

Yet more downside from falling steel prices

Earnings and PO cut once again; reiterate underperform

Indian steel equities have been underperforming; we expect further downside as steel prices continue to fall more than our earlier expectations. We have cut our FY10 EPS forecasts for Tata, SAIL and JSW by 19-36%. We have also cut POs by 2-41%. Lower POs reflect both earnings cut and higher discounts to our DCF valuation. We have raised the discount in Tata and JSW Steel to 50% (40%) and for SAIL and JSPL to 30% (20%).

Steel prices have more downside

Indian steel prices are down ~24% to Rs32000/t. We expect further fall to Rs28000/t to bring it in line with import parity. The decline in European steel prices has been sharper at 45%. But it is interesting to note that despite lower input costs, the gross 'spread' for a non integrated steel company is still double the levels last down cycle in 1997-98. Hence, risk of further steel price declines.

We cut FY10 sales volume forecasts 1-27%

We still forecast vol. growth for FY10 but at a reduced rate of ~12%. Over the last 10 years, India's steel demand has grown at ~1.2x IIP growth. Assuming similar correlation, we forecast India's demand to grow by 3-5% in FY10. Tata, JSW and SAIL, being low cost producers, will likely see higher than India avg vol. growth.

Falling input costs is limited benefit for our steel coverage

Our global team has cut coking coal price to US\$125/t (\$300/t) and iron ore to \$74/t (\$92/t) for FY10. This lowers the cost support to steel prices. Also this offers limited benefit to integrated players – SAIL and Tata India operations. For Corus, we forecast price decline to be higher and compression of spread.

Tata Steel: FY10EPS cut 36% to Rs39, PO cut 41% to Rs128

We forecast FY10 EPS to decline 62%. At Rs187, it is at P/E of 4.8x FY10 and P/B of 0.6x. Our PO is based on 50% discount to DCF and implies P/B of 0.4x, similar to levels reached in the last down cycle in 1998.

SAIL: FY10EPS cut 19% to Rs11, PO cut 39% to Rs52

We expect FY10 EPS to decline 25%. At Rs70, it is at FY10 P/E of 6.2x & P/B of 1.0x. Our PO, based on 30% discount to DCF, implies P/B of 0.8x. Premium to Tata is justified on lower sensitivity & high cash position, ~Rs36.4/share.

JSW Steel: FY10EPS cut 28% to Rs50, PO cut 32% to Rs153

We forecast EPS to decline 18%. At Rs219, it is at FY10 P/E of 4.4x & P/B of 0.44x. Our PO, based on 50% discount to DCF and implies to P/B of 0.3x. However Risks are high given high sensitivity and steep gearing ~1.6x .

Equity | India | Steels
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Table 1: PO Changes (Rs/share)

| | New PO | Old PO | CMP | Up/D'side |
|-----------|--------|--------|-----|-----------|
| Tata | 128 | 216 | 187 | -32% |
| SAIL | 52 | 85 | 70 | -26% |
| JSW Steel | 153 | 219 | 219 | -30% |
| JSPL | 720 | 738 | 813 | -11% |

Source: Merrill Lynch
**= Prices as on 12 Dec 2008

Table 2: EPS Changes

| Rs | FY09E | | | FY10E | | |
|------|-------|-----------|------|-------|-----------|------|
| | New | Old % chg | | New | Old % chg | |
| Tata | 102 | 131 | -22% | 39 | 61 | -36% |
| SAIL | 15 | 20 | -24% | 11 | 14 | -19% |
| JSW | 61 | 88 | -30% | 50 | 69 | -28% |
| JSPL | 170 | 173 | -1% | 146 | 152 | -4% |

Source: Merrill Lynch Estimates

Table 3: Sensitivity and Net Gearing

| | Sensitivity Net Gearing | |
|-----------------|-------------------------|-------|
| | 1% chg in price | FY09E |
| Tata | 26% | 1.1 |
| JSW Steel | 10% | 1.8 |
| SAIL | 5% | (0.4) |
| JSPL- Consol | 3% | 0.8 |
| JSPL- Std alone | 5% | |

Source: Tata, JSW Steel, SAIL, JSPL, Merrill Lynch Estimates

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POs slashed sharply by 2-41%

Continuing fall in steel prices leads us to cut our earnings forecasts. In addition, continuing recession fears imply that the down cycle could last for longer and earnings visibility deteriorates further. Hence we have build in higher discounts to our DCF valuations. We note our POs correspond to P/B of 0.4x for Tata, 0.3x JSW and 0.8x for SAIL. We note that lower discount for SAIL and JSPL is justified owing to lower sensitivity to steel prices and stronger balance sheet. Table 4 summarizes our PO changes.

Table 4: PO changes and basis

| Rs | Old | | New | |
|-----------|-----|-----------------|-----|-------------------|
| | PO | Discount to NPV | | Discount to NPV |
| Tata | 216 | 40% | 128 | 50% |
| JSW Steel | 219 | 40% | 153 | 50% |
| SAIL | 85 | 20% | 52 | 30% |
| JSPL | 738 | 20% | 720 | 30% only on steel |

Source: Merrill Lynch

Earnings cut by 4-36%

Our earnings cut reflect both falling steel prices and lower volume growth forecasts. Table 4 gives the details for each of the companies and our key price and volume assumptions for FY10 are given below.

- Price:** we take benchmark HR steel price of \$500/t. Incorporating import duty of 5% and exchange rate of Rs48.5, we get benchmark domestic HR price of Rs28000/t. This implies a y-o-y decline of 33% and a decline of 13% from current spot price of Rs32000/t.
- Volume:** Sales volume growth in FY09E is -10% to 23% across our steel coverage. In FY10, we are forecasting volume growth of 12% for these companies. Over the last 10 years, India's steel demand has grown at 1.2x of IIP growth. Assuming similar correlation, we forecast India's demand to grow 3-5% in FY10. Our steel names are likely to deliver higher than India average growth given that they are among the lowest cost producers in the country,

Table 5: Summary of EPS Changes

| Rs | FY09E | | FY10E | | FY09E | | FY10E | |
|--------------|-------|-----|-------|-----|------------|-----|------------|------|
| | EPS | | EPS | | EPS growth | | EPS growth | |
| | Is | Was | Is | Was | Is | Was | Is | Was |
| Tata | 102 | 131 | 39 | 61 | 34% | 72% | -62% | -53% |
| SAIL | 15 | 20 | 11 | 14 | -17% | 9% | -25% | -29% |
| JSW Steel | 61 | 88 | 50 | 69 | -20% | 15% | -18% | -21% |
| JSPL- Consol | 170 | 173 | 146 | 152 | 89% | 92% | -15% | -12% |
| JSPL- Steel | 97 | 104 | 71 | 78 | 21% | 30% | -27% | -26% |

Source: Merrill Lynch Estimates

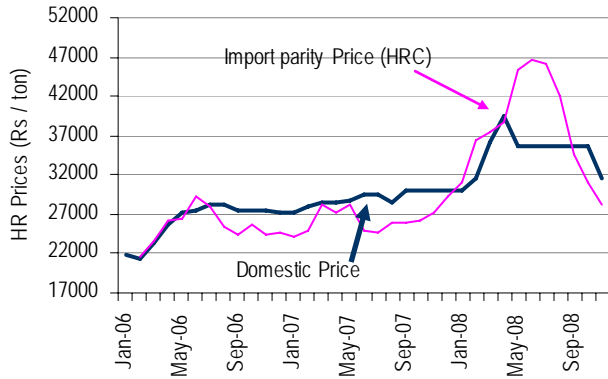
Steel prices continue to fall

The steel environment has deteriorated at a pace faster than our expectations. Recession fears continue to deepen and it is unlikely that demand recovers over the next few quarters. The key prices we are tracking are, domestic prices, China HR export price and Europe HR spot price. Chart 1 and Chart 2 gives the price trends.

China's rising exports have been a key risk to global demand supply balance. The Chinese export price had collapsed to \$425/t in November. It has recovered slightly to \$490/t now, but is still down 50% from its peak in June.

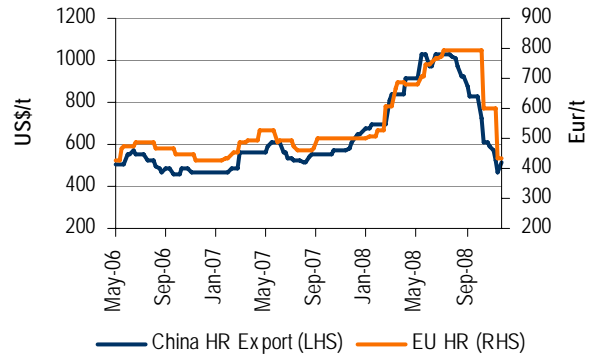
The European spot price is relevant for Tata's Corus realizations. This price is currently Euro435/t, down 45% from its September peak. We suspect some of this price fall may also be owing to excessive de-stocking in Europe owing to credit crunch in the trade channel. We also highlight, for Corus, the effective price decline is likely to be lower since it has ~30% of sales on long term contracts and it has a relatively richer product mix where price changes are less volatile versus spot. Hence we are building in 16.5% decline in Corus realizations for FY10.

Chart 1: Dom. prices at premium to import parity despite import duty



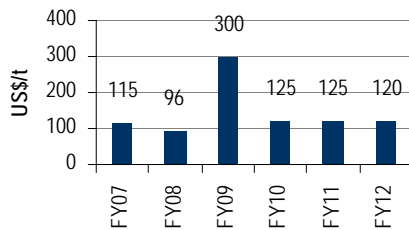
Source: CRU, Bloomberg, Merrill Lynch Estimates

Chart 2: Steep decline in global prices



Source: Metals Bulletin, Bloomberg

Chart 3: ML HCC benchmark forecast

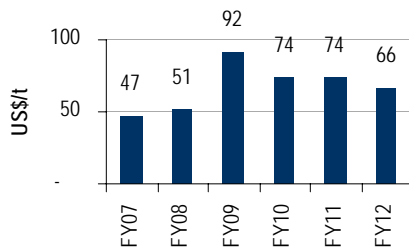


Source: Merrill Lynch Estimates

Raw material forecasts cut

For FY10, our global team has cut coking coal price to US\$125/t from earlier \$300/t. We are also forecasting lower iron ore price of \$74/t versus \$92/t earlier. We expect this is likely to lower the cost support to steel prices in a weaker demand environment. Also, lower input costs have limited benefit for Tata India operations and SAIL since both these companies have integration levels. Tata India owns 100% of iron ore and ~70% of coking coal. SAIL owns 100% of iron ore but has no coking coal. The benefit is relatively higher for the non integrated JSW Steel but it sources 40% of iron ore and entire coke from the spot market and was already benefiting from lower spot prices. Tata's Corus division (33% of Group EBIT in FY10) is the single biggest beneficiary of lower input prices since it has no raw material integration. The bad news however is that the end product steel, prices are also falling. Given Corus' "converter" status we believe the key parameter to track for Corus is the spread between the input and selling price or in other words the EBITDA/ton. In FY10, we are forecasting Corus' EBITDA/ton to half to \$52 versus \$102 in FY09.

Chart 4: ML iron ore benchmark forecast



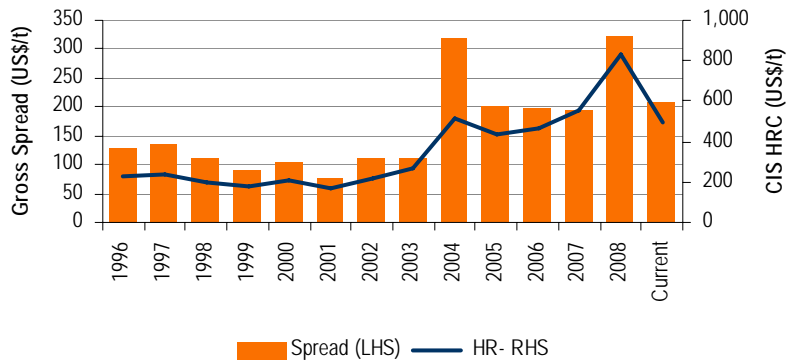
Source: Merrill Lynch Estimates

Continuing high spreads is the key risk to steel prices

Despite the sharp fall in steel prices across various regions, it is interesting to note that gross spreads appear to be still very high and therein lies the risk that steel prices can fall further. Our back of the envelope calculation for a non integrated steel company is as follows. We take contract iron ore and coking coal prices, add freight and apply the production norms (1.6x iron ore and 0.8x coking coal) to get the input cost. We take the CIS HR as the selling price and the difference gives us the spread. We acknowledge that our calculation is simplistic but nonetheless it helps to indicate a rough trend in the spreads.

Based on the above methodology, using our FY10 forecasts of \$125/t for coking coal and \$74/t for iron ore and current selling price of \$500/t, we arrive at a spread of \$210/t. This is sharply lower than FY09 spread of \$323/t but more importantly it is still almost double of the levels witnessed in earlier down cycle in 1997 and 1998. Hence we believe there is significant risk that steel prices could fall further. Chart 5 gives the spread trends since 1996.

Chart 5: Gross Spread still high vs historic levels



Source: CRU, Merrill Lynch Estimates

Tata Steel: Key Forecast and Assumptions

Table 6: Tata Steel: Whats Changed?

| | FY09E | | | FY10E | | | FY11E | | |
|----------------------|-----------|-----------|-------|-----------|-----------|-------|-----------|-----------|-------|
| | New | Old | % chg | New | Old | % chg | New | Old | % chg |
| Revenue | 1,533,445 | 1,567,641 | -2% | 1,320,590 | 1,504,539 | -12% | 1,359,641 | 1,581,785 | -14% |
| India EBITDA | 99,417 | 112,202 | -11% | 76,104 | 105,510 | -28% | 74,549 | 126,369 | -41% |
| Corus EBITDA | 78,314 | 96,701 | -19% | 38,577 | 45,911 | -16% | 46,326 | 45,677 | 1% |
| Group EBITDA | 187,091 | 218,263 | -14% | 124,041 | 160,780 | -23% | 130,234 | 181,406 | -28% |
| Margins | 4% | 14% | -34% | 11% | 11% | 0% | 5% | 11% | -55% |
| Net Profits | 83,440 | 107,336 | -22% | 32,080 | 50,378 | -36% | 34,218 | 62,764 | -45% |
| EPS | 101.6 | 130.7 | -22% | 39.1 | 61.3 | -36% | 41.7 | 76.4 | -45% |
| Blended Realisation | | | | | | | | | |
| Indian Ops (Rs/t) | 36,467 | 37,419 | -3% | 28,846 | 32,938 | -12% | 28,814 | 34,170 | -16% |
| Corus (GBP/t) | 742 | 753 | -2% | 619 | 708 | -13% | 632 | 708 | -11% |
| Volumes | | | | | | | | | |
| Indian Ops (mn tons) | 5.3 | 5.5895 | -5% | 5.9 | 6.422 | -9% | 6.5 | 8.2895 | -22% |
| Corus (mn tons) | 19.3 | 19.3 | 0% | 19.3 | 19.3 | 0% | 19.3 | 19.3 | 0% |

Source: Tata Steel, Merrill Lynch Estimates

Table 7: Corus key forecast and assumptions

| | FY08 | FY09E | FY10E | FY11E |
|----------------------|--------|--------|--------|--------|
| Sales vol. (mn tons) | 20.3 | 19.3 | 19 | 19 |
| % chg | 7.0% | -4.9% | 0.0% | 0.0% |
| Revenue (mn GBP) | 11,968 | 14,313 | 11,952 | 12,191 |
| % chg | 25.7% | 19.6% | -16.5% | 2.0% |
| Realization- GBP/ton | 590 | 741.6 | 619.3 | 631.6 |
| % chg | 16% | 25.8% | -16.5% | 2% |
| EBITDA (mn GBP) | 1093 | 969 | 477 | 573 |
| EBITDA margin | 9.1% | 6.7% | 3.9% | 6.5% |
| % chg | 0.55 | -11.3% | -50.7% | 20.1% |
| EBITDA/ton | 54 | 50 | 25 | 30 |

Source: Tata Steel, Merrill Lynch Estimates

Table 8: Tata Steel standalone:Key forecasts and assumptions

| | FY08 | FY09E | FY10E | FY11E |
|------------------------------|-------------|--------------|--------------|--------------|
| Steel volume sales (m tons) | 4.8 | 5.3 | 5.9 | 6.5 |
| % change | -0.3% | 10.9% | 10.4% | 10.3% |
| Avg Steel Realization (Rs/t) | 29,361 | 36,467 | 28,846 | 28814 |
| % change | 17.0% | 24.2% | -20.9% | -0.1% |
| Benchmark HRC (US\$/ton) | 594 | 843 | 500 | 532 |
| Benchmark CRC (US\$/ton) | 652 | 909 | 539 | 574 |
| Exchange rate - Rs/US\$ | 40 | 46 | 49 | 46 |
| Product Mix (volume) | | | | |
| - HR | 30% | 28% | 26% | 28% |
| - CR | 26% | 23% | 21% | 19% |
| - GPGC | 10% | 9% | 8% | 7% |
| - Longs | 33% | 39% | 44% | 45% |
| - Semis | 1% | 1% | 1% | 0% |
| Turnover | 196,933 | 243,546 | 221,518 | 241255 |
| EBITDA | 82,235 | 99,417 | 76,104 | 74549 |
| EBITDA Margins | 41.8% | 40.8% | 34.4% | 30.9% |

Source: Tata Steel, Merrill Lynch Estimates

Table 9: Consolidated earnings forecast

| | FY08 | FY09E | FY10E | FY11E |
|---|------------------|----------------|----------------|----------------|
| Net Turnover | 1,315,359 | 1,533,445 | 1,320,590 | 1,359,641 |
| % chg | 421.7% | 16.6% | -13.9% | 3.0% |
| EBITDA | 179,931 | 187,091 | 124,041 | 130,234 |
| % chg | 146.6% | 4.0% | -33.7% | 5.0% |
| - Tata Steel | 82,235 | 99,417 | 76,104 | 74,549 |
| - Corus | 88,336 | 78,314 | 38,577 | 46,326 |
| - Natsteel | 2,309 | 2,309 | 2,309 | 2,309 |
| - Millenium | 5,103 | 5,103 | 5,103 | 5,103 |
| - Others | 1,948 | 1,948 | 1,948 | 1,948 |
| EBITDA/Ton - \$ | 154 | 143 | 88 | 96 |
| EBITDA margin | 13.7% | 12.2% | 9.4% | 9.6% |
| Depreciation | 41,370 | 43,361 | 44,526 | 47,869 |
| EBIT | 138,562 | 143,729 | 79,515 | 82,365 |
| Interest | 41,838 | 40,315 | 40,315 | 40,315 |
| Profit bef Other Income | 96,724 | 103,415 | 39,200 | 42,050 |
| Other income | 5,742 | 3199 | 3199 | 3199 |
| Pre-tax profit | 102,466 | 106,613 | 42,398 | 45,249 |
| Total tax | 40,493 | 23,455 | 10,600 | 11,312 |
| Tax rate - Average | 39.5% | 22.0% | 25% | 25.0% |
| Net profit | 61,973 | 83,158 | 31,799 | 33,937 |
| % chg | 48.8% | 34.2% | -61.8% | 6.7% |
| Share of Profit of Associates | 1,681 | 1,681 | 1,681 | 1,681 |
| Minority Interest | 1,399 | 1,399 | 1,399 | 1,399 |
| Profit Attributable to Share Holders | 62,255 | 83,440 | 32,080 | 34,218 |
| % chg | 49.0% | 34.0% | -61.6% | 6.7% |
| XO Income,net of Tax | 61,244 | | | |
| PAT after exceptionals | 123,499 | 83,440 | 32,080 | 34,218 |
| Fully diluted Shares Outstanding - mn | 821.3 | 821.3 | 821.3 | 821.3 |
| EPS (Consolidated) | 75.8 | 101.6 | 39.1 | 41.7 |
| % chg | 5.4% | 34.0% | -61.6% | 6.7% |

Source: Tata Steel, Merrill Lynch Estimates

SAIL: Key Forecast and Assumptions

Table 10: Whats Changed

| | FY09E | | | FY10E | | | FY11E | | |
|-------------------------|---------|---------|--------|---------|---------|-------|---------|---------|-------|
| | New | Old | % chg | New | Old | % chg | New | Old | % chg |
| Revenue | 450,549 | 480,985 | -6% | 387,737 | 437,128 | -11% | 416,946 | 506,753 | -18% |
| EBITDA | 86,482 | 116,501 | -26% | 63,374 | 80,333 | -21% | 81,179 | 91,393 | -11% |
| Margins | 19% | 24% | | 16% | 18% | | 19% | 18% | |
| Net Profits | 62,508 | 82,171 | -24% | 46,838 | 57,946 | -19% | 52,546 | 59,236 | -11% |
| EPS (Rs) | 15.1 | 19.9 | -23.9% | 11.3 | 14.0 | -19% | 12.7 | 14.3 | -11% |
| Volumes (mn tons) | 11.2 | 11.3 | -1% | 11.7 | 11.8 | -1% | 13.1 | 13.9 | -6% |
| Avg Realisations (Rs/t) | 37,401 | 39,749 | -6% | 30,197 | 34,085 | -11% | 29,302 | 34,085 | -14% |

Source: SAIL, Merrill Lynch Estimates

Table 11: SAIL Key assumptions and forecast.

| | FY08A | FY09E | FY10E | FY11E |
|---------------------------------|---------|---------|---------|---------|
| Steel Sales (m tons) | 12.3 | 11.2 | 11.7 | 13.1 |
| % change | 3% | -9% | 5% | 11% |
| Average steel realisation- Rs/t | 30,016 | 37,401 | 30,197 | 29,302 |
| % change | 12% | 25% | -19% | -3% |
| Domestic HR Realisations | 28210 | 35563 | 27990 | 28071 |
| % change | 15% | 26% | -21% | 0% |
| Exchange rate - Rs/US\$ | 40 | 46 | 49 | 46 |
| Net Turnover (Rs m) | 395,085 | 450,549 | 387,737 | 416,946 |
| EBITDA (Rs m) | 105,714 | 86,482 | 63,374 | 81,179 |
| EBITDA margin (%) | 26.8% | 19.2% | 16.3% | 19.5% |
| EBITDA / Ton (Rs) | 8,595 | 7,745 | 5,404 | 6,216 |
| Pre-tax profit (Rs m) | 114,674 | 95,433 | 71,509 | 80,222 |
| Net profit (Rs m) | 75,328 | 62,508 | 46,838 | 52,546 |
| EPS (Rs) | 18.2 | 15.1 | 11.3 | 12.7 |
| % change | 22% | -17% | -25% | 12% |

Source: SAIL, Merrill Lynch Estimates

JSW Steel: Key Forecast and Assumptions

Table 12: What's Changed?

| | FY09E | | | FY10E | | | FY11E | | |
|-------------------------|---------|---------|-------|---------|---------|-------|---------|---------|-------|
| | New | Old | % chg | New | Old | % chg | New | Old | % chg |
| Revenue | 176,488 | 208,603 | -15% | 173,821 | 266,955 | -35% | 210,554 | 337,833 | -38% |
| EBITDA | 36,937 | 45,443 | -19% | 39,648 | 44,832 | -12% | 44,154 | 58,905 | -25% |
| Margins | 21% | 22% | -4% | 23% | 17% | 36% | 21% | 17% | 20% |
| Net Profits | 12,632 | 17,951 | -30% | 10,330 | 14,214 | -27% | 11,245 | 19,183 | -41% |
| Group EPS | 61 | 88 | -30% | 50 | 69 | -28% | 55 | 94 | -42% |
| Volumes (mn tons) | 3.5 | 4.1 | -15% | 4.6 | 6.2 | -27% | 6.0 | 8.2 | -27% |
| Avg Realisations (Rs/t) | 40,035 | 39,122 | 2% | 29,971 | 34,012 | -12% | 29,660 | 34,736 | -15% |

Source: JSW Steel, Merrill Lynch Estimates

Table 13: Summary of Forecasts

| Rs in Mn | FY08 | FY09E | FY10E | FY11E |
|----------------------|---------|----------|---------|---------|
| Revenues | | | | |
| JSW Steel Standalone | 113,553 | 150,702 | 148,455 | 188,792 |
| US Plates and Pipes | 12,678 | 37,003 | 31,708 | 30,392 |
| Intersegment Sales | (2,776) | (11,218) | (6,342) | (8,630) |
| Total Revenue | 123,455 | 176,488 | 173,821 | 210,554 |
| EBITDA | | | | |
| JSW Steel Standalone | 31,816 | 30,669 | 33,356 | 38,520 |
| US Plates and Pipes | 1,858 | 6,268 | 6,293 | 5,633 |
| Group EBITDA | 33,673 | 36,937 | 39,648 | 44,154 |
| Group EBITDA Margins | 27% | 20.9% | 22.8% | 21.0% |

Source: JSW Steel, Merrill Lynch Estimates

JSPL: Key Forecast and Assumptions

Table 14: What's Changed?

| | FY09E | | | FY10E | | | FY11E | | |
|-------------------------|---------------|---------------|------------|---------------|---------------|------------|---------------|---------------|-------------|
| | New | Old | % chg | New | Old | % chg | New | Old | % chg |
| Revenue | 101,646 | 101,980 | 0% | 97,729 | 104,319 | -6% | 93,812 | 104,951 | -11% |
| JSPL EBITDA | 26,317 | 27,827 | -5% | 20,592 | 21,875 | -6% | 22,520 | 27,781 | -19% |
| JPL EBITDA | 19,577 | 18,718 | 5% | 21,167 | 21,167 | 0% | 17,092 | 17,092 | 0% |
| Group EBITDA | 45,894 | 46,545 | -1% | 41,760 | 43,042 | -3% | 39,612 | 44,874 | -12% |
| Margins | 45% | 46% | | 43% | 41% | | 42% | 43% | |
| Net Profits | 26,955 | 27,342 | -1% | 23,024 | 24,000 | -4% | 21,921 | 25,998 | -16% |
| Steel EPS | 97 | 104 | -7% | 71 | 78 | -8% | 84 | 110 | -24% |
| Power EPS | 73 | 68 | 7% | 74 | 74 | 0% | 55 | 55 | 0% |
| Group EPS | 170 | 173 | -1% | 146 | 152 | -4% | 139 | 164 | -16% |
| Volumes (mn tons) | 1.6 | 1.6 | 0% | 2.1 | 2.1 | 0% | 2.2 | 2.2 | 0% |
| Avg Realisations (Rs/t) | 35,463 | 36,573 | -3% | 29,328 | 32,152 | -9% | 29,381 | 34,170 | -14% |

Source: JSPL, Merrill Lynch Estimates

Table 15: Summary of Forecasts

| Rs in Mn | FY08 | FY09e | FY10e | FY11e |
|-----------------------|---------------|----------------|---------------|---------------|
| Group Revenues | 54,891 | 101,646 | 97,729 | 93,812 |
| y-o-y change | 56% | 85% | -4% | -4% |
| EBITDA | | | | |
| JSPL Standalone | 23,631 | 26,317 | 20,592 | 22,520 |
| JPL Power | 0 | 19,577 | 21,167 | 17,092 |
| Group EBITDA | 23,631 | 45,894 | 41,760 | 39,612 |
| y-o-y change | 69% | 94% | -9% | -5% |
| Group EBITDA margins | 43% | 45% | 43% | 42% |
| JSPL Standalone | 43% | 34% | 29% | 32% |
| JPL Power | NA | 80% | 76% | 71% |

Source: JSPL, Merrill Lynch Estimates

Table 16: JSPL Key metrics and forecasts at a glance

| | FY08 | FY09e | FY10e | FY11e |
|---------------------------|--------|--------|--------|--------|
| Steel vol (mn tons) | 1.3 | 1.6 | 2.1 | 2.2 |
| Pig Iron (mn tons) | 0.3 | 0.3 | 0.1 | 0.0 |
| Sponge iron (mn tons) | 0.4 | 0.3 | 0.0 | 0.0 |
| Steel ASP- Blended- Rs/t | 26,880 | 35,463 | 29,328 | 29,381 |
| Power sales (mn KWH) | | 5,054 | 6,610 | 6,610 |
| Merchant tariff (Rs/ Kwh) | | 6.6 | 5.5 | 4.5 |
| % of power sales | | 57% | 57% | 57% |
| Blended tariff (Rs mn) | | 4.8 | 4.2 | 3.6 |

Source: JSPL, Merrill Lynch Estimates

■ Investment thesis

Jindal Steel and Power Limited

Steel outlook has deteriorated rapidly owing to global growth concerns, weaker Chinese demand and surging Chinese exports. We expect group profits to decline in FY10 owing to decline in steel profits despite robust power profit growth. While valuations for the steel business are nearing trough, negative catalysts such as weak fundamentals, falling steel prices and downward revisions to steel earnings are likely to keep valuation depressed. Hence Underperform.

JSW Steel

Steel outlook has deteriorated rapidly owing to global growth concerns, weaker Chinese demand and surging Chinese exports. We expect JSW Steel net profits to decline in FY10 owing to lower steel prices. Also earnings risks are high owing to high sensitivity to steel prices. While valuations are nearing trough, negative catalysts such as weak fundamentals, falling steel prices and downward revisions to earnings are likely to keep valuation depressed. Hence Underperform.

Steel Authority

Steel outlook has deteriorated rapidly owing to global growth concerns, weaker Chinese demand and surging Chinese exports. We expect SAIL's net profits to decline owing to lower steel prices. Also earnings risks are high owing to high sensitivity to steel prices. While valuations are nearing trough, negative catalysts such as weak fundamentals, falling steel prices and downward revisions to earnings are likely to keep valuation depressed. Hence Underperform.

Tata Steel

Steel outlook has deteriorated rapidly owing to global growth concerns, weaker Chinese demand and surging Chinese exports. We expect Tata Steel's net profits to decline owing to lower steel prices. Also earnings risks are high owing to high sensitivity to steel prices. While valuations are nearing trough, negative catalysts such as weak fundamentals, falling steel prices and downward revisions to earnings are likely to keep valuation depressed. Hence Underperform.

Price objective basis & risk

Jindal Steel and Power Limited (XJDLF)

Our PO of Rs720 is based on SOTP valuation of JSPL's steel and power business. We apply a 30% discount to steel NPV. We believe a discount is justified because of sharp near term demand slowdown, cyclical downturn in the steel sector and higher risks to earnings from falling steel prices. Also, investor risk aversion is likely to be higher given the challenging macro environment and prospects of recession.

Our NPV for the group is Rs833. This implies Rs378 for steel business and Rs455 for the power subsidiary. Our NPV calculation is based on a WACC of 13.7% and terminal growth rate of 0%. We have assumed steel volumes of 1.6mn tons in FY09 and 2.1mn tons in FY10. We have assumed average realization of Rs35,463/t in FY09 and Rs29,328/t in FY10. For the power business, we have assumed 57% of saleable output to be sold on short-term/spot tariff. We assume merchant tariff of Rs6.6/unit in FY09, Rs5.5/unit in FY10 and Rs4.5/unit in FY11. We expect capacity bunching to lead to decline in merchant tariff to Rs2.8/unit in FY12. We assume blended power tariff of Rs4.8/unit in FY09, Rs4.20/unit in FY10 and Rs3.63/unit in FY11.

Upside risks to our valuation are higher steel prices, higher power tariff, better visibility on the execution of Bolivia mine project. Downside risks to our valuation are sharper than expected fall in steel prices, lower than expected steel production, and lower power tariff.

JSW Steel (XJWJF)

Our PO of Rs153 is set at a 50% discount to our NPV. We believe a discount is justified because of sharp near term demand slowdown, cyclical downturn in the steel sector and higher earnings from falling steel prices. Also, investor risk aversion is likely to be higher given the challenging macro environment and prospects of recession.

Our NPV calculation assumes a WACC of 13.7% and perpetuity growth rate of 0%. We assume steel volumes of 3.5mn tons in FY09 and 4.6mn tons in FY10. We now forecast benchmark HR realizations of Rs37,800/t in FY09 and Rs28,000/t in FY10.

Upside risks are higher than expected steel prices owing to better steel fundamentals, lower raw material costs, commissioning of mines and higher import duties. Downside risks are lower than expected steel prices, delays in commissioning of capacities and mines, higher than expected raw material costs and potential government intervention.

Steel Authority (SLAUF)

Our PO of Rs52 is based on a 30% discount to our NPV valuation of Rs75/share. Our NPV assumes a WACC of 13.7% and a perpetuity growth of 0%. We believe a discount is justified because of sharp near term demand slowdown, cyclical downturn in the steel sector and higher risks to earnings from falling steel prices. Also, investor risk aversion is likely to be higher given the challenging macro environment and prospects of recession.

Upside risks to our valuation are higher steel prices, lower input costs, export tariff on Chinese exports and higher import duty. Downside risks are lower than expected steel prices, volumes, and higher input costs.

Tata Steel (TAEFL)

Our PO of Rs128 is based on a 50% discount to our NPV valuation of Rs256/share. Our NPV assumes a WACC of 13.7% and perpetuity growth rate of 0%. We believe a discount is justified because of sharp demand slowdown, cyclical downturn in the steel sector and higher risks to earnings from falling steel prices. Also, investor risk aversion is likely to be higher given the challenging macro environment and prospects of OECD recession. Upside risks to our valuation are higher steel prices, synergy benefits, lower input costs, export tariff on Chinese exports and higher domestic import duty. Downside risks are lower than expected steel prices, volumes and higher input costs.

Analyst Certification

I, Vandana Luthra, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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| Investment rating | Company | ML ticker | Bloomberg symbol | Analyst |
|---------------------|-----------------------------------|-----------|------------------|--------------------|
| BUY | | | | |
| | Banpu Pcl | BPULF | BANPU TB | Komsun Suksumrun |
| | China Shenhua-H | CUAEF | 1088 HK | Alexander Latzer |
| | Intl Nickel In | PTNDF | INCO IJ | Daisy Suryo |
| | PT Adaro Energy Tbk | XPDRF | ADRO IJ | Daisy Suryo |
| | PT Bayan Resources Tbk | XBAYF | BYAN IJ | Daisy Suryo |
| | Tambang Batubara | PBATF | PTBA IJ | Daisy Suryo |
| | Yanzhou Coal | YZCHF | 1171 HK | Alexander Latzer |
| | Yanzhou Coal -A | YZC | YZC US | Alexander Latzer |
| | Zijin Mining - H | ZIJMF | 2899 HK | Alexander Latzer |
| NEUTRAL | | | | |
| | Chalco | ACH | ACH US | Alexander Latzer |
| | Chalco | ALMMF | 2600 HK | Alexander Latzer |
| | Hindalco | HNDFF | HNDL IN | Vandana Luthra |
| | Jiangxi Copper-A | JIXAY | JIXAY US | Alexander Latzer |
| | Jiangxi Copper-H | JIAXF | 358 HK | Alexander Latzer |
| | Sterlite Industr | XTNDF | STLT IN | Vandana Luthra |
| | Sterlite Industries India Limited | SLT | SLT US | Vandana Luthra |
| UNDERPERFORM | | | | |
| | Aneka Tambang | XANEF | ANTM IJ | Daisy Suryo |
| | Angang | ANGGF | 347 HK | Alexander Latzer |
| | Baosteel | BAOSF | 600019 CH | Alexander Latzer |
| | China Steel | CISXF | CISXF US | Albert Hsu |
| | China Steel Corp | CISEF | 2002 TT | Albert Hsu |
| | Gloria Material | GLMTF | 5009 TT | Albert Hsu |
| | Jindal Steel and Power Limited | XJDLF | JSP IN | Bhaskar.N.Basu,CFA |

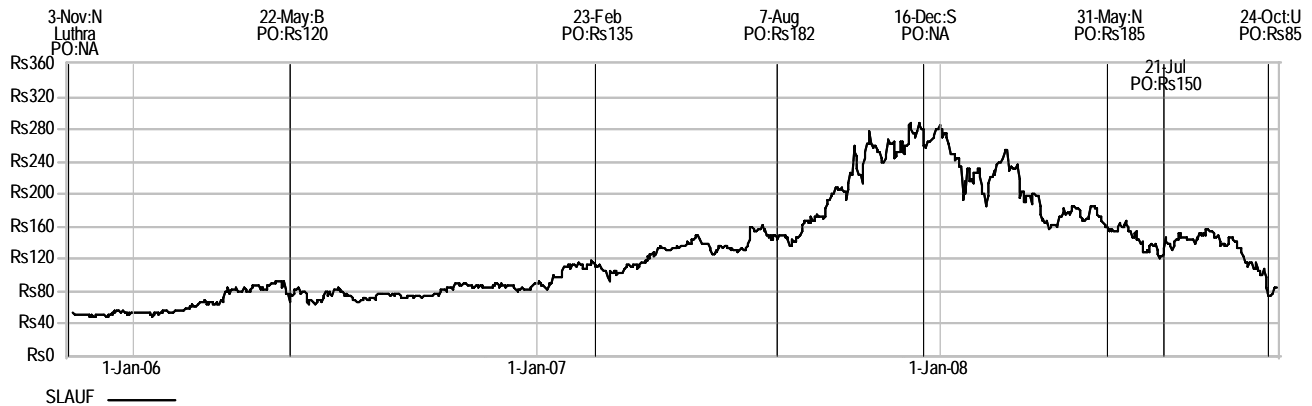
04 December 2008

APR - Metals & Mining Coverage Cluster

| Investment rating | Company | ML ticker | Bloomberg symbol | Analyst |
|-------------------|------------------|-----------|------------------|--------------------|
| | JSW Steel | XJWJF | JSTL IN | Bhaskar.N.Basu,CFA |
| | Maanshan I & S-H | MAANF | 323 HK | Alexander Latzer |
| | NALCO | NAUDF | NACL IN | Vandana Luthra |
| | Steel Authority | SLAUF | SAIL IN | Vandana Luthra |
| | Tata Steel | TAELF | TATA IN | Vandana Luthra |
| | Wuhan Steel | WHNIF | 600005 CH | Alexander Latzer |
| REVIEW | | | | |
| | China Oriental | CUGCF | 581 HK | Alexander Latzer |
| | POSCO | PKXFF | 005490 KS | Alexander Latzer |
| | POSCO -A | PKX | PKX US | Alexander Latzer |

Important Disclosures

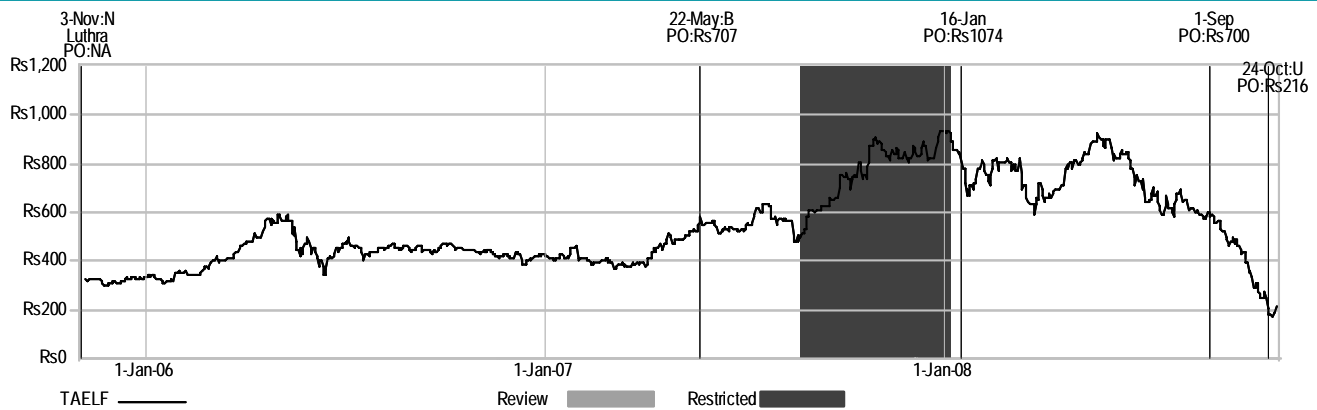
SLAUF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

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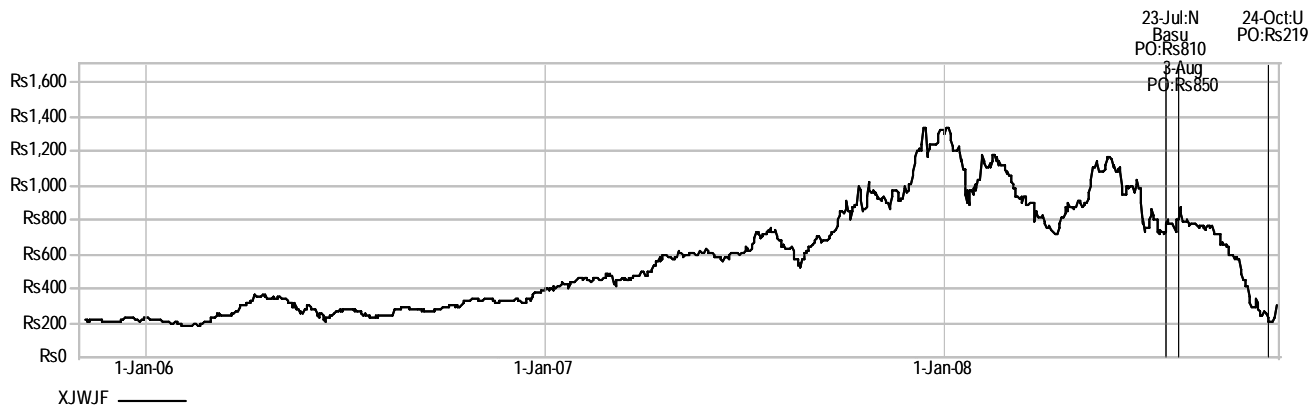
TAEFL Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

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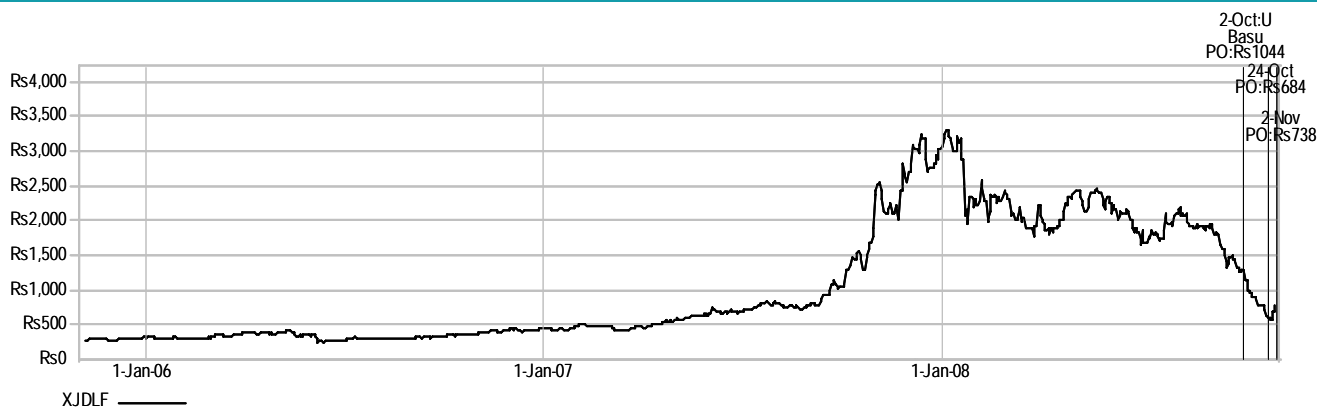
XJWJF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

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XJDLF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

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Investment Rating Distribution: Steel Group (as of 01 Oct 2008)

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|-------------------|-------|---------|-----------------------------|-------|---------|
| Buy | 37 | 71.15% | Buy | 6 | 20.00% |
| Neutral | 5 | 9.62% | Neutral | 0 | 0.00% |
| Sell | 10 | 19.23% | Sell | 2 | 22.22% |

Investment Rating Distribution: Global Group (as of 01 Oct 2008)

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|-------------------|-------|---------|-----------------------------|-------|---------|
| Buy | 1647 | 45.31% | Buy | 429 | 28.83% |
| Neutral | 858 | 23.60% | Neutral | 240 | 31.41% |
| Sell | 1130 | 31.09% | Sell | 227 | 22.02% |

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| Investment rating | Total return expectation (within 12-month period of date of initial rating) | Ratings dispersion guidelines for coverage cluster* |
|-------------------|---|---|
| Buy | ≥ 10% | ≤ 70% |
| Neutral | ≥ 0% | ≤ 30% |
| Underperform | N/A | ≥ 20% |

* Ratings dispersions may vary from time to time where Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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