Indian Steel Sector --

3Q09 likely helped bya freeze in seaborne trade. Will it define the trough in earnings?

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- 3Q results, weak as they will be, are unlikely to be material to stock prices. What will drive the stocks: 1) how long will re-stocking-led demand rebound sustain, and 2) how much will need to be paid on carryover volumes of coking coal and ore?
- Steel demand recovered in December 2008 after weak October and November. While pricing collapsed, a freeze in inter-country trade helped the companies maintain volumes. Government infra demand held up.
- Unlike the rest of the world, production cuts in India have been marginal for leading players. We expect Tata Steel to show 4% YoY EBITDA growth, helped by the weak Indian rupee (volumes down 14% YoY).
- JSW and SAIL, however, are likely to see 60-90% YoY EPS declines due to high coking coal costs, and particularly for JSW, high interest burden. Commissioning of the new JSW BF now set for 2HFebruary 2009.
- A relative positive for SAIL in FY10 is likely to be low carryover volumes on coking coal, as it has not cut utilisation materially.
- We were surprised by JSW not releasing November/December production data (likely down 40%-plus). Update on US mills' orderbook is important.

Valuation metrics

Company	Ticker	CS rating	Price Local	Price FY09	EV/EBITDA (x) FY10	EV/EBITDA (x) FY09	P/B FY09
SAIL	SAIL IN	O	79	125	3.2	4.9	1.2
Tata Steel	TATA IN	O	212	320	4.0	3.4	0.9
JSW Steel	JSTL IN	O	224	350	5.1	3.1	0.5

Note: O = OUTPERFORM, N = NEUTRAL, U = UNDERPERFORM
Source: Company data, Credit Suisse estimates

Will the weak 3Q09 results define the trough in earnings?

3Q09 was marked by liquidity crunch and a buyer's strike for most of the quarter; price cuts in October and November did not result in a demand pickup. A much sharper cut in December, accompanied by some easing in liquidity, helped. Demand for flat steel collapsed completely (e.g. some commercial vehicle manufacturers saw 90%-plus production cuts), but long product demand was held up mainly by government infrastructure projects. Housing demand continues to be weak.

Steel manufacturers globally have made aggressive production cuts. However, for leading producers in India, the cuts have been marginal at most, helped by the collapse in imports (problem with LCs earlier in the quarter). Only JSW announced a 20% cut and has delayed the commissioning of its blast furnace to 2HFebruary 2009 (from October 2008).

The collapse in pricing (HRC was US$520-550/tonne in December 2008 versus US$850-plus in September 2008) we believe would have hurt margins, only marginally offset by the fall in spot prices of ore, scrap and coke.

3Q results, weak as they will be, are unlikely to be material to the stock prices. Whether they define the trough for earnings will depend on: 1) how long will re-stocking-led demand rebound sustain, and 2) how much will need to be paid on carryover volumes of coking coal?

Tata Steel

3Q09 crude steel production was up 17% YoY but saleable steel production was flat. This shows that blast furnace shutdown was not taken but all the metal was not rolled to the finished product: sales volume declined 14% YoY. This inventory build-up could be handy when demand picks up: Tata's industry low costs enable it to take such steps. Long product sales jumped 27% YoY.

Even at current steel prices (US$520/tonne), TISCO continues to be extremely profitable. We expect a net income of Rs11 bn on revenues of Rs54 bn. What will drive the stock though will be the consolidated results expected in February 2009, where results will be materially weaker.

Figure 1: 3Q09 standalone estimates

(Rs mn)	3Q09E	2Q09A	QoQ	3Q08A	YoY
Revenue	53,762	68,507	-22%	49,739	8%
EBITDA	21,700	31,830	-32%	20,966	4%
EBITDA margin	40.4%	46.5%	-6.1%	42.2%	-1.8%
Net income	10,906	17,878	-39%	10,207	7%

Source: Company data, Credit Suisse estimates.

SAIL

Production data available for Bhilai steel plant (most profitable among SAIL's plants) are encouraging: 3Q09 production (1.1MT) was down only 3% QoQ. Net cash companies with low costs tend to accumulate inventory, and SAIL is likely to have done the same. Trends at Bokaro are likely to have remained weak. SAIL's December 2008 sales were normal (likely an overshoot after the lull in October/November). A relative positive for FY10 for SAIL is likely to be low carryover volumes on coking coal, as it has not cut utilisation.

Figure 2: 3Q09 CS estimates

(Rs mn)	3Q09E	2Q09A	QoQ	3Q08A	YoY
Revenue	88,054	122,386	-28%	95,333	-8%
EBITDA	10,418	30,115	-65%	29,834	-65%
EBITDA margin	11.8%	24.6%	-12.8%	31.3%	-19.5%
Net income	7,126	20,096	-65%	19,347	-63%
EPS (Rs)	1.73	4.87	-65%	4.68	-63%

Source: Company data, Credit Suisse estimates.

JSW Steel

We were surprised by JSW making a departure from norms, and not releasing November and December production numbers. Crude steel production for 3Q09 will likely be less than 750kt (versus 1MT in 2Q09): Oct production was 338kt, implying November and December production were probably down 40%-plus. While management may have delivered on its target of Rs10,000/tonne cut in costs, price declines were much greater than earlier expected. We expect JSW to report a modest profit in 3Q09 without considering the negative impact of forex translation.

We eagerly await newsflow on order book for the US plate and pipe mills as till last quarter JSW was carrying orders only for a month.

Figure 3: Q09 consolidated estimates

(Rs mn)	3Q09E	2Q09A	QoQ	3Q08A	YoY
Revenue	33,226	46,414	-28%	28,419	17%
EBITDA	4,623	11,568	-60%	7,575	-39%
EBITDA margin	13.9%	24.9%	-11.0%	27%	-12.7%
Net income	208	5,168	-96%	2,701	-92%
EPS basic (Rs)	1.11	27.63	-96%	14.44	-92%

Source: Company data, Credit Suisse estimates.

Companies Mentioned *(Price as of 09 Jan 09)*
Steel Authority of India Ltd (SAIL.BO, Rs79.20, OUTPERFORM [V], TP Rs125.00)
Tata Steel Ltd (TISC.BO, Rs212.00, OUTPERFORM [V], TP Rs320.00)
JSW Steel Ltd (JSTL.BO, Rs224.30, OUTPERFORM [V], TP Rs350.00)

Disclosure Appendix

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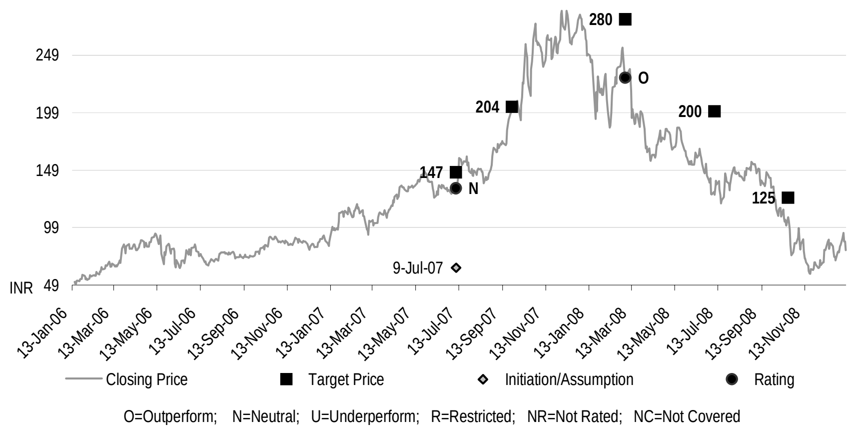
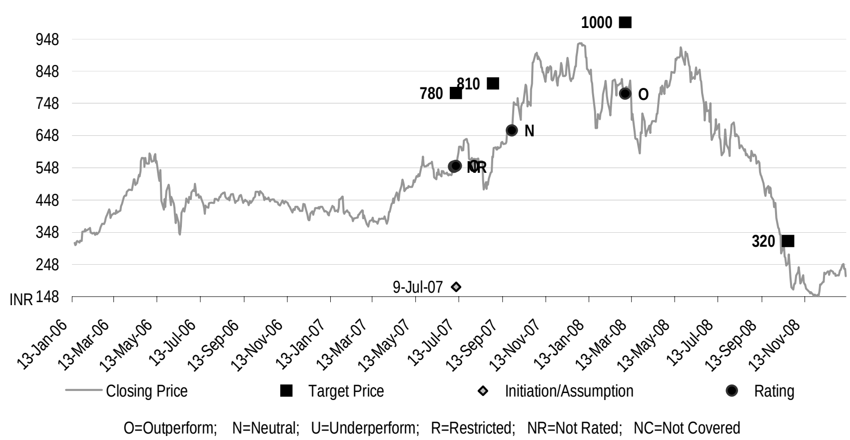
3-Year Price, Target Price and Rating Change History Chart for SAIL.BO

SAIL.BO Date	Closing Price (INR)	Target Price (INR)	Rating	Initiation/ Assumption
9-Jul-07	133.05	147	N	X
26-Sep-07	200.45	204		
4-Mar-08	229.2	280	O	
8-Jul-08	127.5	200		
20-Oct-08	107.85	125		



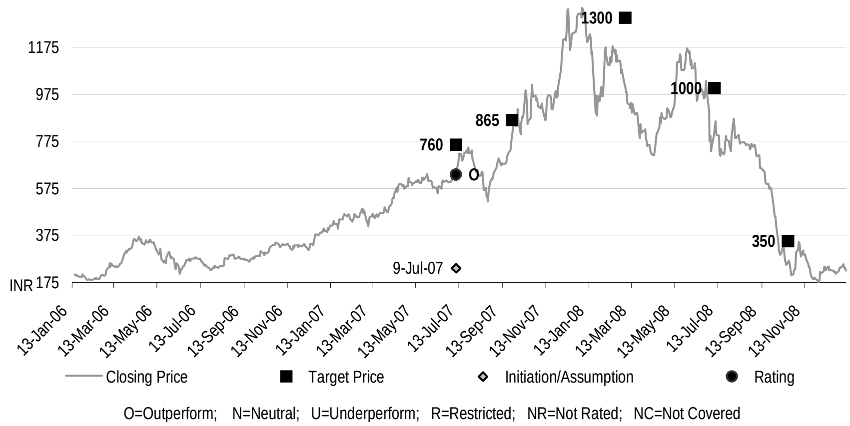
3-Year Price, Target Price and Rating Change History Chart for TISC.BO

TISC.BO Date	Closing Price (INR)	Target Price (INR)	Rating	Initiation/ Assumption
6-Jul-07	550.74		NR	
9-Jul-07	552.82	780	O	X
30-Aug-07	580.97	810		
26-Sep-07	663.65		N	
4-Mar-08	777.75	1000	O	
20-Oct-08	251.7	320		



3-Year Price, Target Price and Rating Change History Chart for JSTL.BO

JSTL.BO Date	Closing Price (INR)	Target Price (INR)	Rating	Initiation/ Assumption
9-Jul-07	632.45	760	O	X
26-Sep-07	804.3	865		
4-Mar-08	1,005.45	1300		
8-Jul-08	830.65	1000		
20-Oct-08	262.25	350		



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Method: We value Steel Authority of India (SAIL) on forward EV/EBITDA (enterprise value/earnings before interest, tax, depreciation, amortisation) ratio and our target price of Rs125 is 5x EV/EBITDA, based on the next rolling four quarters (which is the multiple that we use to value all steel companies in our coverage universe).
Risks: Downside risks to our Rs125 target price for SAIL include: 1) steel price realization for the manufacturers falling below $750/t; 2) given the significant impact of any changes to the Chinese government's regulations on Chinese steel capacity and steel exports, any easing of export regulations could create an oversupply globally; 3) a slowdown in the global economy impacting steel prices and steel demand.
Price Target: (12 months) for (TISC.BO)
Method: We value Tata Steel on forward enterprice value/earnings before interest, tax, depreciation and amortisation (EV/EBITDA) ratio and our target price of Rs320 is 5x EV/EBITDA for the next four quarters (3Q09-2Q10). The stock has moved sharply across forward EV/EBITDA bands (4x to 5x) post-the Corus acquisition. We do not expect a re-rating given that the group has high financial leverage now and Corus is not integrated on the raw material front.
Risks: Downside risks to our Rs320 target price for TATA Steel include: 1) our expectation of a rebuond in steel prices in 1Q09, as if that does not happen then our assumption for steel prices could see downside; 2) coking coal prices for FY10 settling above $200/t; 3) iron ore prices for FY10 settling above $70/t in FY10 (we are currently factoring in a 20% decline for iron ore prices in FY10).
Price Target: (12 months) for (JSTL.BO)
Method: We value JSW Steel on forward enterprise value/earnings before interest, tax, depreciaton and amortisation (EV/EBITDA) ratio. Our target price of Rs350 is 5x EV/EBITDA based on the next rolling four quarters (which is the multiple that we use to value all steel companies in our coverage universe).
Risks: Downside risks to our Rs350 target price for JSW Steel include: 1) our assumption of an upturn in the steel prices starting in April 2009, as if that does not happen then our target price could be at risk; 2) delays in capacity expansion of 2.8 MT in FY09; 3) coking coal prices for FY10 settling above $200/t.

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