

INDIA

Tata Steel

18 April 2007

TATA IN **Outperform**

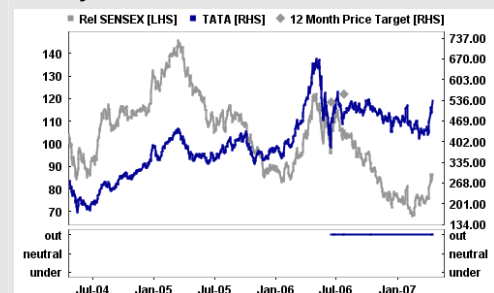
Stock price as of 16 Apr 07	Rs	533.40
12-month target	Rs	556.00
Upside/downside	%	+4.2
Valuation	Rs	556.00
- PER		

GICS sector		materials
Market cap	Rs m	309,624
30-day avg turnover	Rs m	741.4
Market cap	US\$m	7,411
Number shares on issue	m	580.5

Investment fundamentals

Year end 31 Mar		2006A	2007E	2008E	2009E
Total revenue	bn	151.4	188.8	185.1	201.8
EBITDA	bn	59.3	85.7	77.2	83.4
EBITDA growth	%	-1.9	44.4	-9.8	8.0
Reported profit	bn	35.1	52.1	45.7	48.7
EPS rep	Rs	63.33	85.56	74.99	79.91
EPS rep growth	%	0.9	35.1	-12.4	6.6
PE rep	x	8.4	6.2	7.1	6.7
Total DPS	Rs	13.00	15.00	15.00	17.00
Total div yield	%	2.4	2.8	2.8	3.2
ROA	%	30.1	35.0	22.8	19.4
ROE	%	42.1	41.6	25.7	22.1
EV/EBITDA	x	5.4	4.1	4.5	4.2
Net debt/equity	%	22.8	15.1	20.9	21.0
Price/book	x	3.0	2.1	1.6	1.4

TATA IN rel SENSEX performance, & rec history



Source: Datastream, Macquarie Research, April 2007 (all figures in INR unless noted)

Analysts

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Exercise your rights

Event

- The Tata Steel board has approved a financing structure of US\$4.1bn, its equity contribution for the US\$12.9bn Corus acquisition, which we believe is quite positive and EPS accretive in spite of equity dilution to the tune of 46%.

Impact

- Acquisition EPS accretive:** We had estimated standalone EPS of Rs75 for FY3/08E for Tata Steel. After considering the proposed financing structure and using conservative estimates for Corus, the estimated consolidated EPS is revised to Rs82 for FY3/08E, an EPS accretion of 9%.
- Gearing and interest coverage comfortable:** The combined entity will have a gearing of 1.5x and interest coverage of 5.9x for FY3/08E. Low leverage at the Tata Steel level and the non recourse nature of a major portion of debt (US\$6.1bn) at the Corus level offers a positively skewed risk reward ratio for Tata Steel shareholders.
- Existing shareholders to benefit:** The funding is through a mix of rights issue (US\$862m) at a deep discount (Rs300 per share), and convertible preference shares (US\$1bn) at around the current share price (convertible at Rs500–600 per share after two years). This gives an excellent option to existing shareholders to invest at lucrative levels, while de-risking themselves.
- Issue underwritten by Tata Sons:** Tata Sons, the parent company of Tata Steel, has pledged to take up any unsubscribed portion of the above issues. We read this as a sign of confidence by the promoters and also a fair way to increase the promoters' holding.

Earnings revision

- No change.

Price catalyst

- 12-month price target: Rs556.00 based on a PER methodology.
- Catalyst: We expect Tata Steel to post EPS growth of 35% in FY3/07E, driven by higher volumes and substantial cost savings.

Action and recommendation

- Maintain Outperform:** We strongly reiterate our Outperform recommendation for Tata Steel. On pro forma consolidated numbers the stock is trading at a PER of 6.5x and EV/EBITDA of 5.5x for FY3/08E. We believe the 29% discount on PER multiple to the regional average is unreasonable due to the considerably reduced risk profile for Tata Steel shareholders.
- Corus numbers have upside risk:** European steel prices have gone up 15% in the last three months, and given the high leverage it has to steel prices, we see significant upside risk to Corus estimates.

Please refer to the important disclosures on inside back cover of this document, or on our website www.macquarie.com.au/research/disclosures.

Funding the acquisition

The acquisition of Corus for US\$12.9bn is proposed to be funded through the instruments shown below. We have assumed an additional 10% equity dilution at the level of Tata Steel Singapore, based on an equity portion of US\$1.25bn against the total enterprise value of US\$12.9bn being raised in quasi-equity instruments at this subsidiary level.

Fig 1 Total funding plan

Total funding plan	US\$bn
Long-term debt on Corus	6.14
Long-term debt on Tata Singapore	1.41
Quasi-equity on Tata Singapore	1.25
Total funding on Corus assets	8.8
Total equity contribution by Tata Steel	4.1
Total Enterprise value for Corus	12.9

Source: Macquarie Research, April 2007

Fig 2 Funds raised in the form of...

Funds raised in the form of	Dilution (no. of shares, m)	Amount (Rs m)	Amount (US\$m)
Preferential allotment of equity & warrants	55.5	27,733	640
Internal Generation of funds	0	30,000	700
Rights issue of equity shares @ 1:5	121.8	36,550	862
Rights issue of convertible preference shares @1:7 (2% coupon)	87	43,500	1,000
Foreign issue of equity-related instrument	70	21,000	500
External commercial borrowings	-	21,700	500
Total	334	180,483	4,202

Source: Macquarie Research, April 2007

Acquisition EPS accretive

The pro forma consolidated numbers for the combined Tata – Corus, based on our standalone numbers for Tata Steel and conservative estimates for Corus, indicate EPS accretion of 9% from the pre acquisition standalone estimate of Rs75 for FY3/08E. The minority interest reflects our assumed 10% equity dilution at the level of Tata Steel Singapore (as US\$1.25bn is raised in this subsidiary).

Fig 3 Pro forma income statement (Tata Steel and Corus)

Income statement	FY08	FY09	FY10
EBITDA (US\$m) - Tata Steel (standalone)	1,749	1,889	1,583
EBITDA (US\$m) - Corus (standalone)	1,909	1,994	2,080
Synergy benefits (EBITDA contribution)	88	145	225
Total EBITDA (US\$m)	3,745	4,028	3,888
Depreciation (US\$m)	716	837	1,177
Interest (US\$m)	612	625	627
PBT (US\$m)	2,417	2,566	2,084
Tax (US\$m)	671	701	537
PAT (US\$m)	1,747	1,865	1,547
PAT (US\$m) - post minority	1,671	1,785	1,477
Preference dividends (US\$ m)	20	20	-
PAT (US\$m) - post minority & pref. div.	1,651	1,765	1,477
PAT (Rs m) - post minority & pref. div.	72,904	77,962	65,227
Average dil shares o/s (m)	889	889	889
EPS (US\$)	1.9	2.0	1.7
EPS (Rs)	82.0	87.7	73.4

Source: Macquarie Research, April 2007

Gearing and interest coverage remain comfortable

In spite of the leveraged buy-out of Corus, the gearing and interest coverage remain comfortable. The strong cashflows over the next two years should ensure there are sufficient funds for the standalone expansion plans of Tata Steel and reduction of debt.

Fig 4 Gearing remains comfortable

	FY3/08	FY3/09	FY3/10
Debt/equity ratio	1.5x	1.1x	0.8x
Interest coverage	5.9x	6.2x	6.2x

Source: Macquarie Research, April 2007

Fig 5 Pro forma consolidated cashflows

	FY3/08	FY3/09	FY3/10
Cashflow from operations (consolidated) (US\$m)	2,367	2,602	2,654
Tata Steel standalone capex (US\$m)	1,135	1,135	1,370
Corus standalone capex (US\$m)	350	350	350
Total Capex (US\$m)	1,485	1,485	1,720
Free cashflow (US\$m)	882	1,117	934
Possible debt repayment (US\$m)	700	700	700
Free cashflow for additional growth (US\$m)	182	417	234

Source: Macquarie Research, April 2007

Tata Steel has been able to reduce its risk due to the high leverage at Corus by having US\$6.1bn as non recourse debt. This effectively shields Tata Steel shareholders in the case of any severe downturn in the steel sector.

Fig 6 Pro forma consolidated balance sheet (US\$m)

Consolidated Balance sheet	FY3/08	FY3/09	FY3/10
Equity	7,576	9,342	10,819
Debt	11,125	10,125	9,125
Total liabilities	18,701	19,466	19,943
Total long term assets	10,677	11,325	11,867
Net current assets	8,024	8,141	8,076
Total assets	18,701	19,466	19,943

Source: Macquarie Research, April 2007

Valuations are undemanding

Tata Steel, on a consolidated basis, is trading at a PER of 6.5x on FY3/08 estimates and 6.0x on FY3/09 estimates. We believe that given the lowered risk profile of Tata Steel's shareholders the discount to the regional average in terms of PER should be much narrower.

The high leverage of the combined entity could potentially provide a higher EV/EBITDA valuation. While the enterprise value would remain unchanged, the replacement of the existing high debt with market cap would drive returns for shareholders.

Fig 7 Regional valuation comparison

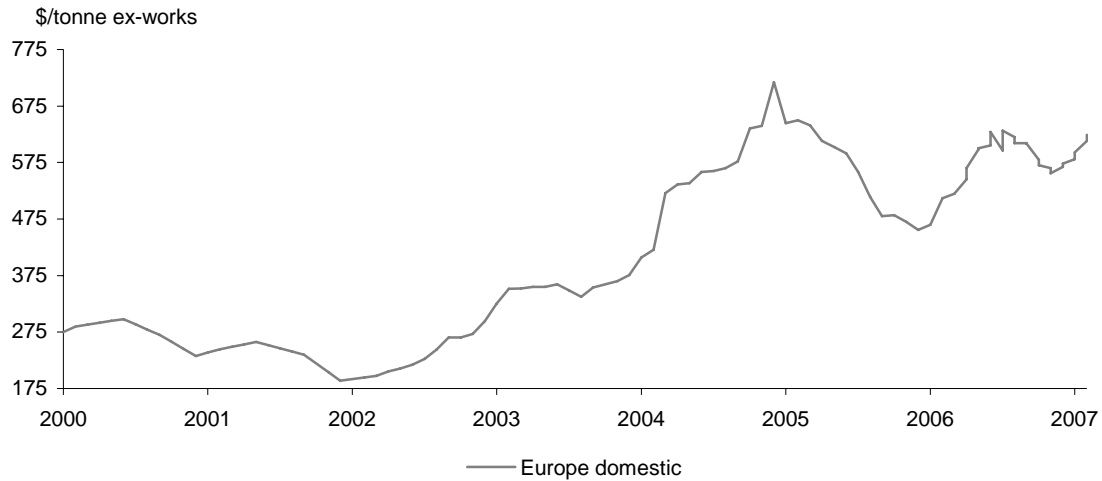
Company	Ticker	Capacity mtpa	PER			EV/EBITDA		
			Jun-07	Jun-08	Jun-09	Jun-07	Jun-08	Jun-09
Australia								
BlueScope Steel	BSL AU	5	12.2x	10.5x	11.2x	7.0x	5.8x	5.4x
OneSteel	OST AU	1.1	16.0x	13.0x	13.0x	8.6x	6.7x	6.6x
Smorgon Steel Group	SSX AU	0.8	13.3x	13.2x	12.2x	8.8x	8.1x	7.6x
Average			13.8x	12.3x	12.1x	8.2x	6.8x	6.6x
Thailand								
			Dec-06	Dec-07	Dec-08	Dec-06	Dec-07	Dec-08
G Steel Public Co	GSTEEL TB	1.5	3.4x	3.0x	2.5x	3.2x	2.7x	1.8x
India								
			Mar-07	Mar-08	Mar-09	Mar-07	Mar-08	Mar-09
JSW Steel	JSTL IN	3.8	8.2x	7.0x	6.2x	4.9x	4.6x	4.4x
Steel Authority of India	SAIL IN	12	9.5x	10.3x	9.5x	5.1x	5.3x	5.0x
Tata Steel	TATA IN	26	6.2x	6.5x	6.0x	3.5x	5.5x	5.1x
Average			8.0x	7.9x	7.3x	4.5x	5.1x	4.9x
HK								
			Dec-06	Dec-07	Dec-08	Dec-06	Dec-07	Dec-08
Maanshan Iron & Steel	323 HK	16	15.7x	12.2x	7.9x	9.8x	7.7x	4.2x
Angang Steel	347 HK	16	13.0x	9.8x	8.3x	7.2x	6.2x	5.6x
Average			14.4x	11.0x	8.1x	8.5x	7.0x	4.9x
Korea								
			Dec-06	Dec-07	Dec-08	Dec-06	Dec-07	Dec-08
Hyundai Steel	004020 KS	10	6.3x	5.7x	5.4x	5.6x	6.3x	6.8x
POSCO	005490 KS	30	10.3x	8.0x	6.7x	5.5x	4.0x	3.1x
Average			8.3x	6.9x	6.1x	5.6x	5.1x	5.0x
Japan								
			Mar-07	Mar-08	Mar-09	Mar-07	Mar-08	Mar-09
Nippon Steel	5401 JP	35	14.4x	13.8x	14.1x	7.7x	6.7x	6.5x
Sumitomo Metal	5405 JP	14	13.9x	13.2x	15.2x	8.1x	7.5x	8.2x
JFE Holdings	5411 JP	27	10.7x	10.4x	10.5x	5.9x	5.1x	4.9x
Average			13.0x	12.5x	13.3x	7.2x	6.5x	6.5x
Taiwan								
			Dec-06	Dec-07	Dec-08	Dec-06	Dec-07	Dec-08
China Steel Corp	2002 TT	11	13.2x	10.0x	9.5x	7.7x	5.8x	5.2x
Asian average			10.6x	9.1x	8.4x	6.4x	5.6x	5.0x

Source: Macquarie Research, April 2007

Combine a play on European steel prices

European steel prices have outpaced global steel prices, growing 15% in the last three months compared to 13% for Asia and flat growth for the US. With the combined entity getting 80% of its revenue from Europe, we consider it a leverage play on European steel prices.

Fig 8 Europe domestic steel prices



Source: Macquarie Research, April 2007

Tata Steel (TATA IN, Outperform, Target price: Rs556.00)

Quarterly Results					Profit & Loss						
		1Q/07A	2Q/07E	3Q/07E	4Q/07E		2006A	2007E	2008E	2009E	
Revenue	m	43,197	48,192	45,894	51,482	Revenue	m	151,394	188,765	185,136	201,831
Gross Profit	m	30,243	31,858	29,452	29,992	Gross Profit	m	90,434	121,545	116,392	126,500
Cost of Goods Sold	m	12,954	16,334	16,442	21,490	Cost of Goods Sold	m	60,960	67,220	68,744	75,331
EBITDA	m	22,437	23,453	20,226	19,552	EBITDA	m	59,315	85,667	77,236	83,428
Depreciation	m	1,985	2,042	2,742	2,248	Depreciation	m	7,751	9,016	10,029	11,525
Amortisation of Goodwill	m	0	0	0	0	Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0	Other Amortisation	m	0	0	0	0
EBIT	m	20,452	21,411	17,484	17,304	EBIT	m	51,564	76,651	67,207	71,903
Net Interest Income	m	-407	-366	-434	-205	Net Interest Income	m	-1,184	-1,412	-2,452	-3,032
Associates	m	0	0	0	0	Associates	m	0	0	0	0
Exceptionals	m	-125	-125	-125	-125	Exceptionals	m	-528	-500	-500	-500
Forex Gains / Losses	m	0	0	0	0	Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	376	1,471	511	797	Other Pre-Tax Income	m	2,548	3,155	4,011	4,375
Pre-Tax Profit	m	20,296	22,391	17,436	17,771	Pre-Tax Profit	m	52,400	77,893	68,265	72,746
Tax Expense	m	-6,839	-7,280	-5,615	-6,036	Tax Expense	m	-17,336	-25,770	-22,585	-24,067
Net Profit	m	13,457	15,110	11,821	11,735	Net Profit	m	35,064	52,123	45,681	48,679
Minority Interests	m	0	0	0	0	Minority Interests	m	0	0	0	0
Reported Earnings	m	13,457	15,110	11,821	11,735	Reported Earnings	m	35,064	52,123	45,681	48,679
Adjusted Earnings	m	13,544	15,198	11,908	11,823	Adjusted Earnings	m	35,433	52,473	46,031	49,029
EPS (rep)		22.09	24.80	19.40	19.26	EPS (rep)		63.33	85.56	74.99	79.91
EPS (adj)		22.23	24.95	19.55	19.41	EPS (adj)		64.00	86.14	75.56	80.49
EPS Growth yoy (adj)	%	30.3	29.6	39.9	41.6	EPS Growth (adj)	%	0.2	34.6	-12.3	6.5
						PE (rep)	x	8.4	6.2	7.1	6.7
						PE (adj)	x	8.3	6.2	7.1	6.6
EBITDA Margin	%	51.9	48.7	44.1	38.0	Total DPS		13.00	15.00	15.00	17.00
EBIT Margin	%	47.3	44.4	38.1	33.6	Total Div Yield	%	2.4	2.8	2.8	3.2
Earnings Split	%	25.8	29.0	22.7	22.5	Weighted Average Shares	m	554	609	609	609
Revenue Growth	%	24.7	24.7	24.7	24.7	Period End Shares	m	554	609	609	609
EBIT Growth	%	44.3	45.1	51.3	56.2						
Profit and Loss Ratios					Cashflow Analysis						
		2006A	2007E	2008E	2009E		2006A	2007E	2008E	2009E	
Revenue Growth	%	4.4	24.7	-1.9	9.0	EBITDA	m	59,315	85,667	77,236	83,428
EBITDA Growth	%	-1.9	44.4	-9.8	8.0	Tax Paid	m	17,471	25,770	22,585	24,067
EBIT Growth	%	-5.0	48.7	-12.3	7.0	Chgs in Working Cap	m	-453	-1,295	-1,546	-2,795
Gross Profit Margin	%	59.7	64.4	62.9	62.7	Net Interest Paid	m	-1,741	-1,412	-2,452	-3,032
EBITDA Margin	%	39.2	45.4	41.7	41.3	Other	m	-5,077	3,155	4,011	4,375
EBIT Margin	%	34.1	40.6	36.3	35.6	Operating Cashflow	m	69,515	111,885	99,832	106,043
Net Profit Margin	%	23.2	27.6	24.7	24.1	Acquisitions	m	0	0	0	0
Payout Ratio	%	20.3	17.4	19.9	21.1	Capex	m	-15,276	-55,000	-50,000	-50,000
EV/EBITDA	x	5.4	4.1	4.5	4.2	Asset Sales	m	0	0	0	0
EV/EBIT	x	6.2	4.5	5.2	4.8	Other	m	-9,370	-10,816	-25,468	-5,587
Balance Sheet Ratios						Investing Cashflow	m	-24,646	-65,816	-75,468	-55,587
ROE	%	42.1	41.6	25.7	22.1	Dividend (Ordinary)	m	-7,135	-10,431	-10,431	-11,822
ROA	%	30.1	35.0	22.8	19.4	Equity Raised	m	-150	14,848	13,235	0
ROIC	%	36.1	42.8	25.3	19.6	Debt Movements	m	-2,226	2,000	20,000	10,000
Net Debt/Equity	%	22.8	15.1	20.9	21.0	Other	m	0	0	0	0
Interest Cover	x	43.5	54.3	27.4	23.7	Financing Cashflow	m	-9,510	6,416	22,804	-1,822
Price/Book	x	3.0	2.1	1.6	1.4	Net Chg in Cash/Debt	m	35,359	52,485	47,169	48,634
Book Value per Share		176.2	253.9	333.5	394.0						
					Balance Sheet						
		2006A	2007E	2008E	2009E		2006A	2007E	2008E	2009E	
Cash	m	2,884	3,755	4,794	6,674	Cash	m	2,884	3,755	4,794	6,674
Receivables	m	5,394	7,023	8,967	12,482	Receivables	m	5,394	7,023	8,967	12,482
Inventories	m	17,321	22,550	28,794	40,083	Inventories	m	17,321	22,550	28,794	40,083
Investments	m	40,700	51,516	76,984	82,571	Investments	m	40,700	51,516	76,984	82,571
Fixed Assets	m	98,651	144,634	184,605	223,080	Fixed Assets	m	98,651	144,634	184,605	223,080
Intangibles	m	0	0	0	0	Intangibles	m	0	0	0	0
Other Assets	m	19,310	24,375	30,423	41,357	Other Assets	m	19,310	24,375	30,423	41,357
Total Assets	m	184,259	253,853	334,568	406,248	Total Assets	m	184,259	253,853	334,568	406,248
Payables	m	28,360	36,922	47,146	65,629	Payables	m	28,360	36,922	47,146	65,629
Short Term Debt	m	0	0	0	0	Short Term Debt	m	0	0	0	0
Long Term Debt	m	25,162	27,162	47,162	57,162	Long Term Debt	m	25,162	27,162	47,162	57,162
Provisions	m	9,727	12,664	16,171	22,510	Provisions	m	9,727	12,664	16,171	22,510
Other Liabilities	m	23,457	22,457	20,957	20,957	Other Liabilities	m	23,457	22,457	20,957	20,957
Total Liabilities	m	86,706	99,205	131,435	166,258	Total Liabilities	m	86,706	99,205	131,435	166,258
Shareholders' Funds	m	97,553	154,648	203,133	239,990	Shareholders' Funds	m	97,553	154,648	203,133	239,990
Minority Interests	m	0	0	0	0	Minority Interests	m	0	0	0	0
Other	m	0	0	0	0	Other	m	0	0	0	0
Total S/H Equity	m	97,553	154,648	203,133	239,990	Total S/H Equity	m	97,553	154,648	203,133	239,990
Total Liab & S/H Funds	m	184,259	253,853	334,568	406,248	Total Liab & S/H Funds	m	184,259	253,853	334,568	406,248

All figures in INR unless noted.

Source: Macquarie Research, April 2007

Important disclosures:

Recommendation definitions

Macquarie Australia/New Zealand

Outperform – return >5% in excess of benchmark return (>2.5% in excess for listed property trusts)
 Neutral – return within 5% of benchmark return (within 2.5% for listed property trusts)
 Underperform – return >5% below benchmark return (>2.5% below for listed property trusts)

Macquarie Asia

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie First South Securities (South Africa)

Outperform – expected return >+5%
 Neutral – expected return from -5% to +5%
 Underperform – expected return <-5%

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Recommendation proportions

	AU/NZ	Asia	RSA
Outperform	44.37%	58.37%	42.20%
Neutral	44.01%	21.30%	46.80%
Underperform	11.62%	20.33%	11.00%

For quarter ending 31 March 2007

Volatility index definition*

This is calculated from the volatility of historic price movements.

Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low–medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to Australian/NZ stocks only

Financial definitions

All "Adjusted" data items have had the following adjustments made:
 Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

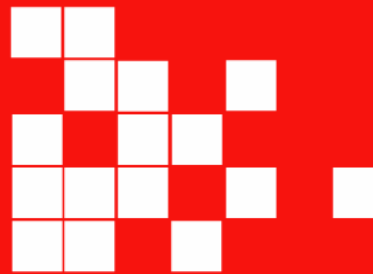
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