SSKI

INDIA RESEARCH

15 March 2007

BSE Sensex: 12544

Tata Steel

Rs433

OUTPERFORMER

COMPANY UPDATE

Mkt Cap: Rs249bn; US $5.5bn

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Tata Steel's stock price has seen a steep 16.7% correction (vis-à-vis 2.7% for the Sensex) ever since the company announced its intention of buying Corus (on 17 October 2006). Concerns on the steep valuation accorded to Corus (US $710 per tonne) by Tata Steel as also the fact that the synergistic benefits that Tata Steel management expects to derive from the acquisition (US $350m over 3-4 years) are still some time away led to the underperformance. However, we believe all the negatives are now adequately priced in. Also, the near-term fundamentals of the steel industry are on an upswing, which should have a bearing on the stock's performance. On a buoyant outlook on steel prices in the domestic market, we have upgraded our FY08 standalone earnings estimate for Tata Steel by 17.7% to Rs69 per share. With proforma consolidated earnings of Rs72 per share, Tata Steel trades at 6x FY08E earnings (assuming US$1.8bn of equity infusion leading to 30% dilution). We rate the stock as Outperformer with a price target of Rs465/share – based on 6.5x FY08E proforma consolidated earnings.

Key financials (standalone)

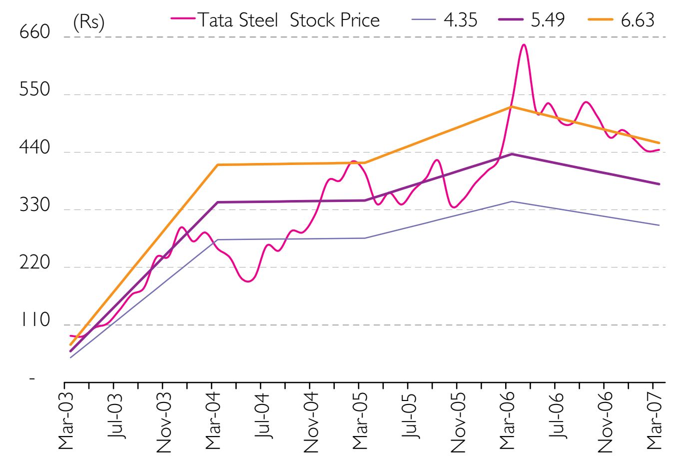
As on 31 March	FY05	FY06	FY07E	FY08E	FY09E
Net sales (Rs m)	144,990	151,394	156,055	160,330	165,828
Shares in issue (m)	554	554	554	609	609
Adj. EPS (Rs)	62.7	63.3	79.5	69.0	67.5
% growth	475.7	0.9	25.5	(13.1)	(2.3)
PER (x)	6.8	6.8	5.4	6.2	6.4
Price/Book (x)	3.4	2.5	1.8	1.4	1.2
EV/EBITDA (x)	4.4	4.4	4.3	4.0	4.1
RoE (%)	60.0	42.3	39.1	26.2	19.9
RoCE (%)	47.3	38.5	33.5	24.0	18.7
EV/CE (x)	2.2	1.8	1.3	1.0	0.8

Prices are as on 14 March

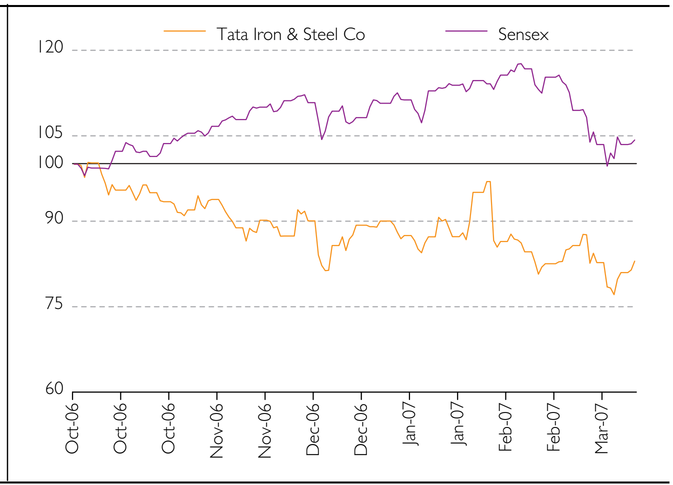
CORUS ACQUISTION HAS NOT GONE DOWN WELL WITH INVESTORS

Tata Steel's revised offer of 608 pence per share for Corus (cumulative US $12.1bn) translates into an EV/EBITDA multiple of 9x on a trailing quarter basis. The valuation appears very high compared to the 5x EV/EBITDA multiple commanded by Tata Steel at the time of the offer. The revised offer price represents a 34% increase over the offer price of 455 pence per share under the original terms of the acquisition. In reaction to this, and that synergistic benefits offered by Corus are some time away, Tata Steel's market capitalization has plummeted by US $1.2bn. This represents a 16.7% drop in stock price compared to 2.7 in the Sensex.

Exhibit 1: Tata Steel – P/E valuation range



Tata Steel vs Sensex (re-based to 100)



Source: Company, SSKI Research

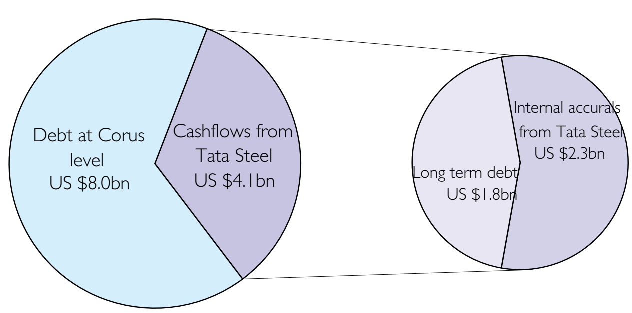
❑ Awaiting financing clarity for Corus acquisition…

The exact financing strategy and contribution of Tata Sons (if any) are yet to be disclosed. According to the original plan of funding (US $10bn), Tata Steel was expected to pump US $2.1bn (using cash equivalents and internal accruals) into Tata Steel, UK – an SPV for the acquisition, and tie up bridge financing of US $1.8bn through its Singapore subsidiary. The remaining portion was expected to be financed through a non-recourse debt in Tata Steel, UK. The management had earlier indicated that the bridge-financing portion created at the Singapore subsidiary level for financing the proposed Corus acquisition was to be replaced by long-term funding over a period of time (possibly through a mix of long-term debt and fresh equity infusion).

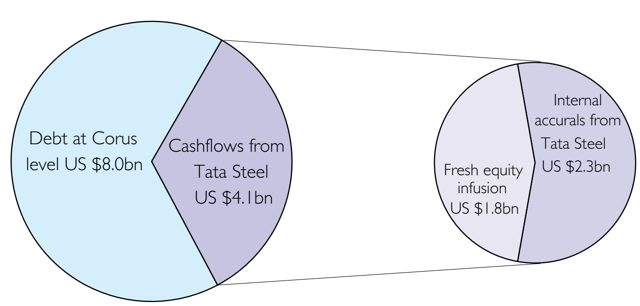
Tata Steel's management has broadly indicated the following funding scenario to finance the US $12.1bn cash outflow (on the revised offer):

- US $8bn to be raised through debt by leveraging Corus cash flows
- The remaining US $4.1bn to be equity contribution of Tata Steel and the Singapore subsidiary into Tata Steel, UK

Exhibit 2: Funding scenario I – entire funding gap met through debt



Funding scenario II – entire funding gap met through fresh equity



Source: Company, SSKI Research

❑ …though consolidation would, at worst, be EPS neutral

We have assumed the following scenario for the break-up of the US $4.1bn to be pumped in as equity by Tata Steel:

- US $2.3bn to be generated by utilizing cash / cash equivalents / investments and internal accruals
- To fund the remaining US$1.8bn in equity/ long-term debt with Tata Sons participating or otherwise

We have assumed the following two scenarios for this portion of the funds: (a) it is entirely financed through long-term debt, OR (b) the entire amount could be raised through equity.

Exhibit 3: Funding scenarios – impact on consolidated EPS

(USD m)	Scenario I	Scenario II
	Entire funding gap met through debt	**Entire funding gap met through equity**
Total cost of acquisition	12,098	12,098
Equity contribution from Tata Steel	2,276	2,276
Fresh equity	-	1,824
Total debt requirement	9,822	7,998
% funded through debt	81.2	66.1
Pre--tax cost of debt (%)	9	9
Interest cost	884	720
Tax break on debt	256	209
Post tax cost of debt	628	511
Consolidated PAT post cost of additional debt-FY07E	1,175	1,292
Consolidated PAT post cost of additional debt-FY08E	1,139	1,256
Additional number of shares at Rs450 (m)	-	182
Dilution (%)		30.0
No of shares outsanding (m)	608	791
Consolidated EPS (Rs) -FY07E	87	74
Consolidated EPS (Rs)- FY08E	83	72
EPS accretion-FY07E (%)	**18.5**	**0.2**
EPS accretion-FY08E (%)	**19.4**	**3.5**
Consolidated Debt to Equity (x)-FY07E	1.2	0.9

Source: SSKI Research

❑ Corus acquisition to yield synergy benefits, but in the long term

At the micro level, Corus is a turnaround story. Back in the early 2000s, the company was losing around US $2bn every year on the bottomline (refer annexure – About Corus, page 7). While a number of external factors beyond the management's control were responsible for the losses, relative operational inefficiencies also contributed. However, a series of initiatives under the aegis of a new management have led to an impressive turnaround in Corus's operational parameters and many more are in the pipeline (refer page 12 for further details).

Besides, Tata Steel management expects to derive synergistic benefits to the tune of ~US $350m from the acquisition over the next 3-4 years. Benefits would accrue from procurement, shared services, improvement in product mix and access to Corus's strong R&D capabilities. Tata Steel's strategy to globalize its steel business is built around achieving maximum value addition by making semi-finished products where raw material is easily available (or can be competitively assembled) and finishing the products at locations close to customers/ markets. However, either option would take time to translate into real benefits for Tata Steel. Even in the case of Corus, a large part of the turnaround in financials is expected only over the longer run, either from shipping raw materials from India or other low cost locations.

HOWEVER, NEAR-TERM FUNDAMENTALS ARE IMPROVING

Rising iron ore prices, attempt by the Chinese government on exports of steel from the country, spiraling freight costs and production cuts effected in Europe have buoyed steel prices in the recent past. With an upbeat environment in the near term, steel prices are likely to remain buoyant over the next few months. A proposal to impose Rs300/tonne (US $6.77/tonne) duty on iron ore in India is likely to add to the cost pressure for Chinese steel manufacturers.

Exhibit 4: Steel prices – on a strong rebound

Source: Bloomberg, SSKI Research

In the Indian market, steel prices have been lagging the price trends prevailing in the rest of Asia and CIS Eastern (10-15% increase over the last two months). Since the beginning of CY07, landed prices of steel in India have gone up from US $500 per tonne to $560 in February – an increase of $60 per tonne – while prices of Indian steel have increased by only $10 per tonne. Recently, Indian manufacturers hiked prices by Rs1,000 per tonne – though there was a subsequent roll back of Rs500 per tonne. With this, prices of Indian steel are currently estimated to be at a 6-8% discount to the landed cost. However, as inflation fears recede, we expect Indian manufacturers to announce a price hike by the end of this month.

❑ Upgrading Tata Steel's standalone estimates for FY08 by 17.7%

Steel prices have staged a rebound over the last two months, and are trading significantly higher than our conservative estimates. We revise our steel price assumption on HRC to US $530/tonne for FY08 and, therefore, upgrade our FY08 earnings estimate for Tata Steel (standalone) by 17.7% to Rs69 per share (before the impact of Corus).

Exhibit 5: Revised earnings estimate

	FY07E		FY08E		FY09E	
	Earlier	Revised	Earlier	Revised	Earlier	Revised
Tata Steel (standalone EPS in Rs)	79.47	79.47	**58.65**	**69.06**	67.49	67.49

Source: SSKI Research

❑ Valuations attractive after the stock price corrects

We expect proforma-consolidated earnings of Rs72 per share for Tata Steel in FY08 in a worst-case scenario, where the entire funding gap is being met through equity. We believe that at the current market price, Tata Steel stock trades at a discount to its domestic and regional peers and at valuations lower than its historical PE multiple of 6.5x. Tata Steel's stock price has corrected sharply by 17% ever since the company announced its intention of buying Corus – chopping off US $1.2bn in market capitalization. However, we believe that the stock price now adequately factors in all the negatives. While we await further clarity on financing of the acquisition, we expect Tata Steel stock to bounce-back to Rs465 per share (based on 6.5x FY08E proforma earnings) – a return of 8% from the current price.

Exhibit 6: Trading comparables

Company	PE (x)		
	FY07E	FY08E	FY09E
Bluescope Steel	10.5	11.1	12.5
POSCO	9.8	7.9	NA
Baoshan Iron & Steel Co-A	12.7	10.9	10.7
Arcelor Mittal	6.9	6.0	5.3
Steel Authority Of India	*7.6*	*7.0*	*6.1*
Jindal Steel & Power	*8.8*	*8.4*	*7.5*
Tata Steel (Standalone)	***5.4***	***6.2***	***6.4***
Tata Steel (Pro-forma)*	***5.8***	***6.0***	***NA***

Source: Bloomberg, SSKI Research

** Based on scenario-II; FY07 is yearend Dec 2006 for POSCO, Baoshan, Arcelor Mittal and yearend June 2007 for Bluescope Steel*

Income statement (standalone)

Year to 31 March (Rs m)	FY05	FY06	FY07E	FY08E	FY09E
Net sales	**144,990**	**151,394**	**156,055**	**160,330**	**165,828**
% growth	54.9	4.4	3.1	2.7	3.4
Operating expenses	85,727	92,607	87,139	90,868	100,321
EBITDA	**59,263**	**58,787**	**68,917**	**69,462**	**65,507**
% growth	208.8	(0.8)	17.2	0.8	(5.7)
Other income	1,766	2,548	2,267	2,267	2,267
Net interest	(1,868.0)	(1,184.4)	(385.5)	(358.1)	(330.7)
Depreciation	6,188	7,751	7,937	8,122	8,308
Pre-tax profit	52,973	52,400	62,861	63,249	59,135
Deferred Tax	0	0	0	0	0
Current Tax	18,231	17,336	18,858	21,188	18,036
Profit after tax	**34,741**	**35,064**	**44,003**	**42,060**	**41,099**
Preference dividend	0	0	0	0	0
Non-recurring items	0	0	0	0	0
Net profit after non-recurring items	34,741	35,064	44,003	42,060	41,099
% growth	766.2	0.9	25.5	-4.4	-2.3

Balance sheet (standalone)

Year to 31 March (Rs m)	FY05	FY06	FY07E	FY08E	FY09E
Paid-up capital	5,537	5,537	5,537	6,092	6,092
Preference share capital					
Reserves & surplus	65,063	89,481	124,459	184,674	215,843
Total shareholders' equity	70,600	95,018	129,996	190,765	221,935
Total current liabilities	36,997	38,087	39,336	41,532	44,797
Total Debt	27,397	25,162	66,722	76,722	76,722
Deferred tax liabilities	8,294	9,570	9,570	9,570	9,570
Other non-current liabilities	15,143	13,887	13,887	13,887	13,887
Total liabilities	87,831	86,706	129,515	141,712	144,976
Total equity & liabilities	**158,431**	**181,724**	**259,511**	**332,477**	**366,911**
Net fixed assets	91,122	98,651	192,291	195,169	198,861
Investments	24,327	40,700	19,700	39,700	59,700
Total current assets	40,834	42,374	47,521	97,609	108,351
Deferred tax assets	0	0	0	0	0
Other non-current assets	2,148	0	0	0	0
Working capital	3,837	4,287	8,185	56,076	63,554
Total assets	**158,431**	**181,724**	**259,511**	**332,477**	**366,912**

Cash flow statement (standalone)

Year to 31 March (Rs m)	FY05	FY06	FY07E	FY08E	FY09E
Pre-tax profit	52,973	52,400	62,861	63,249	59,135
Depreciation	6,188	7,751	7,937	8,122	8,308
chg in Working capital	(7,129)	1,106	2,045	319	969
Total tax paid	(18,231)	(17,336)	(18,858)	(21,188)	(18,036)
Ext ord. Items	-	-	-	-	-
Operating cash Inflow	33,801	43,921	53,985	50,502	50,377
Capital expenditure	(36,584)	(7,947)	(90,000)	(11,000)	(12,000)
Free cash flow (a+b)	(2,784)	35,973	(36,015)	39,502	38,377
Chg in investments	(2,385)	(16,373)	21,000	(20,000)	(20,000)
Debt raised/(repaid)	(6,425)	(2,236)	41,561	10,000	-
Capital raised/(repaid)	(488)	(1,255)	-	28,638	-
Dividend (incl. tax)	(4,708)	(7,195)	(8,204)	(9,025)	(9,929)
Misc	(6,290)	(0)	2	4	3
Net chg in cash	(23,081)	8,915	18,343	49,119	8,450

Key ratios (standalone)

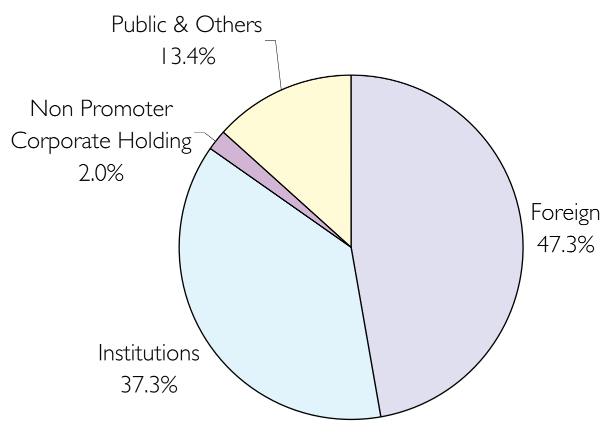
Year to 31 March	FY04	FY05	FY06	FY07E	FY08E
EBITDA margin (%)	40.9	38.8	44.2	43.3	39.5
EBIT margin (%)	36.6	33.7	39.1	38.3	34.5
PAT margin (%)	24.0	23.2	28.2	26.2	24.8
RoE (%)	60.0	42.3	39.1	26.2	19.9
RoCE (%)	47.3	38.5	33.5	24.0	18.7
RoCE - WACC (%)	35.5	25.8	23.0	12.5	6.7
Gearing (x)	0.6	0.4	0.6	0.2	0.1

Valuations (standalone)

Year to 31 March	FY04	FY05	FY06	FY07E	FY08E
Reported EPS (Rs)	62.7	63.3	79.5	69.0	67.5
Adj. EPS (Rs)	62.7	63.3	79.5	69.0	67.5
PER (x)	6.8	6.8	5.4	6.2	6.4
Price/Book (x)	3.4	2.5	1.8	1.4	1.2
EV/Net sales (x)	1.8	1.7	1.9	1.7	1.6
EV/EBITDA (x)	4.4	4.4	4.3	4.0	4.1
EV/CE (x)	2.2	1.8	1.3	1.0	0.8

Prices are as on 14 March

Shareholding pattern



As of December 2006

ANNEXURE: ABOUT CORUS

Corus was formed in October 1999 through the merger of British Steel and Koninklijke Hoogovens with an objective to create scale, offer a wider range of products, increase service offerings and enhance innovation capabilities. The company produced ~18m tonnes of crude steel in 2005 – around 10% of the total production in the EU. Corus is the ninth largest steel producer in the world and the second largest in Europe. While the product portfolio has been biased towards carbon steel, focus is also growing on value-added, differentiated products. For the year ending December 2005, the company generated revenues of GBP9.1bn and net profit of GBP451m.

❑ Manufacturing facilities across the EU

Corus has manufacturing operations in several countries with major plants located in the UK, Netherlands, Germany, France, Norway and Belgium. The company manufactures crude steel at five locations. Carbon steel is produced by using the basic oxygen steelmaking method in the UK at Port Talbot, Teesside and Scunthorpe and in the Netherlands at IJmuiden. In addition, carbon steel is produced by the electric arc furnace method in the UK at Rotherham. Apart from this, Corus has a number of product-specific (rails, narrow strips, special profiles, plates, etc) production facilities across Europe.

Corus – a snapshot of crude steel facilities

Plant location	Production capacity (m tonnes p.a.)	Actual output (m tonnes-2005)	Product	Production route
Port Talbot, West Glamorgan, UK	4.1	3.6	Strip products	Blast furnace
Scunthorpe, South Humberside, UK	4.5	3.8	Long products	Blast furnace
Teesside, Redcar, Cleveland, UK	3.9	3.2	Long products	Blast furnace
Rotherham, South Yorkshire	1.5	0.8	Long products	Electric arc furnace
IJmuiden, the Netherlands	6.8	6.8	Strip products	Blast furnaces
Total	**20.8**	**18.2**		

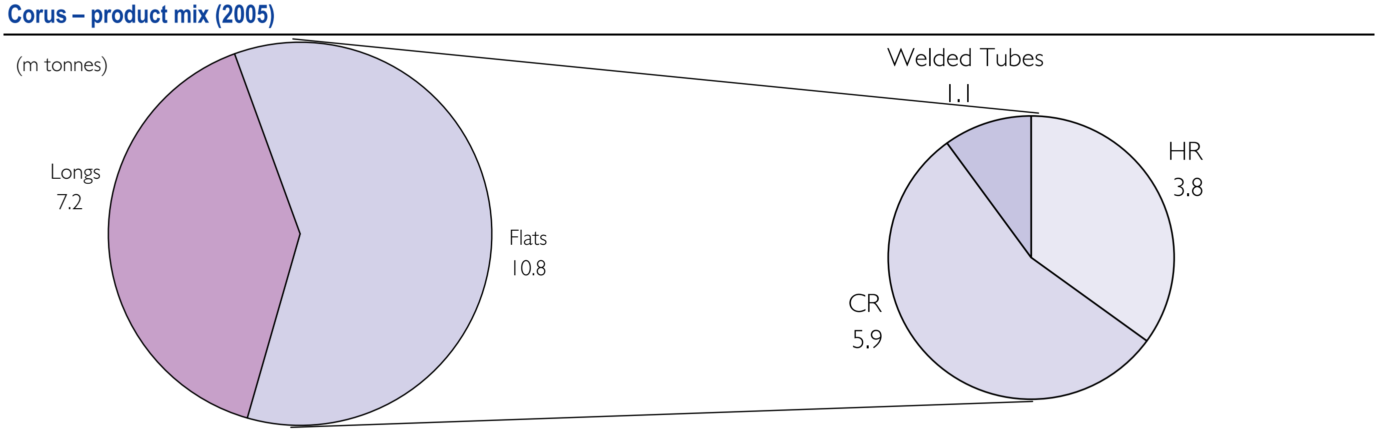
Source: Company, SSKI Research

Corus also had a large aluminium business, majority of which was sold to Aleris in March 2006. Currently, aluminium business comprises only two smelters located in Germany and Netherlands with a total production capacity of 0.2m tpa.

❑ Product offerings and sales mix

Corus's product portfolio has typically been biased towards carbon steel. However, focus is growing on value-added, differentiated products as reflected by the company's product mix in 2005. In the year, Corus rolled about 60% of its crude steel production into HR coils and processed the remaining quantity into sections, plates, engineering steels or wire rod, or sold it in the semi-finished form. Within HR coils, around 35% of the production was sold without further processing, while ~55% was further processed into cold rolling mills and coating lines. The remaining was transferred to Corus tube mills for the manufacture of welded tubes.

Corus – product mix (2005)



Source: Company SSKI Research

Corus has a wide range of product offerings from primary steel to specialized products for the aerospace and automotive industries. Leveraging its wide product portfolio, the group serves a wide base of end markets including automotive, aerospace, packaging, engineering, building and construction sectors. The building and construction markets accounted for 30% of revenues in 2005, while the engineering industry contributed 20% to the total revenues. Automotive, packaging and metal goods markets accounted for 16%, 15%, and 13% of total revenues respectively. In value terms, UK is the largest market for Corus with the rest of Europe (excluding UK) contributing about two-thirds to revenues.

Geographical mix of revenues

Group turnover by destination (GBP m)	2004	% of total	2005	% of sales
UK	2,614	28.0	2,706	26.7
Europe (excluding UK)	4,983	53.4	5,418	53.4
North America	923	9.9	870	8.6
Other areas	812	8.7	1,146	11.3
Total	**9,332**	**100.0**	**10,140**	**100.0**

Source: Company, SSKI Research

❑ Division-wise break-up of revenues

Corus is operationally organized into four divisions based on the nature of products and services:

- Strip Products – the division produces hot rolled, cold rolled, coated steel, tubes and electrical steels
- Long Products – this division produces plates, sections, billet, bars, rail products, slabs, blooms and special profiles
- Distribution & Building Systems – the division operates stockholding and service centres. Besides distributing standard products, the division also produces tailored products (applying further finishes and cutting to size). Corus also provides consulting services including technology, training and operational assistance to steel and aluminium industries
- Aluminum – the division currently consists of two smelters that produce around 250k tonnes of metal per annum

Divisional snapshot

	Volumes* (m tonnes)	Revenues-FY05* (In GBP bn)	EBITDA margin (%-FY05E)
Strip Products	11.1	5.1	15.1
Long Products	7.1	2.6	6.3
Distribution & Building Systems	6.6	3.0	2.1
Aluminium	0.6	1.1	(1.6)

*Source: Company, SSKI Research; * Volumes and revenues before adjusting for intra-group transactions*

❑ Strip Products division

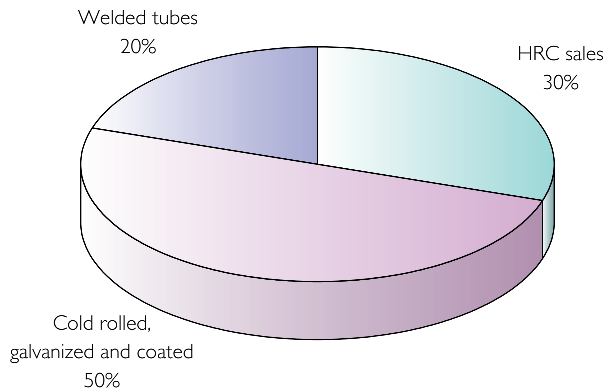
The Strip Products division is made up of Corus Strip Products, IJmuiden and Corus Strip Products, UK. Primary manufacturing of the strip products takes place at Corus's integrated steel making facilities at IJmuiden in the Netherlands and Port Talbot in UK. Both the facilities use the blast furnace method for steel production. The IJmuiden facility, with a capacity of 6.5m tpa, is fully integrated and among the lowest cost producers of steel in Europe. It also has a unique Direct Sheet Plant, which allows casting and rolling in one continuous line. Port Talbot and Llanwern works make up Corus Strip Products, UK. The Port Talbot facility has a capacity of 4.1m tpa and is also fully integrated.

Crude steel production facilities – strips division

location (2005)	Production capacity (m tonnes)	Actual output (m tonnes)	Capacity utilization (%)
Port Talbot, West Glamorgan, UK	4.1	3.6	87.8
IJmuiden, the Netherlands	6.8	6.8	100.0

Source: Company, SSKI Research

Strips division – product mix (2005) by volume



Source: Company, SSKI Research

Though the primary focus of the division is to produce hot rolled, cold rolled and metallic-coated steels, it also produces light gauge steel for packaging and non-packaging applications, hot finished and cold formed steel tubular products and special strips.

Sub-divisions and product profile of the strip products division

Strip Product offerings	Products
Packaging	Tinplate and other coated steel for packaging and non-packaging applications.
Tubes	Steel tubes, hollow sections, line pipe and pipeline project management. Key consuming industries include construction, engineering, energy, automotive and precision tubing markets.
Color	Organic coated steels for applications such as: building envelope (roof and wall), domestic appliances, consumer products and specialist applications.
Special Strip	Plated and clad precision strip products. Expertise in rolling, annealing and electrolytic plating of cold-rolled narrow steel strip, and its downstream processing.
Power	Electrical steels, transformer cores, generator and motor laminations. It is also the largest independent transformer core manufacturer in North America

Strip products – segment financials

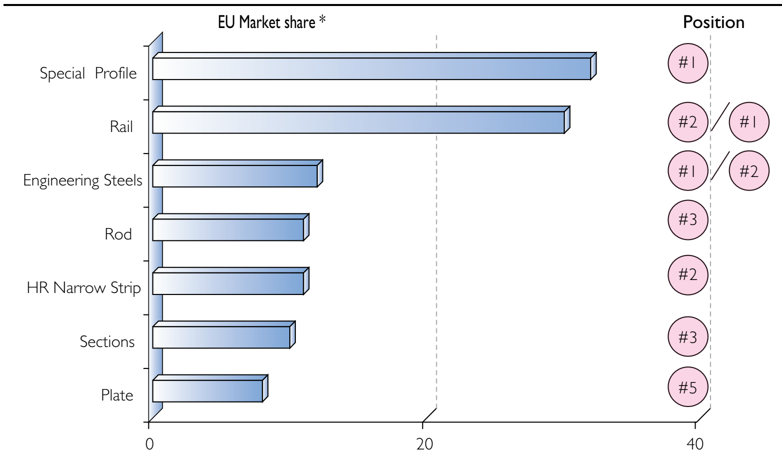
		2003	2004	2005	9M2005	9M2006
Volumes*	'000 tonnes	11,592	12,060	11,140	8,441	8,698
Gross turnover*	£ m	3,916	4,724	5,140	3,919	4,029
Average realisation	£/ tonne	338	392	461	464	463
Total expenditure	£ m	3,677	4,162	4,363	3,280	3,580
Per tonne cost	£/ tonne	317	345	392	389	412
EBITDA	£ m	239	562	777	639	449
Operating margins	%	6.1	11.9	15.1	16.3	11.1

*Source: Company, SSKI Research; * Volumes and revenues before adjusting for intra-group transactions*

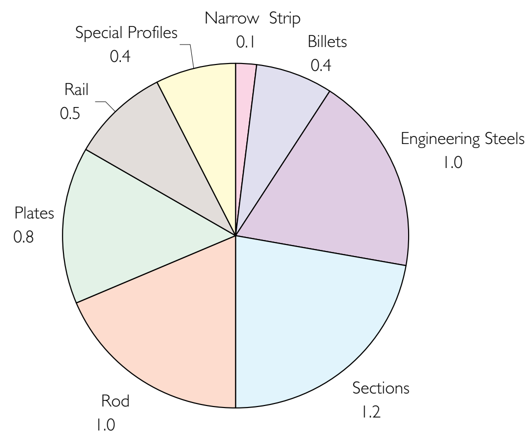
❑ Long Products division

The primary steel requirement of this division is met by Corus's Scunthorpe and Rotherham (UK) plants. Scunthrope is currently the largest integrated iron and steelmaking plant (using the blast furnace process) in the UK with a capacity of 4.5m tonnes. The Rotherham facility uses the electric arc furnace route and specializes in manufacturing engineering steels. With 55% of its revenues coming from the UK, the division is a market leader in special profiles, rail and engineering steel in the EU. Other products in the division's portfolio include rods, HR narrow strips, sections and plates.

Long products – Corus's market share (% - 2004)



Product mix (m tonnes /year - 2004)



Source: Company, SSKI Research

Sub-divisions and product profile of the long products division

Long product offerings	Products
Construction & Industrial	Plates, sections, wire rod and semi-finished steel
Engineering Steels (CES) products	Billets, bar, re-melted steels for aerospace and high performance engineering
Rail	Steel framed modular platform
Narrow Strip	Precision strip products in the hot rolled condition
Special Profiles	Custom designed, hot-rolled and special shaped steel profiles for a wide range of industries including earthmoving equipment, materials handling, shipbuilding and mining
Engineering services	A portfolio of solutions through workshop facilities, project management, design, consultancy and engineering services.

Source: Company, SSKI Research

Long products – segment financials

		2003	2004	2005	9M2005	9M2006
Volumes*	'000 tonnes	8,194	8,172	7,123	5,387	5,496
Gross turnover*	£ m	2,149	2,605	2,679	2,041	2,002
Average realisation	£/tonne	262	319	376	379	364
Total expenditure	£ m	2,134	2,365	2,509	1,884	1,942
Per tonne cost	£/tonne	260	289	352	350	353
EBITDA	£ m	15	240	170	157	60
Operating margins (%)	%	0.7	9.2	6.3	7.7	3.0

*Source: Company, SSKI Research, * Volumes and revenues before adjusting for intra-group transactions*

❑ The Distribution & Building Systems Division

This division focuses on providing an effective route to market the produce of strip products and long products divisions. While large clients directly deal with the mills, smaller clients are serviced through the service centers (where product is cut to size or surface finishes are applied) and stockholders (that purchase from high-volume producers for subsequent resale). For building systems, the company has a network of manufacturing bases providing a wide range of steel and aluminium products for the building industry. Corus also has a consulting division, which provides a wide range of consultancy services from iron ore mining to the marketing of finished products.

By the virtue of being a distribution and trading business, turnover is high but margins are low. At mid-cycle prices, this is a marginally profitable business. The key advantage of being in this business despite lower margins is that it brings Corus close to the end-users of its products, thereby providing information essential to production planning and new product development. Total sales for this division stood at 6.6m tonnes (26% of total volumes) in 2005 and revenues were at GBP3.0bn (25%).

Distribution & Building Systems – segment financials

		2003	2004	2005	9M2005	9M2006
Volumes*	'000 tonnes	6,942	6,348	6,617	4,937	4,894
Gross Turnover*	£ m	2,272	2,606	3,021	2,281	2,274
Average realisation	£/tonne	327	411	457	462	465
Total Expenditure	£ m	2,250	2,499	2,957	2,235	2,209
Per tonne cost	£/tonne	324	394	447	453	451
EBITDA	£ m	22	107	64	46	65
Operating margins	%	1.0	4.1	2.1	2.0	2.9

*Source: Company, SSKI Research, * Volumes and revenues before adjusting for intra-group transactions*

❑ Aluminum division

Corus's aluminium division historically consisted of aluminum smelters, rolling mills and extrusions. On 16 March 2006, Corus announced its plans to sell the aluminium rolled products and extrusions business to Aleris International Inc. for a consideration of US $1.1bn (~£570m). The sale was completed in August 2006. Corus's equity stakes in its Canadian and Chinese joint ventures are also included within the proposed transaction. The smelting operations have remained within Corus. The aluminium division now comprises one business unit – Corus Primary Aluminium, which produces around 250,000 tonnes of pure aluminium metal per year. The two smelters are located in Delfzijl (the Netherlands) and Voerde (Germany). The primary aluminium is cast into products, while scrap is remelted into products, contributing to a total casthouse output of over 300,000 tonnes per year. The division recorded total sales of 0.6m tonnes (3% of total volumes) in 2005 and revenues of GBP1.1bn (9%).

Aluminium division – segment financials

		2003	2004	2005	9M2005#	9M2006
Volumes*	'000 tonnes	598	656	633	73	89
Gross turnover*	£ m	1,028	1,092	1,110	72	138
Average realisation	£/tonne	1,719	1,665	1,754	986	1,551
Total expenditure	£ m	954	1,003	1,128	73	154
Per tonne cost	£/tonne	1,595	1,529	1,208	1,000	1,730
EBITDA	£ m	74	89	(18)	(1)	(16)
Operating margins	%	7.2	8.2	(1.6)	(1.4)	(11.6)

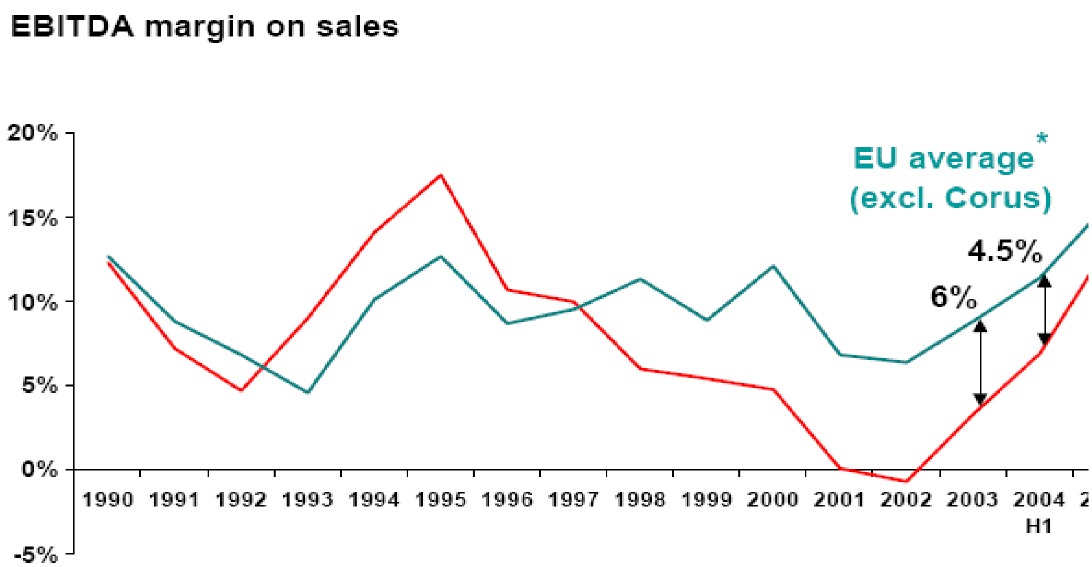
*Source: Company, SSKI Research; # on a comparable basis with 9M2006, * Volumes and revenues before adjusting for intra-group transactions*

❑ Corus – in a transitionary phase

A troubled past

A confluence of tough external market conditions, high power costs, excess manpower and more importantly, a shrinking UK market riddled Corus with huge inefficiencies and consequently rendered it uncompetitive. Further, structurally high energy costs in the UK had made exports unviable from the country. Margin gap between the average EU cost structure and Corus widened significantly, as a result of which Corus failed to report profits until 2003.

Corus's EBITDA margins are gradually improving



Source: Company, SSKI Research

"Restoring success" – the turnaround story post 2003

With the appointment of Philippe Varin as the CEO in May 2003 and a new chairman (Jim Leng), Corus embarked on a remarkable turnaround under a programme called "Restoring Success" that worked on three restructuring strategies – *Legacy Restructuring, UK Restructuring* and *New initiatives* – targeting different operational areas. The first step in this direction was to improve the balance sheet, which was stretched. A significant debt restructuring, coupled with equity raising (GBP291m) in 2003, ensured smooth finances to carry out the restructuring plan. Now on a strong financial footing, Corus turned its focus on becoming operationally efficient through the above three-pronged strategy, designed to deliver EBITDA benefits of GBP680m per annum.

(i) Legacy restructuring plans: The plan targeted three core areas – reduction in manpower, improving the performance of the Dutch strip products (World Class Ijmuiden) and reduction in operational costs in UK Strips (High Performance Strip UK). These initiatives were designed to deliver GBP210m per annum of benefits between June 2003 and end-2005.

(ii) UK restructuring: Restructuring of the UK operations was the second area of focus. The objective of this programme was to improve the efficiency of the UK facilities and align capacity more closely to the likely future demand. This programme was expected to generate benefit of GBP120m at the EBITDA level. As a part of this programme, the Port Talbot facilities were to be expanded, raising strip products output to 4.7m tonnes from 4.1m tonnes. The Stocksbridge facilities were proposed to be partially closed (implemented in June 2005).

(iii) New initiatives: Corus identified further opportunities to cut costs and improve performance by sharing and implementing best practices across the group. The company had identified up to £350m of further potential cost savings from three areas with up to £200m targeted from manufacturing and supplies, £70m from support functions and £80m from volume and mix.

The way forward

Against the GBP210m of benefits expected to be derived from the legacy initiatives, the programme met its targets and yielded gains of GBP216m by December 2005. Technical compulsions in continuing operations at Stocksbridge (earlier planned to be shutdown) and high commissioning costs at Engineering division prevented 'UK restructuring' programme from being fully successful. The total project benefits were revised accordingly and the initiative is now set to deliver savings of £90m (£120m targeted earlier) by end-2006, though annualized savings were restricted to £19m at the end of 2005.

As part of the new initiatives programme, GBP350m of EBITDA benefits have been envisaged through improvement in manufacturing processes, better supply chain management, support function rationalization, and rebalancing of customers and product mix towards premium end markets. To this end, the group completed some £100m of investments during 2005 related to specific opportunities in premium end markets including aerospace and wire rod, where the group was capacity constrained. New initiatives are progressing well on track and the target for these initiatives has been raised to £380m, compensating for the shortfall from UK restructuring.

'Restoring Success' – targets

Initiative (GBP m)	End-2006 targets	Progress to December 2006
Legacy initiatives	210	216
UK restructuring	90	19
New initiatives	380	320
Gross target	**680**	**655**

Source: Company

Broadly, by 2005, Corus has managed to achieve ~80% of its overall target as a part of the "Restoring Success" scheme. Having achieved reasonable success under this programme, Corus's strategy post 2005 encompasses developing a strong and sustainable competitive position in Western Europe, securing access to steel making in lower cost, higher growth regions, enriching the sales mix and continuously benchmarking its performance against the best in class. In support of this, the group announced two major investments during 2005 that are currently under way:

- An investment of £130m at Scunthorpe to strengthen its competitive position in structural sections, rail and wire rod markets; and
- An investment of £153m at IJmuiden, Corus's lowest cost facility, to expand the group's product range and capabilities for the automotive and construction markets.

Both investments would enrich Corus's sales mix by focusing on more value added products and will also significantly improve operational efficiency. Corus will target at least 60% of its deliveries to be value added, differentiated products by the end of 2008. This represents an increase of approximately one-third compared to 2003 when 'Restoring Success' was first launched.

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