

Nat Resources & Energy
Metals & Mining
 Equity – India

Overweight

Target price (INR)	710.00
Share price (INR)	468.55
Potential return (%)	53.0

Performance	1M	3M	12M
Absolute (%)	-18.3	-19.5	-12.9
Relative ^A (%)	-10.3	-10.2	-4.9

Index^A BOMBAY SE IDX

RIC TISC.BO
 Bloomberg TATA IN

Market cap (USDm) 9,798
 Market cap (INRm) 449,440

Enterprise value (INRm) 862,010
 Free float (%) 100

1 September 2011

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Tata Steel Ltd (TATA IN)

OW: Overcoming the chaos

- ▶ **Reverse valuations suggests that markets imply a negative value for Tata Steel Europe (TSE) assets**
- ▶ **We take note of deterioration in global macroeconomic conditions; but do not see immediate risk to our estimates**
- ▶ **Pension fears, liquidity issues not yet concerning; retain OW with TP of INR710**

Markets valuing TSE assets at a negative number—worst-case should be ‘zero’

Current valuations of TATA imply that markets are valuing TSE at a negative value of cUSD1bn (excluding debt) and building in cUSD0.5bn of losses at the EBITDA stage for the next 12-months (see Exhibit 6). We find this irrational, given that the assets should in a worst-case scenario have ‘zero’ value – unless companies have no option but to run assets in losses forever (not the case with TSE, in our opinion). Our analysis leads to following:

- ▶ The market’s willingness to ascribe scrap value to TSE implies c32% upside (Ex 5)
- ▶ Comparison to 2008-09 lows misses the restructuring that happened in the last three years (work force down 16%, Loss making Teeside Cast Product (TCP) facility sold, new measures initiated)
- ▶ If EBITDA/t fell in India to USD325/t and TSE to USD20/t (1QFY12 at USD440 and USD78 respectively), our FY2013e EBITDA has risks of c13% (Ex: 3)
- ▶ Since 2003, TATA has traded only below forward book 12 times (Global Financial Crisis (GFC) period avg trading at 1.05x 12m fwd P/B) and now trades at 1.1x 1QFY12 book (and 0.9x 12m fwd book; see Exhibit 1a)

Macroeconomic environment deteriorated, but situation for TATA better than GFC

We take onboard the heightened risk that macroeconomic climate may deteriorate further; however, we note that our EBITDA estimates for FY12e are 26% lower y-y for TSE and only c6% higher for the India business.

In addition, we note that TSE made its worst-EBITDA loss of USD117/t in 1QFY10, but still ended the year with an EBITDA loss of just USD17/t. Since then however, TATA’s fixed costs are significantly lower (work force lower by 16%, TCP business sold and other measures initiated), which should imply that annual losses (if at all) for TSE should be much more contained than those witnessed during the last GFC.

Retain OW rating and TP of INR710

We find that fears of pension provisions and liquidity drying out are not concerning at this juncture (see Exhibits 7 to 9). We retain our OW rating and TP of INR710.

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Singapore • 26-27 September 2011



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26-27 September 2011
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- Energy
- Agriculture

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A list of presenting companies is on next page.

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List of Confirmed Companies (as of August 15)

Metals & Mining

Ampella Mining Limited (AMX AU)
Anglo American Plc (AAL LN)
Anglogold Ashanti Ltd. (ANG SJ)
Aspire Mining Ltd. (AKM AU)
Centerra Gold Inc. (CG CN)
China Coal Energy Company Limited (1898 HK)
China Zhongwang Hldgs. Ltd. (1333 HK)
CST Mining Group Limited (985 HK)
Fushan International Energy Group Ltd. (639 HK)
Gold Fields (GFI US)
Goldcorp Inc. (GG US)
G-Resources Group Limited (1051 HK)
Hunnu Coal Limited (HUN AU)
Iluka Resources Limited (ILU AU)
Industries Qatar Q.S.C. (IQCD QD)
IRC Limited (1029 HK)
Ivanhoe Mines Ltd. (IVN CN)
Lonmin Plc (LMI LN)

Metals & Mining (Cont')

Medusa Mining Limited (MML AU)
Mongolia Energy Corporation Limited (276 HK)
Nanjing Iron & Steel (600282 CH)
Newmont Mining Corporation (NEM US)
Nyrstar (NYR BB)
Petrodavlovsk PLC ***Newly Confirmed**
PT Adaro Energy Tbk (ADRO IJ)
PT Aneka Tambang Tbk (ANTM IJ)
PT Delta Dunia Petroindo Tbk
Royal Gold, Inc. (RGLD US)
Silver Wheaton Corp. (SLW CN)
SouthGobi Resources Limited (1878 HK)
Teck Resources Limited (TCK CN)
United Company RUSAL Plc (486 HK)
Vale S.A. (VALE US)
Western Areas NL (WSA AU)
Winsway Coking Coal Holdings Ltd. (1733 HK)

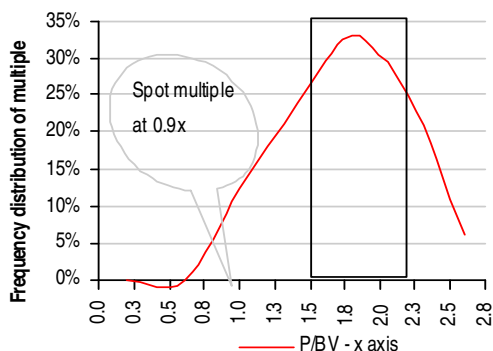
Agriculture

Agrium Inc. (AGU US)
BrasilAgro (AGRO3 BZ)
Cresud, Inc. (CRESY US)
First Pacific Co., Ltd. (142 HK)
ICL - Israel Chemicals Ltd.
Mewah International Inc. (MII SP)
Olam International Limited (OLAM SP)
Orascom Construction (OCIC EY)
PT Astra Agro Lestari Tbk (AALI IJ)
PT Sampoerna Agro Tbk (SGRO IJ)
Tereos International SA (TERI3 BZ)
Viterra Inc. (VT CN)

Energy

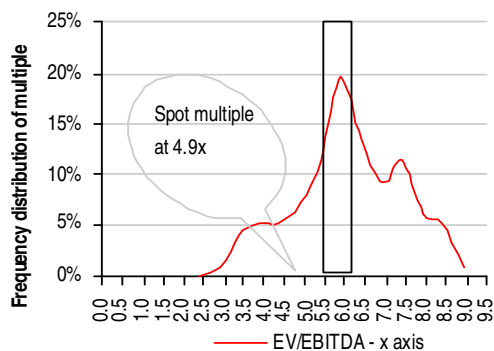
AED Oil Limited (AED AU)
BW Group
BW Offshore Limited (BWO NO)
CGGVeritas (GA FP)
Husky Energy Inc. (HSE CN)
Ivanhoe Energy Inc. (IE CN)
Karoon Gas Australia Ltd. (KAR AU)
Lukoil (LKOH RU)
Penn West Petroleum Ltd. (PWE US)
Petrobras (PETR3 BZ)
PetroVietnam
PT AKR Corporindo Tbk (AKRA IJ)
Salamander Energy Plc (SMDR LN)
TNK-NP Holdings (TNBP RU)

Exhibit 1a: TATA has traded below book value only 12% of the months since August 2003



Source: HSBC calculations, Company reported data

Exhibit 1b: TATA has traded between the range 5.5x-7.5x more than two-thirds of the months since Aug 2003



Source: HSBC calculations, Company reported data

Exhibit 2: TATA is trading below its average GFC period valuations on P/B – At the lower end of GFC period on EV/EBITDA

	P/B	EV/E	TP implied (INR; 2013 basis)				
			P/B		EV/EBITDA		
			low end	Upper end	low end	Upper end	
70% frequency	1-2.2	4.5-7.5	408	897	425	968	P/B excl GW
Avg GFC	1.1	4.8	556	1,223	425	968	P/B incl GW
Lowest GFC	0.4	2.9	428	584*	479		Incl and ex GW
			143	195*	135		

Source: HSBC calculations, Company data (GFC stands for Global financial crisis and is defined by us as the period between 1QCY08-4QCY09)

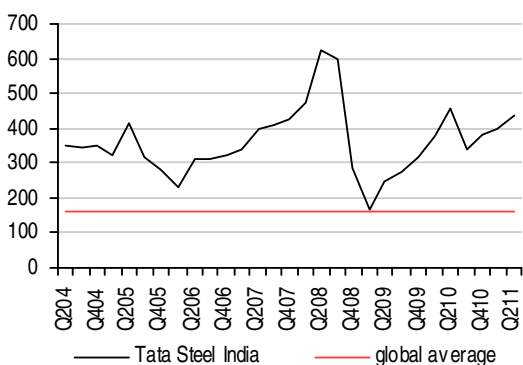
Exhibit 3: Our FY13e EBITDA has just c13% risk when compared to normalized EBITDA margins

Sensitivity on EBITDA

	capacity	EBITDA/t (USD)	EBITDA (USDm)	EBITDA (INRm)
India	10	325	3,250	
Europe	15	20	300	
Others			50	
Total			3,600	162,000
HSBC FY13e EBITDA				187,009
Risk to our 2013 numbers (%)				(13.4)

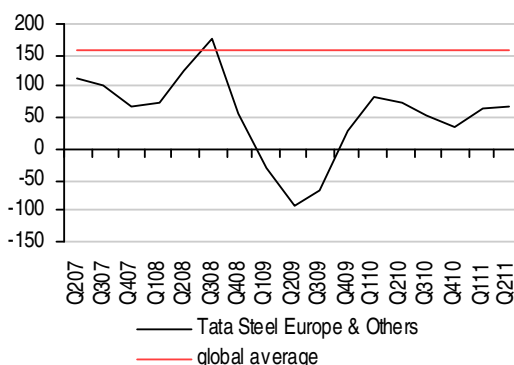
Source: HSBC calculations, Company data

Exhibit 4a: Tata Steel India's lowest EBITDA per ton (USD) since March 04 coincides with the global average during this period



Source: HSBC calculations, Company reported data (EBITDA/t in USD; Dec end basis)

Exhibit 4b: TSE had a bad run during the GFC due to heavy losses incurred at TCP after customers defaulted on off-take agreements. TCP has been sold now



Source: HSBC calculations, Company reported data (EBITDA/t in USD; Dec end basis)

Exhibit 5: Markets are currently ascribing a negative cUSD1b value to TSE assets

Reverse asset valuations (INRbn)

Current price now (a)	469
Fully diluted number of shares (million, b)	1,033
Market capitalization (c = a * b)	484,477
Net debt (end 1QFY12) (d)	450,000
Enterprise Value (c + d)	934,477
Enterprise Value (USD b) (e)	20.8

Value of businesses

India business full capacity (mn tons)	10
Normalized EBITDA/t (USD)	350
Normalized EBITDA (USDm)	3,500
Normalized EV/E multiple (x)	6
Value of India business (USDbn) (f)	21.0

All business ex Tata Steel Europe EBITDA (USDm)	250
Worse case EBITDA (USDm)	115
Normalized EV/E multiple (x)	6
Value of other business (USDbn) (g)	0.7

Value justified by Asia business (USDbn) (h = f + g)	21.7
Current Enterprise Value (USDbn) (e above)	20.8
Implied asset value of Tata Steel Europe (USDbn) (e - h)	(0.9)

Total capacity of Tata Steel Europe (m tons)	15
Capacity of Teeside Cast Products (m tons)	3
Proceeds from sale of TCP (USDm)	500
Implied asset value of resident assets (USDm)	2,500
Implied asset value of resident assets (USDbn)	2.5
Disconnect between asset value and market implied value (USDbn)	3.4
Per share value of disconnect (INR/sh)	149
% upside based on CMP (%)	31.8

Source: HSBC calculations (Note: a) Resident asset value calculated based on TCP sale proceeds neglect the fact that other assets are making profits whereas TCP was selling on cost basis)

Exhibit 6: Markets believe that EPS will fall over 90% vs normalized 1QFY12e EPS over the next one year

Reverse EBITDA calculations (INR/share), reported BV basis

Remarks

Current price now (a)	469	
Book value - end FY2011	387	
Book value - end 1QFY12 (b)	439	
Average P/B multiple used (X) (c)	1.05	Average in GFC period
Market ascribed BV 12-m out (d = a / c)	447	
Market ascribed EPS over next 12 months (e = d - b)	7.4	Not adjusted for new dividends
Quarterly run rate of EPS over next four quarters (f = e / 4)	1.8	
1QFY12 EPS (diluted, adjusted for one offs) (g)	19.1	
% fall implied by markets in EPS (f / g)	(90.3)	

Market implied EBITDA

Quarterly run rate of EPS over next four quarters (f above)	1.8	
Net income estimate (fully diluted, INRm) (h)	1,905	
Pre-tax net income (tax = 34%) (i = h / (1-0.34))	2,886	
Depreciation and interest (j)	18,500	
EBITDA arrived (k = i + j)	21,386	
India quarterly normalized EBITDA (INRm) (l)	25,628	6.7mt @ USD340/t annualized, FY11 avg cUSD400/t
Other business normalized EBITDA (INRm) (m)	1,125	USD100m annualized, FY11 USD250m
Implied quarterly loss at Tata Steel Europe (INRm) (k - l - m)	(5,367)	
Implied quarterly loss at Tata Steel Europe (USDm)	(119)	

Source: HSBC calculations

Overplayed fears on pension liabilities and liquidity

In this section, we note two points – a) Any mismatch, if (and big if at that) at all, in pension liabilities at TSE will not require cash infusion until FY2014e and b) TATA, despite forecasted large capex has enough liquidity to last beyond FY13e.

In a bearish market, pension-liability fears tend to form an overhang on the stock. However, despite acknowledging that pension accounting is translucent in nature, we note the following

- ▶ At the end of FY11, TATA had pension obligations of USD25.3bn, assets of USD25.8bn-thus a net surplus of USD0.5bn. Assets were held 29% in equities, 60% bonds, 7% property and 4% cash.
- ▶ Interim-case, one can assume portfolio asset decline of c4% - assuming TATA's equities resemble MSCI World Index ex US, which is down 14% since 31 March 2011. Importantly though, cash infusion need be made only on next review (triennial review – next due in 2014)
- ▶ Conversely, bond portfolio should have increased given bond yields in UK, US, Germany and Netherlands (UK and Netherlands house most of TSE's operations) are considerably lower.

Exhibit 7: TSE's defined pension plans were running a surplus at end of FY11

TSE Defined benefit pension obligations	INRm	USDbn
Post retirement pension plan obligation	1,137,622	25.3
Net fair value of plan assets	1,160,488	25.8
Net funded status - Asset (liability)	22,866	0.5
Breakup of plan assets	100%	
Equity	29%	
Bonds	60%	
Property	7%	
Cash and others	4%	

Source: Company data, HSBC

Decent liquidity to last well beyond FY13e

- ▶ At the end of FY11, the company had USD2.4bn in cash and cUSD1.1bn in liquid investments and has cUSD0.7bn of pending capex at Jamshedpur and principal payments on its debt of cUSD0.4bn (source: Bloomberg). Assuming from exhibit 7, that the company is running a USD0.6bn net pension liability, we believe at this stage the company can still easily manage to fund the deficit (although it is not required to).

Exhibit8: TATA's major repayments starts only in 2015 – well beyond commissioning of its Orissa first phase expansions

	INRm	USDbn
2012	17,616	0.4
2013	57,522	1.3
Total for 2012/13	75,138	1.7
2014	28,934	0.6
2015	408,857	9.1

Source: Bloomberg

Exhibit9: We believe Tata will continue to stand in a comfortable cash position

	INRm	USDbn
Cash and equivalents at end of 1Q12	202,725	4.5
Undrawn lines of credit	41,895	0.9
FY12 (balance) & FY13 CFO	251,702	5.6
FY12 (balance) & FY13 capex	(194,820)	(4.3)
Cash in FY13 before principal repayments	301,502	6.7
Debt repayments	75,138	1.7
Cash after principal payments	226,364	5.0

Source: HSBC estimates, Company data, Bloomberg

Change in estimates

Exhibit10: Our EBITDA estimates are unchanged

(INRm)	FY12e	FY13e	FY12e	FY13e	FY12e	FY13e
	New	New	Old	Old	Change	Change
Sales	1,289,555	1,448,854	1,277,161	1,436,408	1%	1%
EBITDA	166,331	187,009	166,473	185,277	0%	1%

Source: HSBC estimates

Valuations and risks

We value TATA primarily based on a FY13e EV/EBITDA multiple of 6.0x for Indian and other Asian operations and 4.5x for Tata Steel Europe. Our target EV/EBITDA multiple is based on the historical trading average of the past five years. TATA (consolidated) has historically traded in a one-year forward EV/EBITDA range of 5-7x, which forms the basis of our primary valuation. Consequently, our TP of INR710 implies an upside of 53% (including dividend yield of 1.6%) thus justifying an Overweight rating (Neutral band for a non volatile stock is 6%-16%).

Exhibit11: We value TATA on FY13e EV/EBITDA at INR710 per share

	Valuation base	EBITDA		Multiple (X)	Enterprise Value		
		INRm	USDm		INRm	USDm	INR/share
India operations	2013	136,055	3,023	6.0	816,330	18,141	851
Europe operations	2013	39,401	876	4.5	177,306	3,940	185
South East Asia operations	2013	11,553	257	6.0	69,318	1,540	72
Total operating Enterprise Value		187,009			1,062,954	23,621	1,108
Less: Net debt	2013				431,229	9,583	450
Add: Liquid investments					47,303	1,051	49
Market capitalisation					631,725	14,038	708
Target price (INRs/share)							710

Source: HSBC estimates

Risks: Since a large amount of incremental growth in diluted EPS is driven by increase in volumes, timely expansion is critical. In addition, lower-than-estimated steel prices and higher-than-estimated coking coal costs pose negative risks to our estimates of TATA's earnings.

While we do not account for benefits from raw material projects at this stage, upsides from earlier than expected commissioning can be significant.

Financials & valuation

Financial statements

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Profit & loss summary (INRm)				
Revenue	1,187,531	1,289,555	1,448,854	1,517,381
EBITDA	159,956	166,331	187,009	183,676
Depreciation & amortisation	-44,148	-49,226	-53,454	-56,888
Operating profit/EBIT	115,808	117,105	133,556	126,788
Net interest	-27,700	-28,763	-23,705	-21,868
PBT	121,020	137,344	114,486	109,561
HSBC PBT	97,917	98,153	114,486	109,561
Taxation	-32,459	-34,336	-28,621	-27,390
Net profit	89,827	104,306	87,193	83,532
HSBC net profit	66,725	65,115	87,193	83,532

Cash flow summary (INRm)

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Cash flow from operations	64,629	157,411	133,644	136,618
Capex	-101,636	-111,650	-105,500	-81,750
Cash flow from investment	-83,785	-111,650	-105,500	-81,750
Dividends	-7,146	-7,092	-7,092	-7,092
Change in net debt	49,792	-60,636	-21,052	-47,775
FCF equity	-73,588	-3,243	23,510	50,227

Balance sheet summary (INRm)

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Intangible fixed assets	152,982	152,982	152,982	152,982
Tangible fixed assets	523,934	586,358	638,404	663,266
Current assets	597,686	412,346	450,822	467,417
Cash & others	108,926	1,395	1,464	1,538
Total assets	1,353,076	1,208,192	1,298,714	1,340,171
Operating liabilities	337,610	264,977	297,710	311,791
Gross debt	621,843	453,676	432,694	384,992
Net debt	512,917	452,281	431,229	383,454
Shareholders funds	355,814	453,027	533,128	609,568
Invested capital	828,067	885,314	943,034	970,337

Ratio, growth and per share analysis

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Y-o-y % change				
Revenue	16.0	8.6	12.4	4.7
EBITDA	98.9	4.0	12.4	-1.8
Operating profit	226.1	1.1	14.0	-5.1
PBT	38938.5	13.5	-16.6	-4.3
HSBC EPS		-2.4	33.9	-4.2

Ratios (%)

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Revenue/IC (x)	1.6	1.5	1.6	1.6
ROIC	11.3	10.3	11.0	9.9
ROE	22.8	16.1	17.7	14.6
ROA	8.9	9.7	8.3	7.5
EBITDA margin	13.5	12.9	12.9	12.1
Operating profit margin	9.8	9.1	9.2	8.4
EBITDA/net interest (x)	5.8	5.8	7.9	8.4
Net debt/equity	133.3	94.1	77.1	60.4
Net debt/EBITDA (x)	3.2	2.7	2.3	2.1
CF from operations/net debt	12.6	34.8	31.0	35.6

Per share data (INR)

Year to	03/2011a	03/2012e	03/2013e	03/2014e
EPS reported (fully diluted)	86.95	100.97	84.40	80.86
HSBC EPS (fully diluted)	64.59	63.03	84.40	80.86
DPS	7.39	7.39	7.39	7.39
Book value	370.94	472.29	555.80	635.49

Key forecast drivers

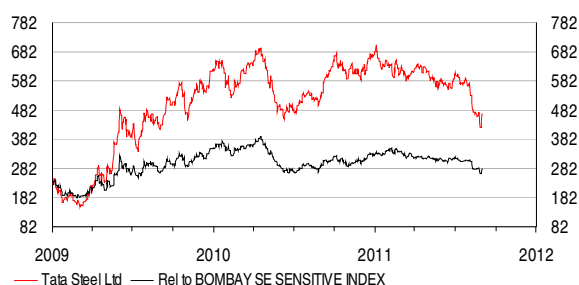
Year to	03/2011a	03/2012e	03/2013e	03/2014e
Crude steel production (mt)	22	22	24	26
Far east HRC prices (US\$/ton)	657	757	713	670
Iron ore prices (US\$/ton)	132	160	140	121
Coking coal prices (US\$/ton)	215	284	250	219

Valuation data

Year to	03/2011a	03/2012e	03/2013e	03/2014e
EV/sales	0.8	0.7	0.6	0.5
EV/EBITDA	5.8	5.2	4.5	4.3
EV/IC	1.1	1.0	0.9	0.8
PE*	7.3	7.4	5.6	5.8
P/Book value	1.3	1.0	0.8	0.7
FCF yield (%)	-17.9	-0.8	5.8	12.3
Dividend yield (%)	1.6	1.6	1.6	1.6

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 01 Sep 2011

Disclosure appendix

Analyst Certification

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Important disclosures

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This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at www.hsbcnet.com/research. Details of these short-term investment opportunities can be found under the Reports section of this website.

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Rating definitions for long-term investment opportunities

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For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the implied return must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However,

stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

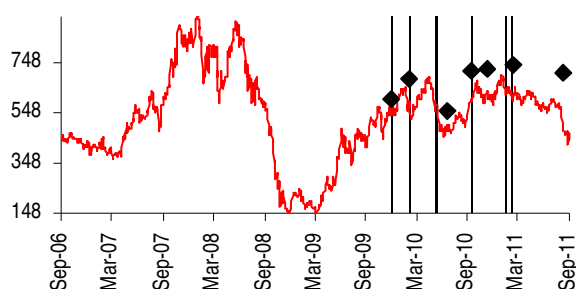
Rating distribution for long-term investment opportunities

As of 01 September 2011, the distribution of all ratings published is as follows:

Overweight (Buy)	53%	(27% of these provided with Investment Banking Services)
Neutral (Hold)	36%	(20% of these provided with Investment Banking Services)
Underweight (Sell)	11%	(19% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Tata Steel Ltd (TISC.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Neutral (V)	01 December 2009
Neutral (V)	Overweight (V)	04 February 2010
Overweight (V)	Neutral (V)	05 May 2010
Neutral (V)	Overweight (V)	13 September 2010
Overweight (V)	Restricted	18 January 2011
Restricted	Overweight	09 February 2011
Target Price	Value	Date
Price 1	608.00	01 December 2009
Price 2	690.00	04 February 2010
Price 3	562.00	18 June 2010
Price 4	720.00	13 September 2010
Price 5	730.00	14 November 2010
Price 6	Restricted	18 January 2011
Price 7	740.00	09 February 2011
Price 8	710.00	14 August 2011

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
TATA STEEL	TISC.NS	468.55	01-Sep-2011	1, 2, 4, 5, 6, 7

Source: HSBC

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