

Morgan Stanley India Company
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December 3, 2008

Stock Rating
Underweight

Industry View
Cautious

Tata Steel

Balance Sheet Concerns, Likely Earnings Squeeze Reaffirms UW Stance

We retain our UW on Tata Steel despite the strong F1H09 results since in our view: 1) the sharp decline in steel prices will cause earnings to come under pressure. We expect F2H09 EBITDA to be just 22% of F1H09 EBITDA. 2) High leverage (net debt/equity of 1.3x at end F2Q09) aggravates concerns amid the liquidity crunch, especially since debt covenants may move out of the company's comfort zone in the near term.

Steep drop in steel prices worsen prospects for F2H09 earnings: We expect Corus' average realization to drop 19% QoQ in F3Q09 and a further 6% in F4Q09. We believe Corus can deliver negative EBITDA of US\$19/t in F2H09. Indian steel prices have declined 15-20% in F3Q09, and we expect a further decline of 5% in F4Q09. We also note that a price bottom has yet not been established despite coordinated production cuts by global steel majors. This leads us to believe that Tata's earnings will pose negative surprises for the Street in F2H09 and F2010, having achieved a peak in F2Q09. In addition, a 30% cut in output by Corus in F2H09 will likely substantially increase the fixed-cost burden.

Debt covenants linked to earnings may look vulnerable near term: With the steep price increases in C1H08, trailing four-quarter EBITDA has increased steadily from Rs91bn in F4Q08 to Rs112bn in F2Q09. We feel this trajectory may be disturbed in the near term with the impending earnings squeeze beginning F3Q09. Corus covenants of debt/EBITDA and EBITDA/interest may move out of the company's comfort zone in the near term, raising questions about penalty interest. We note that the company's solvency should not be an issue given our view that 1) Indian operations would yield an F2009 EBITDA of ~Rs100bn versus a likely group interest cost of about Rs35bn, and 2) Corus loans have recourse only to Corus assets. Nonetheless, we feel these balance sheet concerns in a market strained off liquidity will cause jitters amongst investors.

Key Ratios and Statistics

Reuters: TISC.BO Bloomberg: TATA IN

India Steel

Price target	Rs110.00
Upside to price target (%)	(26)
Shr price, close (Dec 3, 2008)	Rs148.65
Mkt cap, curr (mn)	Rs130,799

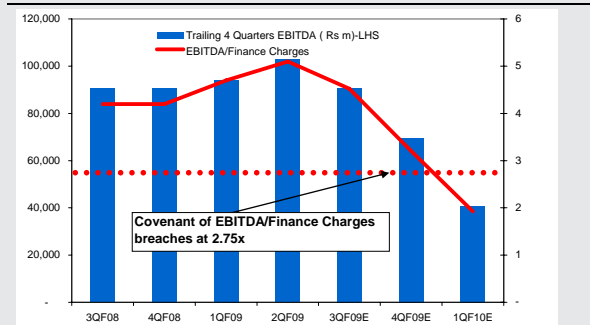
Fiscal Year ending	03/08	03/09e	03/10e	03/11e
ModelWare EPS (Rs)	75.33	77.22	41.75	53.79
Consensus EPS (Rs)§	81.59	105.47	72.65	86.15
Revenue, net (Rs mn)	1,315,357	1,461,989	1,400,435	1,430,819
EBITDA (Rs mn)	177,594	185,172	147,057	161,167
ModelWare net inc (Rs mn)	66,284	70,496	38,111	49,102
P/E	9.2	1.9	3.6	2.8

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

§ = Consensus data is provided by FactSet Estimates.

e = Morgan Stanley Research estimates

EBITDA/Interest Covenant May Be on the Edge Now



Source: Company data, Morgan Stanley Research

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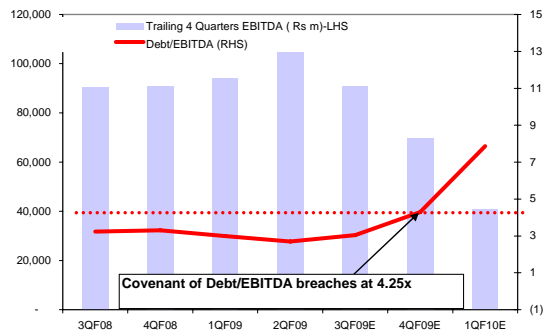
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Tata Steel

Exhibit 1

Debt/EBITDA Covenant too a Likely Concern



Source: Company data, Morgan Stanley Research]

Exhibit 2

Corus Debt Covenants May Come Under Pressure in the Near Term – Corus Debt of US\$6.9bn at end-F2Q09 Derived from Debt/EBITDA of 2.7x per the Company Presentation*

	3QF08	4QF08	1QF09	2QF09	3QF09E	4QF09E	1QF10E
Trailing 4 Quarters EBITDA (Rs m)	90,589	90,814	94,151	111,675	90,903	69,544	40,784
Trailing 4 Quarters EBITDA (GBP m)	1,123	1,154	1,147	1,349	1,196	848	463
Debt(GBP m)	3627	3808	3440	3642	3642	3642	3642
Debt in USD	7,425	7,549	6,790	6,900	5,766	5,742	6163
Debt/EBITDA	3.2	3.3	3.0	2.7	3.0	4.3	7.9
Finance Charges(GBP m)	250	275	244	264	264	264	264
EBITDA/Finance Charges	4.2	4.2	4.7	5.1	4.5	3.2	1.9
Exchange rate Assumptions							
INR GBP	81	79	82	83	76	82	88
INR USD	39.4	39.7	41.6	43.7	48.0	52.0	52.0
GBP-USD	2.0	2.0	2.0	1.9	1.6	1.6	1.7

* Corus debt given in another slide of the company presentation puts the debt figure at end September 2008 at US\$ 5.1bn .We believe the balance US\$1.8bn is accounted for by working capital and other short-term loans.

Source: Company data, Morgan Stanley Research

Exhibit 3

What Is Implied in Our F2009 projection

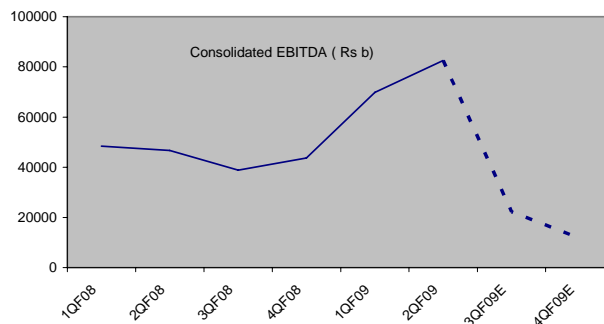
	1HF09	F209E	Implied 2HF09E
Consolidated EBITDA	152,376	185,172	32,796
Corus EBITDA	77,218	69,544	(7,674)
Tata Standalone EBITDA	61,009	97,079	36,070

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 4

We Believe Peak EBITDA Was Achieved in F2Q09; We Expect a Sharp Descent in the Next 2-3 Quarters



e = Morgan Stanley Research estimates Source: Company data, Morgan Stanley Research

Exhibit 5

Tata Steel Standalone - Assumptions in Our F2H09 Earnings Projection

	1QF09	2QF09	3QF09E	4QF09E
Production (mt)	1.19	1.33	1.48	1.43
Average realization (Rs /t)*	45,737	48,286	40,286	34,786
Total cost per ton (Rs /t)	26,460	27,586	25,101	25,737
EBITDA per ton (Rs /t)	25,483	23,139	15,247	9,451

We assume a Rs 8,000/t QoQ reduction in steel prices

We assume a Rs 5,500/t QoQ reduction in steel prices

* Average realization is based on sales volume of steel while total cost and EBITDA are based on production volume of steel.

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 6

Corus - Assumptions in Our F2H09 Earnings Projections

	1QF09	2QF09	3QF09E	4QF09E
Deliveries (mt)	6.2	5.5	4.4	4.4
Average realization (US\$ /t)	1,144	1,285	1,040	975
Total cost per ton (US \$)	1,013	1,104	1,059	994
EBITDA per ton (US \$)	131	181	(19)	(19)

We assume a US\$ 245/t QoQ reduction in steel prices

We assume a US\$ 65/t QoQ reduction in steel prices

Assuming that per ton cost, on a QoQ basis (a) goes up by US\$5/t due to higher fixed costs in the wake of production cut and (b) goes down by US\$ 50/t due to reduced other raw materials and freight costs

Assuming that per ton cost (a) goes up by US\$5/t due to higher fixed costs in the wake of production cut and (b) goes down by US\$ 70/t with a 30% and 50% reduction in iron ore and coking coal contract prices, of which 50% becomes effective from Jan 2009 for Corus

e = Morgan Stanley Research estimates Source: Company data, Morgan Stanley Research

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Tata Steel

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Company Description

Tisco, a flagship company of the Tata group, is the second-largest steel maker in India with a capacity of 5 mtpa with a high level of vertical integration. Its sales basket consists of 40% long products with flat products constituting the rest. Tata Steel has brownfield expansion plans of 5 mtpa and greenfield expansion plans of 11 mtpa at various stages of implementation. Tisco recently purchased UK based Corus Group Plc for an EV value of US\$13.5bn. Post this the company has become the sixth largest steel maker globally with a total capacity of about 24 MT.


India Steel

Industry View: Cautious

MSCI Country: India

Asia Strategist's Recommended Weight: 2.8%

MSCI Asia/Pac All Country Ex Jp Weight: 6.6%

	<p>Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations. For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.</p>
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(as of November 30, 2008)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	Total IBC	% of Rating Category
Overweight/Buy	838	36%	254	40%	30%
Equal-weight/Hold	1037	44%	282	45%	27%
Not-Rated/Hold	31	1.3%	7	1.1%	22.5%
Underweight/Sell	427	18%	90	14%	21%
Total	2,333		633		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

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Tata Steel

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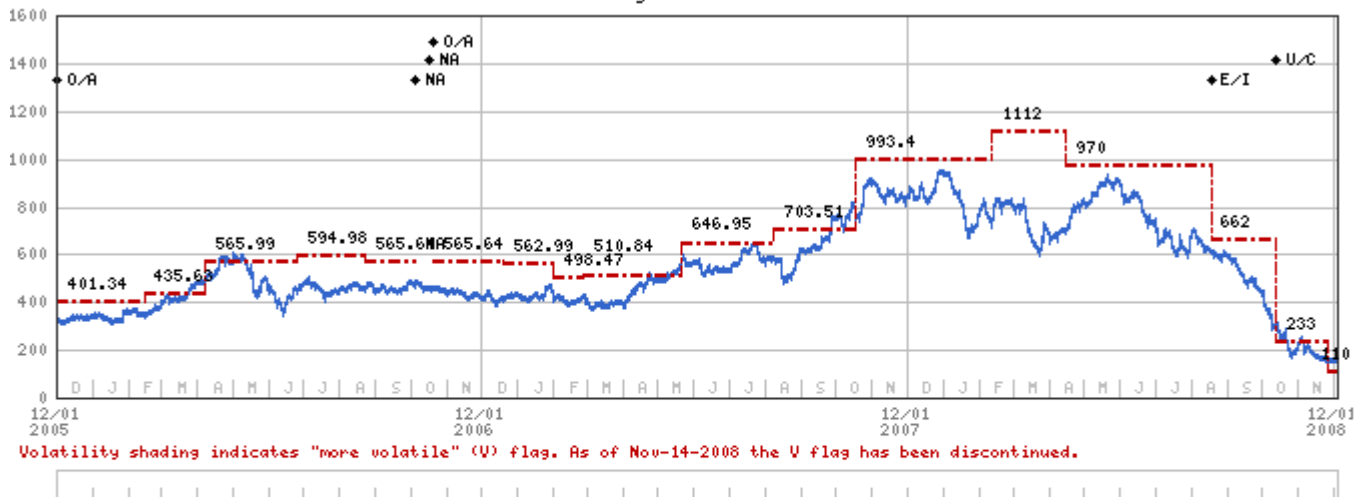
Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.
Equal-weight (E or Equal) - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.
Not-Rated/Hold (NA or NAV) - Currently the analyst does not have adequate conviction about the stock's total return relative to the relevant country MSCI Index, on a risk-adjusted basis, over the next 12-18 months. Please note that NA or NAV may also be used to designate stocks where a rating is not currently available for policy reasons. For the current list of Not-Rated/Hold stocks as counted above in the Global Stock Ratings Distribution Table, please email morganstanley.research@morganstanley.com.
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Stock Price, Price Target and Rating History (See Rating Definitions)

Tata Steel (TISC.BO) - As of 12/3/08 in INR
Industry : India Steel



Stock Rating History: 12/1/05 : O/A; 10/5/06 : NA; 10/17/06 : NA; 10/20/06 : O/A; 8/18/08 : E/I; 10/13/08 : U/C
 Price Target History: 6/15/05 : 399.92; 12/1/05 : 401.34; 2/14/06 : 435.63; 4/7/06 : 565.99; 6/26/06 : 594.98;
 8/23/06 : 565.64; 10/5/06 : NA; 10/20/06 : 565.64; 12/20/06 : 562.99; 2/1/07 : 498.47; 2/26/07 : 510.84;
 5/21/07 : 646.95; 8/8/07 : 703.51; 10/18/07 : 993.4; 2/12/08 : 1112; 4/16/08 : 970; 8/18/08 : 662;
 10/13/08 : 233; 11/26/08 : 110

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) --- Stock Price (Covered by Current Analyst) ---
 Stock Ratings abbreviated as below (Effective 3/18/02, ratings appear as Stock Ratings/Industry View)
 Stock Ratings as of 3/18/02: Overweight (O) Equal-weight (E) Underweight (U) More Volatile (V) No Rating Available (NAU)
 Stock Ratings prior to 3/18/02: Strong Buy (SB) Outperform (OP) Neutral (N) Underperform (UP) No Rating Available (NAU)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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December 3, 2008

Tata Steel

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Industry Coverage:India Steel

Company (Ticker)	Rating (as of)	Price (12/03/2008)
Vipul Prasad		
JSW Steel Ltd. (JSTL.BO)	U (10/13/2008)	Rs183.55
Jindal Steel & Power (JNSP.BO)	U (10/13/2008)	Rs776.9
Steel Authority Of India (SAIL.BO)	U (10/13/2008)	Rs64.75
Tata Steel (TISC.BO)	U (10/13/2008)	Rs164.7

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