Tata Steel Limited

C(h)orus getting stronger

BUY | **CMP: INR498** | **Target Price: INR551**

September 25, 2009 — Strictly confidential

Market Data

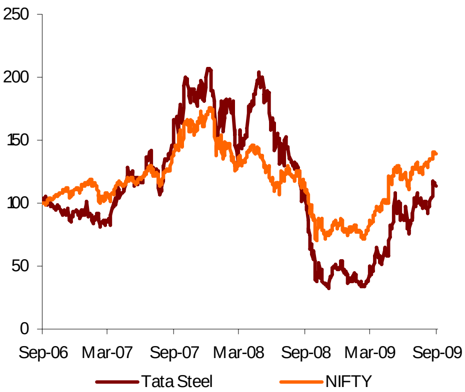
Sector :	Metals
Market Cap (INRbn) :	455
Market Cap (USDbn) :	9
O/S shares (m) :	887
Free Float (m)	646
52-wk HI/LO (INR) :	545/138
Avg Daily Vol ('000) :	17,421
Bloomberg :	TATA IN
Reuters :	TISC.BO

Price Performance

	1m	3m	6m	12m
Absolute	12	28	163	6
Relative	5	10	52	(15)

Shareholding Pattern

Price Performance Vs NIFTY



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Corus turnaround in 2HFY10

Utilization rates at Corus has picked up from 53% in 1QFY10 to >65% in 2Q driven by restocking demand. Improving economic conditions and seasonal factors will enable Corus to achieve ~80% utilization rates in 4QFY10. Increased fixed cost recovery due to improving utilization and beneficial impact of sliding raw material cost is expected to boost gross contribution by ~USD150/t from 3QFY10 onwards. Realisations in Europe have increased by USD60-70/t in the past few weeks and would positively impact EBIDTA in 3QFY10 onwards.

Its Teesside Cast Products (TCP) facility, though operating at low is breaking even at current slab prices. However, the viability of this facility is still questionable in current environment.

Expansion at domestic operations on track

Tata Steel India (TSI) 2.9mt expansion plan is on track to be commissioned in 2010, and would aid earnings expansion in coming years. Its EBITDA/t of USD258/t for 1QFY10, is expected to improve by USD20-25/t over the next two quarters, as benefits of low cost coking coal flow in. Performance will also be positively impacted from the ferro alloys division due to the sharp uptick in realisations.

Valuation

Strong cost savings initiatives and bouyant steel outlook in Europe should trigger gradual earnings improvement at Corus and should impact earnings positively from 3Q onwards. Efforts are on to generate USD75-100/t of EBITDA at Corus even in a depressed price regime. This, along with strong domestic earnings aided by increase in scale and upsurge in ferro alloys realisations make for a strong case for earnings expansion over the next two years. We thus have revised our target price to INR551 (from earlier INR501), and recommend a BUY.

Key financials

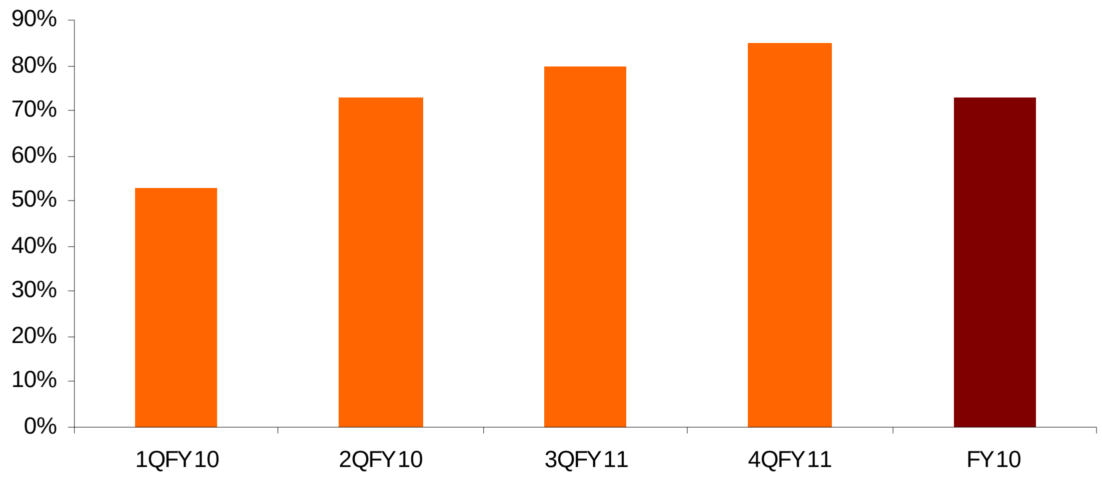
YE March (INRbn)	2008a	2009a	2010e	2011e	2012e
Revenues	1,315	1,471	886	1,050	1,273
EBITDA	172	173	135	161	197
EBITDA Margin (%)	13.1	11.8	15.2	15.3	15.5
EBITDA growth (%)	10	1	-22	19	22
PAT	60	81	21	53	77
EPS (INR)	79	61	25	63	90
P/E	6.0	7.7	20.4	8.2	5.7
P/BV	2.4	3.8	3.3	2.5	1.8
EV/EBITDA	6.9	5.4	7.0	5.8	4.7
RoE (%)	18	29	7	16	19

Source: Antique

Corus - Accelerating earnings improvement

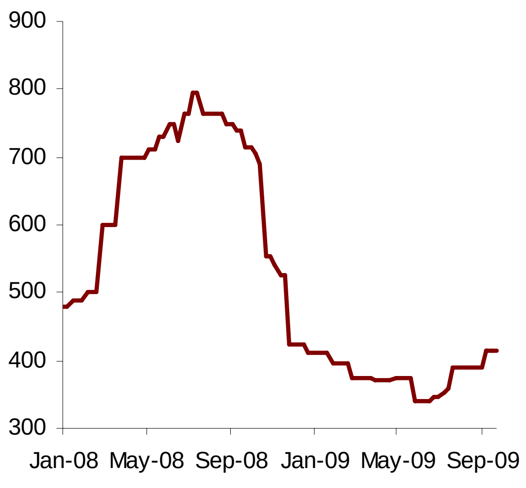
Host of cost savings and restructuring initiatives including fit for future program, potential mothballing of Teesside facility, and demand supply adjustment should yield significant operating benefits in the coming quarters. The demand is picking up in Europe as the restocking cycle sets in leading to higher utilization of installed capacity. This coupled with increasing prices and benefits of low raw material cost should ease earnings overhang at Corus in the coming quarters. We expect Corus to breakeven at EBITDA level in FY10 with meaningfull improvement in FY11 on the back of savings in fixed cost and complete alignment of input cost with realization prices.

Utilisation rates at Corus (%)

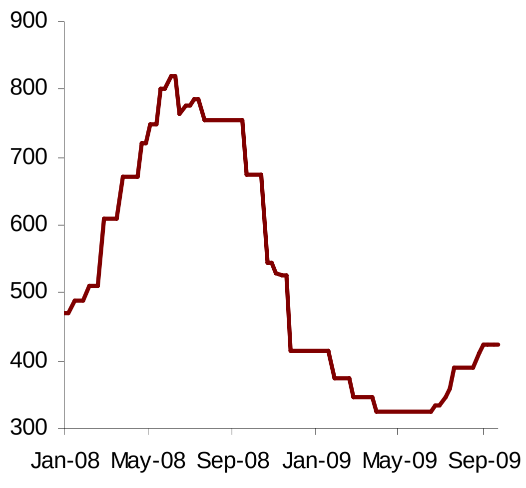


Source: Company

Europe domestic HRC (EUR/t)



Europe import HRC (EUR/t)



Source: Bloomberg

Potential mothballing of TCP

TCP has a steel making capacity of 3.5mt, which is at the risk of being mothballed due to high cost inefficient operations. Post cancellation of the off-take agreement, the utilization rates have been very low at TCP (35%), which is making it difficult to break even on a sustainable basis. Though mothballing of TCP facility is politically sensitive, the company is negotiating with various labor unions to arrive at a suitable solution. TCP is expected to produce 1mt in FY10, and at the current slab prices it is breaking even.

Major shift in staff cost

The fit for future program involves major restructuring in staff cost by laying off an estimated 6,000 workers by the end of FY10. Till date, the company has laid off 2,000 employees and is targeting to downsize another 4,000 man count in 2HFY10 (substantial number could come from potential mothballing of Teesside facility). This will involve a one time restructuring cost of GBP600m, which has a potential to generate a savings of GBP300-350m from FY11 on a sustainable basis.

Optimum capacity of 16mt at Corus

Corus has an installed steel making capacity of 21.5mt, and with potential mothballing of 3.5mt TCP facility it will be left with 18mt capacity. The company is targeting to achieve an optimum size of 16-17mt on a sustainable basis. This process to achieve the same is on and is expected to be in place by the end of this fiscal.

Backward integration for Corus

The company is making serious efforts towards setting up captive raw material sources for Corus. It targets to achieve 50% iron ore and coking coal integration for Corus by FY13-14. Towards that direction, it has picked up interest in coking coal mines in Mozambique and iron ore mines in Canada and South Africa.

Location	Mines	Volumes MT	Start	Peak
Mozambique	Coking coal	1.7	2012	2014
Canada	Iron ore	2-3	2012	2014
South Africa	Iron ore	2	2012	2014

Source: Company

Expansion at domestic operations on track

The 2.9mt brownfield expansion at Jamshedpur is on track, to be commissioned in FY11. We expect the full benefits of the expanded capacity to flow in FY12 onwards. The same should help expand earnings supported by high margins and stable domestic demand. Besides steel making facility, the company is also putting up a pallet plant and coke oven batteries with a total cost of INR130bn.

Equity dilution easing debt pressure

The Company raised USD500m of equity through GDR in the month of July which was partly utilized to reduce debt at Corus, which in effect reduced the net debt by USD247m QoQ. Average cost of borrowing at Corus is at 7.5% accruing from LIBOR linked rates. Its cash and cash equivalent (CCE) is at USD3.9bn including USD2.5bn in cash and 1.4bn of un-drawn credit lines. It has a repayment liability of approximately 600m in FY10 and USD1bn in FY11, with major repayment liability at Corus for payment due in FY13. Its net debt to equity stood at 1.6x in 1QFY10 and the company has indicated a potential for further equity dilution at a later stage.

Valuations

We value Tata Steel on one year forward earnings basis, assigning mid cycle earnings multiple. We are revising our target price to INR551 per share with improving earnings visibility of Corus and stabilizing economic environment in Euro region. There is a strong case of earnings expansion in FY12 as the full benefits of 2.9mt brownfield expansion starts flowing in. Backward integration for Corus is moving gradually should start contributing from FY12 before peaking out in FY14. The stock has already achieved out target price and we recommend a BUY at current levels with a revised target price of INR551 per share.

The key upside risk to our rating and price target shows a sustained rise in steel prices, while the key downside risk continues to show weakness in Europe.

Global Steel relative valuation

		Last	Mcap	PE		EV/EBITDA		DIV Yield	
Company	**Currency**	**Prices**	**$ bn**	**2010e**	**2011e**	**2010e**	**2011e**	**2010e**	**2011e**
SAIL	INR	173	14.8	13.6	10.3	7.4	5.4	1.5%	1.5%
TATA Steel	INR	513	9.4	20.7	8.3	7.7	6.3	2.6%	2.6%
Jindal Steel & Power	INR	609	11.8	17.6	14.8	12.2	10.6	0.1%	0.2%
JSW Steel	INR	841	3.3	14.8	12.7	7.4	5.8	0.9%	0.9%
Indian Average			**39.3**	**16.6**	**11.4**	**8.9**	**7.2**	**1.3%**	**1.3%**
A K Steel	USD	21	2.3	NA	18.4	27.8	5.9	0.9%	0.9%
Nucor	USD	48	15.1	NA	16.2	53.9	7.6	2.9%	2.9%
US Steel	USD	48	6.9	NA	32.5	-8.1	8.0	0.9%	0.4%
US Average			**24.2**	**NA**	**21.0**	**33.8**	**7.5**	**2.2%**	**2.0%**
Arcelor Mittal	USD	26	59.7	-	13.3	13.4	7.0	2.9%	3.4%
SSAB	SEK	113	5.1	-	17.2	144.2	9.0	2.0%	2.6%
Thyssen kruppr	EUR	24	18.0	-	20.8	24.2	5.2	2.4%	2.3%
Voestalpine	EUR	23	5.8	39.2	12.7	8.2	6.4	2.3%	2.7%
Salzgitter	EUR	69	6.1	-	15.1	19.5	3.9	0.9%	1.3%
Europe Average			**94.6**	**2.4**	**15.0**	**22.6**	**6.6**	**2.6%**	**3.0%**
Baosteel	CNY	7	16.8	22.9	14.1	7.9	6.0	1.9%	2.9%
Posco	KRW	487,000	35.5	15.4	13.9	8.2	6.7	1.9%	2.0%
JFE holdings	JPY	3,230	21.9	50.9	11.6	10.7	6.9	1.0%	1.9%
Nippon	JPY	341	25.6	-	14.0	13.4	7.6	0.7%	1.4%
China steel corp	TWD	30	12.1	44.8	13.4	21.1	9.1	2.3%	4.5%
Asia Average			**111.9**	**23.1**	**13.5**	**11.2**	**7.1**	**1.5%**	**2.2%**
Evraz	USD	28	12.1	-	15.6	13.5	7.0	0.0%	0.0%
Novolipetsk	USD	2	14.3	37.8	13.3	11.0	7.6	0.3%	3.7%
Severstal	USD	8	7.9	-	14.3	19.7	6.1	0.0%	1.5%
CIS Average			**34.3**	**15.7**	**14.4**	**13.9**	**7.1**	**0.1%**	**1.9%**
CSN	BRL	53	22.2	18.6	12.2	11.0	7.2	3.4%	2.6%
Gerdua	BRL	24	17.4	27.0	12.0	12.7	7.5	1.3%	1.7%
Usiminas	BRL	47	12.9	24.6	11.1	12.1	6.6	3.1%	2.7%
Latin America Average			**52.5**	**22.9**	**11.8**	**11.8**	**7.1**	**2.6%**	**2.3%**

Source: Bloomberg, Antique

Financials (INR m)

Profit and Loss Account

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
Revenues	1,315	1,471	886	1,050	1,273
Expenses	1,143	1,300	753	890	1,077
EBITDA	172	171	132	161	197
Depreciation & amortisation	41	43	46	49	51
EBIT	131	128	86	112	145
Interest expense	41	33	34	36	35
Other income	5	3	3	-	-
Profit before tax	164	67	54	76	111
Taxes incl deferred taxation	40	19	14	23	33
Profit after tax	123	50	22	54	78
Adjusted profit after tax	60	81	21	53	77
Recurring EPS (INR)	86	67	25	63	90

Balance Sheet

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
Share Capital	62	62	8	8	8
Reserves & Surplus	280	215	281	325	393
Networth	342	277	289	333	401
Debt	536	599	592	535	437
Capital Employed	878	876	881	868	839
Gross Fixed Assets	962	1,005	1,148	1,221	1,229
Accumulated Depreciation	632	631	725	775	829
Net Assets	331	375	423	445	401
Capital work in progress	88	130	47	24	26
Investments	34	64	44	44	44
Other non current assets	181	159	154	154	154
Current Assets, Loans & Advances					
Inventory	214	198	62	110	133
Debtors	187	130	219	129	157
Cash & Bank balance	42	61	43	72	36
Loans & advances and others	171	149	89	106	128
Current Liabilities & Provisions					
Creditors	264	231	93	110	133
Other liabilities & provisions	84	91	91	91	91
Net Current Assets	267	217	229	216	230
Deferred tax assets/(liabilities)	25	18	18	18	18
Misc.Expenses	2	1	1	1	1
Application of Funds	878	927	881	868	839

Per Share Data

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
No. of shares (m)	758	869	869	869	869
BVPS (INR)	213	136	155	206	284
CEPS (INR)	134	143	77	117	148
DPS (INR)	16	10	10	10	10

Margins (%)

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
EBITDA	13%	12%	15%	15%	15%
EBIT	10%	9%	10%	11%	11%
PAT	5%	6%	2%	5%	6%

Key Assumptions

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
Avg strip realisation -Corus ($/t)	-	1,041	775	791	850
Avg HRC realisation -Tata ($/t)	895	836	628	698	771
Iron ore landed - ($/t)	60	148	77	84	85
Iron ore Spot FOB - ($/t)	75	150	75	90	100
Coking coal contrcated FOB - ($/t)	95	300	130	175	175
Coking coal spot FOB - ($/t)	120	400	150	200	200
Coke - ($/t)	225	400	300	325	325
Scrap - ($/t)	200	350	250	275	275
USD~INR	42	45	47	46	46

Cash Flow Statement

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
EBIT	**131**	**128**	**86**	**112**	**145**
Depreciation & amortisation	41	43	46	49	51
Interest expense	45	38	34	36	35
(Inc)/Dec in working capital	(22)	2	(31)	42	(50)
Tax paid	(27)	(34)	(14)	(23)	(33)
CF from operating act	**134**	**156**	**94**	**154**	**118**
Capital expenditure	(487)	(85)	(60)	(50)	(10)
Inc/(Dec) in investments	20	(28)	-	-	-
CF from investing act	**(462)**	**(108)**	**(59)**	**(49)**	**(9)**
Inc/(Dec) in share capital	49	0	0	0	0
Inc/(Dec) in debt	170	21	(10)	(30)	(100)
Dividends paid	(9)	(12)	(10)	(10)	(10)
CF from financing act	**205**	**(28)**	**(54)**	**(76)**	**(145)**
Net cash flow	**(123)**	**21**	**(19)**	**29**	**(36)**
Opening balance	165	40	61	43	72
Closing balance	**42**	**61**	**43**	**72**	**36**

Growth Indicators

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
Revenue	422%	12%	-40%	19%	21%
EBITDA	143%	-1%	-23%	22%	22%
PAT	39%	36%	-74%	156%	45%
EPS	28%	-22%	-62%	149%	44%

Valuation (x)

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
PE	6.0	7.7	20.4	8.2	5.7
P/BV	2.4	3.8	3.3	2.5	1.8
EV/EBITDA	6.9	5.4	7.0	5.8	4.7
EV/Sales	0.70	0.63	1.05	0.88	0.73
Dividend Yield (%)	3.1%	1.9%	1.9%	1.9%	1.9%

Financial Ratios

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
RoE	18%	29%	7%	16%	19%
RoCE	15%	15%	10%	13%	17%
Debt/Equity (x)	1.6	2.2	2.0	1.6	1.1
EBIT/Interest (x)	3	4	3	3	4

Source: Antique

Equity Sales		
Mr. Anish Jhaveri	91-22-4031-3330	anish@antiquelimited.com
Mr. Dharmesh Dalal	91-22-4031-3331	dharmesh@antiquelimited.com
Mr. Manish Shah	91-22-4031-3332	manish@antiquelimited.com
Mr. Shiv Diwan	91-22-4031-3346	shiv.diwan@antiquelimited.com
Mr. Viraaj Teckchandani	91-22-4031-3327	viraaj@antiquelimited.com
Mr. Pradip Seth	91-22-4031-3393	pradip.seth@antiquelimited.com
Mr. Chaitanya Kotadia	91-22-4031-3336	chaitanya@antiquelimited.com
Mr. Anuj Sonpal	91-22-4031-3326	anuj@antiquelimited.com
Derivative Sales		
Mr. Ashish Maheshwari	91-22-4031-3350	ashish.maheshwari@antiquelimited.com
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