

INITIATING COVERAGE
Share Data

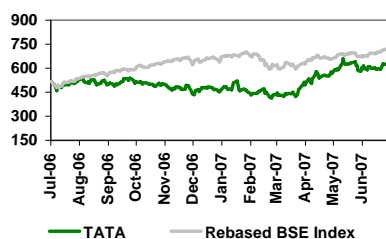
| | |
|-----------------------|----------------|
| Market Cap | Rs. 409.4 bn |
| Price | Rs. 672.25 |
| BSE Sensex | 15092.04 |
| Reuters | TISC.BO |
| Bloomberg | TATA IN |
| Avg. Volume (52 Week) | 1.4 mn |
| 52-Week High/Low | Rs. 691.05/399 |
| Shares Outstanding | 609.0 mn |

Valuation Ratios

| Year to 31 March | 2008E | 2009E |
|------------------|-------|-------|
| EPS (Rs.) | 96.7 | 106.1 |
| +/- (%) | 29.2% | 9.7% |
| PER (x) | 7.0x | 6.3x |
| EV/ Sales (x) | 0.6x | 0.6x |
| EV/ EBITDA (x) | 4.4x | 4.2x |

Shareholding Pattern (%)

| | |
|-----------------|----|
| Promoters | 31 |
| FII's | 17 |
| Institutions | 22 |
| Public & Others | 30 |

Relative Performance

Tata Steel Limited
Hold
Achieving global presence

Tata Iron and Steel Company Ltd (Tata Steel) became the sixth largest steel company in the world following its recent acquisition of Corus Group (plc) (Corus). The Company is currently dealing with the integration of its businesses and implementing the long-term financing for this acquisition which will involve equity issues of USD 2.4 bn (Rs. 101 bn) over the next few years. The acquisition has increased Tata Steel's leverage; the increased debt servicing burden could restrict the Company's future strategic plans for capacity expansion or further acquisitions should the business environment tighten. However, the outlook for steel prices is strong for the next 2-3 years, and in the long term the synergy benefits of this acquisition should materialize.

Key Figures

| Year to March | FY05 | FY06 | FY07 | FY08E | FY09E | CAGR (%) |
|---|---------------|---------------|---------------|---------------|---------------|--------------|
| (Figures in Rs. mn, except per share data) (FY07-09E) | | | | | | |
| Net Sales | 159,986 | 203,221 | 252,133 | 1,206,310 | 1,231,842 | 121.0% |
| EBITDA | 66,727 | 65,912 | 78,882 | 175,572 | 184,314 | 52.9% |
| Net Profit | 39,586 | 37,714 | 42,795 | 78,197 | 85,744 | 41.5% |
| Margins(%) | | | | | | |
| EBITDA | 41.2% | 32.0% | 30.8% | 14.5% | 14.9% | |
| NPM | 24.5% | 18.3% | 16.7% | 6.5% | 6.9% | |
| Per Share Data (Rs.) | | | | | | |
| Normalized EPS | 71.7 | 68.3 | 74.9 | 96.7 | 106.1 | 19.0% |
| PER (x) | 9.4x | 9.8x | 9.0x | 7.0x | 6.3x | |

- Acquiring Corus has significantly multiplied Tata Steel's revenues. However, Corus is currently a much lower margin business than pre-merger Tata Steel, so resulting in the reduction of Tata Steel's overall EBITDA margin.
- At the current price of Rs. 672.25, the stock is trading at a forward PE of 7x FY08E and 6.3x FY09E. The EPS figures for FY08E and FY09E build in an increased number of shares from the forthcoming 1:5 rights issue, 1:7 rights issue of convertible preference shares, and the USD 500 mn foreign issue of an equity related instrument.
- Though we initiate coverage on TISCO with a Hold due to the recent surge in its share price, any decline in the price from current levels would be a good buying opportunity. Our fair value estimate and 18 month price target of Rs. 760, based on a FY09E EV/EBITDA multiple of 5.5x, represents an upside of 13% from current levels.

Rationale

Corus acquisition - high price for low margin business

Tata Steel completed the acquisition of Corus for a transaction value of USD 13.75 bn on April 2, 2007. The final winning bid of 608 pence per share was 34% higher than the initial offer made on October 20, 2006. The enterprise value of the acquisition was around USD 13.75 bn (Rs. 595 bn), working out at USD 751/tonne based on Corus' actual crude steel production of 18.3 mn tonnes in CY06, and USD 649/tonne based on Corus' crude steel capacity. The deal looks expensive considering the low margins of Corus in the past 3 years when steel prices were rising. The acquisition is however a long term call on the structural dynamics of the industry with potential benefits on the longer-time horizon. These include restructuring at Corus, and progressing on low-cost intermediate products.

USD 13.75 bn acquisition of Corus

Tata Steel – Corus: The deal rationale

Through the acquisition of Corus, Tata Steel has increased its crude steel capacity to 27 mtpa. Together the merged entity forms the 6th largest Steel Company in the world. The combined entity has significant presence in both emerging and developed economies, so bringing Tata Steel to the world stage. The acquisition offers Tata Steel access to new markets and presence across the steel value chain, extending its customer reach and providing Tata Steel with a much expanded distribution network. The merged entity will be able to benefit from both high growth in emerging markets and pricing stability in developed markets.

Now the 6th largest steel company in the world

Corus to benefit from low-cost intermediate products from India

In the long term Tata Steel may be able to leverage low-cost intermediate products from India with further processing at Corus to produce high-end finished products such as galvanised steel. This will improve Corus' competitiveness in European markets, while Tata Steel benefits with high-value finished products developed in Corus' R&D facilities. The transfer of technology from Europe to India to develop new products will help to capture growth in India and Asia.

Tata Steel gains access to R&D

Costs savings will take time to ramp up

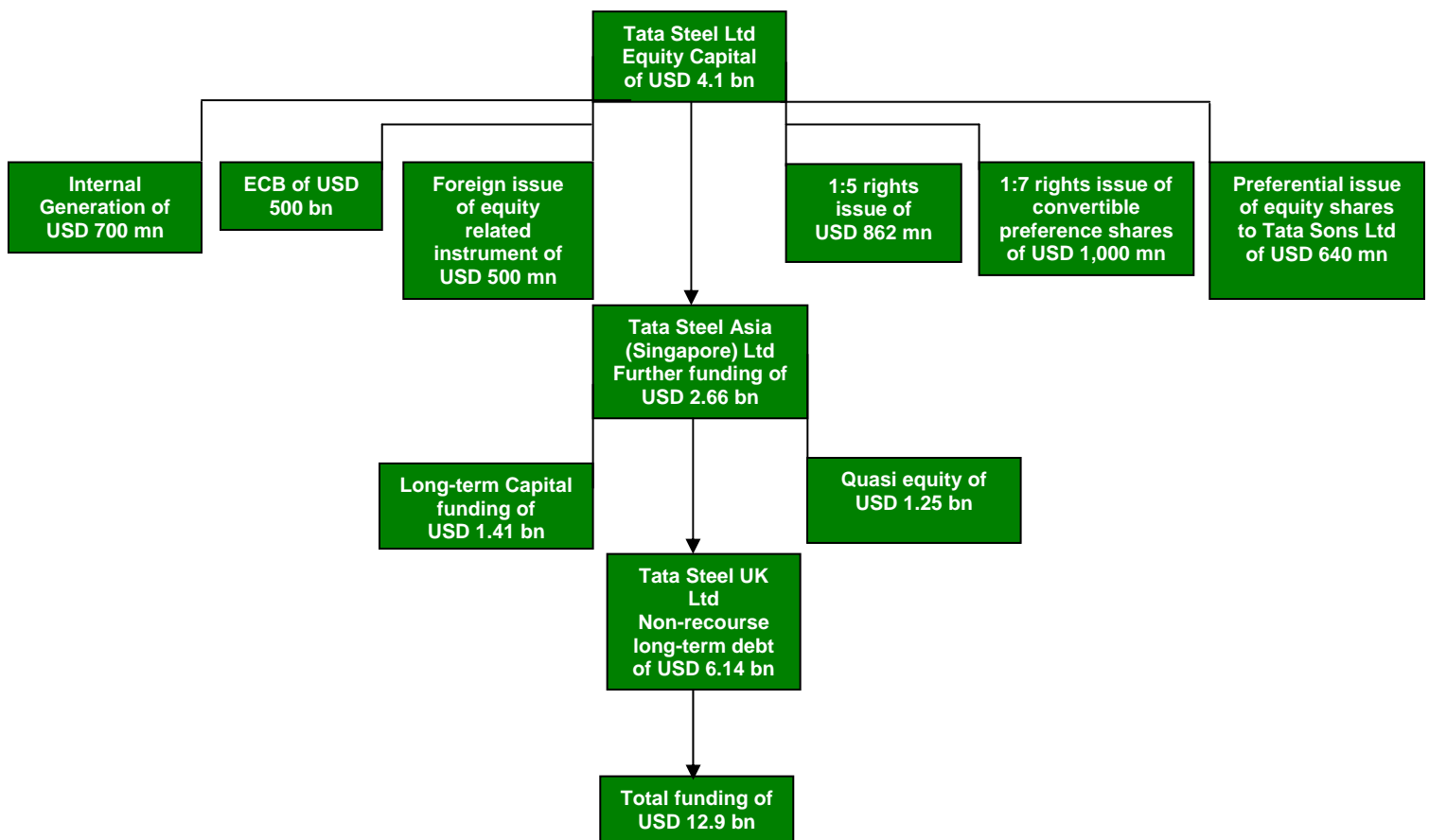
Annual savings of USD 300-350 mn are expected to accrue to the bottomline of the combined entity from FY10 due to synergies. In the next two years, however, savings are likely to be at much lower levels.

Long term financing includes USD 4.1 bn of equity capital from Tata Steel

Corus acquisition - Funding

Tata Steel is planning to fund the USD 12.9 bn acquisition of Corus through a mixture of debt and equity. The long term funding arrangement for the acquisition will be made up of equity capital from Tata Steel (USD 4.1 bn), quasi equity / long term funding (USD 2.66 bn) and non-recourse long-term debt at Corus (USD 6.14 bn).

Corus funding structure



Equity issues

Tata Steel is raising equity of USD 2.9 bn as a long term source of funds for the Corus acquisition. The USD 640 mn preferential issue of equity shares to Tata Sons Ltd was completed on April 17 2007, leaving the Company with 609 mn shares as of that date. The USD 862 mn rights issue will be at a price of Rs. 300 per share and we expect it to be complete by the end of FY08. We also expect the USD 500 mn foreign offering to be complete by the end of FY08, at an issue price of around Rs. 550 per share. The USD 1,000 mn rights issue of convertible preference shares has been quoted as a 2% cumulative convertible preference share, compulsorily convertible into ordinary shares between 18 to 30 months from the date of allotment. We expect an issue price of around Rs. 550 per share for the convertible preference shares.

Full issue of shares will not be complete until FY10 end

The increases in equity capital will come only in stages during the financial years FY08, FY09 and FY10.

Tata Steel – top line growth continues at a slower pace

Tata Steel has no new steel capacities scheduled for completion during FY08. The Company has given guidance for increased steel sales of 1 mn tonnes in FY08 over FY07, from its Indian and south-east Asian operations. With steel prices in Asia expected to remain firm during FY08, this will result in top line growth, though at a slower pace than that of the last 2 financial years.

Tata Steel increased utilisation in FY08 – prices firm

Improving Corus performance

Steel prices are expected to remain firm within the next 2-3 years. The outlook for European demand is positive, and Corus has announced a number of price increases during the first half of CY07 which will contribute to top line growth for the Company. Additionally, Corus has recently reported results that show growth in the Company's steel deliveries, suggesting that volumes for FY08 will be higher as the Company approaches an output closer to its rated capacity.

EU steel market buoyant

Higher capacity utilisation for Corus

Increasing raw materials prices – a concern for Corus

Increasing raw materials costs are a concern for Corus. China is continuing to increase steel production capacity and is importing large volumes of raw materials, driving up prices of iron ore, metallurgical coal and scrap.

Raw materials prices to continue to rise

Corus margins to improve

However, the overall steel price increases, as well as cost savings from merger synergies should see Corus post improved margins over the next 2 years as compared with the last 12 months.

Tata Steel (ex. Corus) is relatively protected from increases in the prices of raw materials since it meets 100% of its iron ore and around 70% of its coal requirements from its own captive mines. This is one factor contributing to maintaining Tata Steel as the world's lowest cost steel producer.

Achieving 50 mtpa of steel capacity

Tata Steel has a target of achieving 50 mtpa of steel capacity by 2015. A number of projects are under way to move towards meeting this target through organic growth.

The 1.8 mtpa Brownfield expansion of the steel works at Jamshedpur is expected to be complete in June 2008, so providing a boost to FY09 production and sales, and taking Tata Steels crude steel capacity from 5.0 mtpa to 6.8 mtpa. A further expansion of 2.8 mtpa at the same works is expected to be complete in 2010, taking the Company's crude steel capacity from its Indian operations to 9.7 mtpa.

Tata Steel Jamshedpur plant to reach capacity of 9.7 mtpa in 2010

These new capacities will demand an increased input of coke, and this will be sourced from Hooghly Met Coke and Power Ltd, a 98% owned subsidiary of Tata Steel. A coke making facility with a capacity of 1.6 mtpa is being set up at Haldia and is expected to be complete in March 2008. The project cost is estimated at Rs. 11.5 bn.

Tata Steel Thailand, a subsidiary of Tata Steel, is setting up a mini-blast furnace with a capacity of 0.5 mtpa. This project will be complete by October 2008, again providing increased production volume and sales in FY09.

Tata Steel has initiated steps to establish three green field steel plants with captive iron ore mines in Orissa, Chattisgarh and Jharkhand, which would add an additional capacity of 23 mtpa.

Potentially the world's second largest producer

Achieving 50 mtpa would make Tata Steel the world's second largest steel producing Company, assuming competitor's capacities remain unchanged.

Non-steel business also expanding

The Company is setting up a greenfield ferro chrome project in South Africa with a capacity of 134,500 tpa, through its subsidiary Tata Steel (KZN) (Pty) Ltd. The likely commissioning date is November 2007. South Africa has access to cheap power and chrome ore, making it an attractive destination for ferro chrome production.

Expanding the non-steel businesses

On March 8 the Company acquired a 100% stake in Rawmet Ferrous Industries Private Ltd in Orissa, adding 50,000 tpa of high carbon ferro chrome capacity. These initiatives will support top line growth.

De-integrated production strategy to maximise value

Tata Steel intends to link low cost steel production facilities with the most favourable steel consuming markets to maximise value across the value chain. Thus potential locations for primary steel making facilities are made on the basis of competitive factors of production. The Company has made steps in this direction with the acquisitions of NatSteel Asia Pte. Ltd and Tata Steel (Thailand) Public Co. Ltd. (formerly Millenium Steel) in 2005 and 2006 respectively. During FY07 this process was continued as NatSteel Asia (Singapore) Pte. Ltd acquired 100% equity stakes in NatSteel Trade International Pte. Ltd and Southern NatSteel (Xiamen) Ltd (both in China), and a majority stake in NatSteel Vina Co. Ltd in Vietnam.

The de-integrated expansion model continues as further acquisitions are made in China and south-east Asia

Branding – moving up the value chain

Tata Steel has a strong branded products business, and drives the de-commoditisation of steel through the innovation and introduction of new branded products such as Tata Steelium (cold rolled steel), Tata Shaktee (galvanised corrugated sheets), and Tata Tiscon (re-bars). The Company's turnover from branded products increased from Rs. 13 bn in FY03 to Rs. 46 bn in FY07. In order to enter new markets the Company has entered into a JV with BlueScope Steel to add to its Coated Steel and Business Solutions business. Building solutions facilities were set up in Pune, Bhiwadi and Chennai during FY07. A coated steel facility is under development at the Company's

Jamshedpur site and is expected to be complete in 2009. The JV Company will offer products such as ZINCALUME steel COLORBLIND steel, LYSAGHT roll formed steel products and BUTLER building systems.

Control over logistics

With the capacity expansions in the pipeline the Company's import/export cargo will increase significantly. To meet this future requirement and to reduce total logistics costs the Company has entered into two JV agreements: The Dhamra Port Company Ltd is a JV with Larsen and Toubro Ltd to develop a deep-sea water port in Orissa to handle cape size vessels. The project is scheduled for completion in early 2010.

Tata NYK Shipping Pte. Ltd is a JV with Nippon Yusen Kabushiki Kaisha to set up a shipping Company to cater to dry bulk and break bulk cargo requirements.

Future logistics considerations are being dealt with in advance

Key Risks

High leverage

The cost of the Corus acquisition is being financed by significant values of debt. This squeezes Tata Steel's bottom line, and should the business environment worsen the necessity to service this debt could constrain Tata Steel in future investment and capacity expansion plans as well as with respect to the Company's inorganic growth options.

High debt could constrain future expansion plans

GBP-EUR exchange rate fluctuations

Corus derives most of its revenue from Europe (including the UK). In 2006, 81% of the Group's total turnover derived from Europe. Steel prices in Europe, including the UK, are set in Euros, whereas the majority of Corus's costs in the UK are not affected by the GBP-EUR exchange rate. Therefore fluctuations in the GBP-EUR exchange rate impact heavily on Corus' UK earnings.

Corus would be impacted by depreciation in the Euro against the Pound

Cyclical nature of the steel industry

The steel industry is highly cyclical, sensitive to general economic conditions and dependent on the condition of several other industries, including the automotive, appliance, construction and energy industries. Should these

High exposure to cyclical nature in vertical industries

industries suffer a downturn, Tata Steel would be similarly affected, thus adversely affecting our rating.

China's exports a threat

Chinese steel supply has begun to outstrip consumption

China became a net exporter of steel for the first time in 2006 and its net export position may increase further. This would impact Tata Steel's end markets and may have a material adverse impact on revenues.

Volatility in raw materials prices

Corus enters into long term supply contracts with raw materials vendors. Thus there can be a significant time lag between changes in prices under purchase contracts and the time when Corus can implement a corresponding price change under its sales contracts with its customers. Furthermore, Corus may not be able to recover increased raw materials costs in higher selling prices at all. Such developments would impact our rating.

Steel production energy intensive

Rising energy costs

Steel production processes are energy intensive and price movements in the energy market would adversely affect Tata Steel's bottom line, impacting our rating.

Steel industry fragmented – prices unstable

Outlook

The steel industry is not consolidated despite recent mergers such as Baosteel and Bayi Steel Group, and Arcelor-Mittal. The top five players in the industry by steel output only command about 25% of global capacity. Therefore, despite the growth in its topline owing to the Corus acquisition, Tata Steel does not command pricing power: Consequently, the impact of increased Chinese steel exports poses a significant risk.

A further round of consolidation may bring price stability

If global consolidation gathers momentum, with perhaps the merger of Thyssenrupp and Nucor or Severstal with Gerdau, then the likelihood of resulting price stability may ease performance pressure on Corus.

Global steel demand growing

Global steel demand is expected to grow by 5.9% in 2007 and 6.1% in 2008, with Indian and Chinese steel demand growing at 10.2% and 13% respectively.

Within India, a rise in disposable incomes together with easy access to funds from banks has led to new housing projects and also growth in the automotive sector, boosting demand for steel. The per capita consumption of steel in India is low at 38 kg compared to 220 kg in China and 300-400 kg in developed countries, and is therefore expected to increase significantly from current levels as the country follows its development path.

Robust revenues – diversified geographical risk

With a firm steel market, announced price increases from Corus, and capacity expansions we see a strong FY08 for Tata Steel. Tata Steel now has a diversified global presence and is less exposed to a downturn in any one geographical region.

Target price represents an upside of 13% over the current price

Our valuation derives from applying a target EV/EBITDA ratio of 5.5x to our FY09E forecast EBITDA of Rs. 184.3 bn to arrive at target price of Rs. 760. This represents an upside of 13% over the current price and we therefore initiate coverage with a Hold rating.

Company Background

World's sixth largest steel company

Established in 1907, Tata Iron and Steel Company Ltd (Tata Steel) is now the sixth largest steel Company in the world, with a pro-forma crude steel production of 27 mn tones in FY07.

The acquisition of Corus, which was completed on April 2, 2007, catapulted the Company onto the global stage, and the combined entity has a diverse presence in both emerging and developed economies.

De-commoditising steel

Tata Steel's products include hot and cold rolled coils and sheets, galvanised sheets, tubes, wire rods, construction rebars, rings and bearings. The Company is driving to de-commoditise steel by introducing specific brands such as Tata Steelium (Cold Rolled Steel), Tata Shaktee (Galvanised

Corrugated Sheets), Tata Tiscon (re-bars), Tata Bearings, Tata Agrico (hand tools and implements), Tata Wiron (galvanised wire products), Tata Pipes (pipes for construction) and Tata Structura (a contemporary construction material).

Corus the ninth largest steel producer

Corus, now Tata Steel's subsidiary, was formed on October 6, 1999 through the merger of British Steel and Koninklijke Hoogovens. It is Europe's second largest and the ninth largest steel producer in the world, having a crude steel capacity of 21.2 mn tonnes in the UK and the Netherlands. It is comprised of four business divisions: Strip Products, Long Products, Distribution & Building Systems, and Aluminium. The Strip Products division produces hot rolled steel strip, cold rolled steel, tubes and pre-finished steels. The Long Products division produces plates, sections, wire rods, slabs and billets. The Distribution & Building division provides further material processing, building systems, tailored solutions and consultancy services to the steel industry.

Presence in south-east Asia

Tata Steel has established a presence in south-east Asia through its acquisitions of NatSteel Asia Pte. Ltd and Tata Steel (Thailand) Public Co. Ltd. (formerly Millenium Steel) in 2005 and 2006 respectively. Tata Steel has recently expanded its presence into Vietnam, entering into a memorandum of understanding with Vietnam Steel Corporation for proposed steel and mining projects in Vietnam.

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