



GEOJIT BNP PARIBAS

Research Notes- Tata Steel -REDUCE (08 Oct 2014)

REDUCE Tata Steel Ltd - Target Price Rs375

- We downgrade Tata Steel to REDUCE from HOLD rating with a revised Target Price of Rs375 from previous TP Rs440. Currently the stock is trading at Rs456.
- Tata Steel is one of the largest steel companies in India. Currently, it has a production capacity of about 9.7m tonnes in India, about 17.8m tonnes in Europe and other small capacities in South East Asia.
- We have lowered our iron ore forecast to USD66/t for FY16E, which is about 18% lower than spot prices on rising supply, especially from Brazil and Australia, and weakening steel demand in China. We expect Tata Steel's India (TSI) operations to be adversely impacted, due to captive ore cost of just USD20/t, implying negative operating leverage from declining ore prices and subsequent decline in steel prices.
- Recovery in European steel demand is likely to benefit Tata Steel, which has a significant presence in Europe.
 - Eurofer is forecasting 3.3% y-y growth in European steel demand in 2014 followed by 3.1% steel demand growth in 2015 (2013 saw a decline of 1.9%). Our demand estimates are relatively more modest at 2.6% in 2014 and 2.3% in 2015.
 - Tata Steel Europe (TSE) margins are unlikely to expand sharply as over-capacity and import pressure from China should keep its pricing power very weak. Yet, we assume margins will expand from USD36/t in FY14 to USD63/t by FY17E.
- Tata Steel is scheduled to commission its Kalinganar 3mt steel capacity expansion by 1Q15, which should result in peak capex for India business and consolidation thereafter. However, we note that Kalinganagar plant will only produce basic-grade HRC, which will lead to overall ASP dilution due to deterioration in the product mix.
- We cut our earnings 20% for FY15E and 38% for FY16E.
 - While we estimate a USD27/t margin expansion for Tata Steel Europe (TSE), we expect a USD60/t margin squeeze for Tata Steel India (TSI) over FY14-17. We expect TSE to account for about 58% of shipments during the period, thus supporting q-q earnings from declining.
- We believe the stock lacks catalysts in the near term. A sustained turnaround in the European steel sector could act as a positive catalyst for the company. For the India business, stronger-than-expected demand recovery and imposition of higher import duties on steel could be key upside catalysts.
- We downgrade Tata Steel to REDUCE as the sector headwinds are stronger than the India demand story. We roll over our valuations to FY16E. This, along with earnings revision, reduces our Target Price to Rs375. We value Tata Steel India (TSI) on 6.0x EV/EBITDA and Tata Steel Europe (TSE) on 5.0x EV/EBITDA. The implied consolidated multiple is 5.7x EV/EBITDA, in line with the historical average. We value investments at Rs76/share.

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