

Metals

Sector coverage view Neutral

Company	Rating	Price, Rs	
		25-Jun	Target
Hindalco	OP	172	260
NALCO	IL	234	300
Tata Steel	IL	532	450
JSPL	OP	1,437	2,100
Sesa	OP	1,143	1,530

Creation of Arcelor Mittal a positive development for steel industry

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- **Mittal Steel-Arcelor merger a positive development for the steel industry**
- **Merger may act as catalyst for further consolidation**
- **Merger positive for steel pricing globally over the long-term**
- **Raw material companies will likely continue to retain their bargaining power despite the merger**

Mittal Steel and Arcelor, the world's largest two steel companies have decided to merge ending a five month bidding war to create the world's largest steel firm. The board of Arcelor, which met on June 25 has agreed to the merger between the two steel majors. The shareholders of Arcelor will vote on the same on June 30. The new company to be called 'Arcelor Mittal' will be the world's largest steel manufacturer with production in excess of 100 mn tons (approximately 10% of global steel production). In our view, the merger is positive for the steel industry in the long-term and could potentially be a catalyst for further consolidation among other players. We maintain IL on Tata Steel and OP on Jindal Steel & Power.

Mittal Steel-Arcelor merger a positive development for the steel industry

The steel industry has thus far been in a structurally unfavorable position. Its main suppliers (iron ore and coking coal industry) as well as its key end-customers (the automobile industry) are highly consolidated while the industry itself has been highly fragmented. This has historically led to the steel companies having low bargaining power with both its suppliers as well as its end-customers. We view the formation of 'Arcelor Mittal' as an important first step in correcting this imbalance. While control over 10% of global steel production will likely not be enough to take on the large raw material and automobile companies, we view the merger as an important and positive development for long term steel industry fundamentals.

Merger may act as catalyst for further consolidation

The merger between Mittal Steel and Arcelor could trigger further consolidation among global steel majors. The main Japanese steel companies may now contemplate mergers between themselves to avoid becoming potential takeover targets and also to maintain their current standing in negotiations with both the raw material and automobile companies. China's steel policy declared last year has also laid a strong emphasis on creating large domestic steel companies and reducing the fragmented nature of the industry there, as it exists currently. In our view, the next year or two could see further moves being made by global steel majors on the consolidation front.

Merger positive for steel pricing globally over the long-term

The creation of Arcelor Mittal has positive implications for steel pricing. The inability of the global steel industry to close down excess supply due periods of supply gluts has long been the bane of the industry and has causes periods of acute financial distress for the industry every few years. While control of 10% of global steel production will likely not be enough to avoid such periods going forward, we view the merger as an important first step towards stability in steel prices over the long term. The merger would however have positive implications on steel pricing in some key segments like auto sheets much sooner on account of the merged companies cross continental spread.

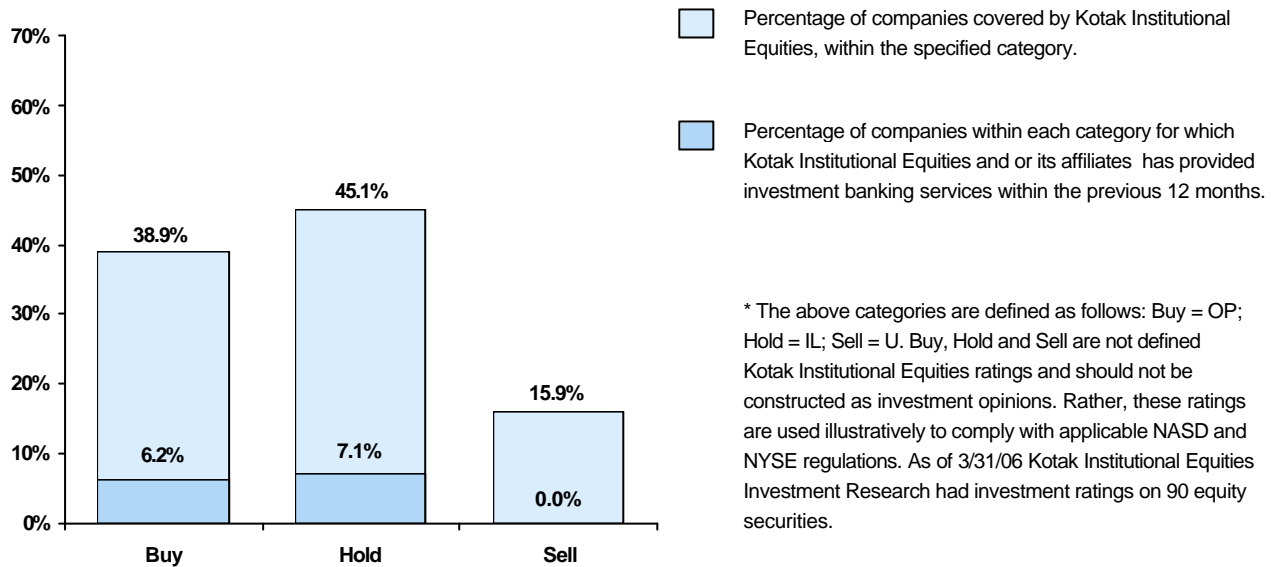
Raw material companies will likely continue to retain their bargaining power despite the merger

In our view, the merger will not be enough to give the steel industry the upper hand with respect to the raw material companies. The top three raw material companies control about 75% of global iron ore supply and their bargaining power will likely not be impacted by the creation of 'Arcelor Mittal', in our view. We maintain our positive view on iron ore.

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Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities.

As of March 31, 2006

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IL = In-Line. We expect this stock to perform in line with the BSE Sensex over the next 12 months.

U = Underperform. We expect this stock to underperform the BSE Sensex over the next 12 months.

Our target price are also on 12-month horizon basis.

Other definitions

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NM = Not Meaningful. The information is not meaningful and is therefore excluded.

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