

COMPANY UPDATE

Tata Steel (TISC.BO)

Buy

Equity Research

Reiterate Buy (on CL) on near-term catalysts, favorable valuations**What's changed**

We reiterate our Buy rating (on Conviction List) on Tata Steel, on positive steel price trends in Europe and Asia.

Since end November, **European mills have started increasing their offer prices** for January HRC production by 7%-10% on cost push inflation and seasonal pick-up in demand. In the past two weeks, European spot steel prices have started inching up by 3%-5% in anticipation of inventory restocking in 1QCY11. Tata Steel Europe also announced an increase in section (long product) prices by £50/ton (+10%), effective January 2011.

For India operations, **we expect a 7%-10% increase in India domestic prices in 4QFY11**. Regional Asian prices have already started to firm up thus far in December – a leading indicator for domestic prices.

Implications

With Corus' (Tata Steel Europe) earnings highly levered to utilization and spot pricing in Europe, we expect Corus to report strong operating performance in 4Q – a 1% rise in Europe steel prices should increase FY12E consolidated EPS by 7.9%. In our view, at current price levels, the market is assigning unjustifiably low value to Europe operations; hence, any positive development in Europe Steel should drive up the stock price.

Valuation

We reiterate our Conviction Buy on Tata Steel, with a P/B-based 12-month TP of Rs764, implying 24% upside. In our view, the current price does not reflect Tata Steel's strong growth trajectory (46% FY10-FY13E EBITDA CAGR) and improving return profile. At 1.6X FY12E P/B, the stock is trading in line with the sector average despite sector-leading FY12E ROE of 27% (sector ROE: 20%). On earnings-based multiples, the stock is trading at 4.6X FY12E EV/EBITDA, at 26% discount to the mid-cycle of 6.2X and 16% discount to peers.

Key risks

Slower-than-expected demand recovery and pricing at Tata Steel Europe.

INVESTMENT LIST MEMBERSHIP

Asia Pacific Buy List

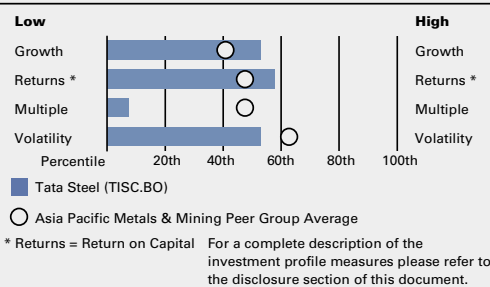
Asia Pacific Conviction Buy List

Coverage View: Neutral

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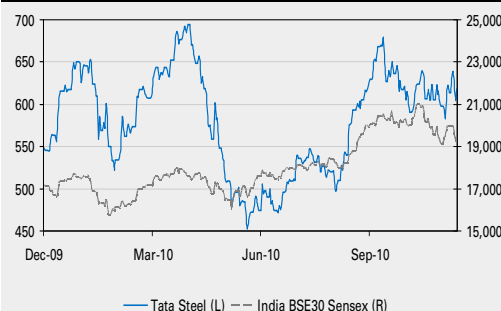
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Investment Profile

Key data	Current
Price (Rs)	618.10
12 month price target (Rs)	764.00
Market cap (Rs mn / US\$ mn)	558,222.2 / 12,389.8
Foreign ownership (%)	19.5

	3/10	3/11E	3/12E	3/13E
EPS (Rs)	(3.93)	73.71	97.76	132.78
EPS growth (%)	(103.2)	1,974.8	32.6	35.8
EPS (diluted) (Rs)	(24.27)	68.14	90.37	122.74
EPS (basic pre-ex) (Rs)	(3.93)	73.71	97.76	132.78
P/E (X)	NM	8.4	6.3	4.7
P/B (X)	2.2	1.9	1.6	1.2
EV/EBITDA (X)	10.6	6.1	4.6	3.4
Dividend yield (%)	2.3	2.8	3.1	3.8
ROE (%)	(8.0)	25.8	27.3	29.3
CROCI (%)	4.4	8.5	10.5	12.6

Price performance chart

Share price performance (%)	3 month	6 month	12 month
Absolute	4.2	31.3	12.7
Rel. to India BSE30 Sensex	0.4	13.9	(0.7)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 12/10/2010 close.

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Tata Steel: Summary Financials

Profit model (Rs mn)	3/10	3/11E	3/12E	3/13E	Balance sheet (Rs mn)	3/10	3/11E	3/12E	3/13E
Total revenue	1,023,931.2	1,141,259.5	1,315,106.5	1,288,884.7	Cash & equivalents	67,878.1	100,771.4	151,955.8	234,251.8
Cost of goods sold	(831,024.1)	(870,351.1)	(985,081.7)	(912,965.2)	Accounts receivable	116,239.5	100,055.6	115,297.0	112,998.1
SG&A	(165,668.8)	(158,730.9)	(182,546.3)	(186,100.3)	Inventory	186,866.4	174,070.2	164,180.3	152,160.9
R&D	0.0	0.0	0.0	0.0	Other current assets	67,693.9	67,693.9	67,693.9	67,693.9
Other operating profit/(expense)	8,970.8	1,789.4	2,094.6	2,334.3	Total current assets	438,677.9	442,591.2	499,127.0	567,104.7
EBITDA	81,126.4	160,128.1	200,127.2	250,085.0	Net PP&E	457,958.3	497,439.2	534,082.4	562,209.6
Depreciation & amortization	(44,917.3)	(46,161.3)	(50,554.0)	(57,931.5)	Net intangibles	146,566.7	146,566.7	146,566.7	146,566.7
EBIT	36,209.1	113,966.8	149,573.2	192,153.5	Total investments	54,177.9	66,093.2	70,983.2	74,560.6
Interest income	0.0	2,585.0	885.8	1,939.1	Other long-term assets	0.0	0.0	0.0	0.0
Interest expense	(30,220.6)	(30,735.1)	(29,694.7)	(29,228.5)	Total assets	1,097,380.8	1,152,690.2	1,250,759.3	1,350,441.6
Income/(loss) from uncons. subs.	1,268.6	0.0	0.0	0.0	Accounts payable	119,259.9	132,925.4	153,173.8	150,119.7
Others	11,158.7	11,915.3	4,890.1	3,577.4	Short-term debt	3,684.0	3,684.0	3,684.0	3,684.0
Pretax profits	18,415.8	97,732.0	125,654.4	168,441.5	Other current liabilities	180,567.4	180,567.4	180,567.4	180,567.4
Income tax	(21,518.4)	(31,170.9)	(36,325.6)	(46,572.1)	Total current liabilities	303,511.3	317,176.8	337,425.2	334,371.1
Minorities	(152.4)	8.4	(1,042.4)	(1,956.8)	Long-term debt	527,319.5	508,777.2	514,664.1	516,664.1
Net income pre-preferred dividends	(3,255.0)	66,569.6	88,286.4	119,912.6	Other long-term liabilities	29,570.4	29,570.4	29,570.4	29,570.4
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	556,889.9	538,347.6	544,234.5	546,234.5
Net income (pre-exceptionals)	(3,255.0)	66,569.6	88,286.4	119,912.6	Total liabilities	860,401.2	855,524.5	881,659.8	880,605.7
Post-tax exceptionals	(16,837.2)	0.0	0.0	0.0	Preferred shares	0.0	0.0	0.0	0.0
Net income	(20,092.2)	66,569.6	88,286.4	119,912.6	Total common equity	228,138.9	288,333.4	359,229.9	458,004.4
EPS (basic, pre-exception) (Rs)	(3.93)	73.71	97.76	132.78	Minority interest	8,840.7	8,832.3	9,874.7	11,831.5
EPS (basic, post-exception) (Rs)	(24.27)	73.71	97.76	132.78	Total liabilities & equity	1,097,380.8	1,152,690.2	1,250,759.3	1,350,441.6
EPS (diluted, post-exception) (Rs)	(24.27)	68.14	90.37	122.74	BVPS (Rs)	275.57	319.26	397.76	507.13
DPS (Rs)	14.23	17.02	19.26	23.40	Ratios	3/10	3/11E	3/12E	3/13E
Dividend payout ratio (%)	(58.6)	23.1	19.7	17.6	CROCI (%)	4.4	8.5	10.5	12.6
Free cash flow yield (%)	(3.7)	6.9	7.6	14.6	ROE (%)	(8.0)	25.8	27.3	29.3
Growth & margins (%)	3/10	3/11E	3/12E	3/13E	ROA (%)	(1.7)	5.9	7.3	9.2
Sales growth	(30.5)	11.5	15.2	(2.0)	ROACE (%)	2.3	12.2	15.2	19.0
EBITDA growth	(55.4)	97.4	25.0	25.0	Inventory days	88.6	75.7	62.7	63.2
EBIT growth	(74.0)	214.7	31.2	28.5	Receivables days	43.9	34.6	29.9	32.3
Net income growth	(141.7)	431.3	32.6	35.8	Payable days	49.4	52.9	53.0	60.6
EPS growth	(136.7)	403.7	32.6	35.8	Net debt/equity (%)	195.4	138.5	99.3	60.9
Gross margin	18.8	23.7	25.1	29.2	Interest cover - EBIT (X)	1.2	4.0	5.2	7.0
EBITDA margin	7.9	14.0	15.2	19.4	Valuation	3/10	3/11E	3/12E	3/13E
EBIT margin	3.5	10.0	11.4	14.9	P/E (analyst) (X)	NM	8.4	6.3	4.7
Cash flow statement (Rs mn)	3/10	3/11E	3/12E	3/13E	P/B (X)	2.2	1.9	1.6	1.2
Net income pre-preferred dividends	(3,255.0)	66,569.6	88,286.4	119,912.6	EV/EBITDA (X)	10.6	6.1	4.6	3.4
D&A add-back	44,917.3	46,161.3	50,554.0	57,931.5	EV/GCI (X)	0.6	0.7	0.6	0.5
Minorities interests add-back	152.4	(8.4)	1,042.4	1,956.8	Dividend yield (%)	2.3	2.8	3.1	3.8
Net (inc)/dec working capital	46,465.2	42,645.6	14,897.0	11,264.2					
Other operating cash flow	(13,177.7)	(11,915.3)	(4,890.1)	(3,577.4)					
Cash flow from operations	75,102.2	143,452.7	149,889.7	187,487.8					
Capital expenditures	(69,471.5)	(85,642.1)	(87,197.2)	(86,058.8)					
Acquisitions	0.0	0.0	0.0	0.0					
Divestitures	0.0	0.0	0.0	0.0					
Others	19,453.9	0.0	0.0	0.0					
Cash flow from investments	(50,017.6)	(85,642.1)	(87,197.2)	(86,058.8)					
Dividends paid (common & pref)	(13,209.1)	(15,375.0)	(17,395.0)	(21,133.1)					
Inc/(dec) in debt	(26,866.3)	(18,542.3)	5,886.9	2,000.0					
Common stock issuance (repurchase)	24,464.7	9,000.0	0.0	0.0					
Other financing cash flows	(3,079.4)	0.0	0.0	0.0					
Cash flow from financing	(18,690.1)	(24,917.3)	(11,508.0)	(19,133.1)					
Total cash flow	6,394.5	32,893.3	51,184.4	82,296.0					

Note: Last actual year may include reported and estimated data.
Source: Company data, Goldman Sachs Research estimates.

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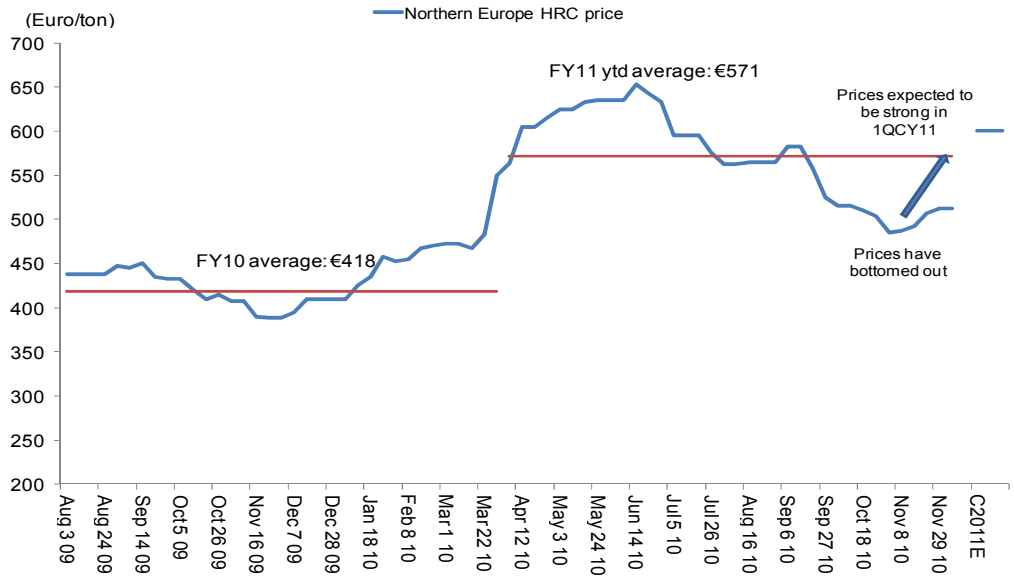
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Exhibit 1: European prices have bottomed; we expect prices to be relatively strong in 1QCY11

Northern Europe domestic HRC price



Source: Steel Business Briefing, Goldman Sachs Research estimates.

Exhibit 2: Tata Steel Europe's earnings are highly levered to steel prices

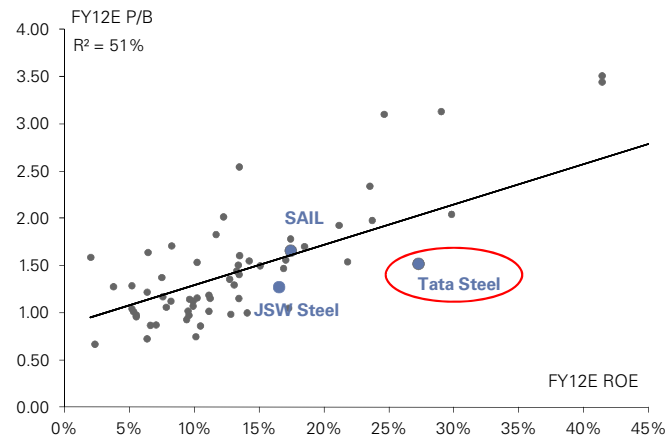
Sensitivity to steel prices and raw material costs

Change in FY2012E estimates	+ 1% change in				
	Average selling prices	Benchmark Coking coal prices (US\$)	Benchmark Iron ore prices (US\$)	Iron ore & coking coal prices (US\$)	
Tata Steel India					
EBITDA	1.9%	-0.4%	0.0%	-0.4%	100% captive iron ore 50% imported coking coal dependency
Net Profit	2.3%	-0.5%	0.0%	-0.5%	
Tata Steel Europe					
EBITDA	17.2%	-2.7%	-3.0%	-5.7%	0% integration
Tata Steel Consolidated					
EBITDA	5.6%	-1.0%	-0.8%	-1.7%	35% captive iron ore 75% imported coking coal dependency
Net Profit	9.9%	-1.7%	-1.4%	-3.1%	

Source: Company data, Goldman Sachs Research estimates.

Exhibit 3: Tata Steel is currently trading at a discount to our global metals coverage on PB/ROE...

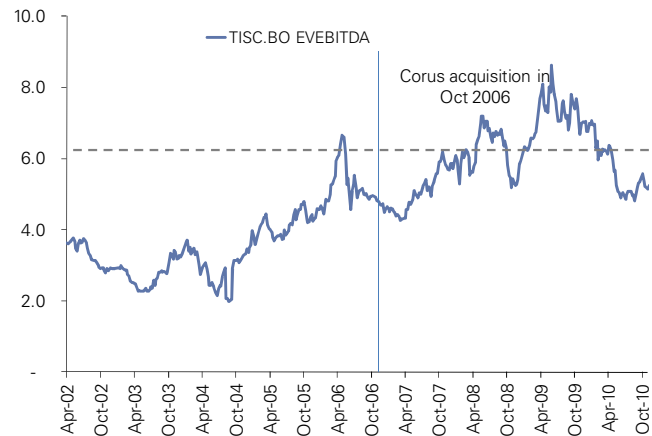
Global metals & mining P/B vs. ROE framework



Source: Company data, Goldman Sachs Research estimates.

Exhibit 4: Tata Steel is trading below mid-cycle valuations on earnings-based multiples

Tata Steel 12-month forward EV/EBITDA



Source: Company data, Goldman Sachs Research estimates.

Exhibit 5: Valuation scenario analysis implies a low multiple for Tata Steel's Europe business

	FY2012E	Relative to Peers		
Consolidated				
Current market cap (Rs mn)	558,222			
Net debt (Rs mn)	366,392			
Enterprise value (Rs mn)	924,615			
Tata Steel stand-alone				
EBITDA/ton (US\$)	\$433	SAIL \$212	JSW Steel \$184	Average \$198
EBITDA (Rs mn)	133,786			
Target FY12E EV/EBITDA (based on peer avg)	5.6x	7.0x	4.2x	5.6x
Enterprise value (Rs mn)	749,783			
Other subsidiaries inc. Tata Steel Europe				
Implied EV	174,831	ThyssenKrupp	ArcelorMittal	EU average
EBITDA	66,341			
EBITDA/ton (US\$)	\$73			
Implied EV/EBITDA	2.6x	6.6x	7.9x	6.7x
Discount to peers	-61%			

Source: Company data, Goldman Sachs Research estimates.

Reg AC

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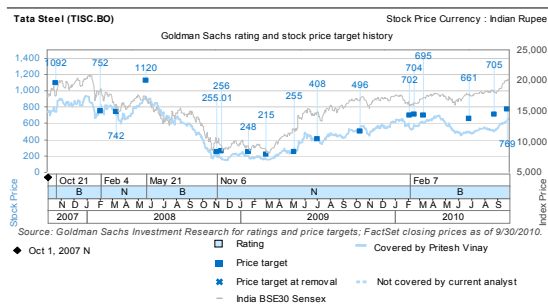
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