

## Tata Steel

STOCK INFO.	BLOOMBERG
BSE SENSEX: 10,086	TATA IN
S&P CNX: 2,945	REUTERS CODE
	TISC.BO

21 July 2006

**Buy**
*Previous Recommendation: Buy*
**Rs484**

Equity Shares (m)	609.2
52-Week Range	679/329
1,6,12 Rel. Perf. (%)	1/27/-7
M.Cap. (Rs b)	294.6
M.Cap. (US\$ b)	6.3

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
3/06A	151,394	37,557	61.7	0.2	7.8	3.1	37.3	37.7	1.8	4.6
3/07E	165,353	40,675	66.8	7.8	7.2	2.1	27.4	32.5	1.4	3.6
3/08E	154,000	36,224	59.5	-11.7	8.1	1.6	18.9	24.0	1.4	3.6

\* PAT and EPS numbers are consolidated based on fully diluted equity

- 1QFY07 EBITDA at Rs15.8b (our expectation, Rs15.3b) and margins are higher v/s our expectation on the back of improved realization as well as contained cost structure. Recurring PAT of Rs9.65b was also higher than our expectation of Rs9.05b.
- Revenues were up 13% YoY to Rs39.2b. Steel revenues moved up by 14.5% and non-steel revenues were up 4.1%. Steel volumes increased 30.5% YoY to 1.12m ton.
- Blended net realizations declined 12.3% YoY (Rs4,355per ton), however on a sequential basis, realization moved up 7.9% (Rs2,285 per ton) to Rs31,133 per ton. Sequential recovery in realization was back-ended, so its full impact will be visible in 2QFY07 where realizations are likely to be at least Rs2,000 higher sequentially.
- EBITDA margins declined 546bp YoY to 40.4% (steel prices were at an all-time high in 1QFY06). Sequentially, margins were up 888bp on account of improving realization and improved cost structure. EBITDA per ton declined Rs4,412 YoY but increased by Rs3,823 per ton QoQ to Rs14,180 per ton.
- During the quarter Tata Steel has approved issue of equity/warrants to its promoters Tata Sons, in 2 tranches, which will increase Tata Steel's equity by 10% from Rs5.5b-Rs6.1b
- We are upgrading our FY07 consolidated PAT by 6.7% to Rs40.7b. Accordingly we are also upgrading FY08 consolidated PAT by 5.8% to Rs36.2b. After adjusting for equity dilution, Tata Steel is likely to post EPS of Rs66.8 in FY07 and Rs59.5 in FY08. The stock is trading at 7.2x PER and 3.6x EV/EBITDA FY07E on consolidated numbers.

 Reiterate **Buy**.

**QUARTERLY PERFORMANCE (STANDALONE)**

(Rs Million)

Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
<b>Sales (ton)</b>	<b>854,238</b>	<b>1,179,605</b>	<b>1,107,345</b>	<b>1,255,864</b>	<b>1,115,066</b>	<b>1,152,000</b>	<b>1,192,500</b>	<b>1,310,434</b>	<b>4,418,311</b>	<b>4,770,000</b>
Change (%)	-3.2	15.3	11.0	24.3	30.5	-2.3	7.7	4.3	12.9	8.0
<b>Net Sales</b>	<b>34,645</b>	<b>38,651</b>	<b>36,808</b>	<b>41,290</b>	<b>39,159</b>	<b>42,225</b>	<b>41,182</b>	<b>42,787</b>	<b>151,394</b>	<b>165,353</b>
Change (%)	9.5	3.4	-1.4	6.8	13.0	9.2	11.9	3.6	4.4	9.2
<b>EBITDA</b>	<b>15,882</b>	<b>16,516</b>	<b>13,909</b>	<b>13,008</b>	<b>15,812</b>	<b>16,953</b>	<b>15,022</b>	<b>15,689</b>	<b>59,315</b>	<b>63,477</b>
As % of Net Sales	45.8	42.7	37.8	31.5	40.4	40.2	36.5	36.7	39.2	38.4
Interest	342	307	364	172	293	275	275	257	1,184	1,100
Depreciation	1,706	1,755	1,846	1,933	1,951	2,000	2,000	2,049	7,751	8,000
Other Income	303	1,188	413	644	779	600	700	521	2,548	2,600
Extra-ordinary Exp.	296	290	801	-344	184	185	185	196	528	750
<b>PBT</b>	<b>13,842</b>	<b>15,352</b>	<b>11,311</b>	<b>11,891</b>	<b>14,163</b>	<b>15,093</b>	<b>13,262</b>	<b>13,709</b>	<b>52,399</b>	<b>56,227</b>
Tax	4,601	4,898	3,777	4,060	4,630	4,860	4,270	4,414	17,336	18,555
Effective Tax Rate (%)	33.2	31.9	33.4	34.1	32.7	32.2	32.2	32.2	33.1	33.0
<b>Reported PAT</b>	<b>9,241</b>	<b>10,454</b>	<b>7,534</b>	<b>7,831</b>	<b>9,533</b>	<b>10,233</b>	<b>8,992</b>	<b>9,295</b>	<b>35,064</b>	<b>37,672</b>
Change (%)	24.0	12.5	-15.4	-13.8	3.2	-2.1	19.3	18.7	0.9	7.4
<b>Adjusted PAT</b>	<b>9,439</b>	<b>10,652</b>	<b>8,068</b>	<b>7,605</b>	<b>9,657</b>	<b>10,359</b>	<b>9,117</b>	<b>9,427</b>	<b>35,417</b>	<b>38,175</b>
Change (%)	24.1	12.6	-9.6	-18.7	2.3	-2.7	13.0	24.0	0.2	7.8

E: MOST Estimates

### Higher volumes drive revenues

Total revenues were up 13% YoY to Rs39.2b. Steel revenues moved up by 14.5% and non-steel revenues rose by 4.1%. Steel volumes increased 30.5% YoY to 1.12m tons. Production growth was driven by higher output from the upgraded G blast furnace.

#### SEGMENTWISE REVENUES (RS M)

	1QFY07E	1QFY07	% VAR	FY07	FY06	% VAR
<b>Net revenues from</b>						
Steel	34,716	30,315	14.5	148,800	134,675	10.5
Others	6,220	5,974	4.1	23,000	24,303	-5.4
Inter-segment	1,777	1,644	8.1	6,447	7,585	-15.0

Source: Company/Motilal Oswal Securities

### Sequential recovery in realization; full impact will be visible in 2QFY07

Blended net realizations declined 12.3% YoY (Rs4,355 per ton), however on a sequential basis realization moved up by 7.9% (Rs2,285 per ton) to Rs31,133 per ton. Sequential recovery in realization was back-ended, hence the full impact will be visible in 2QFY07 where realizations are likely to be at least Rs2,000 higher sequentially. Currently HRC realizations stand at around Rs26,000 per ton, which is significantly higher than our FY07 HRC assumption of Rs22,000 per ton. Should the current prices sustain over the full year, we may see a significant earnings upgrade for Tata Steel from our current estimates.

### Contained costs and improved realization leads to sequential margin expansion

The company has shown Rs1,582 per ton sequential decline in blended operating cost to Rs20,937 per ton mainly on account of savings on freight, staff and raw material costs. Even on a YoY basis blended operating costs declined by 4.7%. Sequentially, margins were up 888bp to 40.4% on account of improving realization and better cost structure, however on a YoY basis EBITDA margins declined 546bp YoY, as steel prices were at an all-time high in 1QFY06. EBITDA per ton declined by Rs4,412 YoY but increased by Rs3,823 per ton QoQ to Rs14,180 per ton.

The company reported extra ordinary income of Rs184m on account of adjustments in the employee separation expense account. After adjusting for this, the company has reported a recurring net profit of Rs9.7b, up 2.3% YoY.

### Firm steel prices likely to translate into improved margins

Steel prices have improved further in 2QFY06 and are hovering between US\$50-US\$60 per ton, which is lower than its previous highs. We believe that firm steel prices and the contained cost structure for Tata Steel will translate into better operating margins in forthcoming quarters.

### Change in estimates on account of upgrading PAT; impact of dilution

During the quarter Tata Steel has approved an issue of equity/warrants to its promoters Tata Sons, in two tranches, which will increase Tata Steel's equity by 10% from Rs5.5b to Rs6.1b. Tata Steel's 1QFY07 numbers are slightly higher than our expectation on account of its improved cost structure.

As a result, we are upgrading our FY07 consolidated PAT by 6.7% to Rs40.7b. Accordingly we are also upgrading FY08 consolidated PAT by 5.8% to Rs36.2b. However adjusted for equity dilution, Tata Steel is likely to post an EPS of Rs66.8 in FY07 and Rs59.5 in FY08.

### Long-term growth plans

The company has already started working on its 2m ton expansion plan and placed order for its blast furnace at Jamshedpur which will increase its saleable steel capacity to 7m ton. This will involve a capex of Rs50b and is expected to be completed in Mar08. Tata Steel has reiterated its mega investment plan, which will increase the company's existing capacity of 5m ton to 25m ton by 2015. The company believes that its lowest cost structure and backward integration will result in cash flows which will help to fund the expansion plan.

**Attractive valuation; sustainable competitive advantage, we reiterate Buy**

Tata Steel's 1QFY07 numbers are higher than our expectation and driven by improved realization and contained cost structure. Company has shown impressive volume growth and continued its focus on value added product and richer product mix.

Stock trades at 7.2x PER and 3.6x EV/EBITDA FY07E on consolidated numbers. We believe that stock is quoting at attractive earning valuation. Considering attractive valuation and company sustainable advantage which it is leveraging by aggressive growth plan we maintain our positive view on stock and recommend **Buy**.

## Tata Steel: an investment profile

### Company description

Tata Steel is one of the lowest cost steel producers in the world, with a capacity of 5m ton. Its captive raw material source gives it a sustainable competitive advantage over its peers. With its latest acquisition of NatSteel, Singapore, it has transformed itself from a single-location steel producer to a multi-location steel producer. Tata Steel's products command a premium in the market mainly due to better quality and long-term relationships with customers.

### Key investment arguments

- Access to captive raw material sources gives Tata Steel a sustainable competitive advantage over its peers.
- Attractive valuations, with low risk to earnings.

### Key investment risks

- Possibility of sharp correction in steel prices due to huge capacity addition in China.

### Recent developments

- The company has completed its rebar mill expansion which will improve its product mix significantly in coming quarters.
- The company has also placed order for blast furnace for its 2m ton expansion in Jamshedpur.

### Valuation and view

- We estimate standalone EPS of Rs62.7 per share in FY07 and consolidated EPS of Rs66.8 per share. Stock is quoting at 7.2x PER and 3.6x EV/EBITDA FY07E.
- We maintain **Buy** on stock with a price target of Rs668 per share.

### Sector view

- Steel prices in global markets have improved significantly and are likely to remain firm.
- We maintain our view that business dynamics is moving in favor of integrated players. We maintain our positive view on integrated players with captive raw materials — Tata Steel and JSPL .

#### COMPARATIVE VALUATIONS

		TATA STEEL	SAIL	JSPL
P/E (x)	FY07E	7.2	6.6	6.6
	FY08E	8.1	7.3	7.7
P/BV (x)	FY07E	2.1	1.7	1.8
	FY08E	1.6	1.4	1.5
EV/Sales (x)	FY07E	1.4	0.7	2.0
	FY08E	1.4	0.6	1.8
EV/EBITDA (x)	FY07E	3.6	3.1	5.2
	FY08E	3.6	3.1	5.7

#### SHAREHOLDING PATTERN (%)

	JUN.06	MAR.06	JUN.05
Promoters	26.9	26.8	26.6
Domestic Institutions	21.0	20.9	21.9
FII's/FDIs	22.9	22.8	16.1
Others	29.2	29.5	35.4

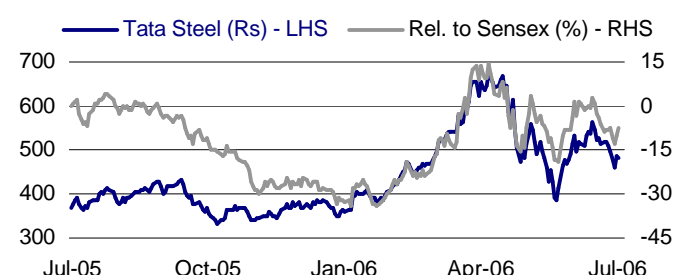
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	66.8	72.4	-7.7
FY08	59.5	67.6	-12.0

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
484	668	38.1	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
<b>Net Sales</b>	<b>107,024</b>	<b>144,989</b>	<b>151,394</b>	<b>165,353</b>	<b>154,000</b>
YoY Growth (%)	22.7	35.5	4.4	9.2	-6.9
Total Expenditure	72,071	84,535	92,079	101,876	96,590
<b>EBIDT</b>	<b>34,952</b>	<b>60,455</b>	<b>59,315</b>	<b>63,477</b>	<b>57,410</b>
Change (%)	51.9	73.0	-1.9	7.0	-9.6
% of Net sales	32.7	41.7	39.2	38.4	37.3
Depreciation	6,251	6,188	7,751	8,000	8,500
<b>EBIT</b>	<b>28,701</b>	<b>54,267</b>	<b>51,564</b>	<b>55,477</b>	<b>48,910</b>
Int. & Finance Charges	2,506	1,868	1,184	1,100	1,000
Other Income	1,405	1,480	2,548	2,600	2,500
Empl. Seper. Comp.	2,224	1,191	528	750	750
Non-recurring Exp.	0	0	0	0	0
Non-recurring Income	1,283	286	0	0	0
<b>Profit before Tax</b>	<b>26,659</b>	<b>52,974</b>	<b>52,399</b>	<b>56,227</b>	<b>49,660</b>
Tax	9,197	18,231	17,336	18,555	16,437
Effective Rate (%)	34.5	34.4	33.1	33.0	33.1
<b>Profit after Tax</b>	<b>17,462</b>	<b>34,742</b>	<b>35,064</b>	<b>37,672</b>	<b>33,223</b>
Change (%)	72.5	99.0	0.9	7.4	-11.8
% of Net Sales	16.3	24.0	23.2	22.8	21.6
<b>Adj. Profit after Tax</b>	<b>18,078</b>	<b>35,336</b>	<b>35,417</b>	<b>38,175</b>	<b>33,724</b>
Change (%)	51.1	95.5	0.2	7.8	-11.7
<b>Consolidated PAT</b>	<b>18,078</b>	<b>36,306</b>	<b>37,557</b>	<b>40,675</b>	<b>36,224</b>
Growth (%)	37.4	95.5	0.2	7.8	-11.7

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
Share Capital	3,692	5,537	5,537	5,807	6,092
Reserves	39,907	62,914	89,484	133,711	172,763
<b>Net Worth</b>	<b>43,599</b>	<b>68,451</b>	<b>95,020</b>	<b>139,518</b>	<b>178,854</b>
Loans	33,733	27,397	25,162	15,162	10,162
Deferred Tax Liability	8,400	8,294	9,570	9,570	9,570
Provision for ESS	15,631	15,143	13,887	14,637	15,387
<b>Capital Employed</b>	<b>101,362</b>	<b>119,285</b>	<b>143,639</b>	<b>178,887</b>	<b>213,973</b>
Gross Fixed Assets	132,695	149,577	165,649	190,649	215,649
<b>Gross Block</b>	<b>132,695</b>	<b>149,577</b>	<b>165,649</b>	<b>190,649</b>	<b>215,649</b>
Less: Depreciation	54,116	58,455	66,999	74,999	83,499
<b>Net Fixed Assets</b>	<b>78,579</b>	<b>91,122</b>	<b>98,651</b>	<b>115,651</b>	<b>132,151</b>
Investments	21,941	24,327	40,700	40,700	40,700
<b>Curr. Assets, Loans &amp; Advances</b>					
Inventory	12,493	18,726	21,748	23,753	22,122
Sundry Debtors	6,513	5,818	5,394	5,891	5,487
Cash & Bank Balances	2,507	2,467	2,887	21,004	39,696
Others	19,317	13,824	12,349	13,487	12,561
<b>Current Liab. &amp; Prov.</b>					
Sundry Creditors	22,184	26,898	28,360	30,975	28,848
Current Liabilities	22,184	26,898	28,360	30,975	28,848
Provisions	17,804	10,102	9,727	10,624	9,895
<b>Net Current Assets</b>	<b>842</b>	<b>3,836</b>	<b>4,290</b>	<b>22,536</b>	<b>41,123</b>
<b>Application of Funds</b>	<b>101,362</b>	<b>119,285</b>	<b>143,639</b>	<b>178,887</b>	<b>213,974</b>

E: Most Estimates

RATIO					
Y/E MARCH	2004	2005	2006	2007E	2008E
<b>Basic (Rs)</b>					
<b>Fully Diluted EPS</b>	<b>29.7</b>	<b>58.0</b>	<b>58.1</b>	<b>62.7</b>	<b>55.4</b>
<b>Consolidated EPS</b>	<b>29.7</b>	<b>59.6</b>	<b>61.7</b>	<b>66.8</b>	<b>59.5</b>
Cash EPS	43.9	75.0	78.0	79.5	69.3
Book Value per Share	78.7	123.6	171.6	240.3	293.6
DPS	6.7	13.0	13.0	15.0	15.0
Payout (Incl. Div. Tax) %	14.1	20.7	20.5	22.1	25.0
<b>Valuation (x)</b>					
P/E		8.3	8.3	7.7	8.7
Consolidated PER		8.1	7.8	7.2	8.1
Cash PE		6.4	6.2	6.1	7.0
EV/EBITDA		4.8	4.6	3.6	3.6
EV/Sales		2.0	1.8	1.4	1.4
Price to Book Value		4.3	3.1	2.1	1.6
Dividend Yield (%)		2.7	2.7	3.1	3.1
<b>Profitability Ratios (%)</b>					
RoE	41.5	51.6	37.3	27.4	18.9
RoCE	29.7	46.7	37.7	32.5	24.0
<b>Turnover Ratios</b>					
Debtors (Days)	22	15	13	13	13
Inventory (Days)	43	47	52	52	52
Creditors (Days)	76	68	68	68	68
Working Capital (Days)	-10.8	-5.9	-2.9	-2.9	-2.9
Asset Turnover (x)	1.4	1.6	1.5	1.4	1.2
<b>Leverage Ratio</b>					
Debt/Equity (x)	0.8	0.4	0.3	0.1	0.1

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
OP/(Loss) before Tax	26,659	52,974	52,399	56,227	49,660
Depreciation & Amort.	6,251	6,188	7,751	8,000	8,500
Interest Paid	2,506	1,868	1,184	1,100	1,000
Direct Taxes Paid	-9,197	-18,231	-17,336	-18,555	-16,437
(Inc)/Dec in Wkg. Capital	7,938	-3,034	-34	-129	1,532
<b>CF from Op. Activity</b>	<b>34,157</b>	<b>39,765</b>	<b>43,965</b>	<b>46,643</b>	<b>44,255</b>
Other Items	-3,138	-5,136	-482	479	509
<b>CF after EO Items</b>	<b>31,019</b>	<b>34,629</b>	<b>43,483</b>	<b>47,122</b>	<b>44,764</b>
(Inc)/Dec in Fixed Assets & (Pur)/Sale of Invest.	-8,757	-16,883	-16,072	-25,000	-25,000
<b>CF from Inv. Activity</b>	<b>-18,752</b>	<b>-19,268</b>	<b>-32,445</b>	<b>-25,000</b>	<b>-25,000</b>
Issue of Shares	0	0	0	15,403	13,235
Inc / (Dec) in Debt	-8,523	-6,336	-2,236	-10,000	-5,000
Interest Paid	-2,506	-1,868	-1,184	-1,100	-1,000
Dividends Paid	-2,461	-7,198	-7,198	-8,307	-8,307
<b>CF from Fin. Activity</b>	<b>-13,490</b>	<b>-15,402</b>	<b>-10,618</b>	<b>-4,004</b>	<b>-1,072</b>
<b>Inc / (Dec) in Cash</b>	<b>-1,224</b>	<b>-41</b>	<b>420</b>	<b>18,117</b>	<b>18,692</b>
Add: Opening Balance	3,731	2,507	2,467	2,887	21,004
<b>Closing Balance</b>	<b>2,507</b>	<b>2,467</b>	<b>2,887</b>	<b>21,004</b>	<b>39,696</b>



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**Tata Steel**

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

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