

India

REDUCE (no change)

Consensus ratings*:	Buy 23	Hold 5	Sell 6
Current price:	Rs841		
Target price:	Rs711		
Previous target:	Rs750		
Up/downside:	-15.5%		
InCred Research / Consensus:	-48.5%		
Reuters:	TATA IN		
Bloomberg:	TATA IN		
Market cap:	US\$14,159m	Rs1,028,171m	
Average daily turnover:	US\$142.7m	Rs10361.5m	
Current shares o/s:	1,145.0m		
Free float:	66.9%		

*Source: Bloomberg



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	(17.8)	(36.8)	(23.5)
Relative (%)	(14.9)	(30.3)	(22.9)

Major shareholders	% held
Promoter & Promoter Group	33.1
LIC India	9.0
HDFC Trustee Company	4.6

Analyst(s)



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Tata Steel

European pain to return

- With high inflation and rising interest rates, the western world will see steel demand destruction leading to a massive destocking-led fall in prices.
- Artificial deleveraging because of working capital has somewhat reversed in FY22 and the rest will reverse in FY23F. Debt to go up to Rs700bn by FY23F.
- We have valued Tata Steel at 0.7x FY23F P/BV to arrive at our new target price of Rs711 (from Rs750 earlier). Retain Reduce rating on the stock.

Old pain (Europe) to make a comeback for Tata Steel

For a better part of last 17 years, Tata Steel's performance has been plagued by its European division. There was a flash-in-the-pan kind of performance in FY07 and again in FY22, but for a better part of the last two decades the overall performance of the company has not been up to the mark. We believe that in coming three years the same pain will return. We don't expect Tata Steel Europe or TSE to post a positive EBITDA in FY23F. Overall debt will increase as working capital requirement will again increase in FY23F (for analysis of working capital issues please click our May 2021 report [IN: Steel - Irrational enthusiasm close to its end](#) and our 24 Jun 2022 report [IN: Steel - Supply shock is over and so is bull cycle](#)).

Artificial balance sheet deleveraging will come to an end

A massive rise in other current liabilities, which are statutory liabilities, led to artificial debt reduction by ~Rs60-70bn. High current payables also led to the release of cash from working capital. In our May 2021 report, we had anticipated a Rs200bn increase in working capital against which the actual increase was Rs160bn (please see Tata Steel section of our report published on 17 May 2021 [IN: Steel - Recent market exuberance close to its end](#)). Falling EBITDA, rising capex and cash being sucked in working capital will lead to a rise in debt to Rs700bn by FY23F.

Valuation nowhere near the bottom; steel prices to fall more

Normally, Tata Steel bottoms near 0.5x P/BV in a downcycle. It's unlikely that one will lose money if one buys at that level. Can it reach that level? We don't know but we can surmise (based on the analysis given in this report) that steel prices have a US\$125-150/t downside (assuming coking coal prices fall to the US\$350-370 range). Despite high energy prices, falling scrap prices have ensured that electric arc furnaces or EAFs will remain operational in Europe and high raw material cost squeezing BF's or blast furnaces but not enough to cause a shutdown.

We value Tata Steel at 0.7x P/BV; retain Reduce with new TP of Rs711

We have valued Tata Steel at 0.7x FY23F P/BV to arrive at our new target price of Rs711 (Rs750 earlier). We refrained from valuing Tata Steel on an EV/EBITDA basis in these volatile times as anybody's earnings projection has no meaning under such circumstances. A sudden big fall in coking coal prices is an upside risk to our call.

Financial Summary	Mar-20A	Mar-21A	Mar-22A	Mar-23F	Mar-24F
Revenue (Rsm)	1,369,768	1,533,084	2,423,269	1,972,389	1,859,109
Operating EBITDA (Rsm)	174,631	304,963	634,900	285,357	268,079
Net Profit (Rsm)	27,196	81,818	417,493	103,712	78,604
Core EPS (Rs)	56.5	75.0	349.2	86.5	65.6
Core EPS Growth	(37.5%)	32.9%	365.3%	(75.2%)	(24.2%)
FD Core P/E (x)	35.46	12.06	2.42	9.72	12.83
DPS (Rs)	4.1	4.1	4.1	4.1	6.5
Dividend Yield	1.19%	2.97%	2.97%	2.97%	2.97%
EV/EBITDA (x)	11.67	5.60	2.44	5.84	6.31
P/FCFE (x)	7.28	22.71	5.52	2.68	11.66
Net Gearing	137.7%	89.0%	43.7%	50.7%	50.7%
P/BV (x)	1.31	1.36	0.88	0.83	0.80
ROE	9.1%	11.9%	44.4%	8.8%	6.3%
% Change In Core EPS Estimates			13.04%	3.24%	
InCred Research/Consensus EPS (x)					

SOURCES: INCRED RESEARCH, COMPANY REPORTS

European pain to return

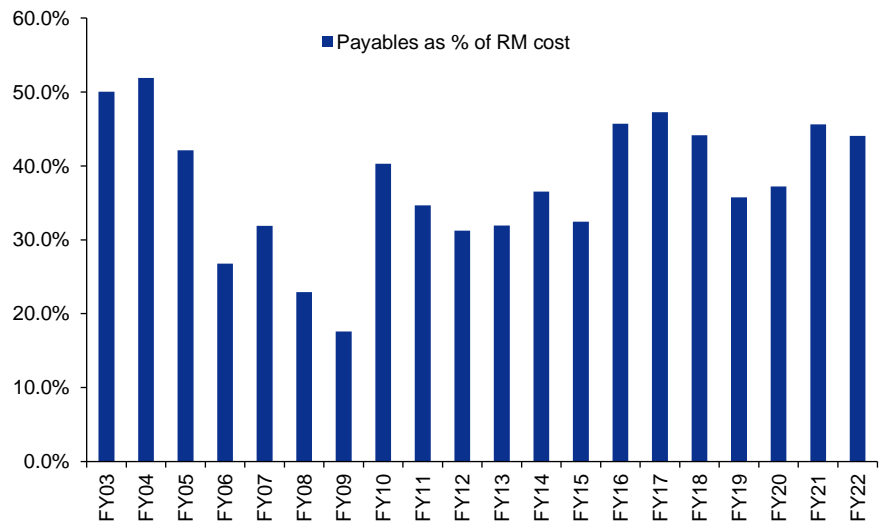
For a better part of the last 17 years, Tata Steel’s performance has been plagued by its European division. There has been a flash-in-the-pan kind of performance in FY07 and again in FY22, but for a better part of the last two decades the overall performance of the company has not been up to the mark. We believe that in coming three years the same pain will return. We don’t expect TSE to post a positive EBITDA in FY23F. Overall debt will increase as working capital requirement will again increase in FY23F (for analysis of working capital issues please click our May 2021 report [IN: Steel - Recent market exuberance close to its end](#)).

Working capital requirement to increase along with debt

While we saw ~Rs160bn increase in working capital during FY22, we expect working capital requirement to increase further by Rs90bn in FY23F. Capex in India business and a fall in EBITDA will lead net debt to rise by Rs110bn in FY23F.

Higher payables were leading to cash release from working capital ➤

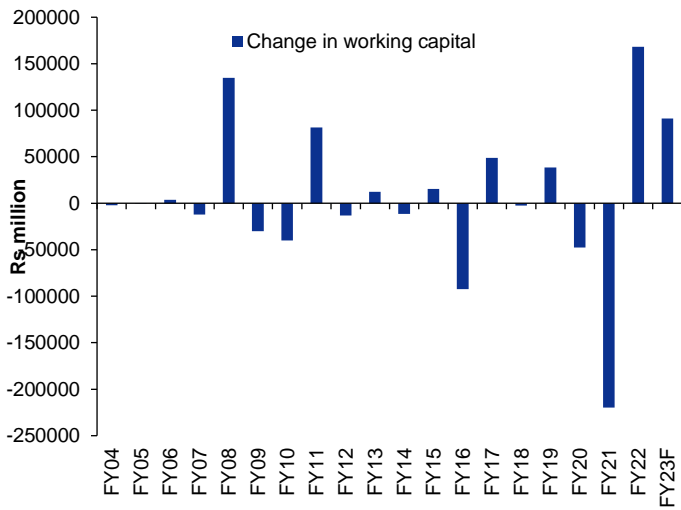
Figure 1: When raw material (RM) cost increases, normally payables as a % of RM cost should come down but the reverse has happened; when RM prices fall it will hit the balance sheet



SOURCES: INCRED RESEARCH, COMPANY REPORTS

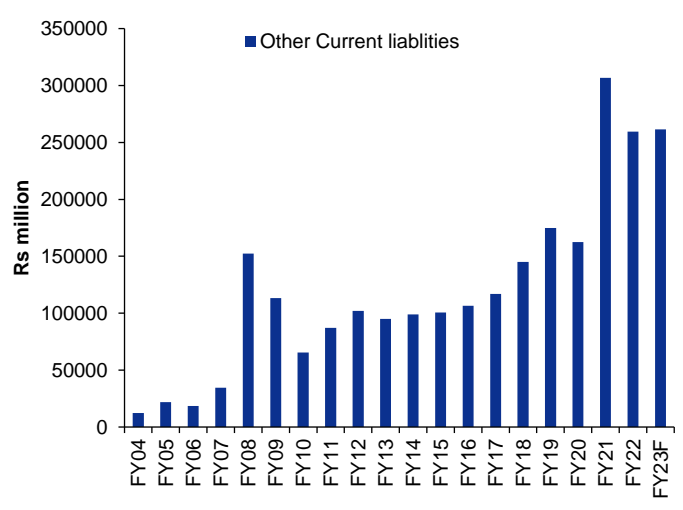
While working capital has increased in FY22, it will rise further in FY23F ➤

Figure 2: Major deleveraging in FY21 was led by cash release in working capital, mostly by a significant increase in other current liabilities



SOURCES: INCRED RESEARCH, COMPANY REPORTS

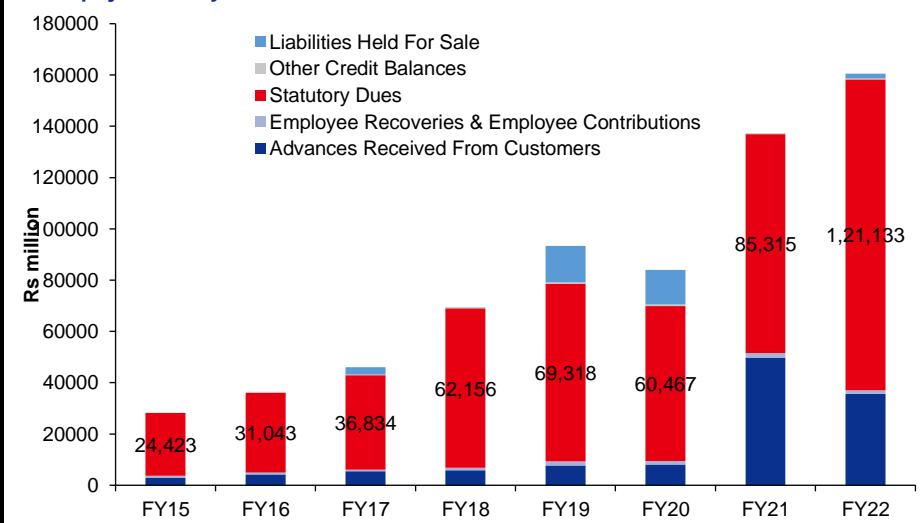
Figure 3: Working capital release in FY21 was driven by a massive increase in other current liabilities which got reversed in FY22



SOURCES: INCRED RESEARCH, COMPANY REPORTS

The composition of other current liabilities showed that it will reverse ➤

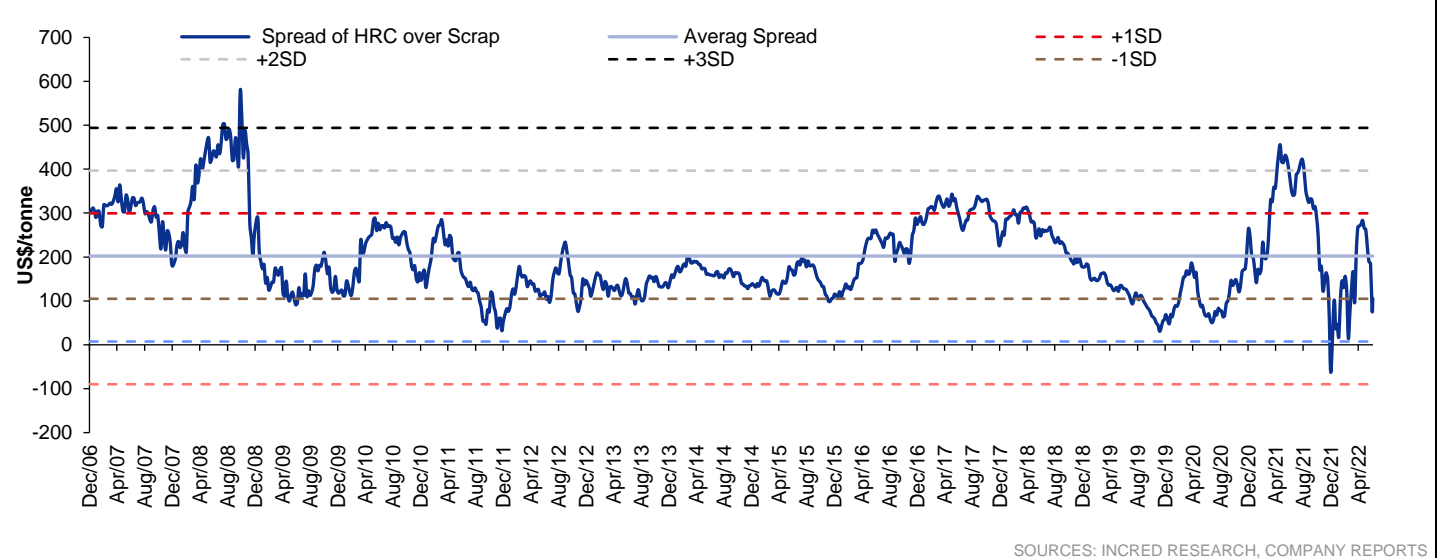
Figure 4: Tata Steel has delayed paying statutory dues and it has become 2x over FY20; around Rs60bn debt reduction in FY22 is just artificial because the company didn't pay statutory dues on time



SOURCES: INCRED RESEARCH, COMPANY REPORTS

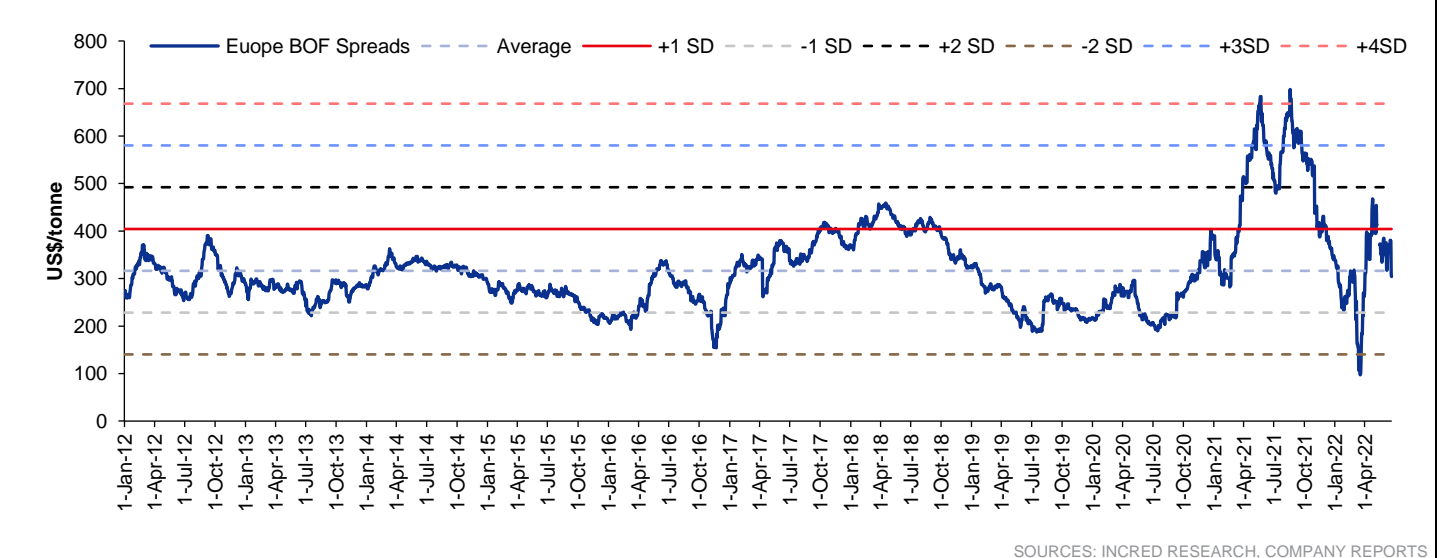
In Europe, despite high energy prices, EAFs are still making money and so they are not closing down ➤

Figure 5: Fall in scrap prices are making EAFs still viable despite the high power cost at US\$0.20/ kWhr; please note that electric arc furnaces sometimes have long-term power contracts and rarely 100% of their requirement is based on spot market prices



As supply chain is destocking, BF-based steel spreads are falling and they have some distance to go before bottoming out ➤

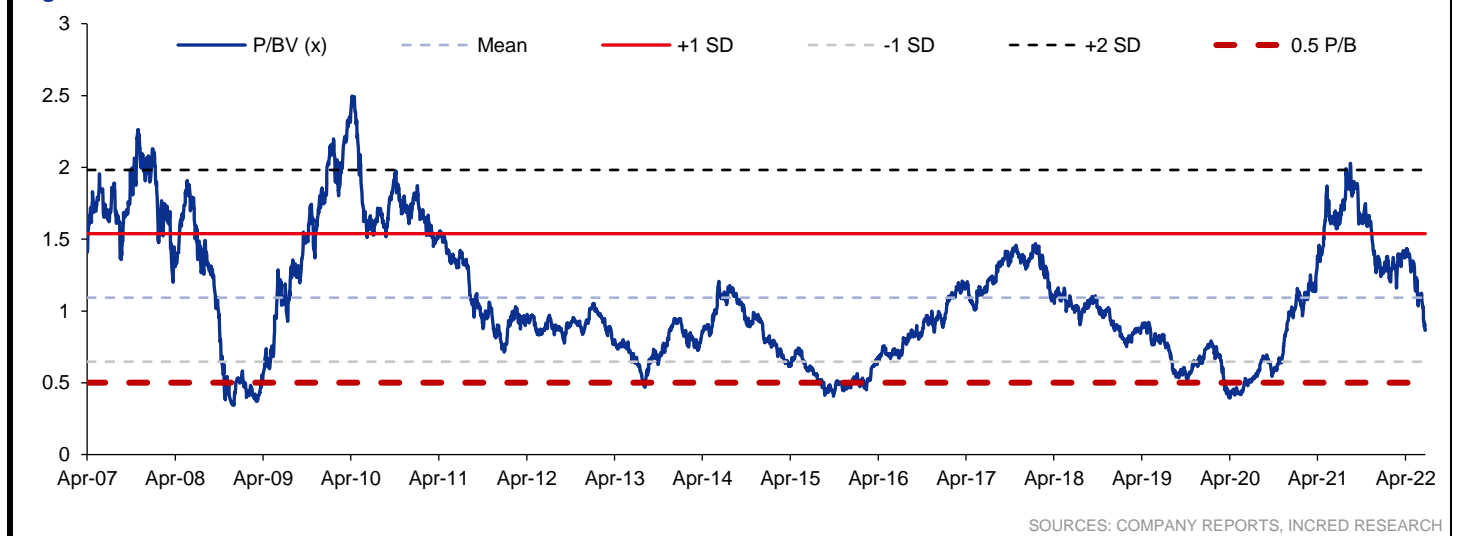
Figure 6: Despite the recent fall, European steel spreads are way too high, more so when so when the supply chain is destocking; we expect steel prices to fall to around US\$150/t before stabilizing



Valuations nowhere near the bottom ➤

When steel prices and the spreads are falling, earnings estimation is impossible and hence, book value remains the correct metric to look at. On that basis, Tata Steel has a long way to go. Normally, it bottoms out at 0.5x P/BV.

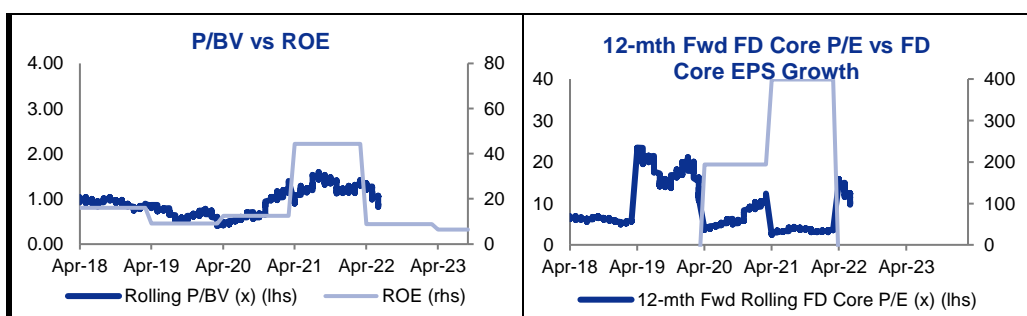
Figure 7: Price/BV trend



Is Tata Steel cheap on the earnings parameter? No, because no one can estimate future earnings correctly ➤

We don't think Tata Steel is cheap on the EV/EBITDA front as:

1. After seeing at least three steel cycles, we are sure that earning estimation (with a reasonable success probability) on inflection point is impossible.
2. During the Lehman collapse, QE (quantitative easing) led to massive demand surge after six months and hence, earnings recovered just too fast.
3. Currently, QE has become a blunted weapon as high inflation is killing demand anyway and rising interest rates will make projects/businesses unviable.
4. Demand will decline and the supply chain will destock. It's a well-known fact that steel is an oversupplied commodity and hence, unlike refining, even a 1% demand decline for steel products will create a shock wave across the supply chain.

BY THE NUMBERS

Profit & Loss

(Rs mn)	Mar-20A	Mar-21A	Mar-22A	Mar-23F	Mar-24F
Total Net Revenues	1,398,167	1,562,942	2,439,592	1,972,389	1,859,109
Gross Profit	1,398,167	1,562,942	2,439,592	1,972,389	1,859,109
Operating EBITDA	174,631	304,963	634,900	285,357	268,079
Depreciation And Amortisation	(84,407)	(92,336)	(91,009)	(97,253)	(97,482)
Operating EBIT	90,223	212,626	543,891	188,105	170,597
Financial Income/(Expense)	(75,335)	(76,067)	(54,622)	(66,314)	(80,191)
Pretax Income/(Loss) from Assoc.	1,880	3,273	6,492		
Non-Operating Income/(Expense)	18,435	8,956	7,849	7,849	7,849
Profit Before Tax (pre-EI)	35,203	148,789	503,609	129,640	98,255
Exceptional Items	(37,521)	(10,432)	(1,341)		
Pre-tax Profit	(2,317)	138,357	502,269	129,640	98,255
Taxation	25,684	(56,539)	(84,776)	(25,928)	(19,651)
Exceptional Income - post-tax					
Profit After Tax	23,367	81,818	417,493	103,712	78,604
Minority Interests	3,829				
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	27,196	81,818	417,493	103,712	78,604
Recurring Net Profit	64,716	87,987	418,608	103,712	78,604
Fully Diluted Recurring Net Profit	64,716	87,987	418,608	103,712	78,604

Cash Flow

(Rs mn)	Mar-20A	Mar-21A	Mar-22A	Mar-23F	Mar-24F
EBITDA	174,631	304,963	634,900	285,357	268,079
Cash Flow from Invt. & Assoc.					
Change In Working Capital	41,962	164,913	(96,177)	(91,175)	8,638
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense	31,705	(21,444)	11,105		1,554
Other Operating Cashflow	8,138	63,859	(170,412)	22,307	48,738
Net Interest (Paid)/Received	(75,807)	(76,067)	(54,622)	(66,314)	(80,191)
Tax Paid	21,059	7,043	119,017	25,928	19,651
Cashflow From Operations	201,687	443,267	443,810	176,103	266,469
Capex	(100,123)	(65,340)	(99,527)	(200,000)	(180,000)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	(45,181)	(27,889)	(9,285)		
Cash Flow From Investing	(145,304)	(93,229)	(108,812)	(200,000)	(180,000)
Debt Raised/(repaid)	76,073	(306,606)	(152,307)	400,000	
Proceeds From Issue Of Shares	1,875	32,390	3,257	12	
Shares Repurchased					
Dividends Paid	(18,152)	(11,505)	(30,201)	(29,970)	(29,970)
Preferred Dividends					
Other Financing Cashflow	(76,742)	(85,175)	(54,760)	(66,314)	(80,191)
Cash Flow From Financing	(16,946)	(370,897)	(234,011)	303,728	(110,161)
Total Cash Generated	39,438	(20,859)	100,987	279,831	(23,692)
Free Cashflow To Equity	132,457	43,432	182,690	376,103	86,469
Free Cashflow To Firm	132,191	426,105	389,620	42,417	166,660

SOURCES: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS...cont'd

Balance Sheet					
(Rs mn)	Mar-20A	Mar-21A	Mar-22A	Mar-23F	Mar-24F
Total Cash And Equivalents	114,866	130,011	244,234	524,065	500,373
Total Debtors	78,849	95,398	122,464	178,326	168,084
Inventories	310,687	332,764	488,244	427,884	414,389
Total Other Current Assets	82,925	43,946	70,624	70,624	70,624
Total Current Assets	587,327	602,119	925,566	1,200,899	1,153,471
Fixed Assets	1,499,930	1,453,912	1,510,222	1,612,969	1,695,487
Total Investments	28,533	34,630	58,254	58,254	58,254
Intangible Assets	40,545	43,447	43,112	43,112	43,112
Total Other Non-Current Assets	347,859	270,297	317,302	317,302	317,302
Total Non-current Assets	1,916,867	1,802,287	1,928,890	2,031,637	2,114,156
Short-term Debt	191,845	94,921	251,008	451,008	451,008
Current Portion of Long-Term Debt					
Total Creditors	213,809	259,675	367,649	270,190	254,672
Other Current Liabilities	180,568	354,075	287,223	289,008	289,427
Total Current Liabilities	586,222	708,671	905,880	1,010,207	995,108
Total Long-term Debt	971,437	724,802	504,709	704,709	704,709
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	13,960	106,981	101,365	101,365	101,365
Total Non-current Liabilities	985,398	831,783	606,074	806,074	806,074
Total Provisions	170,946	139,333	171,518	171,518	173,072
Total Liabilities	1,742,566	1,679,788	1,683,471	1,987,798	1,974,253
Shareholders Equity	735,763	742,388	1,144,430	1,218,184	1,266,818
Minority Interests	25,866	32,697	26,554	26,554	26,554
Total Equity	761,629	775,085	1,170,985	1,244,738	1,293,373

Key Ratios					
	Mar-20A	Mar-21A	Mar-22A	Mar-23F	Mar-24F
Revenue Growth	(11.5%)	11.9%	58.1%	(18.6%)	(5.7%)
Operating EBITDA Growth	(40.6%)	74.6%	108.2%	(55.1%)	(6.1%)
Operating EBITDA Margin	12.7%	19.9%	26.2%	14.5%	14.4%
Net Cash Per Share (Rs)	(914.75)	(575.35)	(426.67)	(526.91)	(546.68)
BVPS (Rs)	641.96	619.29	954.66	1,016.19	1,056.76
Gross Interest Cover	1.20	2.80	9.96	2.84	2.13
Effective Tax Rate		40.9%	16.9%	20.0%	20.0%
Net Dividend Payout Ratio	17.7%	32.5%	7.2%	28.9%	38.1%
Accounts Receivables Days	25.71	20.35	16.30	27.83	34.01
Inventory Days	nm	nm	nm	nm	nm
Accounts Payables Days	nm	nm	nm	nm	nm
ROIC (%)	(23.5%)	7.6%	23.8%	7.2%	6.3%
ROCE (%)	4.7%	11.5%	29.1%	8.2%	6.7%
Return On Average Assets	(13.4%)	5.6%	17.7%	5.2%	4.4%

SOURCES: INCRED RESEARCH, COMPANY REPORTS

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ADVANC – Excellent, Certified, **AMATA** – Excellent, Certified, **ANAN** – Excellent, n/a, **AOT** – Excellent, n/a, **AP** – Excellent, Certified, **ASP** – Excellent, n/a, **AWC** – Excellent, Declared, **AU** – Good, n/a, **BAM** – Very Good, Certified, **BAY** – Excellent, Certified, **BBL** – Excellent, Certified, **BCH** – Very Good, Certified, **BCP** – Excellent, Certified, **BCPG** – Excellent, Certified, **BDMS** – Excellent, n/a, **BEAUTY** – Good, n/a, **BEM** – Excellent, n/a, **BH** – Good, n/a, **BJC** – Very Good, n/a, **BLA** – Very Good, Certified, **BTS** – Excellent, Certified, **CBG** – Very Good, n/a, **CGET** – n/a, n/a, **CENDEL** – Excellent, Certified, **CHAYO** – Very Good, n/a, **CHG** – Very Good, n/a, **CK** – Excellent, n/a, **COM7** – Excellent, Certified, **CPALL** – Excellent, Certified, **CPF** – Excellent, Certified, **CPN** – Excellent, Certified, **CPNREIT** – n/a, n/a, **CRC** – Excellent, Declared, **DELTA** – Excellent, Certified, **DDD** – Excellent, n/a, **DIF** – n/a, n/a, **DOHOME** – Very Good, Declared, **DREIT** – n/a, n/a, **DTAC** – Excellent, Certified, **ECL** – Excellent, Certified, **EGCO** – Excellent, Certified, **EPG** – Excellent, Certified, **ERW** – Very Good, Certified, **GFPT** – Excellent, Certified, **GGC** – Excellent, Certified, **GLOBAL** – Excellent, n/a, **HANA** – Excellent, Certified, **HMPRO** – Excellent, Certified, **HUMAN** – Good, n/a, **ICHI** – Excellent, Certified, **III** – Excellent, Declared, **INTUCH** – Excellent, Certified, **IRPC** – Excellent, Certified, **ITD** – Very Good, n/a, **IVL** – Excellent, Certified, **JASIF** – n/a, n/a, **JKN** – n/a, Certified, **JMT** – Very Good, n/a, **KBANK** – Excellent, Certified, **KCE** – Excellent, Certified, **KEX** – Very Good, Declared, **KKP** – Excellent, Certified, **KSL** – Excellent, Certified, **KTB** – Excellent, Certified, **KTC** – Excellent, Certified, **LH** – Excellent, n/a, **LPN** – Excellent, Certified, **M** – Very Good, Certified, **MAKRO** – Excellent, Certified, **MC** – Excellent, Certified, **MEGA** – Very Good, n/a, **MINT** – Excellent, Certified, **MTC** – Excellent, Certified, **NETBAY** – Very Good, n/a, **NRF** – Very Good, Declared, **OR** – Excellent, n/a, **ORI** – Excellent, Certified, **OSP** – Excellent, n/a, **PLANB** – Excellent, Certified, **PRINC** – Very Good, Certified, **PR9** – Excellent, Declared, **PSH** – Excellent, Certified, **PTT** – Excellent, Certified, **PTTEP** – Excellent, n/a, **PTTGC** – Excellent, Certified, **QH** – Excellent, Certified, **RAM** – n/a, n/a, **RBF** – Very Good, n/a, **RS** – Excellent, Declared, **RSP** – Good, n/a, **S** – Excellent, n/a, **SAK** – Very Good, Declared, **SAPPE** – Very Good, Certified, **SAWAD** – Very Good, n/a, **SCB** – Excellent, Certified, **SCC** – Excellent, Certified, **SCGP** – Excellent, Declared, **SECURE** – n/a, n/a, **SHR** – Excellent, n/a, **SIRI** – Excellent, Certified, **SPA** – Very Good, n/a, **SPALI** – Excellent, Certified, **SPRC** – Excellent, Certified, **SSP** – Good, Certified, **STEC** – Excellent, n/a, **SVI** – Excellent, Certified, **SYNEX** – Very Good, Certified, **TCAP** – Excellent, Certified, **THANI** – Excellent, Certified, **TIDLOR** – n/a, Certified, **TISCO** – Excellent, Certified, **TKN** – Very Good, n/a, **TOP** – Excellent, Certified, **TRUE** – Excellent, Certified, **TTB** – Excellent, Certified, **TU** – Excellent, Certified, **TVO** – Excellent, Certified, **VGI** – Excellent, Certified, **WHA** – Excellent, Certified, **WHART** – n/a, n/a, **WICE** – Excellent, Certified, **WORK** – Good, n/a.

- CG Score 2021 from Thai Institute of Directors Association (IOD)

- Companies participating in Thailand's Private Sector Collective Action Coalition Against Corruption programme (Thai CAC) under Thai Institute of Directors (as of August 5, 2021) are categorised into: companies that have declared their intention to join CAC, and companies certified by CAC.

Recommendation Framework

Stock Ratings

Definition:

Add	The stock's total return is expected to exceed 10% over the next 12 months.
Hold	The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
Reduce	The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings

Definition:

Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings

Definition:

Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.