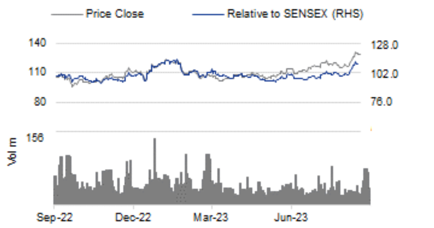
India

REDUCE *(no change)*

Consensus ratings*:	Buy 25 Hold 4 Sell 2
Current price:	Rs130
Target price: ▲	Rs82
Previous target:	Rs70
Up/downside:	-36.9%
InCred Research / Consensus:	-38.4%
Reuters:	TISC.NS
Bloomberg:	TATA IN
Market cap:	US$19,082m
	Rs1,582,719m
Average daily turnover:	US$49.2m
	Rs4078.7m
Current shares o/s:	12,212.1m
Free float:	66.9%

**Source: Bloomberg*



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	7.6	18.9	22.5
Relative (%)	5.6	11.8	10.0

Major shareholders	% held
Promoter & Promoter Group	33.9
LIC India	6.4
SBI MF	2.9

Tata Steel

European blues stage a comeback

- All hopes of balance sheet deleveraging have been dashed and, instead, its leveraging has started. Tata Steel will have to halt capex for deleveraging.
- One-time subsidy from the UK government won't help Tata steel Europe. It needs subsidies on a regular basis to post a sustained positive EBITDA.
- We value Tata Steel at 6.5x EV/EBITDA to arrive at our target price of Rs82. The rise in TP is due to a higher P/E multiple (vs. 6x earlier). Retain REDUCE.

Balance sheet is unlikely to improve

Higher capex, multiple one-offs in payables (like higher customer advances, statutory liabilities & liabilities because of goods and services availed), which resulted in extraordinary working capital release in FY21, have still not normalized, and lower operational cash flow as profits are trending downwards will result in balance sheet debt to remain at Rs800bn for the next three years. Tata Steel has committed to incur a capex of Rs160bn in FY24F. While we expect its capex to moderate (as profits fall), still the company should end up incurring Rs130bn and Rs100bn capex in FY25F & FY26F, respectively. The consensus view has been quite bullish on balance sheet deleveraging, but we estimate net debt to increase to Rs803bn by FY26F (FY23 net debt stood at Rs715bn).

Europe's EAF steel output to rise – exerting pressure on TSE profits

With lower power cost and increased scrap availability, Europe's electric arc furnaces or EAFs are viable once again. They are much more profitable vis-à-vis blast furnaces (BFs) if we account for the carbon tax on BFs. Europe can easily produce 102-105mt of steel scrap (based on historical highs) and has around 90mt of working EAF capacity (operating at 65% utilization). It is likely that we will witness a 13-14% rise in Europe's EAF steel production in FY24F, exerting pressure on blast furnaces' profits. Tata Steel mostly operates BF-based capacities and hence, its profits can remain under stress. We don't feel that Tata Steel Europe (TSE) can post any positive EBITDA for the next three years.

Indian HRC prices to remain subdued; coking coal prices may rise

Higher domestic steel prices are leading to increased imports from China. While the industry is asking for protection, we believe it's unlikely to come. The government protected the steel industry in FY16 primarily to save the banking sector. India has no such problems now as prices are high enough for steel companies to service their debt. FY24F is likely to be a dull year for coking coal prices as Europe will shift mostly to the EAF route to make steel. While Indian demand will rise, it won't be enough to balance the coal market. We expect the market to remain in surplus (although only by ~ 8-10t) in FY24F but from FY25F onwards, the coking coal market will be again in deficit.

Retain REDUCE rating with a higher target price of Rs82

We roll forward our target price to Sep 2024F and hence, raise it to Rs82 (6.5x Sep 2025F EV/ EBITDA) Upside risk: Sudden rise in steel prices because of China economic stimulus.

Financial Summary	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Revenue (Rsm)	2,423,269	2,433,527	2,634,001	2,794,365	2,945,160
Operating EBITDA (Rsm)	634,900	323,002	270,231	273,453	283,693
Net Profit (Rsm)	417,493	80,754	66,881	66,246	65,996
Core EPS (Rs)	34.3	6.6	5.5	5.4	5.4
Core EPS Growth	376.1%	(80.8%)	(16.7%)	(0.9%)	(0.4%)
FD Core P/E (x)	3.79	19.58	23.65	23.87	23.96
DPS (Rs)	2.5	2.5	2.0	2.0	2.0
Dividend Yield	1.93%	1.93%	1.54%	1.54%	1.54%
EV/EBITDA (x)	3.34	7.06	8.70	8.70	8.35
P/FCFE (x)	8.66	18.76	60.95	24.09	15.12
Net Gearing	43.7%	64.6%	68.4%	68.4%	65.2%
P/BV (x)	1.38	1.53	1.47	1.42	1.37
ROE	44.4%	7.4%	6.4%	6.1%	5.8%
% Change In Core EPS Estimates			0.04%		
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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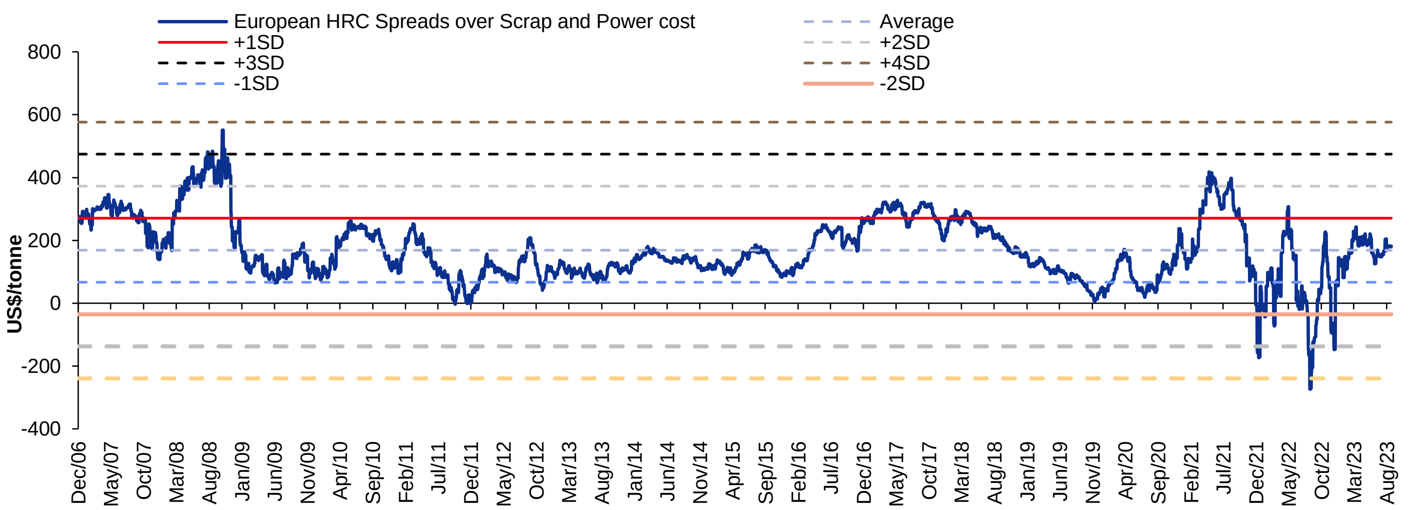
European blues stage a comeback

Europe's blast furnaces in trouble as power becomes cheaper and scrap prices won't rise

Europe's blast furnaces were ruling the roost as electric arc furnaces or EAFs were uncompetitive there. EAFs had two headwinds during and after the Covid-19 pandemic such as 1) high power prices, and 2) lower scrap collection (because of the pandemic-led lockdown), leading to higher scrap prices as well. Hence, EAFs were unprofitable, which led to increased pricing power for BFs. The situation has completely reversed now. We expect EAFs' production to rise significantly (10-15%) over the CY22 level, which will put blast furnaces or BFs under stress. Rising EAF steel production in Europe will lead to 20,000t more graphite electrode consumption, which is positive for HEG (ADD) and Graphite India (UNRATED).

Europe's blast furnace spreads over power and scrap fell to a multi-decade low ➤

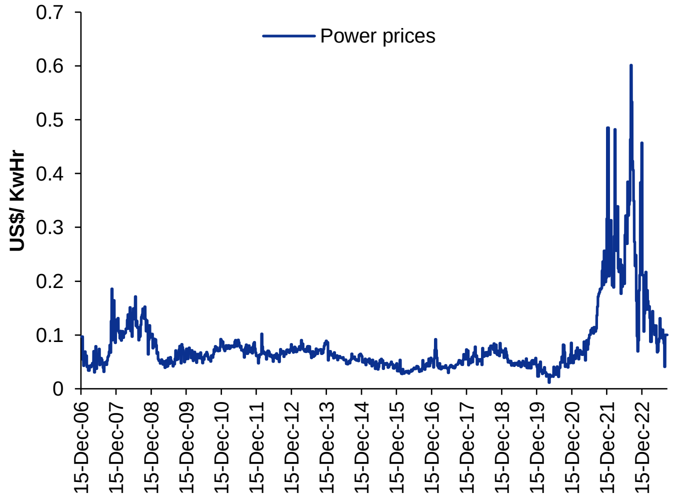
Figure 1: Europe's EAFs were bleeding in 2022 as higher power prices rendered them unprofitable



SOURCE: INCRED RESEARCH, COMPANY REPORTS

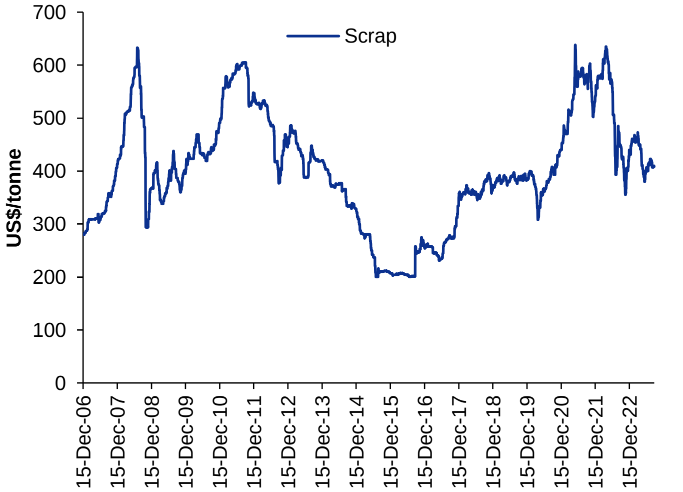
Power prices were quite high and scrap prices were also high compared to the historical range ➤

Figure 2: Prices of power rose to as high as US$0.6/ KwHr…



SOURCE: INCRED RESEARCH, COMPANY REPORTS

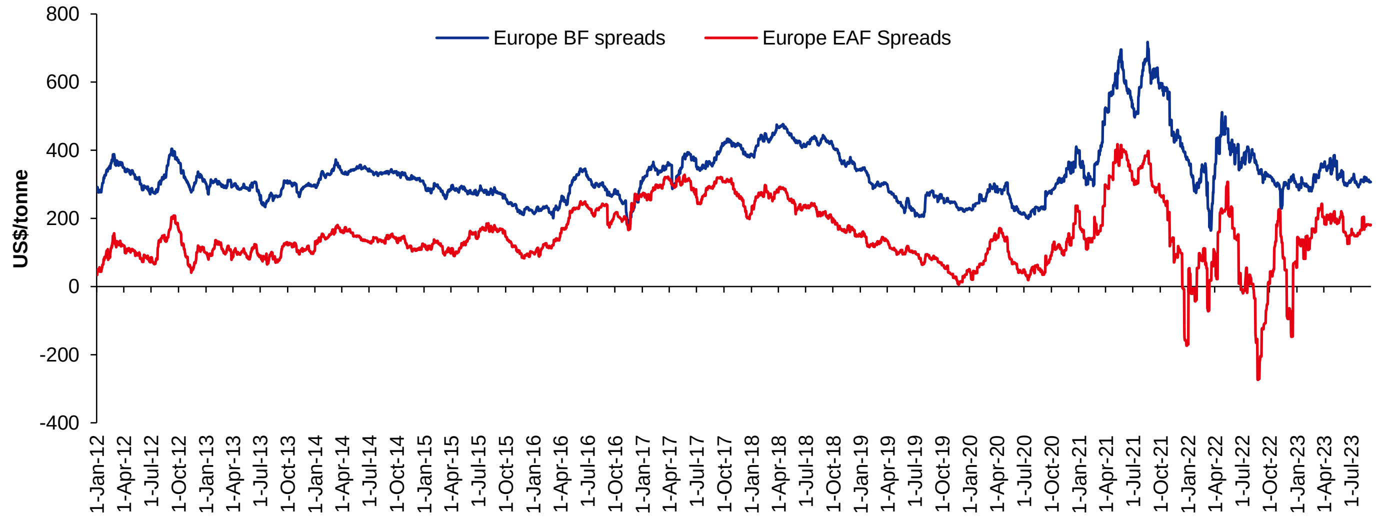
Figure 3: …and that of scrap to US$600/t



SOURCE: INCRED RESEARCH, COMPANY REPORTS

As a result, EAFs were rendered unprofitable and BFs were in business ➤

Figure 4: Please note that because of higher fixed cost, BFs' spreads over raw material need to be higher by at least US$150/t compared to EAFs; however, during the energy crisis they were much higher because EAFs were not making even gross profit and BFs were ruling the market



SOURCE: INCRED RESEARCH, COMPANY REPORTS

BFs face high carbon tax as well, which will make then unviable in the coming days ➤

1. The European steel industry receives free allocation for carbon emission based on a statistical benchmark called EU ETS (Emission Trading System). This benchmark is set to be revised for the 2025F-30F period.
2. This benchmark gives a limit on how much carbon emission is allowed for the steel industry without any costs, after which any extra emission cost must be borne by the steel manufacturer.
3. This becomes more important because the cost of carbon permits in Europe has reached an all-time high of 95 euros/t (Rs8,642/t). While this is bad for the BF method of steel production, it's a tailwind for the EAF method of steel production which, in turn, benefits HEG.

EU emission trading system

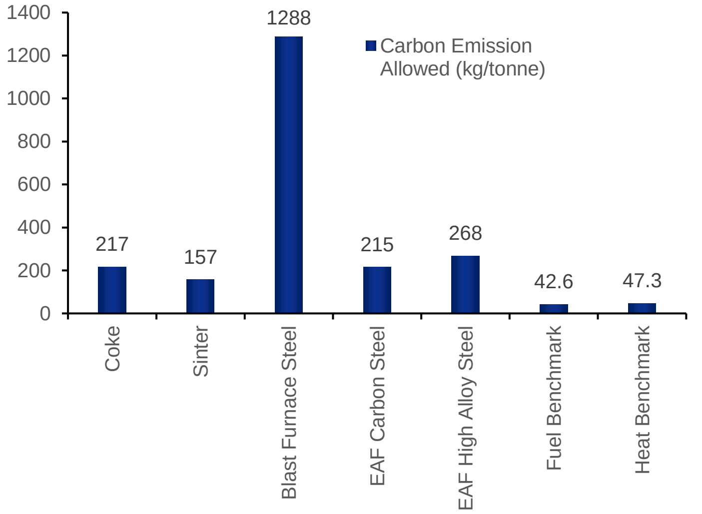
The European steel industry receives free allocation for carbon, with the allocation based on five products - coke, sinter, blast furnace steel, electric arc furnace or EAF carbon steel, EAF high alloy steel and the fuel and heat fall-back benchmarks for those processes that are not covered by the above methods.

How are the benchmarks set for carbon emissions?

4. The average emission by 10% best performers sets the benchmark, i.e., if there are 30 blast furnace plants in Europe, the average emission by the top three plants will decide the benchmark level.
5. However, a few BFs invested in alternative technologies, like direct reduction of steel, and as a result, they will bring down the average benchmark for carbon emissions. As such alternative technologies were already active in the EU in 2021-22 (which is the reference period for the update of 2026F-30F benchmarks), they would contribute to a sharp reduction of those benchmarks in 2026F-30F because the benchmarks are set only by the average of lowest 10% emitting installations as mentioned (i.e., 2.5 installations set the benchmark for the entire sector comprising 25 installations).
6. In addition to the reduction linked to the modification of benchmarks, the sector would also face in 2030F the 50% phase-out due to the carbon border adjustment mechanism (CBAM). Therefore, the sector would face huge free allocation shortage and carbon costs, even if low carbon investments (which require massive financial resources) are successful and the sector would

reduce its emissions by around 30% compared to today's levels. The worst-hit would be BFs used in steel production.

Figure 5: Carbon emissions allowed under the 2020-25 ETS scheme will be cut further during 2026F-30F



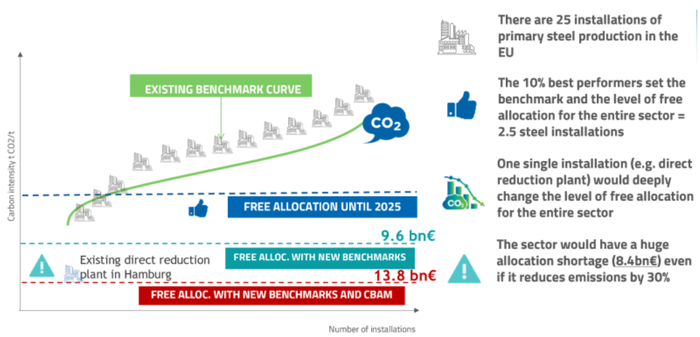
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 6: Scenario analysis for different rate of carbon emissions by steel mills, assuming 96 euro/t as carbon cost

	Annual reduction	50% CBAM reduction in 2030F	30% reduction in emissions
Annual Direct Emissions	185 mt/year	185 mt/year	130 mt/year
Annual Preliminary Free Allocation	86mt	43mt	43mt
Annual Free Allocation Shortage	99mt	142Mt	87mt
Annual Direct Carbon Costs (2025F-30F)	9.6bn euros	13.8bn euros	8.4bn euros

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 7: Diagram explaining the shortfall in carbon allocation and additional costs



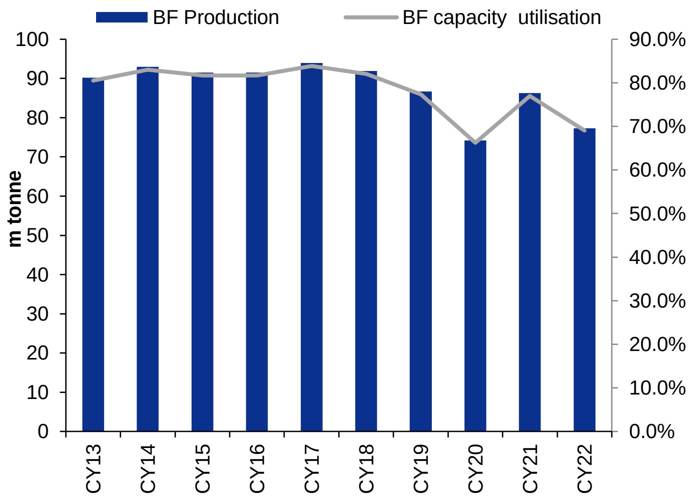
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 8: Price of carbon permits/t touches an all-time high

SOURCE: INCRED RESEARCH, COMPANY REPORTS

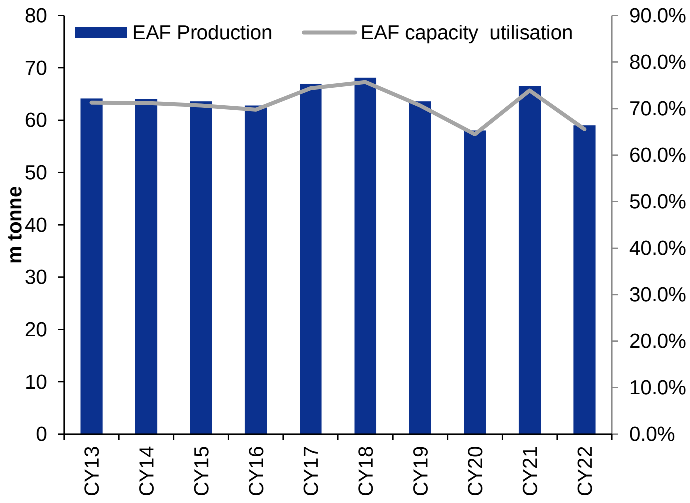
Europe has a significant unused EAF steel production capacity

Figure 9: Europe BF steel production has come down



SOURCE: INCRED RESEARCH, EUROFER

Figure 10: EAF steel production declined in CY22, but is likely to go up



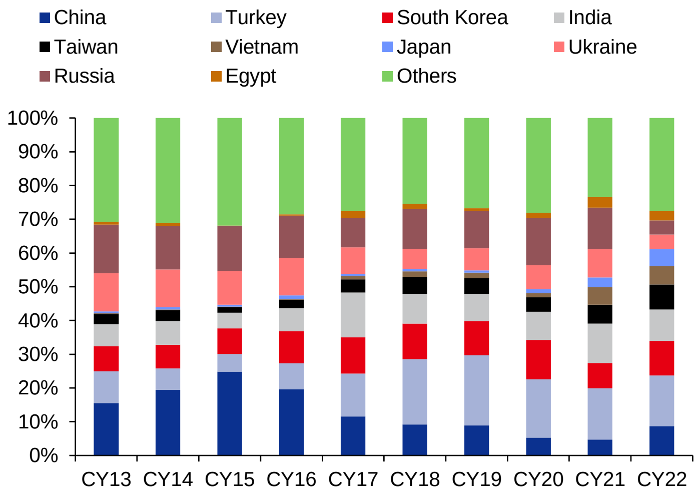
SOURCE: INCRED RESEARCH, EUROFER

In the new regime of high carbon tax and lower power prices, EAF steel production will be the preferred route

In the new regime of high carbon tax, EAF will be the preferred route as even 100 kg extra carbon emission will destroy the already thin profitability of European blast furnaces.

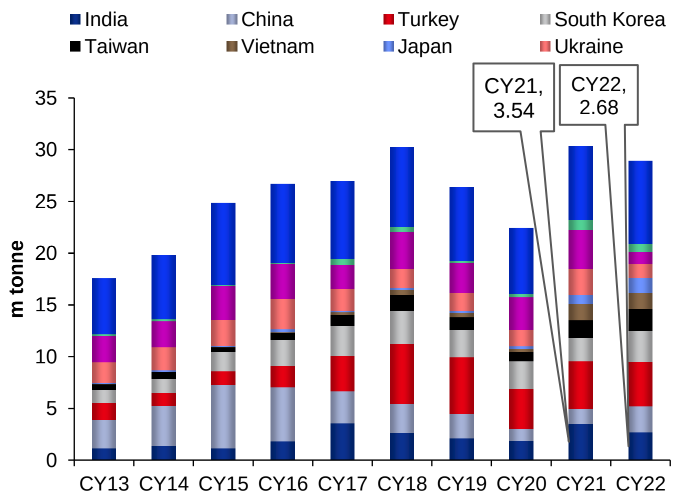
Indian exporters gained in 2021 as Europe was rushing to fill its supply chain

Figure 11: Chinese steel exports have come down in Europe and more or less have been replaced by India



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 12: India's steel exports to Europe nearly doubled in 2021 and fell by 25% YoY in 2022

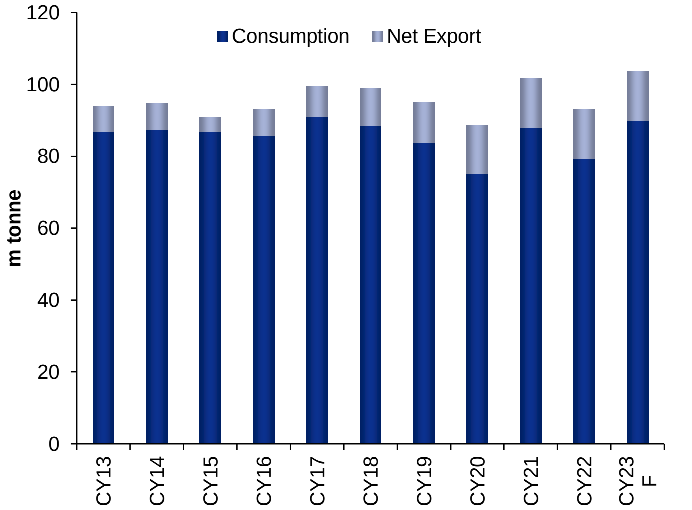


SOURCE: INCRED RESEARCH, COMPANY REPORTS

Don't expect scrap prices to rally in Europe as EAFs ramp up

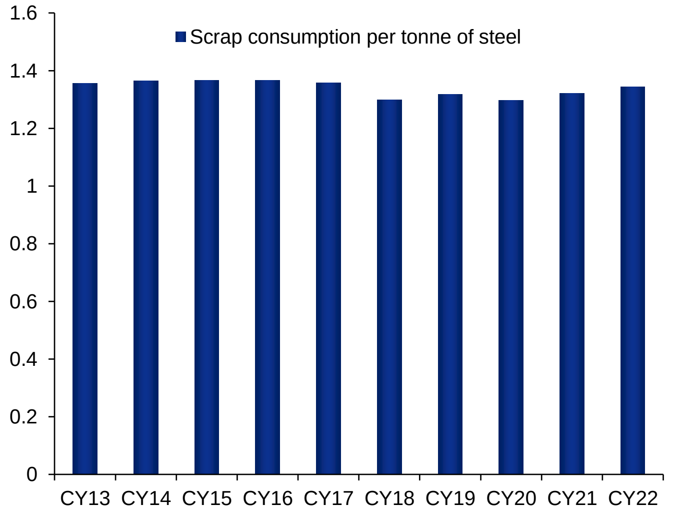
There can be one legitimate concern of the investors that scrap prices can rally if EAF steel production ramps up and thus, profitability of EAFs will get impaired. However, our analysis shows that Europe can easily produce 102-105mt of scrap. Accounting for the usual export of 13mt scrap, scrap availability for local consumption is still more than 90mt, and it can produce 67mt of steel in 2023F (a 13% rise YoY).

Figure 13: Europe can easily produce 102-103mt of scrap and thus, scrap exports can remain around 13-14mt – as a result, scarcity of scrap in the global market will not occur



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 14: Assuming 1.34t scrap consumption per tonne of EAF steel, production can rise to 67mt or a 13% growth YoY



SOURCE: INCRED RESEARCH, COMPANY REPORTS

If EAF steel production rises by 8-10mt in Europe, then graphite electrode prices will rally but their demand elasticity with price is extremely low ➤

An 8-10mt rise in EAF steel production will raise graphite electrode demand by 16,000-18,000t. Given the tightly balanced market for graphite electrodes, we expect their prices to rise. Please note that even if graphite electrode prices double from the current levels, still, at the maximum, EAFs' cost of steel production will rise by US$10/t, which is insignificant.

Balance sheet to deteriorate

Tata Steel's balance sheet to deteriorate as it embarks on the capex plan and earnings remains subdued. In FY24F, the company plans to incur a capex of Rs 160bn. The slowing global steel cycle is a big headwind on the cash flow of the company and added to it is the planned capex.

Tata Steel has an ambitious capex plan to achieve 30mt capacity by FY30F ➤

Tata Steel has planned a consolidated capital expenditure (capex) of Rs160bn for FY24F. This is a significant increase from a capex of Rs120bn in FY23.

The capex will be used to fund several projects, including:

1. Expansion of the Kalinganagar plant in Odisha to 8mtpa from 3mtpa currently.
2. Modernization of the Jamshedpur plant in Jharkhand.
3. Development of new greenfield projects in India.
4. Acquisition of iron ore mines in India and Australia.
5. Research and development in new technologies, such as hydrogen steel-making.

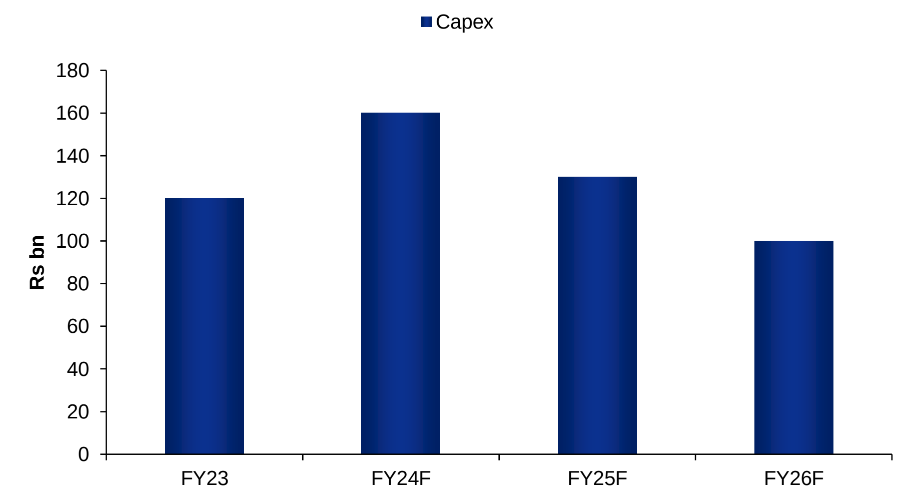
Here is a breakdown of the capex by region:

1. India: Rs100bn
2. Europe: Rs20bn
3. Other countries: Rs40bn

The capex in India will be to fund the expansion of Kalinganagar plant, modernization of Jamshedpur plant, and development of new greenfield projects. The capex for Europe will be used to upgrade the company's blast furnaces and continuous casting machines. The capex for other countries will be used to acquire iron ore mines and invest in research and development. The company expects to achieve a capacity of 30mtpa by 2030F.

This means that Tata Steel will have to do continuous capex in the coming years➤

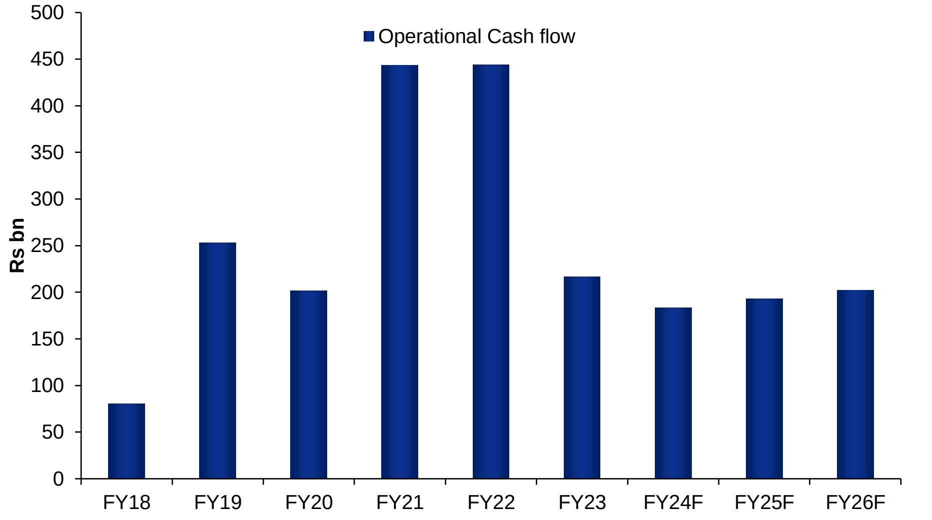
Figure 15: Capex to remain elevated for Tata Steel



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Operational cash flow touched its peak in FY22

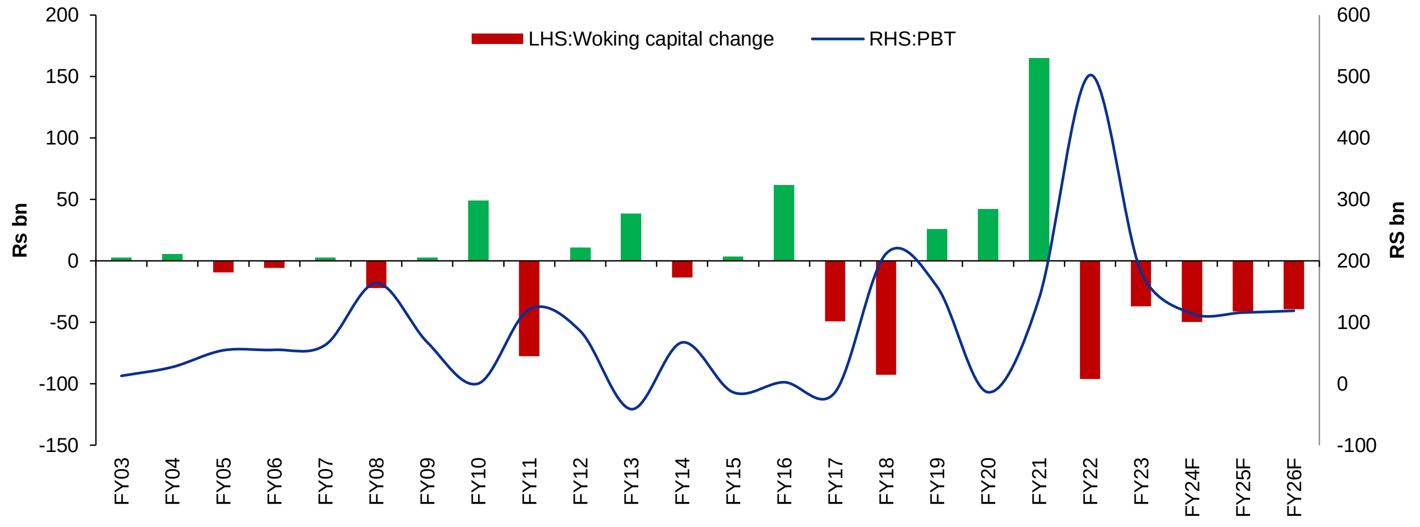
Figure 16: Operational cash flow touched its peak in FY22



SOURCE: INCRED RESEARCH, COMPANY REPORTS

There was significant working capital release in FY21, which was unprecedented and is unlikely to happen again

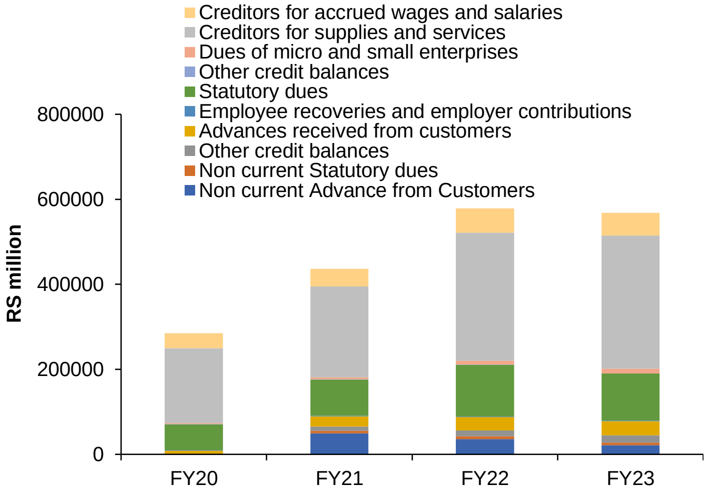
Figure 17: Working capital release in FY21 gave a false impression of deleveraging



SOURCE: COMPANY REPORTS, INCRED RESEARCH

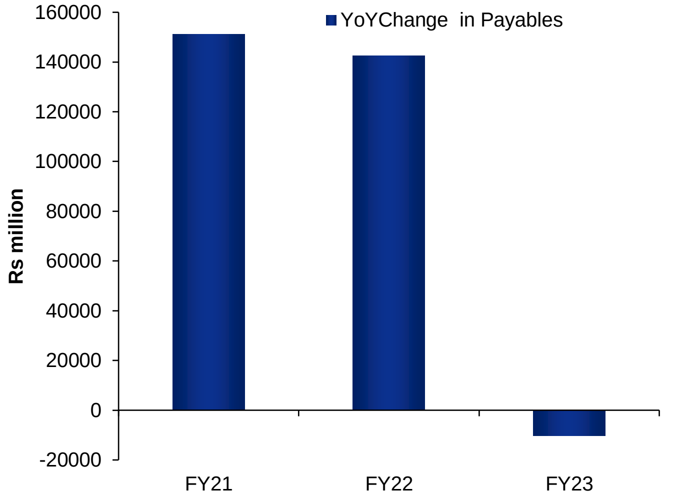
Working capital release in FY21 was transitory

Figure 18: Exponential rise in payables in FY21, and it has not come down in FY22 and FY23



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 19: Working capital release in FY21 and FY22 can be explained by the rise in payables



SOURCE: INCRED RESEARCH, COMPANY REPORTS

A few things that will decline in the coming quarters and hence, working capital will increase, are as follows:

1. Customer advances, which used to be in the range of Rs10bn, increased by 5x but will normalize.
2. The company is carrying high statutory liability for some time now. As PAT settles at a lower trajectory, this will also come down.
3. Creditors for supplies and services are also coming down, and this trend will accelerate in the coming quarters.

We value the stock at 6.5x EV/EBITDA to arrive at a target price of Rs82; retain REDUCE

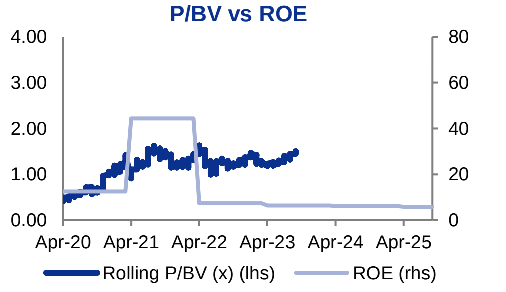
Figure 20: Our fair value of the stock is Rs82

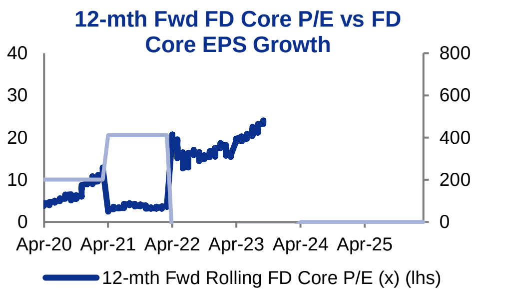
Target Price

Item	Unit	Valuation
Sep 2025F EBITDA	Rs m	2,78,573
1- year Forward Multiple	x	6.5
Sep 2025F EV	Rs m	18,10,724
Sep 2024F Net Debt	Rs m	8,08,505
Sep 2024F Equity Value	Rs m	10,02,219
Sep 2024F Equity Value	Rs/share	81.95
1-year Forward Target Price	Rs/share	82.00

SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS





Profit & Loss

(Rs mn)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Total Net Revenues	**2,439,592**	**2,433,527**	**2,634,001**	**2,794,365**	**2,945,160**
Gross Profit	**2,439,592**	**2,433,527**	**2,634,001**	**2,794,365**	**2,945,160**
Operating EBITDA	**634,900**	**323,002**	**270,231**	**273,453**	**283,693**
Depreciation And Amortisation	(91,009)	(93,352)	(98,455)	(100,129)	(107,455)
Operating EBIT	**543,891**	**229,650**	**171,777**	**173,324**	**176,238**
Financial Income/(Expense)	(54,622)	(62,987)	(67,914)	(67,914)	(67,914)
Pretax Income/(Loss) from Assoc.	6,492	4,181			
Non-Operating Income/(Expense)	7,849	10,375	10,375	10,375	10,375
Profit Before Tax (pre-EI)	**503,609**	**181,219**	**114,237**	**115,784**	**118,698**
Exceptional Items	(1,341)	1,133			
Pre-tax Profit	**502,269**	**182,351**	**114,237**	**115,784**	**118,698**
Taxation	(84,776)	(101,598)	(47,356)	(49,538)	(52,702)
Exceptional Income - post-tax					
Profit After Tax	**417,493**	**80,754**	**66,881**	**66,246**	**65,996**
Minority Interests					
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	**417,493**	**80,754**	**66,881**	**66,246**	**65,996**
Recurring Net Profit	418,608	80,252	66,881	66,246	65,996
Fully Diluted Recurring Net Profit	**418,608**	**80,252**	**66,881**	**66,246**	**65,996**

Cash Flow

(Rs mn)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
EBITDA	634,900	323,002	270,231	273,453	283,693
Cash Flow from Invt. & Assoc.					
Change In Working Capital	(96,177)	(37,065)	(49,782)	(41,110)	(39,286)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense	11,105	(29,607)			
Other Operating Cashflow	(170,412)	(31,700)	(16,424)	(20,787)	(27,114)
Net Interest (Paid)/Received	(54,622)	(62,987)	(67,914)	(67,914)	(67,914)
Tax Paid	119,017	55,188	47,356	49,538	52,702
Cashflow From Operations	**443,810**	**216,831**	**183,468**	**193,180**	**202,080**
Capex	(99,527)	(138,148)	(160,000)	(130,000)	(100,000)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	(9,285)	(48,651)	2,481	2,481	2,481
Cash Flow From Investing	**(108,812)**	**(186,798)**	**(157,519)**	**(127,519)**	**(97,519)**
Debt Raised/(repaid)	(152,307)	54,281			
Proceeds From Issue Of Shares	3,257	14	11		
Shares Repurchased					
Dividends Paid	(30,201)	(62,926)	(62,926)	(62,926)	(62,926)
Preferred Dividends					
Other Financing Cashflow	(54,760)	(61,176)	(67,914)	(67,914)	(67,914)
Cash Flow From Financing	**(234,011)**	**(69,807)**	**(130,829)**	**(130,841)**	**(130,841)**
Total Cash Generated	100,987	(39,775)	(104,881)	(65,180)	(26,280)
Free Cashflow To Equity	**182,690**	**84,314**	**25,949**	**65,661**	**104,561**
Free Cashflow To Firm	**389,620**	**93,019**	**93,863**	**133,575**	**172,475**

SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS…cont'd

Balance Sheet

(Rs mn)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Total Cash And Equivalents	244,234	169,873	101,014	71,855	81,597
Total Debtors	122,464	82,572	87,527	92,778	98,345
Inventories	488,244	544,153	588,981	624,839	658,558
Total Other Current Assets	70,624	70,057	70,057	70,057	70,057
Total Current Assets	**925,566**	**866,655**	**847,577**	**859,529**	**908,556**
Fixed Assets	1,510,222	1,713,277	1,774,823	1,804,693	1,797,238
Total Investments	58,254	47,803	47,803	47,803	47,803
Intangible Assets	43,112	56,017	56,017	56,017	56,017
Total Other Non-Current Assets	317,302	196,466	196,466	196,466	196,466
Total Non-current Assets	**1,928,890**	**2,013,562**	**2,075,107**	**2,104,978**	**2,097,523**
Short-term Debt	251,008	276,356	276,356	276,356	276,356
Current Portion of Long-Term Debt					
Total Creditors	367,649	378,325	378,325	378,325	378,325
Other Current Liabilities	287,223	318,270	318,270	318,270	318,270
Total Current Liabilities	**905,880**	**972,951**	**972,951**	**972,951**	**972,951**
Total Long-term Debt	504,709	572,574	572,574	572,574	572,574
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	101,365	94,025	94,025	94,025	94,025
Total Non-current Liabilities	**606,074**	**666,599**	**666,599**	**666,599**	**666,599**
Total Provisions	171,518	188,915	188,915	188,915	188,915
Total Liabilities	**1,683,471**	**1,828,465**	**1,828,465**	**1,828,465**	**1,828,465**
Shareholders Equity	1,144,430	1,030,821	1,073,289	1,115,111	1,156,683
Minority Interests	26,554	20,931	20,931	20,931	20,931
Total Equity	**1,170,985**	**1,051,752**	**1,094,220**	**1,136,042**	**1,177,614**

Key Ratios

	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Revenue Growth	58.1%	0.4%	8.2%	6.1%	5.4%
Operating EBITDA Growth	108.2%	(49.1%)	(16.3%)	1.2%	3.7%
Operating EBITDA Margin	26.2%	13.3%	10.3%	9.8%	9.6%
Net Cash Per Share (Rs)	(41.88)	(55.61)	(61.24)	(63.63)	(62.83)
BVPS (Rs)	93.71	84.41	87.89	91.31	94.72
Gross Interest Cover	9.96	3.65	2.53	2.55	2.59
Effective Tax Rate	16.9%	55.7%	41.5%	42.8%	44.4%
Net Dividend Payout Ratio	7.3%	38.3%	36.5%	36.9%	37.0%
Accounts Receivables Days	16.30	15.38	11.79	11.78	11.84
Inventory Days	nm	nm	nm	nm	nm
Accounts Payables Days	nm	nm	nm	nm	nm
ROIC (%)	23.8%	5.0%	4.8%	4.6%	4.5%
ROCE (%)	29.1%	11.2%	8.3%	8.2%	8.2%
Return On Average Assets	17.7%	3.7%	3.7%	3.6%	3.5%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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