EPIC

Fundamental Report

TATA Steel Ltd.

Building base for tomorrow's castles

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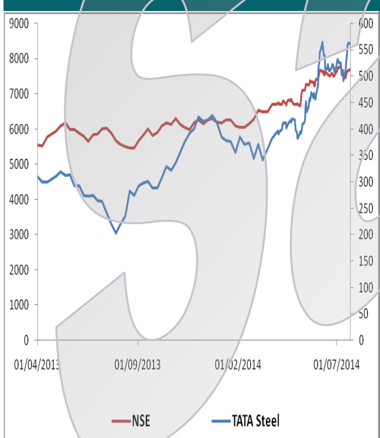
Stock Info

Sector	Iron & Steel
Bloomberg Code	TATA IN
Makt Cap (Rs Cr)	54,594
Debt (Rs Cr)	68,393
Cash (Rs Cr)	8,604
52 Week H/L	579/195
Face Value (Rs)	10
Promoter Stake(%)	31.4
DII Holding (%)	25.4
FII Holding (%)	18.4
Other Holding (%)	24.8

Stock Performance



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- **Capacity additions and rising demand to boost revenues**

Among the top ten global producers of crude steel, TATA steel's consolidated revenue for FY14 stood at Rs 148,614 Cr, up by 10.3 % YoY. Total deliveries for FY14 were 26.56 mt (+10.1% YoY), highest ever achieved by company. The increase in revenue was mainly due to brownfield expansion taken by Tata Steel India (TSI) at their Jamshedpur facility, to ramp up production capacity by 2.9 mtpa to 9.7 mtpa, which produced 8.93 mt, up 12.4% YoY in FY14. TSI delivered higher volumes with better operating efficiency and enhanced product mix. Revenues were supported by better volume of finished products from Tata Steel Europe (TSE) in FY14 to 13.86 mt up 6.1% YoY, which was supported by revamped blast furnace and improved economic reliability. Sales volume of Tata Steel South East Asia (SEA), also reported an increase of 28% YoY, at 3.98 mtpa in FY14, owing to operational improvements and cost reduction. Company's other divisions also reported their highest ever production volume. We believe that company's revenues would continue to grow mainly due to ongoing brownfield expansion and improving demand for steel.

- **European Earnings to make TATA Steel stronger**

TSE and other overseas subsidiaries (TSE&OS) have not been performing since the financial crisis hit them in CY2008. Lower demand and pricing pressures for steel products resulted in higher fixed costs, resulting in poor margins. However, there are signs of recovery and demand is picking up. We expect that Tata Steel's global operations will benefit from a cyclical upturn in demand, focus on reducing cost and restructuring of its costs structure. Company has already started optimizing its service centers and looking to efficiently utilize its resources

- **Govt. JVs and lifting of mining bans in Odisha to provide raw material security**

Dark clouds of illegal mining circled TSI over the last year. However, the issue has been resolved now and the Supreme Court of India has ordered the respective state governments to look into the matter and provide lease as per agreements. TSI can continue to extract iron ore for their Jamshedpur plant from four mines. The company is looking aggressively to expand its domestic operations and entered into several JVs with government undertakings, like MMTC and NMDC to explore other possibilities of land acquisition and mining, extraction setting up of steel plants in India.

- **Outlook**

We expect robust increase in the volume of steel production in foreseeable future, with a CAGR of 7.3% over the next couple of years. The spurt in revenue will be strongly supported by Europe region where the spread is expected to increase by \$20/Tn to \$190/Tn in FY15. We expect EBITDA/Tn to be Rs 6,373 in FY15. TATA Steel is factored to trade at EV/EBITDA of 7.53x

Financial Performance

Y/E March (Rs Cr)	FY12	FY13	FY14	FY15E	FY16E	FY17E
Revenue	134,473	134,712	148,614	159,749	173,085	186,997
YoY (%)	*12.6*	*0.2*	*10.3*	*7.5*	*8.3*	*8.0*
EBITDA	13,990	12,800	16,928	18,421	20,461	22,480
Margin %	*10.4*	*9.5*	*11.4*	*11.5*	*11.8*	*12.0*
PAT	5,390	(7,058)	3,595	4,271	5,523	6,670
Margin %	*4.0*	*(5.2)*	*2.4*	*2.7*	*3.2*	*3.6*
EPS (Rs)	53.6	(74.5)	35.2	42.1	55.0	66.8
ROE %	*12.6*	*(20.7)*	*8.9*	*10.2*	*12.4*	*14.0*
ROCE %	*9.5*	*7.6*	*10.3*	*11.2*	*12.6*	*14.2*
BVPS	439	352	417	433	458	491

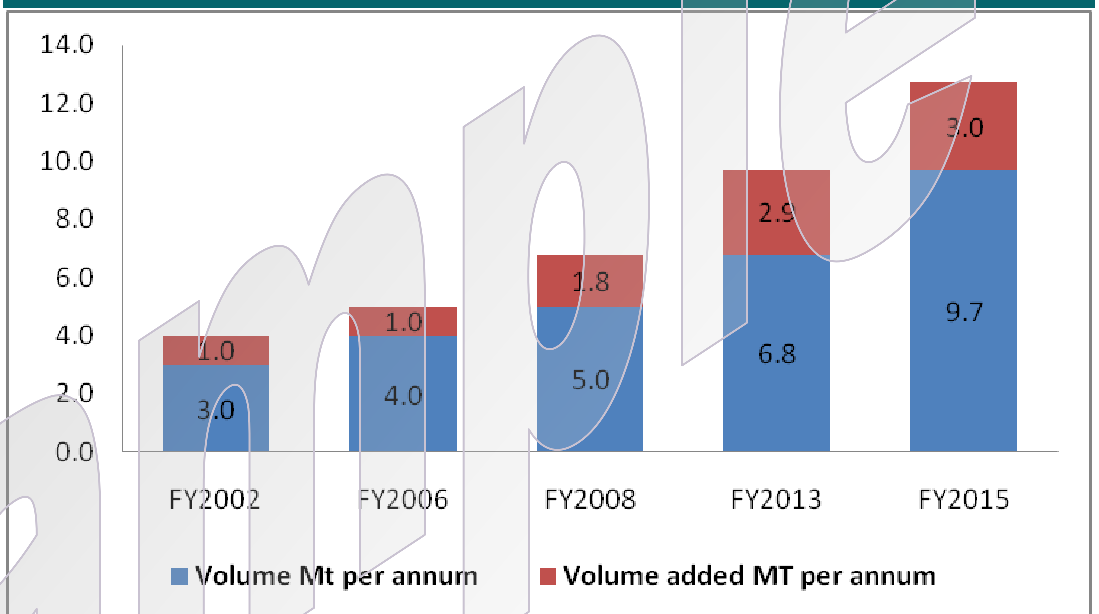
Source: Company, Epic Research

Capacity expansion and strong demand to drive revenues

Company plans to invest about Rs 40,000 Cr for planned capacity additions

TSI ramped up its capacity in second half of FY13 by 2.9 mtpa to 9.7 mtpa in its Jamshedpur plant. Company is focusing on expanding capacity by both greenfield and brownfield operations. While Jamshedpur facility was brownfield expansion, the company is also in process of setting up first phase of 6 mtpa greenfield project in Kalinganagar and ramping up it in FY15. The total financing of projects stands at around Rs 40,000 Cr. Major portion of revenue is generated from domestic sales of respective countries with very little exports. The company is also in joint venture with Nippon steel Ltd for production of Zinc-Aluminum coated coils. Apart from this the company is also set to increase its volume by introduction of new product mix in Europe and South East Asia.

Capacity Expansion at TATA Steel India



Source: Company, Epic Research

Company plans to increase its installed capacity by 60% in next three years

TATA Steel has been enhancing its capacity on a regular basis to meet the industry's demand. Company managed to produce 1 mt of excessive steel in FY14 and with commissioning of first phase of 6 mtpa Kalinganagar project at the end of 2015, TSI's total capacity will increase to 12.7 mtpa. Owing to strong demand, company expects to continuously increase its capacity to 16 mtpa by 2018.

Capacity Utilization Rate is one of the best in the industry

In addition, company has been making good use of its assets. The Capacity Utilization (CU) rate with which company operates is approx. 80%, which is considered good as per industry standards given the volume of production is high. TSI's capacity utilization rate increased from 83.2% in FY13 to 91.6% in FY14, mainly due to first full year of operation of its Jamshedpur plant, after the capacity addition. We expect that the company can easily increase its utilization rate in the coming years backed by timely technological advances and company's ongoing efforts to improve its efficiency.

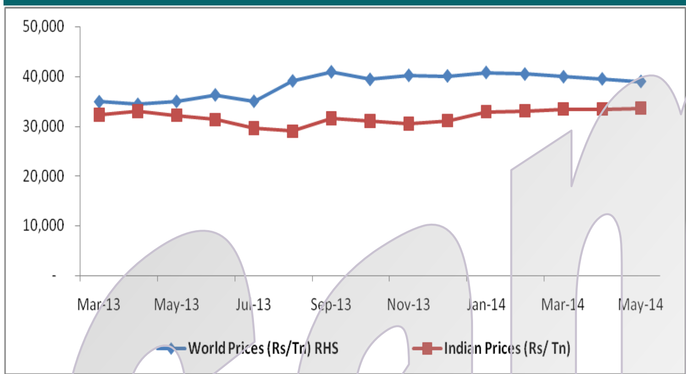
Global recovery and positive economic growth to steady its international business

Global demand to boost average realized prices

The price of steel mostly depends on the manufacturing power of country and its G.D.P. Global steel raw material prices largely control the steel prices. With the Chinese economy in turbulent times, big miners are deleveraging their balance sheet amidst slowdown in production. However the scenario has improved marginally with European economy back on track and showing promising future. The global crude steel prices have increased from $400/Tn to be at levels around $600/Tn and fluctuating with demands.

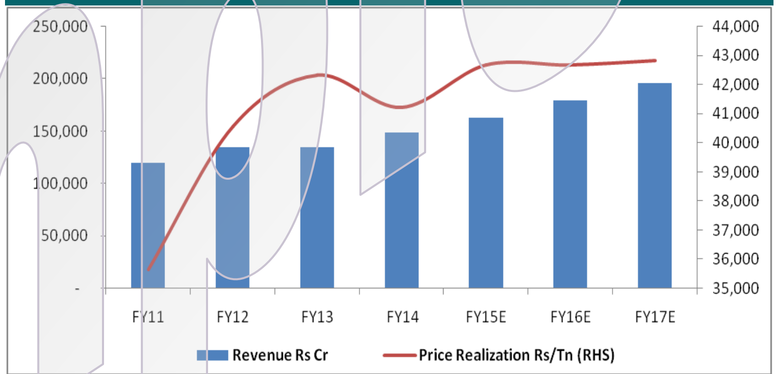
Indian Steel prices had been selling at a discount to world traded prices. This gives a huge opportunity for Indian markets to cater global needs and reduce the prevailing gap between prices. Many Indian Steel companies including TATA Steel rose their crude steel prices by Rs 500-1,000/Tn on the backdrop of poor performance by China and increased import duty earlier in FY13 along with freight price hike.

Indian and World Crude Steel Price



Source: World Steel Org, MEPS, UK

TSI—Average Price Realization



Source: Company, Epic Research

Demand for steel products is heavily linked to G.D.P growth and infrastructure sector growth in general. Indian operations will benefit from 1) Economic growth / positive G.D.P outlook; 2) Lowering of financing charges for the sector and 3) Key policy changes proposed by new government coming into foray. The government said it will remove hurdles impeding steel sector growth and help the domestic industry achieve 300 million tonnes (MT) annual production by 2025.

Revival in European operations a big positive

TSE and other overseas subsidiaries (TSE&OS) have not been performing since the financial crisis hit them in CY2008. Lower demand and pricing pressures for steel products resulted in higher fixed costs, resulting in poor margins. However, there are signs of recovery and demand is picking up. We expect that Tata Steel's global operations will benefit from a cyclical upturn in demand, focus on reducing cost and restructuring of its costs structure. Company has already started optimizing its service centers and looking to efficiently utilize its resources. We believe that above mentioned initiatives along with rising demand would help company in generating positive cash flows from FY16. However, we expect the margins from International operations, especially European operations to remain low, as they have high maintenance capex.

Govt. JVs and raw material security to reduce costs and help in better utilization rates

For the production of steel, Iron ore and Coking Coal forms the most important raw material. Tata steel operations provide them with continuous supply of raw material owing to their attractive mines. Raw material division of TATA Steel raises over 14 Mn Tn of ores from its captive collieries, iron ore mines and quarries.

JV to provide long term supply of Raw Materials

Apart from Indian operations, TSE is dependent mainly on imported iron ore from Canada and South Africa. With good consumption ratio of more than 0.60, company uses efficient arc furnaces and specialized pellet plants for better consumption. Tactonite Project of New Millennium Iron Corp, Canada, a JV in which Tata Steel owns 80% stakes, provides with iron ore washing facilities and is main supplier to the European Operations.

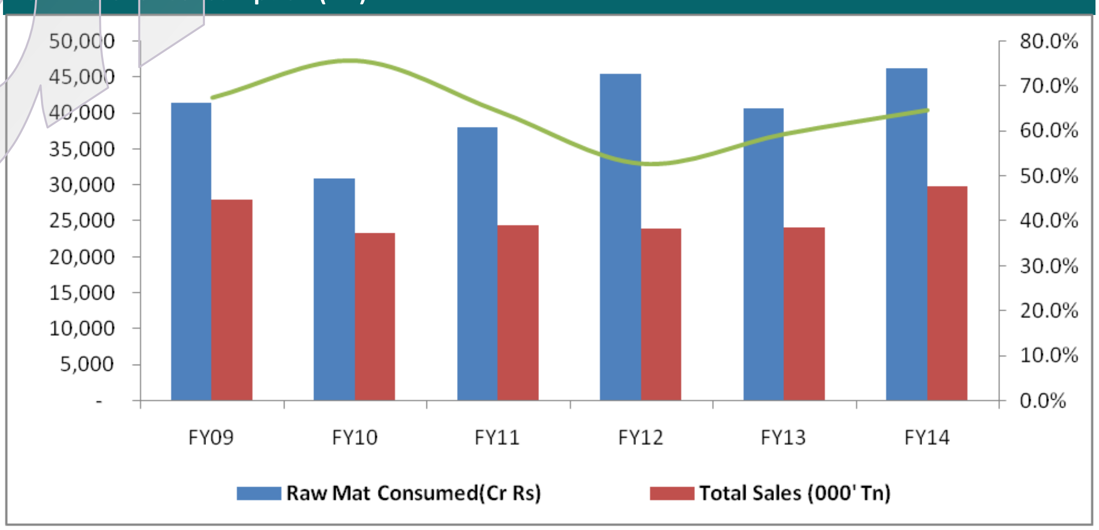
JV with Riversdale Mining ltd, Australia with 35% stake in two coal projects Benga and Tete, South Africa including 40% off-take rights of coking coal. Has 5% equity stake in Carborough Downs JV, Australia in partnership with Vale, Nippon, JFE and POSCO for the extraction of coal. Currently it is producing 1 Mtpa with further expansion plans along with agreement with Al Bahja group, Oman for mining of limestone in Uyun region.

Skepticism over mining ban lifted

Raw material security to help margins

TSI obtains 75% of its iron ore from mines located in Odisha, while remaining it acquires from Jharkhand. With the approval of mining lease in the state of Odisha by Supreme Court, Tata Steel continues to extract iron ore at its full capacity from 4 iron ore mines in Odisha. Moreover, the company is in talks with Government of India for increasing the mining capacity of iron ore to 9 mtpa from 7 mtpa which would tremendously increase the production capacity. Also the company has joint ventures with other mining companies across the world with good availability of raw materials for the operations.

Raw material Consumption (Mt)



Source: Company, Epic Research

COMPANY OVERVIEW

India's largest integrated steel company in private space

Established in 1907, Tata Steel Group is among the top ten global producers of crude steel in the world with a capacity of over 29 mtpa. It has its operations in 26 countries and commercial presence in almost 50 countries. It is the second most geographically diversified group in the world. With the acquisition of Corus group in 2007 Tata became one of the most reputed companies with diversified portfolio.

Indian Operations:

TSI, part of Tata group has its headquarters in Jamshedpur where it began its operations in 1907. The plant capacity has been rising ever since the establishment of first plant and as of now, the capacity stands at 9.7 mtpa crude steel production. The first unit of 6.0 mtpa capacity plant is set to start at the end of year FY15 which would increase its capacity tremendously to 12.7 Mtpa. Company's Indian operations were affected by ban on iron ore mines in Odisha, from which company sources majority of its iron ore supplies. Due to the ban, they had to import iron ore, which added to the cost pressures.

European Operations: Recovery on the cards

Steel demand in Europe has plummeted to less than 30% after the 2007-08 crises. FY13 was a challenging year for TSE, as the company faced rebuilding furnaces and damage problem. The company performed robustly in FY13-14 which helped them produce 2.2 Mt of crude steel more as compared to previous year mainly on account of increase in product portfolio. TSE comprise manufacturing hubs (Strip Products Mainland Europe, Strip Products UK, Long Products Europe and Downstream Operations) and Integrated Businesses (Plating, Cogent Power, specialty and Bar). TSE is still the biggest contributor in terms of revenue to Tata Group.

South East Asia: Growth back on track

NatSteel Singapore in South-East, was able to produce more than 900,000 Tn of crude steel due to better demand and with the implementation of high energy saving electric arc furnace. Total Group sales of NatSteel Singapore increased by 38% yoy to 2.5 mtpa. Tata Steel Thailand's statements were in green after 4 years which recorded profit along with increase in domestic sales by 10% YoY to 1.4 Mt.

TATA Steel Plant details

Country/Region	Region	Capacity (mtpa)
India	Jamshedpur	9.7
Europe	Glamorgan	4.9
Europe	Scunthorpe	4.5
Europe	Rotherham	1.2
Europe	Netherlands	7.2
Thailand	Bangkok	1.7
Natsteel Group	Singapore	3.6
	TOTAL	32.8

Integrated mines and long term raw material availability helps in controlling costs

TSI holds attractive raw material portfolio of iron ore mines and coal mines which largely caters the need of plant. The iron ore mines are largely located in the states of Odisha and Jharkhand while coal mines located in Jharkhand. Apart from coal and iron ore mines, company also has Ferro chrome, Dolomite and Pyroxenite Flux mines which aid in manufacturing of high quality steel hence making Tata steel self sufficient in the production.

TSI relies on JV's for proper supply of coal

Coal Mines	State	Reserves (Mt)	EC Approved (mtpa)
Jharia	Jharkhand	19,430	4.1
West Bokaro	Jharkhand	5,012	3.9

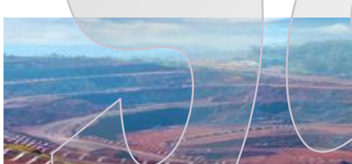
Source: Ministry of Mines, Company

Ferro Alloy and Charge chrome plants

Country	Location	Type	Plant capacity	Prod capacity (Tpa)
India	Joda, Odisha	Mn Alloys	1*15, 1*9MVA	52,000
India	Cuttack, Odisha	Mn & Cr Alloys	2*16.5 MVA	50,000
India	Bamnipal, Odisha	High C Fe-Cr	1*33.5 MVA	50,000
S.A	Richards Bay	Charge Chrome	1 x 38 MVA	130,000

Source: Ministry of Mines, Company

Coal Mines are mostly located in Jharkhand State which provides optimum quality of coal along with washing facilities. However, Tata Steel ltd is still dependent on JV for supply of coal to its facilities present around the globe. The impact of rupee depreciation caused the coking prices to increase but the poor demand of steel by the growing economies caused the prices to decrease.



Company also owns Dolomite and Pyroxenite flux mines which are mainly used in manufacture of steel; hence Tata Steel is self sufficient in various other minor minerals. Dolomite mines are located in Gomardhi, Odisha and has annual production capacity of 500,000 Mt while the Flux mines are located in Sukinda, Odisha having Magnesium Silicate Mineral type flux with annual production of 300,000 Mt.

Iron Ore Mines	Area	State	Reserves MT	EC Approved Capacity	Lease time	Lease Expiry	Lease Area (Ha)
Noamundi	Singhbhum West	Jharkhand	3,810.0	4 mtpa	20 Years	31/12/2021	1,160.0
Joda West	Keonjhar	Odisha	1,374.4	11.36 mtpa	20 Years	16/01/2023	1,437.7
Katamati	Keonjhar	Odisha	54.92	2.9 mtpa	20 Years	16/01/2022	403.2

Source: Ministry of Mines, Company

FINANCIAL PERFORMANCE

We expect revenues to remain strong on higher volumes and greater demand

TATA Steel group revenue in FY14 stood at Rs 148,614 Cr up 10.3% YoY from Rs 134,712 Cr in FY13 mainly backed by strong performance in TSI on improvement of sales volume and by TSE on account of improvement in steel demand on revival of European Economy, well augmented by growth in its TATA Steel SEA segment.

Strong sales and company's product-mix to boost revenues

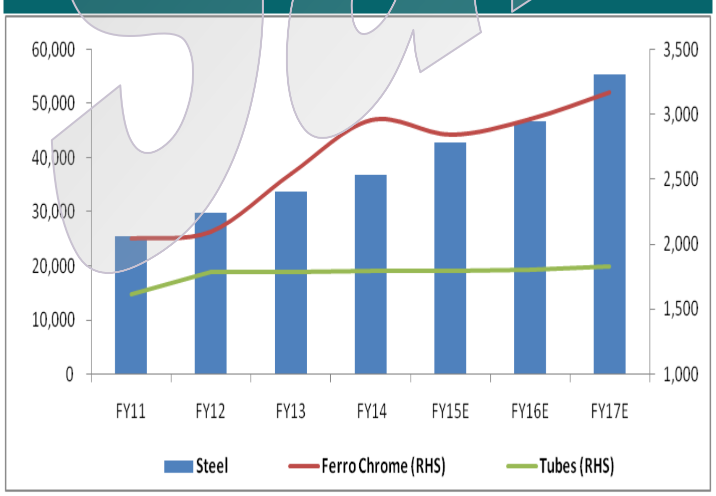
Company's TSE segment, (56.6% of group's revenues in FY14) reported Rs 84,666 Cr (+8.5% YoY) backed by an increase in sales volumes to 13.6 Mt (+6% YoY) in FY14, augmented by 2.2% YoY growth in the average price realizations. While the sales volumes were high mainly due to the production in revamped Blast Furnace at Port Talbot and Scunthorpe Plant, price realizations increased due to launching of 30 new products. Company also benefitted by improved demand for steel products due to improvement in macroeconomic conditions across Europe.

TSI segment (28.3% of group revenue in FY14) reported revenues of Rs 41,711 Cr (+9.1% YoY), mainly due to an increase of 13.9% in its sales volumes to 8.52 Mt in FY14. However, the revenues were mitigated by weak average price realizations, which were down 4.1% YoY to 43,208 Rs/Tn in FY 14. Sales volume improvement was due to full capacity utilization of Jamshedpur plant and an increase in demand for company's products.

SEA segment (11.5% revenue in FY14) were up by 23% YoY to Rs 16,988 Cr, mainly due to expense cost reduction by 20% and increase in sales of Thailand wire business by 33% along with increase in sales of rebar by 10%. SEA contributes 10% to the group revenue. Rest of World contribute 3.6% with revenue of Rs 5,284 Cr.

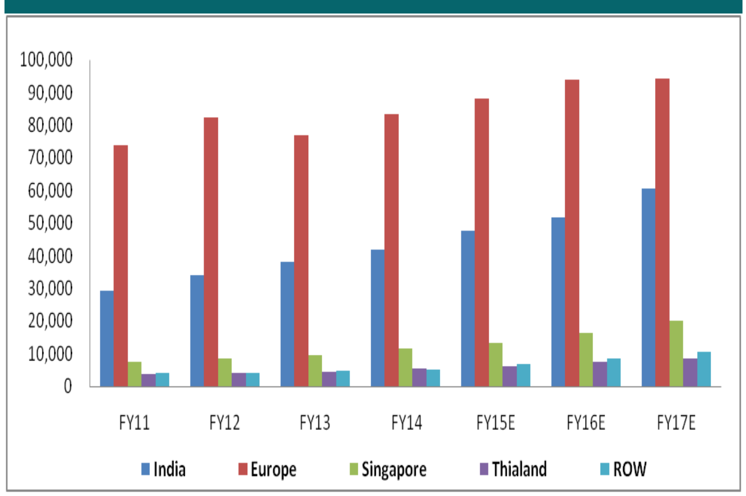
Going forward, we expect company revenues to grow backed by continuous capacity additions and rising demand for steel products, backed by positive economic growth outlook. We are bullish on the Indian steel demand as Govt. initiatives would propel growth, thereby increasing steel demand.

TSI Segmental Performance (Rs Cr)



Source: Company, Epic Research

TATA Steel Group performance (Rs Cr)



Source: Company, Epic Research

OPERATIONAL PERFORMANCE

Operational performance to improve

Group's EBITDA in FY14 was at Rs 16,928 Cr up 32.2% YoY in FY13, which was at Rs 12,800 Cr due to decrease in purchase of finished goods and decrease in changes of inventory and WIP. EBITDA margin was at 11.4% in FY14 up 190bps in FY13. Depreciation showed marginal increase of 4.8% to Rs 5,841 Cr. Company's EBIT was at Rs 11,087 Cr up 53.4% as compared to FY13 which was at Rs 7,225 Cr. Earnings before tax (EBT) for FY14 was at Rs 6,722 Cr, as compared to loss of Rs 4,133 in FY13 mainly due to exceptional charges of Rs 7,390 Cr in FY13 as compared to Rs 28 Cr in FY14. Company's PAT figures were in red and faced loss in FY13 of Rs 7,058 Cr (adjusted PAT Rs 332 Cr) mainly due to high impairment charges, the company posted robust performance in FY14, with PAT of Rs 3,595 Cr. Group EBITDA/Tn in FY14 was at Rs 6,373, up 17.6% YoY from FY13.

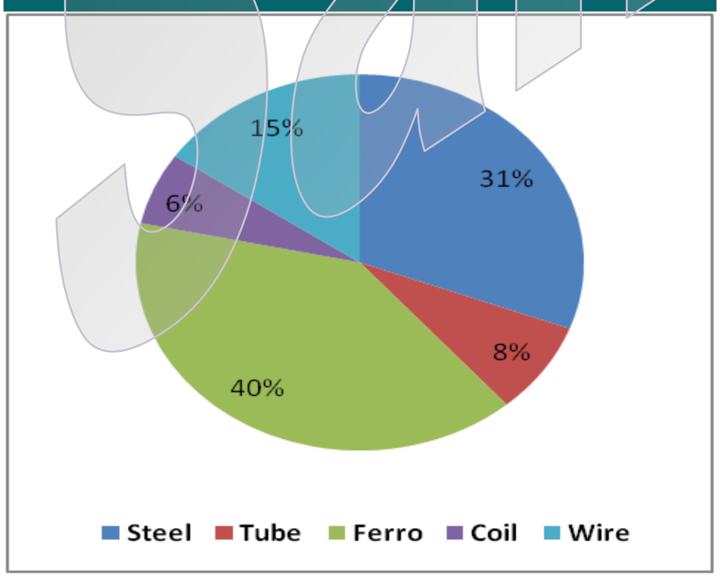
TSE's EBITDA in FY14 was at Rs 3,008 Cr up from Rs 764 Cr as the company completed major operational changes in Blast Furnace 4 located at Port Talbot, and reduced maintenance and operational cost with helped TSE to generate more EBITDA.

Asset restructuring in TSE to boost EBITDA from European operations

TSI's EBITDA in FY14 stood at Rs 13,281 Cr up 14% YoY from Rs 11,698 Cr on better utilization of raw materials, reduction in fuel consumption and improved logistic and other expenses with the implementation of efficient facilities. TATA Steel SEA's EBITDA declined by 9% in FY14 to Rs 439 Cr as compared to Rs 483 Cr in FY13 on account of increased prices of coal and iron and transportation cost.

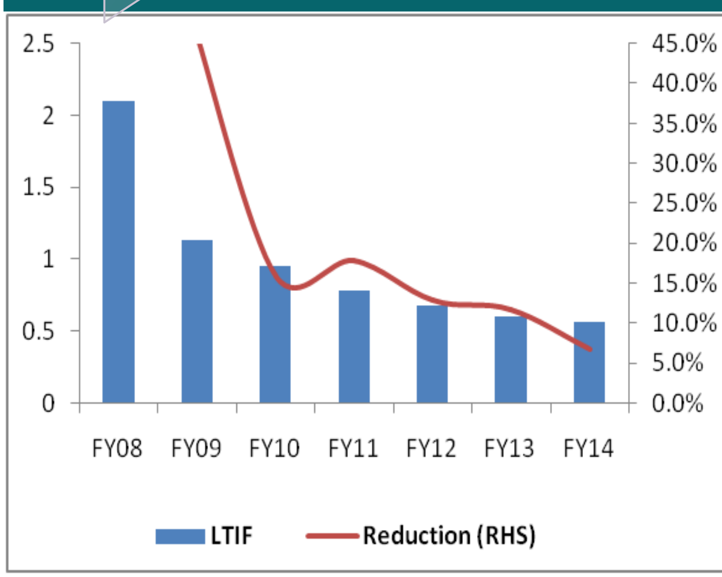
Company is taking efforts to reduce the lost time frequency and utilize its resources better by keeping a good check on its resources. Consumption of electricity for the production of one unit of product. The company has managed to save electricity by revamping European assets. In addition, company's Lost time frequency rate has been declining at a rapid pace, which shows the safety measures and quality control systems adopted are of the highest standards, hence employees can focus more on time consumption and production.

Electricity Consumption in Kwh/Unit Produced



Source: Company, Epic Research

Lost time Injury Frequency Rate



Source: Company, Epic Research

Robust Profit in Gloomy Environment

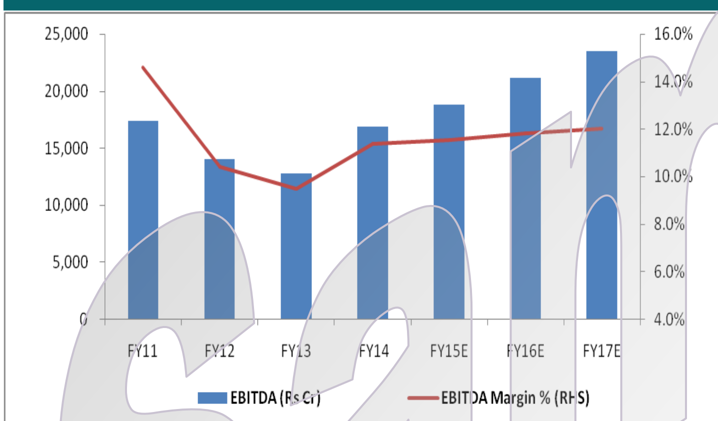
PAT in FY14 was Rs 3,595 Cr v/s loss of Rs 7,058 Cr in FY13 mainly due to impairment charges in European facility. Company performed extremely well in slowdown of economy while debt were high at Rs 68,393 Cr mainly due to capacity expansion of Kalinganagar plant.

Net Debt/EBITDA ratio to improve substantially

Company to retire debt from FY16

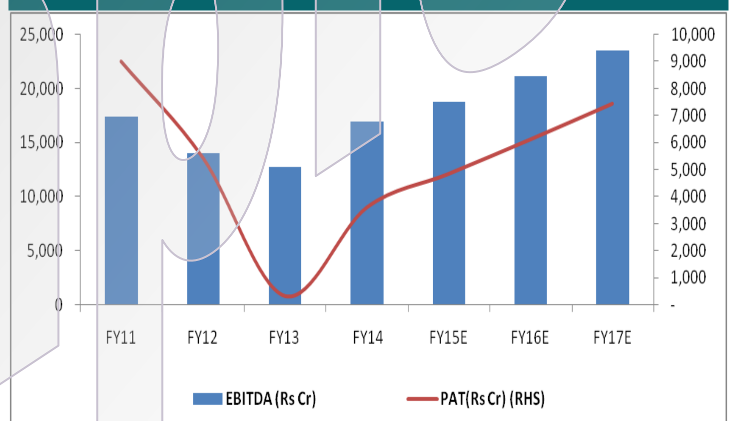
The company is still under huge debt of Rs 68,393 Cr which is a big concern for the company along with capex of Rs 16,500 Cr for FY14 and to remain same for FY15, as the company is undergoing exhaustive capacity expansion for Kalinganagar plant. However, the Debt level is to decline from FY16 onwards as the company would start its operation with increased capacity (12.7 mtpa) and increased profit will help ride off debt. We expect the Debt/Equity to improve to 1.58x in at the end of FY16. Net Debt/EBITDA ratio is likely to improve from 4.04x to 3.63x at the end of FY16.

EBITDA-Margin



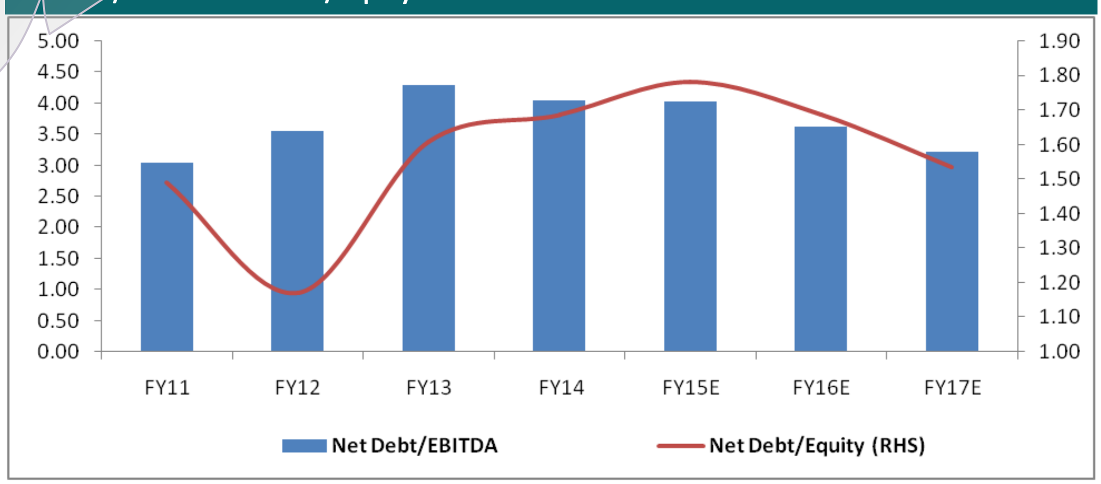
Source: Company, Epic Research

EBITDA-PAT



Source: Company, Epic Research

Net Debt/EBITDA– Net Debt/ Equity



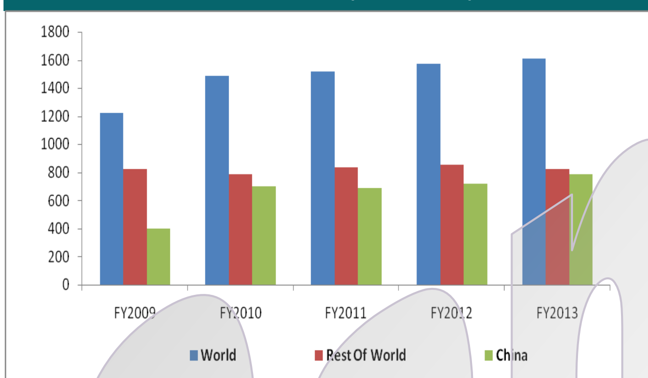
Source: Company, Epic Research

World Steel Industry

About 49% of the world crude steel is produced in China

As per the World Steel Organization, the total industrial production came out to be 1,607 Mt up 3.5% YoY, the slowest in the decade showing a global slowdown in the demand. The demand circled the Chinese industry and very much affected the prices globally. China continues to be the top producer of total steel production of 49% of total industrial output. Over the past one year, Chinese economy is going under a transformational change to get rid of the pollution caused by many factories as a result of which many steel manufacturing units were affected with zero production. This triggered a series of effects which led to poor steel demand and increased inventory, owing to dumping and poor quality. The firms are under heavy debt unable to pay with poor internal and external demands. World production increased with a CAGR of 3.3%.

World Crude Steel Production (Million Tn)



Source: World Steel org , Epic Research

Product - Mt	FY 07	FY 08	FY 09	FY 10	FY 11	FY 12	FY 13
China	494.9	500.3	573.6	626.7	683.3	724.7	779.0
Japan	120.2	118.7	87.5	109.6	107.6	107.2	110.6
U.S	98.1	91.4	58.2	80.6	86.2	88.6	87.0
India	53.5	57.8	62.8	68.3	72.2	77.3	81.2
E.U.	210.2	198.2	139.3	172.8	177.7	168.6	165.6
Russia	72.4	68.5	60.0	66.9	68.7	70.6	69.4
South Korea	51.5	53.6	48.6	58.5	68.5	69.3	66.0
Germany	48.6	45.8	32.7	43.8	44.3	42.7	42.6
Turkey	25.8	26.8	25.3	29.0	34.1	35.9	34.7

Source: World Steel org , Epic Research

Steel demand to pick up on the back of growing economies

Steel demand should continue to recover in CY 2014, with developed markets – including Europe – all seeing positive economic growth. As a general rule, economic growth fuels consumption of steel products, backed by growth in infrastructure segment. Although there is a slight oversupply situation prevailing in the world steel industry at the moment, we expect that this scenario is poised to change in short term, as the demand for steel picks up. Production remains in oversupply and capacity utilization rates are generally low, which means producers should be able to respond quickly to any increase in demand, which in turn is likely to cap steel prices. The main area of uncertainty lies with China and the emerging markets as we expect high stocks of steel, tight credit conditions and government clampdowns on surplus capacity in China, will go some way to restriction production growth and a slower economy in China is likely to impact its demand for exports from emerging markets.

Going forward, we believe that the industry would benefit from the rising demand coupled with better price realizations, as the raw material costs are at rock bottom prices and are likely to increase. Since most of the steel players have integrated raw material supply and long term contracts, it will help them improve the steel price margins.

World Iron Ore price recovery showing signs of revival

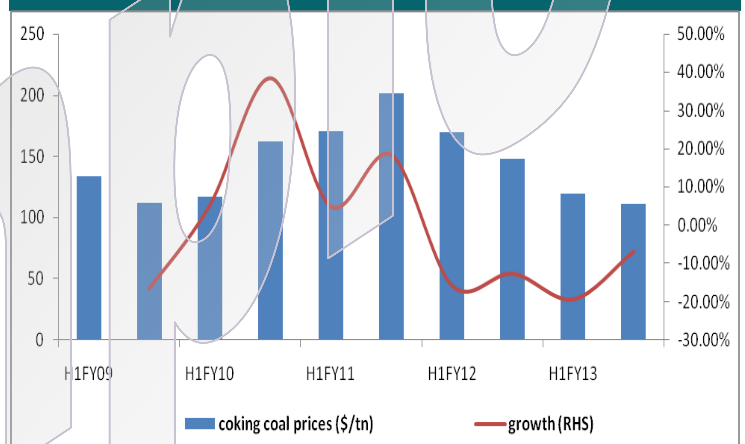
Iron ore price recovery on the cards

The demand of iron-ore is highly linked to the urbanization of the world economy and the performance of China and other developing nations. According to World Steel Association, the demand of steel industry is likely to increase by 3% in FY15. Weaker prices of Iron Ore in the International markets are sure to affect the Indian steel companies. The steep cut in the iron ore prices in the past two years has considerably affected the margins of steel manufacturers. With the sluggishness in the G.D.P data across the globe, there has been a mismatch between the demand and supply. However there had been a marginal recovery in iron-ore prices as the production of China increased in past 2 months. May 2014 witnessed iron ore prices falling to $100.56/Tn from $ 114.58/Tn in April 2014 coupled with appreciation of rupee favored steel companies for importing iron ore.

World Iron Ore Prices

Source: MEPS, UK

World Coking Coal Prices



Source: MEPS, UK

Coking Coal prices on back on track

According to Bureau of Resources and Energy Economics (BREE), spot coking coal prices have fallen by more than 20% to $107/ Tn in April 2014, lowest since January 2013. India imports more than 40 MT of coking coal per annum, and reduction in prices will be extremely beneficial for steel industry. However, in the past two months coal prices have taken an upturn with prices close to $100/Tn and still increasing at a marginal rate. Increase in coal prices will put pressure on many manufacturing units and pull the gross profit down.

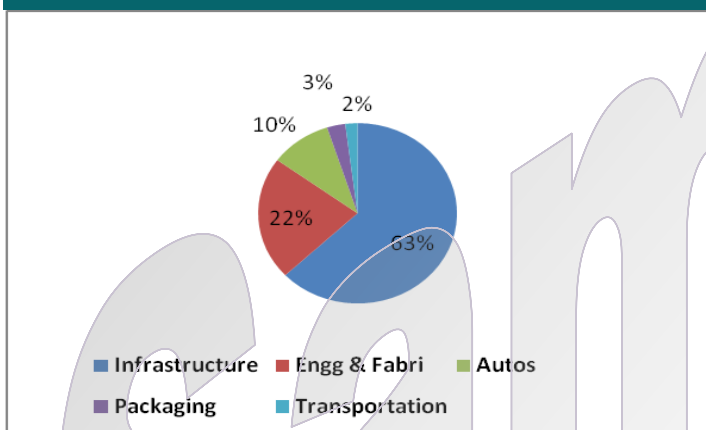
Going forward, we expect the revival in Iron and Coking coal prices, which would relieve the pressure from steel prices. As described above, most of the manufactures are integrated steel producers and have assured supply of iron ore and coal from captive mines. Hence, marginal increase in iron ore and coal costs would be beneficial to such players in the short term.

Indian Steel Sector

India's per capita steel consumption is just 57.2 kgs as compared to world average of 217 kgs.

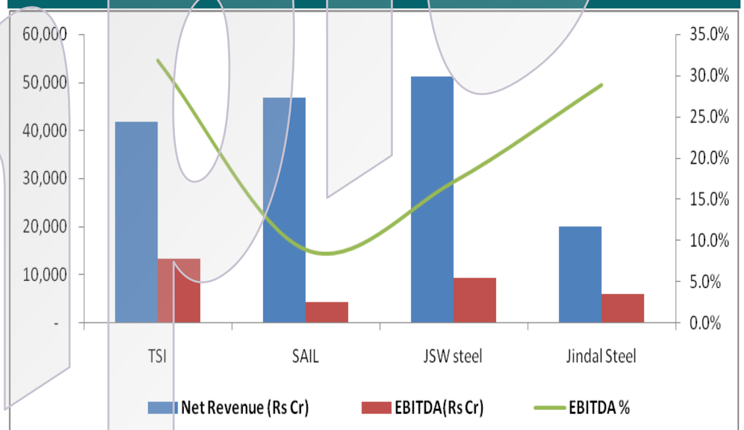
India's position in world's steel production remained unchanged at the fourth slot in 2013 with an output of 81.2 mt, the second highest growth of 5.1% among the top five producers. Despite the tremors felt by Indian economy in 2013, Steel sector came out strongly posing a robust growth. The steel industry is set to pose another year of tremendous growth owing to emerging economic markets. India's current per capita finished steel consumption at 57.2 kg is well below the world average of 217 kg. With rising income levels expected to make steel increasingly affordable, there is vast scope for increasing per capita consumption of steel. Indian economy is all set to revive at a G.D.P of 5.5-5.9% in FY15 and further improving and on the back of revival of sentiments seen in the recently held General Elections the Indian economy is poised for a robust growth in years to come. With approval of many lagging projects and introduction of new plans the growth is sure. With infrastructure development as the prime objective many new developmental projects will be started and Indian Steel Industry is bound to rise with CAGR of >7% in years to come.

Steel consuming sectors



Source: Indian Steel corporation

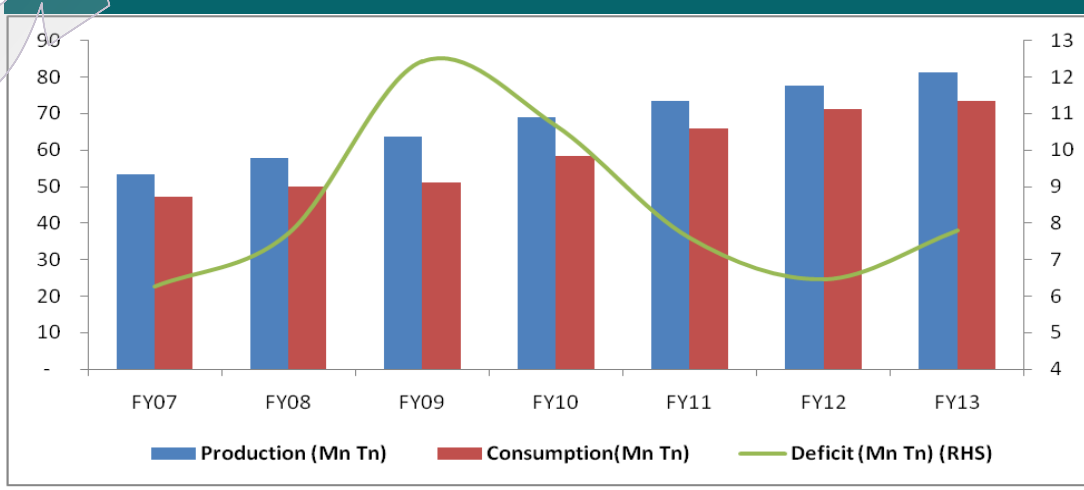
India's top steel manufactures



Source: Epic Research

Consumption catching up with the production

India's Crude Steel Production and Consumption



Source: World Steel org, Epic Research

VALUATIONS:

Company looks well positioned to take advantage of the growing steel demand

Driven by volume growth of 10.4% to 29 mn tonnes in FY15 and 32 mn tonnes in FY16 along with gradual recovery in global steel demand, which is expected to increase at a CAGR of 3.3% till FY16. Tata Steel plans to restructure assets in its European business and focus on core business would be crucial in sustaining the cost advantage. Company's debt is expected to remain high, due to ongoing capacity expansion projects, especially Kalinganagar plant. Although company is actively looking to offload its debt, but it will take another two years before any significant debt reduction can be seen.

Valuation Methodologies

We base our valuation on weighted average price, taking into consideration fair values from DCF Method, P/E Multiple and EV/EBITDA Multiples, as specified above. We assign a 70% weight to DCF methodology and 15% each to P/E multiple and EV/EBITDA multiple, as explained below.

Weighted Average Valuation

Methodologies	Weight Assigned	Target Price	Weighted Average price
Target price using DCF			
Target price using P/E			
Target price using EV/EBITDA approach			
Weighted average common stock price			
Current stock price			
Upside/(Downside) from current levels			

For the calculation of Target price using Discounted Cash Flow (DCF) method, we have considered WACC at 11.3%, and terminal growth rate at 3.6%.

Price by DCF Valuation	
Terminal cash flow	
Perpetual NOPLAT growth rate	
WACC	
Net equity value (Cr)	
No. of shares (Cr)	
Target Price (Rs)	
Current Price (Rs)	
Upside Potential	

PE Valuation

For P/E valuation, three year average Industry P/E came out to be 9.98. We believe there is a potential for company as it is undervalued compared to current industry average of 13.78x. Thus we believe that the company can easily achieve a P/E multiple of 14.47x**EV/EBITDA Valuation**

Price by P/E Valuation	
Average P/E	
Premium/Discount	
Price-to-Earnings multiple	
Estimated EPS (Rs)	
Price by Price-to-Earnings ratio	

Average EV/EBITDA for the industry stands at 8.76. Owing to company's strong operations, we arrive at a multiple of 7.53x.

Price by EV/EBITDA Valuation	
Average EV/EBITDA	
Premium/(Discount)	
EV/EBITDA Multiple	
Market Capitalization	
No of shares in Cr	
Target Price by EV/EBITDA multiple (Rs)	

Risks to our valuations:

Demand and Oversupply: We have based our global steel demand outlook on positive economic growth, which would fuel the demand for steel products worldwide. However, any slowdown in growth or economy not performing as per our expectations, would result in lower steel demand, negatively affecting company's revenues. In addition, there are oversupply concerns in the steel industry, which might result in price wars and company's revenues may fall short of our expectations.

Raw material Shortfall: Shortfall in coking coal and iron ore will affect its production worldwide. Though, company has many JV and long term contracts with many global exporters that ensure continuous supply of materials, any irregular supply due mining in JV companies or any other cause will affect its productivity.

Rupee depreciation: Rupee depreciation will cause raw material prices to increase and spreads to decrease which will affect the revenues sharply. With India going under tremendous policy changes, there is room for pressure on the rupee, hence volatility could affect earnings. Company covers the risk of price fluctuation with hedging contracts.

FINANCIAL SUMMARY (CONSOLIDATED)

INCOME STATEMENT

Y/E March (Rs Cr)	FY12	FY13	FY14	FY15E	FY16E	FY17E
Total Revenue	**134,473**	**134,712**	**148,614**	**159,749**	**173,085**	**186,997**
YoY growth %	*12.6%*	*0.2%*	*10.3%*	*7.5%*	*8.3%*	*8.0%*
Raw Material	45,458	40,643	46,243	49,868	53,338	59,122
Purchase of Finished Goods	21,073	18,474	17,008	19,081	21,540	22,710
Change in Inventory	(786)	1,419	(515)	246	370	493
Selling & other Expenses	55,596	61,854	69,466	72,689	77,978	82,843
Other Income	858	479	517	556	602	650
EBITDA	**13,990**	**12,800**	**16,928**	**18,421**	**20,461**	**22,480**
EBITDA Margin %	*10.4%*	*9.5%*	*11.4%*	*11.5%*	*11.8%*	*12.0%*
Depreciation	4,517	5,575	5,841	6,064	6,811	7,320
EBIT	**9,473**	**7,225**	**11,087**	**12,357**	**13,650**	**15,160**
Interest	4,250	3,968	4,337	4,965	4,680	4,364
Exceptional Items	3,362	(7,390)	(28)	0	0	0
EBT/PBT	8,585	(4,133)	6,722	7,392	8,970	10,795
Tax	3,636	3,229	3,058	3,141	3,766	4,479
Minority Interest and associate	441	305	(69)	20	320	354
Net Profit/ PAT	**5,390**	**(7,058)**	**3,595**	**4,271**	**5,523**	**6,670**
Net Profit Margin %	*4.0%*	*-5.2%*	*2.4%*	*2.7%*	*3.2%*	*3.6%*

BALANCE SHEET

Y/E March (Rs Cr)	FY12	FY13	FY14	FY15E	FY16E	FY17E
Shareholder's Funds	42,616	34,172	40,532	42,042	44,485	47,721
Long term Borrowings	56,753	60,455	66,989	68,572	64,087	59,399
Other Current liabilities	47,483	52,279	64,123	72,260	79,259	84,872
TOTAL- EQUITIES AND LIABILITIES	**146,852**	**146,906**	**171,644**	**182,874**	**187,831**	**191,991**
Tangible assets	62,128	69,213	85,981	93,852	98,562	99,836
Non Current Assets	**27,915**	**23,449**	**27,674**	**28,492**	**29,467**	**30,130**
Inventories	26,996	24,851	29,548	31,047	32,204	32,964
Trade receivables	14,878	13,994	16,006	16,767	17,693	18,603
Cash and bank Balances	10,799	9,860	8,605	8,537	4,942	5,025
Short-term loans and advances	3,717	4,061	3,193	3,752	4,411	4,766
Other current assets	417	1,479	638	427	552	667
Current Assets	**56,808**	**54,244**	**57,989**	**60,530**	**59,802**	**62,025**
TOTAL- ASSETS	**146,852**	**146,906**	**171,644**	**182,874**	**187,831**	**191,991**

CASH FLOW

Y/E March (Rs Cr)	FY12	FY13	FY14	FY15E	FY16E	FY17E
Profit/(Loss) before Tax	8,585	(4,133)	6,722	7,392	8,970	10,795
Adjustments	5,194	16,897	4,340	20	320	354
Working Capital changes	13,779	12,764	11,063	7,412	9,290	11,149
Other Operating Activity	1,072	3,129	(68)	15	(356)	348
Taxes (Paid)	(3,467)	(2,569)	(3,058)	(3,141)	(3,766)	(4,479)
Net Cash from Operating Activity	**11,385**	**13,324**	**7,936**	**4,286**	**5,167**	**7,018**
Tangible Assets	(12,078)	(15,472)	(9,632)	(7,373)	(4,286)	(929)
Purchase/(Sale) of Investment	2,193	987	(5,205)	(498)	(424)	(345)
Capital WIP	6,179	2,163	99	(1,166)	(1,759)	(1,132)
Net Cash from Investing Activity	**(3,705)**	**(12,321)**	**(14,666)**	**(9,037)**	**(6,470)**	**(2,406)**
Proceeds from Borrowings	(3,348)	2,777	13,488	7,515	1,284	(609)
Dividends (incl tax)	(1,350)	(1,359)	(1,003)	(1,003)	(1,003)	(1,003)
Other Financing Activities	(3,765)	(3,463)	(8,107)	(1,829)	(2,573)	(2,916)
Net Cash from Financing Activity	**(8,462)**	**(2,045)**	**4,378**	**4,683**	**(2,292)**	**(4,529)**
Net Change in Cash	**(783)**	**(1,042)**	**(2,352)**	**(68)**	**(3,595)**	**83**
Opening Cash Balance	10,805	10,799	9,860	8,605	8,537	4,942
Closing Cash Balance	10,799	9,860	8,605	8,537	4,942	5,025

FINANCIAL RATIOS

Y/E March (Rs Cr)	FY12	FY13	FY14	FY15E	FY16E	FY17E
EPS	53.61	(74.54)	35.19	42.15	55.04	66.84
Book Value per share	438.80	351.86	417.34	432.89	458.04	491.36
Valuations (x)						
P/E	9.10	(5.31)	9.19	11.95	13.15	14.46
P/BV	1.22	1.52	1.28	1.24	1.17	1.09
PROFITABILITY RATIOS						
RoCE (%)	9.53	7.64	10.31	11.17	12.57	14.15
ROE (%)	12.65	(20.65)	8.87	10.16	12.42	13.98
MARGIN RATIOS						
EBITDA margin (%)	10.40	9.50	11.39	11.53	11.82	12.02
EBIT margin (%)	7.04	5.36	7.46	7.74	7.89	8.11
PBT margin (%)	6.38	(3.07)	4.52	4.63	5.18	5.77
PAT margin (%)	4.01	(5.24)	2.42	2.67	3.19	3.57
TURNOVER RATIOS						
Payable turnover	3.20	2.78	2.74	2.81	2.92	3.04
Days payable	113.97	131.31	133.31	130.00	125.00	120.00
Receivables turnover	9.04	9.63	9.28	9.53	9.78	10.05
Days receivable	40.38	37.92	39.31	38.31	37.31	36.31
Inventory turnover	2.57	2.51	2.33	2.44	2.55	2.72
Days Inventory	142.11	145.26	156.39	149.70	143.27	134.32
SOLVENCY RATIOS						
Debt -EBITDA	3.57	4.29	4.04	4.12	3.76	3.38
Debt-Equity ratio	1.17	1.61	1.69	1.81	1.73	1.59
Interest Coverage ratio	2.23	1.82	2.56	2.49	2.92	3.47

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HOLD (10%) ≥ 0% ≤ 10%
SELL < (10%)

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