

Tata Steel

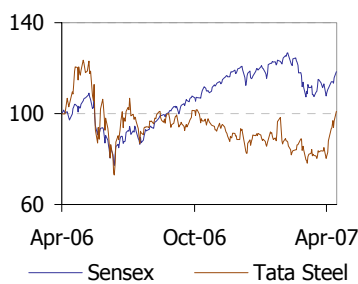
Relative to sector: **Neutral**

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Relative Performance



Source: Bloomberg, ENAM Research

Stock data

No. of shares* : 860mn
Market cap ^ : Rs 307bn
52 week high/low : Rs 679/ Rs.377
Avg. daily vol. (6mth) : 4.9 mn shares
Bloomberg code : TATA IN
Reuters code : TISC.BO

* Fully diluted equity after conv of pref shr
^ Mkt Cap based on current equity

Shareholding (%)	Mar-07	QoQ chg
Promoters	30.5	0.3
FII's	17.4	(0.7)
MFs / UTI	3.2	(0.1)
Banks / FIs	18.6	0.6
Others	30.2	0.0

Financial Summary

Y/E Mar	Sales (Rs mn)	Adj. PAT (Rs mn)	Consensus EPS* (Rs)	EPS (Rs)	Change YoY (%)	P/E (x)	RoE (%)	RoCE (%)	EV/EBIDTA (x)	DPS (Rs)
2006	151,394	34,177	-	39.7	0	13.3	42	49.2	4.7	14.8
2007E	179,937	46,090	-	53.6	35	9.9	38	43.0	2.8	15.7
2008E^	981,831	58,494	72.9	68.0*	27	7.8	21	15.8	5.6	15.7
2009E^	1,040,369	77,870	80.6	90.5*	33	5.8	27	19.3	4.7	17.1

Source: *Consensus broker estimates, Company, ENAM estimates. Note : ^FY08 & FY09 are Tata + Corus financials (post acquisition). * EPS based on fully diluted equity assuming conversion of preference shares.

REDUCING LEVERAGE, DILUTING GROWTH

Tata Steel's USD 4.1bn funding plan entails massive equity dilution, which has been a negative surprise. The company's immediate equity issuance of 27% (1:5 rights @ Rs 300 plus ~7% overseas issuance) is likely to result in base FY08 EPS dilution in the range of 13%. Also, further issuance of preference shares to be converted into equity shares in the range of Rs 500-600 after two years, will further dilute FY08 EPS by 10%, compressing EPS growth in the medium to long term. *We believe, the dilution is significant considering Tata Steel's healthy balance sheet containing strategic investments (~USD 1bn), in other group companies, which could have been monetized.*

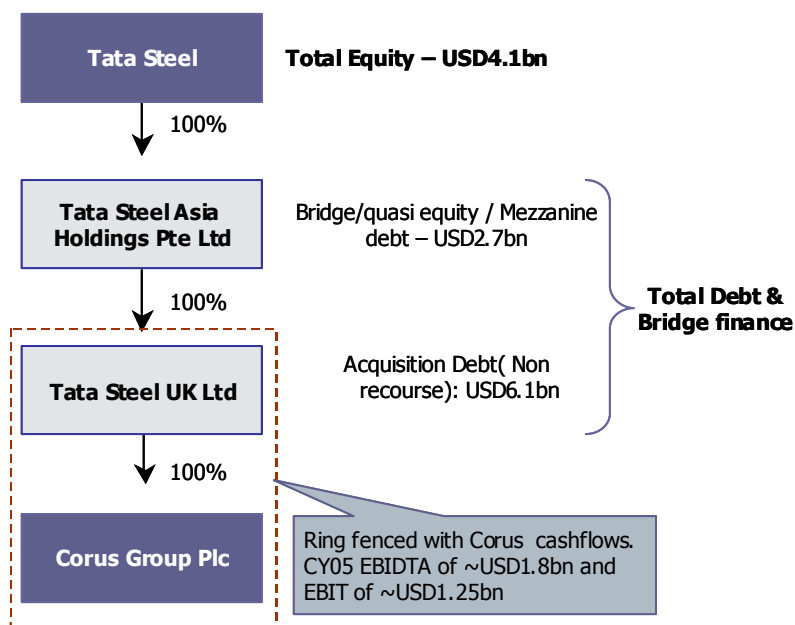
The equity infusion would scale down the consolidated FY08 debt level from USD 12.6bn closer to USD 10.1bn. As a result, the financial leverage will be down from earlier 3.1x to 1.6x in FY08.

Tata Steel would inject USD 4.1bn into Tata Steel Asia, which would raise additional USD 2.7bn as bridge financing. This USD 6.8bn would be injected into Tata Steel UK, which would raise debt of ~USD 6.1bn (*structure details on Pg 2*).

We revise consolidated FY08E earnings (fully diluted adjusted for conversion of preference shares) downward by ~22% to Rs 68, from Rs 87.1 earlier. FY08 EPS, considering only short-term dilution (without considering preference conversion), would stand at Rs 75.7.

At CMP Rs 529 the stock trades at 7.8x FY08E diluted earnings; and we believe valuations are inline with the global peers (see page 3). We revise our earlier target price of Rs 602 (based on 7x FY08 target P/E) to Rs 544 on higher target P/E of 8x. We believe valuations are likely to improve given significant reduction in financial leverage and less sensitivity to serious downswing in the steel cycle. Considering that current steel cycle is expected to remain strong, the consolidated company earnings are likely to witness a further upside as our HRC assumptions at USD 540/ tonne (12-15% discount to prevailing prices) do not capture the current steel pricing trend. We reduce our rating to sector **Neutral** with a price target of Rs 544, inline with equity dilution.

Combined group structure



Source: Company, ENAM Research

Financing Structure:

Tata Steel: USD 4.1bn equity

- Internal accruals- USD 700mn
- External Commercial Borrowings - USD 500mn
- Funds from the preferential issue of equity shares to Tata Sons Ltd – USD 640mn (already raised)
- Rights issue of equity shares to the shareholders in the ratio 1:5 at a price of Rs 300 per share: USD 682mn
- Simultaneous but un-linked rights issue of convertible preference shares in the ratio of 1:7, having a coupon rate of 2% with conversion into equity shares after two years at a price in the range of Rs 500 to Rs 600 per share, as may be determined at the time of the issue – USD 1bn
- A foreign issue of an equity-related instrument up to an amount of USD 500 mn following the right issue

Tata Steel Singapore and Tata Steel UK: Debt

- Tata Steel would inject ~USD 4.1bn into its Tata Steel Singapore entity.
- Tata Singapore entity would in turn, raise a further ~USD 2.7bn as quasi equity/debt.
- The above ~USD 6.8bn will be infused into Tata Steel, UK as equity, which would further raise a debt of ~USD 6.14bn. This debt would be ring fenced with Corus' cash flows.

Comparative valuation

	Crude steel 2006 (mtpa)	1yr forward (x)			RoC (%)	ROE (%)	D/E (x)	OPM (%)	Remarks
		P/E	EV/ EBIDTA						
Arcelor Mittal	118	8.4	5.9	10.5	17.0	0.7	17.5	More than 100% dilution on acquisition	
Nippon Steel	34	15.2	8.7	13.3	24.0	0.7	19.4	N.A.	
Posco	31	8.5	4.9	19.0	23.0	0.2	29.3	N.A.	
JFE Steel	32	12.4	7.4	13.7	29.0	0.9	20.0	N.A.	
Baosteel	26	12.7	6.3	N.A.	17.7	0.5	22.0	N.A.	
Tata+ Corus (Without integration benefits)	24	7.8	5.5	15.8	21.0	1.6	14.7	Close to 40% dilution	

Source: ENAM estimates; Bloomberg, RoC: $(PAT + Interest \times (1 - Tax\ rate)) / Total\ Capital$

Company Financials: FY08 and FY09 are consolidated nos.

Income statement

(Rs. mn)

Y/E Mar	FY06	FY07E	FY08E^	FY09E^
Net sales	149,101	177,621	979,492	1,038,007
Other opt. Inc.	2,293	2,316	2,339	2,362
Total income	151,394	179,937	981,831	1,040,369
Cost of goods sold	73,120	84,485	726,028	740,050
Contribution (%)	53	54	26	29
AdvT/Sales/Distrn O/H	19,487	19,947	111,909	127,912
Operating Profit	58,787	75,505	143,894	172,407
Other income	2,161	332	5,198	5,148
PBIDT	60,948	75,837	149,092	177,555
Depreciation	7,751	8,233	35,519	38,203
Interest	1,684	1,761	31,219	29,817
Other pretax	0	0	0	0
Pre-tax profit	51,513	65,843	82,354	109,534
Tax provision	17,336	19,753	23,860	31,665
(-) Minority Int.	0	0	0	0
Associates	0	0	0	0
Adjusted PAT	34,177	46,090	58,494	77,870
E/o income / (Exp)	887	0	0	0
Reported PAT	35,064	46,090	58,494	77,870

Key ratios

(%)

Y/E Mar	FY06	FY07E	FY08E^	FY09E^
Sales growth	4.8	19.1	451.4	6.0
OPM	39.4	42.5	14.7	16.6
Oper. profit growth	(0.8)	28.4	90.6	19.8
COGS / Net sales	48.3	47.0	73.9	71.1
Overheads/Net sales	12.9	11.1	11.4	12.3
Depreciation / G. block	5.0	5.0	4.2	4.2
Effective interest rate	6.4	4.9	6.4	6.9
Net wkg.cap / Net sales	0.0	0.0	0.1	0.1
Net sales / Gr block (x)	1.0	1.1	1.9	1.2
RoCE	49.2	43.0	15.8	19.3
Debt / equity (x)	0.3	0.3	1.6	1.4
Effective tax rate	33.7	30.0	29.0	28.9
RoE	41.8	38.0	21.0	27.0
Payout ratio (Div/NP)	23.4	19.8	23.1	18.9
EPS (Rs.)	39.7	53.6	68.0	90.5
EPS Growth	0.3	34.9	26.9	33.1
CEPS (Rs.)	75.7	93.6	109.3	135.0
DPS (Rs.)	14.8	15.7	15.7	17.1
EPS - Bf. conv.of pref.shr	-	-	75.7	100.7

Balance sheet

(Rs. mn)

Y/E Mar	FY06	FY07E	FY08E^	FY09E^
Total assets	143,639	217,649	775,217	775,316
Gross block	154,074	164,651	844,052	902,422
Net fixed assets	87,075	89,420	268,535	288,702
CWIP	11,577	31,000	50,000	50,000
Investments	20,266	20,266	69,133	87,141
Wkg. cap. (excl cash)	1,403	2,371	101,622	106,590
Cash / Bank balance	2,884	54,159	68,010	68,010
Goodwill/Def tax assets	20,433	20,433	217,916	174,873
Capital employed	143,639	217,649	775,217	775,316
Equity capital	5,537	5,807	8,600	8,600
Reserves	89,484	141,524	269,649	289,769
Borrowings	25,162	46,862	442,741	422,720
Others	23,457	23,457	54,228	54,228

Cash-flow

(Rs. mn)

Y/E Mar	FY06	FY07E	FY08E^	FY09E^
Sources	32,764	82,243	529,074	81,346
Cash profit	43,204	54,323	94,013	116,073
(-) Dividends	8,204	9,105	13,485	14,706
Retained earnings	34,999	45,218	80,528	101,367
Issue of equity	0	15,325	114,363	0
Borrowings	(2,236)	21,700	334,183	(20,021)
Applications	32,764	82,243	529,074	81,346
Capital expenditure	15,281	30,000	53,370	58,370
Investments	17,032	(0)	528,000	18,008
Net current assets	34	968	1,589	4,968
Change in cash	417	51,275	(53,885)	0

Source: Company, ENAM Research Note : ^ FY08 & FY09 are Tata + Corus financials (post acquisition).

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