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Shareholding (%)

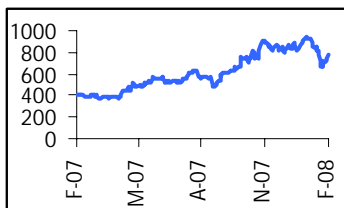
Promoters	33.7
FII's	20.1
MFs/Banks	4.2
Insurance Co.	15.4
Others	26.6

Share price performance

52-week high/low (Rs)	957/353		
	-1m	-3m	-12m
Abs (%)	-16.8	-14.0	91.9
Rel* (%)	-3.3	-4.6	63.4

*to Nifty

Stock chart



Results in line; Valuations at a discount to global peers

During Q3FY08, Tata Steel reported an 11.3% YoY growth in net revenues, driven by an 18.3% increase in blended realisations and a 0.8% increase in sales volumes of saleable steel. In line with higher realisations, the company's EBITDA margins expanded by 230 bps to 42.2%, and EBITDA grew by 17.5%YoY. Net profits, though, declined 2.5%YoY due to higher interest costs. Tata Steel's interest cost increased by Rs1.6bn during the quarter, as a US\$2.9bn bridge loan at the Singapore SPV was re-financed by the standalone entity in India. Since the bridge loan has now been re-paid through the proceeds from the rights issue, convertible preference issue and preferential allotment of equity to the promoters, the company's interest costs are expected to fall by 1.6bn from Q4FY08E.

In FY09E, we expect Tata Steel's Indian operations to benefit from higher steel prices and the commissioning of an 1.8 mn tonnes billet plant. However, for Corus, we do not expect any incremental growth in net earnings during FY09E, as the increase in iron ore and coking coal contract prices would offset the rise in steel prices. Moreover, since Corus is completely devoid of any captive sources for its raw material requirements, its operating margins may come under pressure.

At the current price, Tata Steel (consolidated) is trading at an EV/EBIDTA of 5.6x FY09E. While this is above the historical band, it remains at a discount to global peers. We, hence, maintain an 'Accumulate' rating on the stock.

The key highlights of Q3FY08 are:

- ▲ **Higher realisations and volumes drive topline growth:**
An 18.3% increase in blended realisations and a 0.8% growth in sales volumes of saleable steel enabled Tata Steel to register an impressive 11.3%YoY growth in net sales during Q3FY08. On a QoQ basis, the company reported a 3.9% growth in topline, driven by a 2.1% increase in sales volumes of saleable steel and a 1.8% improvement in blended realisations. Apart from an increase in steel prices YoY, change in the product mix in favour of flat steel coupled with higher share of branded steel sales led to the increase in blended realisations.

Accumulate
Rs776

February 1, 2008

Market cap

Rs bn 718

US\$ bn 18

Avg 3m daily volume

2,564,638

Avg 3m daily value

USD mn 54

Shares outstanding (mn)

869

Reuters/Bloomberg

TISC.BO/TATA.IN

NSE/BSE

TATASTEEL/500470

Sensex

18,243

Nifty

5,317

Tata Steel

- ▲ **Margins expand further to 42.2%:** In Q3FY08, Tata Steel's operating profit margins expanded further to 42.2%, higher by 225bps YoY. The increase was driven by better realisations as well as lower coking coal prices. During the quarter, the company benefited from a 15% reduction in coking coal prices for FY08. This translated into a 17.5%YoY growth in operating profits to Rs20.97bn.
- ▲ **Higher interest cost and lower non-operating income impacts net profit:** Tata Steel reported a 2.5%YoY decline in net profits during Q3FY08 due to higher interest cost and lower other income. Interest cost grew by 597%YoY to Rs3.6bn, as part of the debt raised for funding the Corus acquisition was through Tata Steel's books. Moreover, a US\$2.9bn bridge loan at the Singapore SPV was re-financed by the standalone entity in India; this further led to an increase in interest costs to the tune of Rs1.6bn for the quarter. Other income declined 32.1% YoY to Rs670.3mn as surplus funds were utilised for part funding the Corus acquisition.

Other developments

- ▲ **Expansions on track:** Of the ongoing expansions, the Jamshedpur expansion of 1.8mn tonnes billet plant is progressing as per schedule; the plant is expected to begin production from H2CY08. The billets thus produced would be supplied to Tata Steel's foreign subsidiaries in South East Asia; at these locations, the billets would be converted into high-value construction steel. It is to be noted here that this is part of Tata Steel's strategy to make semi-finished steel closer to the raw material sources, and convert it to high-value finished steel closer to target markets. The project cost is expected to be within the sanctioned budgeted cost of Rs45.5bn.

By FY11, Tata Steel is also likely to put up a 2.34mn steel capacity integrated up to HR coils, and a 0.5mn tonne slab facility at its Jamshedpur plant. The project is estimated to cost Rs91.6bn.

Raw Material Integration

- ▲ **Mozambique Coal :** Tata Steel has entered into a JV agreement with Riversdale Mining for Benga and Tete coal tenements; the company would hold a 35% stake (for US\$100mn) in the JV. The Benga tenement, spread over 25,000 hectares, is inferred to have a coal reserve of~1.225bn tonnes. Tata Steel has an off-take agreement of 40% of the coking coal produced on commercial terms. Production is expected to commence by 2010.

Tata Steel

- ▲ **Iron ore** : Tata Steel has entered into a JV agreement with an Ivory Coast state owned company, Sodemi, to develop the Mt.Nimba mine that has estimated reserves of more than 500mn tonnes. Tata Steel will have a 75% stake in this JV. Production is expected to commence after three years.
- ▲ **Limestone** : Tata Steel has entered into a 70:30 joint venture with the Al Bahja Group through Al Riman Mining LLC, the group's existing mining company. The JV would mine metallurgical grade limestone from Uyun Mine in Salalah in southern Oman. Production is expected to commence by 2010.
- ▲ **JV with SAIL**: Tata Steel and SAIL have entered into a JV to identify and mine coal blocks in India. Currently, four coking coal blocks in Jharkhand are being evaluated by a joint working group. The company is expected to be formed by March,2008.

Valuations

During CY08, iron ore contract prices are expected to rise by 40-50%, whereas coking coal prices are expected to increase by 35%. Given this cost push, robust global demand for steel, and efforts taken by the Chinese Government to cut down on production, we expect a sharp increase in steel prices, going forward. On a stand alone basis, Tata Steel's entire requirement of iron ore is met through captive sources. The company will thus be insulated from the expected increase in iron ore prices and would benefit from the iron-ore price led cost push; however, the standalone entity will be partially impacted by the rising coking coal prices.

At the current price, Tata Steel (consolidated) is trading at an EV/EBIDTA of 5.6x FY09E. While this is above the historical band, it is still at a discount to global peers. We hence maintain an 'Accumulate' rating on the stock.

Table 1. Quarterly result table

Rs mn	Q3FY08	Q3FY07	YoY (%)	Q2FY08	QoQ (%)
Net Sales from operations	49,739.2	44,699.8	11.3	47,850.9	3.9
Total Expenses	28,773.1	26,863.6	7.1	27,596.5	4.3
(Increase)/Decrease in stock	(614.3)	(790.2)	-22.3	(158.9)	286.6
Raw material Consumed	9,308.5	8,314.9	11.9	7,998.6	16.4
Traded goods purchased	1,083.3	1,109.9	-2.4	1,071.5	1.1
Power and fuel	2,395.1	2,260.7	5.9	2,386.8	0.3
Employee cost	3,646.4	3,610.7	1.0	3,769.3	-3.3
Freight and handling	2,876.9	2,856.1	0.7	2,799.6	2.8
Other expenditure	10,077.2	9,501.5	6.1	9,729.6	3.6
EBITDA	20,966.1	17,836.2	17.5	20,254.4	3.5
Depreciation	2,092.1	1,990.6	5.1	2,050.1	2.0
EBIT	18,874.0	15,845.6	19.1	18,204.3	3.7
Interest expense / (Interest income)	3,626.7	520.3	597.0	2,021.5	79.4
Other Income	670.3	987.4	-32.1	943.2	-28.9
PBT	15,917.6	16,312.7	-2.4	17,126.0	-7.1
Provision for tax	5,060.7	5,182.5	-2.4	5,557.9	-8.9
PAT	10,856.9	11,130.2	-2.5	11,568.1	-6.1
EO items	(171.1)	(492.7)	-65.3	340.2	-150.3
Net Profit	10,685.8	10,637.5	0.5	11,908.3	-10.3
Equity (Face value X)	7,105.3	5,806.7	22.4	6,091.7	16.6
Cash EPS	39.0	22.6	72.5	22.4	74.4
EPS	15.3	19.2	-20.3	19.0	-19.5
Adjusted EPS	15.3	18.3	-16.6	19.5	-21.8
Key ratios (%)					
EBIDTA Margin	42.2	39.9		42.3	
Interest/Sales	7.3	1.2		4.2	
Tax/PBT	31.8	31.8		32.5	
NPM	21.5	23.8		24.9	

Source: IISL research, company

Financials (Standalone)

Profit & Loss					Balance Sheet				
In Rs million	FY06	FY07	FY08E	FY09E	In Rs million	FY06	FY07	FY08E	FY09E
Net sales	151,393.9	175,520.2	197,102.8	264,148.2	Equity capital	5,536.7	5,804.7	8,690.8	8,690.8
YoY (%)	4.4	15.9	12.3	34.0	Quasi Equity	0.0	1,472.6	2.0	2.0
Total expenses	92,078.8	105,787.5	115,332.6	150,097.2	Reserves	103,370.7	142,729.7	318,006.3	373,259.4
Inc/dec in stock	(1,049.1)	(824.7)	(998.9)	(3,638.0)	Net worth	108,907.4	150,007.0	326,699.1	381,952.2
Raw material cost	30,243.8	36,656.9	43,131.4	62,547.9	Total borrowings	25,161.5	96,453.3	94,969.8	94,665.5
Staff cost	13,515.1	14,548.3	15,421.2	17,580.2	Deferred tax	9,570.0	7,489.4	6,927.4	6,089.1
Power and fuel cost	8,191.7	9,216.9	9,625.0	12,295.0	Total liabilities	143,638.9	253,949.7	428,596.3	482,706.7
Other manufacturing expe	24,283.4	28,789.8	30,389.1	38,928.6	Gross block	145,947.2	159,290.8	167,626.0	207,507.6
Other expenses	16,893.9	17,400.3	17,764.8	22,383.5	Less: Acc. depreciation	66,056.6	73,859.6	81,953.0	91,187.3
EBIDTA	59,315.1	69,732.7	81,770.1	114,051.1	Net block	79,890.6	85,431.2	85,673.0	116,320.3
YoY (%)	(1.9)	17.6	17.3	39.5	CWIP	18,759.9	24,974.4	40,000.0	45,000.0
EBIDTA (%)	39.2	39.7	41.5	43.2	Investments	40,699.6	61,061.8	292,696.1	303,867.3
Other income	2,547.6	4,336.7	2,927.0	3,038.7	Current assets	42,376.0	137,018.9	69,041.6	81,487.4
PBIDT	61,862.7	74,069.4	84,697.1	117,089.7	Inventories	21,747.5	23,329.8	26,389.3	36,422.4
Interest	1,184.4	1,739.0	9,584.2	7,889.8	Debtors	5,394.0	6,316.3	7,093.0	9,505.7
Gross profit	60,678.3	72,330.4	75,112.9	109,199.9	Cash	2,883.9	76,813.5	5,000.0	5,000.0
Depreciation	7,751.0	8,192.9	8,093.4	9,234.3	Loans and advances	12,350.6	30,559.3	30,559.3	30,559.3
PBT and extra ordinary	52,927.3	64,137.5	67,019.5	99,965.6	Current liabilities	28,359.9	35,232.0	36,796.5	41,950.3
Extra ordinary items	(527.7)	(1,521.0)	0.0	0.0	Provisions	9,727.3	19,304.6	22,017.9	22,017.9
PBT	52,399.6	62,616.5	67,019.5	99,965.6	Net current assets	4,288.8	82,482.3	10,227.2	17,519.1
(-) Tax	17,335.8	20,395.0	21,829.1	32,560.1	Miscellaneous expenses	0.0	0.0	0.0	0.0
Current Tax	16,060.0	20,920.1	22,391.1	33,398.4	Total assets	143,638.9	253,949.7	428,596.3	482,706.7
Deferred Tax	1,275.8	(525.1)	(562.0)	(838.3)					
Tax/ PBT	33.1	32.6	32.6	32.6					
PAT	35,063.8	42,221.5	45,190.4	67,405.5					
Adjusted net profit	35,063.8	42,221.5	45,190.4	67,405.5					
YoY (%)	0.9	20.4	7.0	49.2					

Key Ratios					Cash Flow				
	FY06	FY07	FY08E	FY09E	In Rs million	FY06	FY07	FY08E	FY09E
EPS (Rs)	63.3	72.7	52.0	77.6	Net profit	35,063.8	42,221.5	45,190.4	67,405.5
Adjusted EPS (Rs)	63.3	72.7	52.0	77.6	Depn and w/o	7,751.0	8,192.9	8,093.4	9,234.3
CEPS (Rs)	79.6	85.9	60.7	87.2	Deferred tax	1,275.8	(525.1)	(562.0)	(838.3)
Book value (Rs)	196.7	258.4	375.9	439.5	Change in working cap	(36.2)	(4,263.9)	441.6	(7,291.9)
Dividend per share (Rs)	14.8	19.0	14.0	14.0	Other income	2,547.6	4,336.7	2,927.0	3,038.7
Debt-equity (x)	0.2	0.6	0.3	0.2	Operating cash flow	41,506.8	41,288.7	50,236.4	65,470.9
ROCE	42.1	32.3	22.1	23.3	Other income	2,547.6	4,336.7	2,927.0	3,038.7
ROE	36.4	32.6	19.0	19.0	Capex	(15,279.1)	(19,948.0)	(23,360.8)	(44,881.6)
					Investments	(16,373.1)	(20,362.2)	(231,634.3)	(11,171.2)
Valuations					Investing cash flow	(29,104.6)	(35,973.5)	(252,068.2)	(53,014.1)
PE (x)	12.3	10.7	14.9	10.0	Dividend	(8,204.3)	(11,043.3)	(12,152.4)	(12,152.4)
Cash PE (x)	9.8	9.0	12.8	8.9	Equity	94.3	10,489.7	142,238.7	0.0
Price/book value (x)	3.9	3.0	2.1	1.8	Debt	(2,235.5)	71,291.8	(1,483.5)	(304.4)
Dividend yield	1.9	2.5	1.8	1.8	Financing cash flow	(10,345.5)	70,738.2	128,602.8	(12,456.8)
Market cap/sales	2.8	2.6	3.4	2.6	Others	(1,640.0)	(2,123.8)	1,991.8	0.0
EV/sales (x)	3.0	2.7	3.9	2.9	Net change in cash	416.7	73,929.6	(71,237.2)	0.0
EV/EBDITA (x)	7.3	6.2	8.6	6.1	Opening cash	2,467.2	2,883.9	76,813.5	5,000.0
					Closing cash	2,883.9	76,813.5	5,000.0	5,000.0

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