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Event Update

Tata Steel

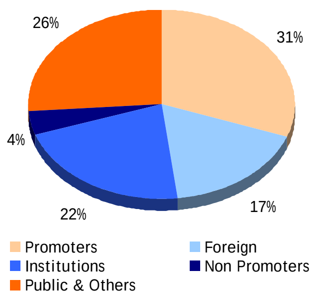
Market Performer | **Rs 529** | **April 18, 2007**

From lightweight to welterweight

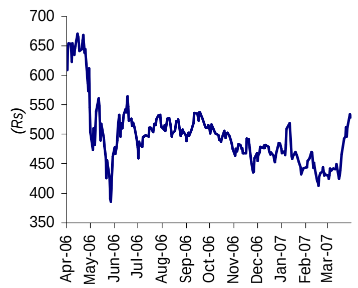
Company Details

Market Cap:	Rs 306,820m
52-Week High/Low:	Rs 679 / 377
Bloomberg Code:	TATA@IN
Reuters Code:	TISC.BO / NS
Shares O/s:	580m
Average Volume (3 months):	5.6m

Share-Holding Pattern



Price Chart



Price Performance

(%)	1m	3m	12m
Absolute	23.0	11.2	(10.3)
Relative to the Sensex	15.4	15.5	(25.4)

(Stock price as on April 17, 2007)

On 17th April Tata Steel announced its financing plan to acquire Corus. Key takeaways from the plan are:

- Issuing 56m equity shares on a preferential basis to promoters, thereby raising about Rs 28,889m.
- Issuing rights shares in the proportion of 1:5 (one rights share for five Tata Steel shares held). Rights share would be issued at Rs 300 each, thereby raising about Rs 38,160m. That implies a potential equity dilution of around 183.2m shares, about 32% of the present equity.
- Issuing convertible preference shares in the ratio of 1:7 at a 2% coupon rate (convertible after two years at Rs 500-600 each), raising about Rs 45,000m. So, a further equity dilution of 90m shares after two years.
- Raising about Rs 21,000m through overseas equity instruments. At an average price of Rs 550, an additional equity dilution of 38m shares.
- Raising Rs 21,700m by ECBs.
- Internal accruals to contribute about Rs 30,000m.
- The balance (about $8.1bn) would be raised through various syndicated loans and related instruments, terms and conditions and rates of which are not clear yet.

Key Figures

Y/e March	FY07E	FY08E	FY09E
Revenues *(Rs m)*	1,053,202	1,072,859	1,126,502
EBITDA *(Rs m)*	131,498	151,223	173,906
Margins (%)	*12.5*	*14.1*	*15.4*
PAT *(Rs m)*	62,644	75,859	91,057
EPS *(Rs)*	108.0	99.4	102.2
PER *(x)*	4.9	5.3	5.2
EV / E *(x)*	5.0	5.0	4.7
EV / Sales *(x)*	0.6	0.7	0.7
RoCE (%)	*18.8*	*23.1*	*24.2*
RoE (%)	*21.2*	*29.2*	*27.9*

Resources for funding Corus

Instrument	Issue Price *(Rs)*	Amount *(Rs m)*
Rights Issue (1:5)	300	36,660
Preferential Issue of 56m shares	516	28,889
Convertible Preference Shares (1:7)	500-600	45,000
Overseas Equity Instruments	500-600	21,000
ECBs	----	21,700
Total		**153,249**

Time favours Tata

The chief factor in making the Corus acquisition a success would be how to improve its profitability and margins. Since the time Tata Steel announced the acquisition, steel prices have risen substantially. This has helped in raising resources at competitive cost. For the next year at least, the steel cycle looks strong and prices are expected to remain firm. This would help Tata Steel, as Corus' financials are expected to improve substantially and add handsomely to the former's bottom line. In a nutshell, all the negativities of the deal would evaporate if steel prices stay firm and Corus' profitability substantially improves. In the current scenario this is most probable.

Will huge debt mar its own expansion plans in India?

Yes and No

Yes. If the steel cycle suddenly turns south and prices tumble, debt would turn burdensome -- and servicing it would be problematic. This could affect earnings. It could also put in jeopardy other expansion plans. Raising the requisite resources would be difficult since debt would be hard to come by and internal accruals would be insufficient to meet demand.

No. It appears that the company would be able to maintain the debt-equity ration at around 1.1:1. Raising funds in the form of equity is perhaps the better of the options. First, it is better in times of rising interest rates. Also, in a commodity business like this, debt should be looked at only after equity because of the cyclical factor and the perils of high gearing should the cycle turn downwards and earnings dwindle. Second, this allows for the possibility of raising debt for future expansion projects. Besides, one can always go in for additional debt when interest rates soften.

Corus, not Tata, is the captain

We believe that Corus, and not Tata Steel, is the captain. We know that Tata Steel's operations, profitability, etc. have stabilized; there is no concern on that front. So this whole consolidation and synergy benefits to Tata Steel's financials in a large way hinge on Corus' profitability and margin betterment, which, in turn, depend on the positive synergy between the two and sustained firm steel prices and demand.

A positive surprise in Corus' earnings would keep the Tata ship nicely afloat and may even transform it to an airship to fly to higher planes (depending on the scale of positive surprises in earnings). On the other hand, any negative surprise may sink the Tata ship.

Valuation and Recommendation

Consolidated Financials

Y/e March	FY07E	FY08E	FY09E
No. of Shares *(million)*	580	763	891
Consolidated Debt *(Rs m)*	350,000	350,000	350,000
Consolidated EBIDTA *(Rs m)*	131,498	151,223	173,906
EV *(Rs m)*	656,820	753,733	821,445
EV / EBIDTA *(x)*	5.0	5.0	4.7
PAT *(Rs m)*	62,644	75,859	91,057
EPS *(Rs)*	108.0	99.4	102.2

Conclusion

Tata Steel has done the very smart thing by staggering equity dilution over three years. As a result, the immediate impact on earnings would be minimal. TS would raise about Rs 153,249m through equity, for an immediate dilution of about 183.2m shares.

At the CMP of Rs 529, the stock trades at about 5x FY08E EBIDTA and at a P/E of 5.3x FY08E EPS. Based on expected robust demand, we expect steel prices to be firm for a year or so. This would provide Tata Steel with sufficient cash flow to tide over the huge debt. This would also offer it enough time to stabilize and synergize operations and help in overcoming initial glitches. Looking to the future, the stock seems to be undervalued; as such, it seems to have enough steam left to appreciate from present levels, provided steel prices stay firm and Corus starts contributing handsomely.

Overall, we feel that equity dilution is not as serious an issue as it is made out to be, since earnings accretion would take care of the higher equity. In a way it would be EPS neutral, though with a positive bias. **We upgrade the stock to Market Performer.**