	34.5	61.5
Valuation Ratios (x)				
P/E	3.9	20.0	14.8	9.2
P/CEPS	3.3	9.0	7.9	5.9
P/BV	1.4	1.6	1.5	1.3
EV / EBITDA	3.3	6.9	7.0	5.1
Dividend Yield (%)	38.7	2.7	1.6	2.6
Operating Ratios				
Gross Profit Margins (%)	65.8	53.5	57.4	58.2
EBITDA Margins (%)	26.0	13.3	12.9	16.7
Effective Tax Rate (%)	17.1	57.4	35.0	35.0
Net Profit Margins (%)	16.9	3.1	4.3	6.9
Net Debt / Equity (x)	0.4	0.6	0.5	0.4
Net Debt / EBITDA (x)	0.7	2.0	1.9	1.3
Fixed Asset Turnover (x)	1.2	1.2	1.1	1.1
Inventory Turnover Days	97	93	73	69
Receivables Days	24	14	15	14
Payables Days	73	64	58	50
Profitability Ratios				
RoCE (%)	24.9	5.4	7.3	10.6
RoE (%)	44.6	8.7	9.4	14.8
RoIC (%)	28.0	6.2	8.3	11.8

Source Company data, I-Sec research

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