

Pick of the week



Tata Steel Ltd

Recommendation
BUY
Time Period
12 Months
Current Price
₹ 435
Target Price
₹ 560
Potential Upside
28.7%

Investment Argument

- Tata Steel's Q3FY20 adjusted consolidated EBITDA of Rs25 bn (-63% yoy, -32% qoq) excludes Rs10bn of FX gains and Rs1.5bn of reversal in wage cost. Standalone volumes at 3.43 mn tons were +15% yoy helped by higher exports (+183% yoy)- partially offset price pressure. Realization at Rs44,522/ton declined 11% qoq led by higher exports, reset of auto contracts and weaker domestic prices. Adjusted EBITDA at Rs9,650/ton was -37% yoy and -12% qoq lower realizations.
- In Q3FY20 Exports more than doubled yoy to 0.85 mn tons with the decline in domestic demand, forming 18% of the total volumes (7% in 3QFY19). Exports have increased by more than 50% in 9MFY20 on a yoy basis. Steel prices bottomed out in October 2019 and have since increased 12% in the past three months following international prices. The company maintained its guidance on volumes at 13.6 mn tons in FY20 due to ramp up of Bhushan steel and Usha Martin plants.
- Europe business: EBITDA/ton declined to US\$57/ton in 3QFY20 (2QFY20: US\$10/ton) led by sharp spread contraction with £75/ton qoq lower steel prices. Renegotiation of long-term contracts (30-35% of volume) from CY20 would be a headwind in coming quarters. However, partial recovery in steel spreads should help achieve EBITDA breakeven in 4QFY20E. Management expects cost reduction initiatives to start yielding results gradually over the next 3-4 quarters. KIE expects Europe to achieve cash breakeven in FY22E on a full year basis.
- The company guided that it shall prioritize commissioning of the CRM mill complex and 6 mtpa pellet plant for completion 2HFY21E and take up capex for KPO2 expansion post this completion after studying the market conditions at that time. KIE expects the company's domestic steel margins to recover by ~Rs3,000/ton qoq in 4QFY20E and forecast EBITDA/ton of Rs12,150/ton in FY21E versus Rs11,440/ton in FY20E.
- The company's net debt declined by Rs23 bn to Rs1,046 bn primarily through release of working capital through liquidation of high cost inventory during the quarter. The company has cash reserves of Rs52 bn. KIE expects Leverage ratios will improve with recovery in EBITDA aided by capacity ramp ups and increasing cost efficiencies. KIE has a fair value of Rs560, valuing India business at 6x and Europe business at 4x September FY21E EBITDA.