



Tata Steel

STOCK INFO.	BLOOMBERG
BSE SENSEX: 19,243	TATA IN
	REUTERS CODE
S&P CNX: 5,702	TISC.BO

26 October 2007

Buy

Previous Recommendation: Buy

Rs991

Equity Shares (m)	847.6
52-Week Range	1,049/399
1,6,12 Rel. Perf. (%)	18/42/46
M.Cap. (Rs b)	716.2
M.Cap. (US\$ b)	17.7

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	251,197	42,786	70.2	3.1	12.0	3.4	27.9	31.8	1.9	6.6
3/08E	1,275,253	97,842	115.4	64.3	7.3	1.8	24.6	17.2	0.8	5.2
3/09E	1,311,766	110,774	130.7	13.2	6.5	1.5	22.6	16.3	0.7	4.6

* PAT and EPS numbers are consolidated based on fully diluted equity; USD=Rs40.4; GBP=1.98USD

- Adjusted PAT for 2QFY08 was up 3.1% YoY to Rs11.7b, higher than our estimate of Rs11.1b. Reported profit was higher at Rs11.9b due to total extra ordinary item of Rs340m, which included forex gain of Rs0.9b. Consolidated results will be announced later.
- Net sales increased 14.3% YoY to Rs47.9b driven by sales volumes growth of 2.9% YoY to 1.218 m tons (v/s est of 1.25m tons) and blended realization growth of 11.4% YoY to Rs35,280/ton (v/s est of Rs 35,000/ton).
- EBITDA increased 18.8% YoY to Rs 20.3b while margins improved 160bp YoY (better product realization) and 180bp QoQ (due to leveraging of fixed costs on account of volume growth despite lower realization) to 42.3%. EBITDA per ton of Rs15,220 remained flat QoQ and posted impressive growth of 15% YoY to Rs1984/ton.
- Eurofer is likely to file anti-dumping case against Chinese exports within two weeks (as per Metal Bulletin) and this is likely to instigate Chinese government to take further steps to curb exports, which are already declining in the past few months. Several media reports suggest possibility of China hiking export duty by 5% effective November 1, 2007 which augurs well for realizations, especially for European producers such as Corus, as global demand continues to grow at a strong clip. We remain positive on the steel cycle. The stock trades at attractive valuations (at ex-rights price of Rs845) of 4.6x FY09E EV/EBITDA, 6.5x FY09E P/E and 1.5x FY09E P/B (RoE of 22.6%), at a substantial discount to valuations of SAIL and JSW Steel. Tata Steel is our top pick in metals.

QUARTERLY PERFORMANCE

(RS MILLION)

Y/E MARCH	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Standalone Financials										
Net Sales	39,159	41,858	44,700	49,804	41,976	47,851	50,162	50,162	175,520	190,150
Change (YoY %)	13.0	8.3	21.4	20.6	7.2	14.3	12.2	0.7	15.9	8.3
EBITDA	15,813	17,048	17,836	19,035	16,992	20,254	19,677	19,677	69,733	76,599
Change (YoY %)	-0.4	3.2	28.2	46.3	7.5	18.8	10.3	3.4	17.6	9.8
(% of Net Sales)	40.4	40.7	39.9	38.2	40.5	42.3	39.2	39.2	39.7	40.3
Interest	293	478	520	448	800	2,022	1,494	1,524	1,739	5,839
Depreciation	1,951	1,957	1,991	2,294	2,112	2,050	2,245	2,240	8,193	8,648
Other Income	779	1,772	987	798	1,461	943	987	798	4,337	4,190
PBT (after EO Inc.)	14,164	15,943	15,820	16,690	19,025	17,466	16,567	16,353	62,617	69,411
Total Tax	4,630	4,928	5,183	5,655	6,804	5,558	5,678	5,605	20,395	23,645
% Tax	32.7	30.9	32.8	33.9	35.8	31.8	34.3	34.3	32.6	34.1
Reported PAT	9,534	11,015	10,638	11,035	12,221	11,908	10,889	10,748	42,222	45,767
Adjusted PAT	9,658	11,321	10,969	11,300	9,983	11,676	11,125	10,983	43,247	43,717
Change (YoY %)	2.3	6.3	41.9	48.6	3.4	3.1	1.4	-2.8	22.1	1.1
Consolidated Financials										
Net Sales	57,641	60,083	59,712	74,697	311,542	319,697*	322,007	322,007	251,197	1,275,253
EBITDA	17,414	18,504	18,905	19,679	49,043	52,706*	50,128	50,128	74,502	202,006
Adjusted PAT	10,318	11,696	10,872	9,894	20,308	26,652*	25,664	25,522	42,782	97,842

E: MOSt Estimates: tss=ton of steel sales; Exchange rate assumed GBP=1.98 USD, USD=40.4 INR; * Estimated

STANDALONE FINANCIALS

Y/E MARCH	FY07				FY08			
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE
Production ('000 tons)	1,109	1,258	1,290	1,272	1,065	1,280	1,300	1,300
Change (YoY %)	17	4	11	1	-4	2	1	2
Sales (000 tons)	1,115	1,184	1,234	1,261	1,041	1,218	1,300	1,300
Change (YoY %)	27.4	0.4	11.5	0.4	-6.6	2.9	5.3	3.1
Realisation (Rs per ton)	31,133	31,656	32,236	35,135	36,665	35,280	35,000	35,000
Change (QoQ %)	7.9	1.7	1.8	9.0	4.4	-3.8	-0.8	0.0
Change (YoY %)	-10.1	6.0	8.5	21.8	17.8	11.4	8.6	-0.4
Net Sales	39,159	41,858	44,700	49,804	41,976	47,851	50,162	50,162
Change (YoY %)	13.0	8.3	21.4	20.6	7.2	14.3	12.2	0.7

Source: Company/Motilal Oswal Securities

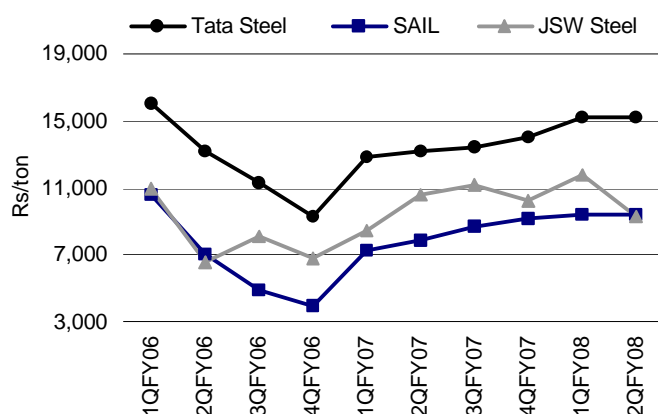
Realizations boosted the topline

Net sales increased 14.3% YoY to Rs47.9b, driven by sales volumes growth of 2.9% YoY to 1.218 m tons (v/s est of 1.25m tons) and blended realization growth of 11.4% YoY to Rs 35,280/ton (v/s est. of Rs 35,000/ton).

EBITDA per ton posted strong growth of 15% YoY

EBITDA increased 18.8% YoY to Rs 20.3b while margins improved 160bp YoY (better product realization) and 180bp QoQ (due to leveraging of fixed costs on account of volume growth despite lower realization) to 42.3%. EBITDA per ton remained flat QoQ and posted impressive growth of 15% YoY to Rs15,220/ton.

EBITDA PER TON



Source: Company/Motilal Oswal Securities; For SAIL, 2QFY 08 is estimate

Key take-away from the conference call:

1. Realization was higher YoY by Rs2,800/t on flat products, Rs2,500-4,000/t on auto grade, Rs3,000/t on long products, Rs1,500/ton on tubes
2. Guidance of crude steel production of 5.2m tons for FY08
3. Ferro-alloy costs were higher YoY
4. Interest expense increased QoQ due to swapping of forex loan of US\$1.6b to rupee loan
5. Effective tax rate for Corus is expected to be 12-15%
6. Total debt on the stand-alone balance sheet is Rs130b; ~15% of this is in foreign currency
7. Outstanding bridge loan after completion of rights issue will be ~US\$700m
8. US\$500m ADR initially planned is under discussion and will be decided later
9. Corus sells 30% of its products on annual contracts
10. Pension funds of Corus are in surpluses.

FY09 PAT will be boosted by lower interest cost, tax and synergy benefits

After rights issue of Rs91b, consolidated interest cost will be lower. Placement of Corus debt into tax efficient balance sheet of Netherlands unit will bring down effective tax rate. Corus is trying to increase the share of soft coking coal in blending in the process of coke making at its plant to partially mitigate the risk of rising coal costs. Further synergies are likely to flow on account outsourcing of consumables, refractories, stores and spares globally. The margins of consolidated entity are likely to increase due to rising share of more profitable India operations.

Valuations

We have assumed in our model that the entire fund raising is completed during FY08 and equity is diluted to 848m shares while the US\$875m CARS are assumed to be part of debt. The resulting market capitalization is US\$17.9b and enterprise value is Rs26.9b.

CALCULATIONS FOR EQUITY DILUTION

A.Existing shares in million (a)	609
B.Rights Issue 1:5 (Rs m)	36,550
Issue price	300
Million shares (b)	122
C.Rights CCPS 9:10 @ Rs 100;2% coupon (Rs m)	54,825
Conversion price (6CCPS=1 share on Sep 1, '09)	600
Million shares (c)	91
D. Foreign offering of equity (Rs m)	20,200
Issue price assumed*	800
Million shares (d)	25
New funds raised (B+C+D)	111,576
E.Additional shares issued (e=b+c+d) m	238
F. Total no. of shares (f=d+e)	848
G. CARS (US\$ m)	875
Amount (Rs m)	35,350
Issue price (Rs)	877
Million shares (g)	70
H. Fully diluted equity (f+g)	888

Source: Company/Motilal Oswal Securities

CALCULATIONS FOR AVERAGE SHARE PRICE

	SHARES (NO.)	AMOUNT (RS)	AT PRICE	REMARKS
Existing shares	100	99,060	991	
1:5@300 rights	20	6,000	300	
CCPS	15	9,000	600	9 CCPS of Rs 100 each (coupon of 2%) 1 Common share will be issue on 1Sep '09 for 6CCPS
	135	114,060	845	This is the avg. cost of buying shares before Nov 5 at CMP

Source: Company/Motilal Oswal Securities

The company recently announced details of rights issue, which will bring down the average cost of Tata Steel's shares (Refer to table below "Calculations for average share price").

We believe that raw material cost pressures for Corus due to re-negotiation of annual contracts in FY09 will be offset by price increase. Eurofer is likely to file anti-dumping case against Chinese exports within two weeks (as per Metal Bulletin) and this is likely to instigate Chinese government to take further steps to curb exports which are already declining in the past few months. Several media reports suggest possibility of China hiking export duty by 5% effective 1 November 2007 which augurs well for realizations, especially for European producers such as Corus, as global demand continues to grow at a strong clip. We remain positive on the steel cycle. The stock trades at attractive valuations (at ex-rights price of Rs845) of 4.6x FY09E EV/EBITDA, 6.5x FY09E P/E and 1.5x FY09E P/B (RoE of 22.6%), at a substantial discount to valuations of SAIL and JSW Steel. Tata Steel is our top pick in metals.

Tata Steel: an investment profile

Company description

Tata Steel (TATA), lowest cost producer, after acquisition of Corus (which is many times its size) has become the sixth largest steel maker globally. The combined entity (Tata-Corus) now has its business spread over Europe (37%), UK (22%), Asia (24%), North America (8%) and Rest of the World 9%. Tata-Corus (26mtpa) now has 17% raw materials security and plans to increase the production to 34mtpa through brownfield expansions at Jamshedpur and greenfield projects in Orissa, which will enhance the raw material security to 40%.

Key investment arguments

- ☞ Tata Steel is leveraging low cost advantage of India to feed finishing mill of its global subsidiaries. The brownfield expansion at Jamshedpur to raise the capacity to 10mtpa by 2010 and greenfield project in Orissa will raise the total capacity from 5mtpa currently to 13mtpa by 2010 in India.
- ☞ Tata Steel is focusing to expand the thin margins of Corus through reworking of product pricing, procurement policies, asset sweating and further improvement in operating efficiencies. Corus now has a focused promoter.

Key investment risks

- ☞ Earnings of Tata Steel now have high leverage to steel prices.

Recent developments

- ☞ MoU signed to mine coal in Mozambique, which has reserves of more than 500m tons.

Valuation and view

- ☞ The stock trades at attractive valuations (at ex-rights price of Rs845) of 4.6x FY09 EV/EBITDA, 6.5x FY09 P/E. Top pick in metals.

Sector view

- ☞ Strongly growing global demand of steel, rising industry consolidation (ex-China) leading to greater production discipline, declining exports of steel from China due to rising costs of metallics, and trade friction with western world is keeping the steel prices high. We prefer companies that deliver stronger volume growth, reduce operating costs and have security of raw materials.

COMPARATIVE VALUATIONS

		TATA STEEL	JSW STEEL	SAIL
P/E (x)	FY08E	7.3	9.8	12.8
	FY09E	6.5	9.0	12
P/BV (x)	FY08E	1.8	2.4	4.5
	FY09E	1.5	2.0	3.4
EV/Sales (x)	FY08E	0.8	2.2	2.4
	FY09E	0.7	2.0	2.2
EV/EBITDA (x)	FY08E	5.2	7.4	7.3
	FY09E	4.6	7.1	7

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	33.8	33.8	30.3
Domestic Inst	19.0	17.8	19.5
Foreign	21.4	22.7	21.5
Others	25.8	25.7	28.7

EPS: MOST FORECAST VS CONSENSUS (RS)

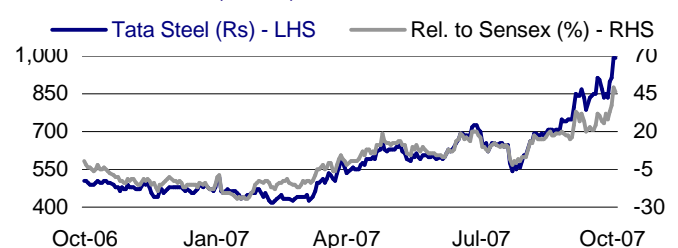
	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	115.4	91.6	26.0
FY09	130.7	97.9	33.5

TARGET PRICE AND RECOMMENDATION

**CURRENT PRICE (RS)	*TARGET PRICE (RS)	UPSIDE (%)	RECO.
991	1,315	32.7	Buy

*Ex-rights target price for 1 year; **Adjusted for the benefits of rights (1:5@300)

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (CONSOLIDATED)					
(RS MILLION)					
Y/E MARCH	2005	2006	2007	2008E	2009E
Net sales	159,986	202,444	251,197	1,275,253	1,311,766
Change (%)	43.8	26.5	24.1	407.7	2.9
Total Expenses	97,973	139,061	176,695	1,073,247	1,099,985
EBITDA	62,013	63,383	74,502	202,006	211,781
% of Net Sales	38.8	31.3	29.7	15.8	16.1
Depn. & Amortization	6,455	8,604	10,110	41,281	42,634
EBIT	55,558	54,780	64,392	160,725	169,147
Net Interest	1,981	1,555	4,112	34,579	26,169
Other income	1,824	2,466	4,381	5,629	2,600
PBT before EO	55,401	55,691	64,660	131,775	145,578
EO income	-977	-541	-1,521	43,963	-1,825
PBT after EO	54,424	55,150	63,139	175,738	143,753
Tax	18,712	17,939	21,474	36,647	36,214
Rate (%)	34.4	32.5	34.0	27.2	25.2
Reported PAT	35,712	37,211	41,665	139,091	107,539
Minority interests	260	186	675	800	800
Share of asso. PAT	580	322	792	2,670	2,670
Attributable PAT	36,033	37,346	41,782	140,961	109,409
Adjusted PAT	36,674	37,711	42,786	97,842	110,774
Change (%)	90.3	2.8	13.5	28.7	13.2

BALANCE SHEET					
(RS MILLION)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Share Capital	5,537	5,537	5,807	8,476	8,476
Reserves	65,653	94,722	140,584	388,810	481,743
Net Worth	71,189	100,258	146,390	397,286	490,219
Minority Interest	935	1,236	1,911	3,031	3,831
Total Loans	33,156	33,774	30,899	505,989	505,989
Deferred Tax Liability	23,818	23,947	23,513	29,542	37,519
Capital Employed	129,098	159,216	202,714	935,848	1,037,558
Gross Block	142,235	167,447	172,447	706,970	780,968
Less: Accum. Deprn.	63,039	72,000	82,110	123,391	166,025
Net Fixed Assets	79,196	95,447	90,337	583,579	614,943
Capital WIP	18,994	13,574	28,574	13,574	13,574
Investments	25,942	34,789	40,567	52,646	52,646
Curr. Assets	50,720	59,081	93,552	609,899	686,923
Inventory	20,892	22,765	24,229	224,505	229,606
Account Receivables	13,247	12,198	13,768	179,546	182,276
Cash and Bank Balanc	4,657	7,768	32,984	177,039	243,951
Others	11,924	16,350	22,571	28,808	31,090
Curr. Liability & Pr	45,752	43,675	50,316	323,850	330,528
Account Payables	31,417	30,269	34,175	243,254	249,190
Provisions & Others	14,335	13,406	16,142	80,596	81,338
Net Current Assets	4,967	15,406	43,235	286,049	356,395
Appl. of Funds	129,098	159,216	202,714	935,848	1,037,558

E: MOST Estimates

USD=Rs41; GBP=1.98USD

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	66.2	68.1	70.2	115.4	130.7
Cash EPS	76.2	82.7	89.2	212.8	177.2
BV/Share	128.6	181.1	252.1	468.7	578.3
DPS	13.0	13.0	16.3	15.0	15.0
Payout (%)	22.4	21.8	25.8	15.2	13.4
Valuation (x)					
P/E		12.4	12.0	7.3	6.5
Cash P/E		10.2	9.5	4.0	4.8
P/BV		4.7	3.4	1.8	1.5
EV/Sales		2.4	1.9	0.8	0.7
EV/EBITDA		7.8	6.6	5.2	4.6
Dividend Yield (%)		15	19	18	18
Return Ratios (%)					
RoE	51.5	37.6	27.9	24.6	22.6
RoCE	43.0	34.4	31.8	17.2	16.3
RoIC	45.9	35.9	42.2	16.9	17.4
Working Capital Ratios					
Asset Turnover (x)	12	13	12	14	13
Debtor (Days)	30.2	22.0	20.0	51.4	50.7
Inventory (Days)	13.1	11.2	9.6	17.6	17.5
Working Capital Turnov	0.2	3.8	4.1	8.5	8.6
Leverage Ratio (x)					
Current Ratio	1.1	1.4	1.9	1.9	2.1
Interest Cover Ratio	28.0	35.2	15.7	4.6	6.5
Debt/Equity	0.4	0.3	0.0	0.8	0.5

CASHFLOW STATEMENT					
(RS MILLION)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Pre-tax Profit	54,424	55,150	63,139	175,738	143,753
Depreciation	6,455	8,604	10,110	41,281	42,634
(Inc)/Dec in Wkg. Cap.	-1,095	-7,328	-2,613	-98,759	-3,435
Tax Paid	-18,751	-16,490	-21,629	-24,643	-28,262
CF from Op. Activi	41,034	39,936	49,007	93,617	154,690
(Inc)/Dec in FA +CWIP	-25,161	-19,793	-20,000	-519,524	-73,998
(Pur)/Sale of Investme	-3,392	-8,847	-5,778	-12,018	
CF from Inv. Activi	-28,553	-28,640	-25,778	-531,541	-73,998
Equity raised/(repaid)	1,845		270	111,861	
Chg in minorities	449	301	675	1,120	800
Debt raised/(repaid)	-1,734	618	-2,875	475,090	
Dividend (incl. tax)	-8,214	-8,204	-11,043	-14,876	-14,905
Other financing activitie	-2,947	-900	14,961	8,580	119
CF from Fin. Activi	-10,602	-8,186	1,988	581,775	-13,986
(Inc)/Dec in Cash	1,879	3,110	25,217	143,851	66,707
Add: opening Balance	2,779	4,657	7,768	32,984	177,039
Closing Balance	4,657	7,768	32,984	176,835	243,746



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Tata Steel

- | | |
|---|-----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | Yes |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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