

3QFY08 results below expectation

18th March 2008**BUY**

Price	Target Price
Rs659	Rs1085

Sensex – 14,809

Price Performance

(%)	1M	3M	6M	12M
Absolute	(20)	(25)	6	73
Rel. to Sensex	(2)	1	11	45

Source: Bloomberg

Stock Details

Sector	Metals & Mining
Reuters	TISC.BO
Bloomberg	TATA@IN
Equity Capital (Rs mn)	7306
Face Value (Rs)	10
52 Week H/L (Rs)	970/372
Market Cap (Rs bn)	481.1
Daily Avg Vol (No of shares)	2732190
Daily Avg Turnover (US\$ mn)	53.8

Shareholding Pattern (%)
(31st Dec.'07)

Promoters	33.7
FII/NRI	20.6
Institutions	20.0
Private Corp.	3.1
Public	22.6

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Tata Steel reported their 3QFY08 consolidated results. The results were below expectation. On a consolidated basis, for the third quarter, the company reported net sales of Rs318.9bn (qoq down 1.6%), EBITDA of Rs39.4bn (qoq down 16.5%) and Adj. PAT of Rs12.7bn (qoq down 14.9%). During the quarter, the company reported Adj FDEPS of Rs14.56. Tata Steel reported lower interest cost (Rs10.8bn (qoq down 22%)) due to reduction in debt on account of repayment of loans from the proceeds of rights and CCPS issues. During the 4QFY08, the company expects further reduction of interest cost due to repayment of bridge loans. As on 31st Dec. '08, the company has consolidated net debt of Rs440bn. At CMP of Rs659 the stock is trading at 6.1x FY09E FDEPS of Rs108.5. We have fine tuned the target price to Rs1,085 to account for the hike in iron ore and steel prices and expected hike in coking coal and scrap prices. We maintain a BUY on the stock with a target price of Rs1,085. We also attended the conference-call of Tata Steel. Key highlights of the call are as under:

EU markets weak on seasonal effect, expect re-stocking to push demand

- European markets have witnessed lower activities in the third quarter due to seasonal effect. Consequently, the third quarter has not witnessed significant price hike by Corus.
- Corus sell almost 70% of its output on spot market mainly to construction, infrastructure sectors. Balance 30% is sold through annual contracts to automotive and packaging industry which have witnessed a slow down and stock pile up during the second quarter of FY08, which is expected to come down in 4QFY08.

Corus performance

For the 3QFY08, Corus reported net sales of Rs238.7bn and for 9MthsFY08, of Rs736.8bn. During 3QFY08 and 9MthsFY08, Corus' EBIT margins stood at 4.44% and 6.92% respectively.

	3QFY08	6MFY08	9MFY08
Net Sales	238,670	498,090	736,760
Raw Material costs	112,530	234,060	354,090
Other Expenditure	50,530	138,076	151,990
Depreciation & Other exp	65,020	114,660	179,680
Total Expenditure	228,080	457,680	685,760
EBIT	10,590	40,410	51,000
<i>EBIT Margin</i>	<i>4.44%</i>	<i>8.11%</i>	<i>6.92%</i>
Interest	6,060	19,340	22,360
PBT before extraordinary	4,530	21,070	28,640
<i>Adj. PBT margin</i>	<i>1.90%</i>	<i>4.23%</i>	<i>3.89%</i>

All fig in Rs mn except percentage

Despite subdued 3QFY08 performance the outlook for Corus remains positive considering the recent price hike announced by the company; primarily driven by high demand and rising costs of raw material. Corus recently settled iron ore contract price with Vale with 65% hike yoy. Corus is expected to further increase the prices post settlement of coking coal contracts. We believe that with the demand picking up in EU markets, Corus will largely be able to pass on the increased costs of raw material. On 5th Feb '08, ArcelorMittal announced 12-15% price hike for flat products w.e.f 1st Apr '08; and on 21st Feb '08, announced a further hike of Euro40/t for flat products w.e.f 1st Apr '08. During 3QFY08, Corus achieved liquid steel production level of 4.91mt (yoy down 3.7%, qoq down 0.9%)

Recent price hikes by Corus

Date	Particulars	Price Hike	Effective Date
8-Oct-07	Engg Steel - aerospace steel	3%-6%	1-Jan-08
18-Oct-07	Packaging plus prices	6%	1-Jan-08
23-Nov-07	Reversing Plate Mill UK	£30/t ~ \$60/t	1-Jan-08
11-Jan-08	UK Strip products - Aluminum strip steel	€60/t - \$93/t	1-Jan-08
5-Feb-08	Corus Tubes - cold-formed hollow sections	£50/t - \$100	1-Apr-08
7-Feb-08	Reversing Plate Mill & Structural Sections UK	£60/t - \$120/t	1-Apr-08
12-Feb-08	Flat products - UK	£80-£106/t ~ \$160-\$212/t	1-Apr-08
15-Feb-08	Strips products at Ijmuiden - HR, CR and HDG	€100/t ~ \$155/t	1-Apr-08
18-Feb-08	IRON ORE PRICE SETTLEMENT DONE AT 65% HIKE		
29-Feb-08	Wire rod - UK	£70-£90/t ~ \$140-180/t	1-Apr-08

Other Highlights

- The consolidated adjusted net margins are still on declining trend (declined from 5.2% in 1QFY08 to 4.6% in 2QFY08 and further declined to 4.0% in 3QFY08). The decline was primarily due to 1) Lower activities in EU markets on account of seasonal effect, constraining Corus from imposing price hikes, and 2) delay in repayment of debt, leading to higher levels of interest costs especially in 1HFY08. Tata Steel consolidated is currently achieving a run rate of 30% of the target synergy of USD450mn, which is targeted by the completion of the third year of acquisition.
- The consolidated EBITDA margins declined by 220bps qoq, primarily on account of increase in raw material costs at Corus due to higher cost of purchased coke and increase in energy costs, owing to higher winter tariffs.
- Freight costs at Nat Steel increased to the tune of Rs2bn due to freight charges on import of coking coal for Tata Steel India operations. Going forward, Tata Steel will continue to book coking coal freight through Nat Steel.
- Corus' 70% freight is booked on long-term time charter agreements and 30% on spot.
- The employee costs stood at Rs41.7bn (qoq up 6%). The increase in cost was primarily on account of higher pension costs at Corus.
- Effective tax rate for 3QFY08 was 35% (qoq up 1,337bps). The increase was primarily on account of increase in deferred tax owing to one time charge of acquisition costs. Going forward, the company expects cash tax rate for Indian operations to go down and effective tax rate for Corus to go down to around 20%. However, the effective tax rate for the consolidated entity is likely to remain at 35% due to higher deferred taxes, arising out of capitalization of 1.8mtpa expansion at Jamshedpur.

Expansion projects on track

- The 1.8mtpa expansion project at Jamshedpur is on track and target date is maintained at July 2008. The capex for the expansion also remains on targeted Rs45.5bn.
- For the next phase of expansion which will take the capacity of Tata Steel Jamshedpur facility to 10mtpa by 2010 is on track with major equipment orders already placed during 2QFY08. The total outlay for the project is Rs91.6bn.
- Work has already started on the greenfield project at Orissa for its 6mtpa plant and major equipment orders have been placed. Land acquisition is in progress. The total capex for the new plant is pegged at Rs156.6bn.
- The company expects ferro chrome plant in South Africa to commence operations in Jul. '08.

Progress on raw material sufficiency

- Tata Steel aims to have a 50% sufficiency over the long term over its raw material and has taken first step towards the same.
- Tata Steel has acquired 30% stake in Riversdale Mining Limited for its coking coal project in Mozambique. The company expects first shipment of coking coal in from CY2010. As per the agreement Tata Steel has an offtake arrangement of 40% of the output.
- The company has also signed an agreement with the state owned company of Ivory Coast, Sodemi. Tata Steel will hold 75% stake in the JV. The JV will develop the iron ore mine at Mt, Nimba which has a potential reserve of around 500mt. The JV will setup a pelletization plant and supply pellets to feed its facilities at Corus.
- Tata Steel has also entered into a 70:30 JV with the Al Baheja Group in Oman to develop limestone reserves. The JV will mine metallurgical grade limestone in southern Oman. The mine is expected to start limestone shipments from CY2010. The project is still in the initial phase of exploration and drilling.
- Further, Tata Steel has entered into a JV with SAIL to explore 4 coking coal blocks in Jharkhand to ensure coking coal supplies for the expanded capacities of both Tata Steel Jamshedpur and SAIL. The JV is expected to be formed by March 2008 and start preparatory work on exploration and drilling and securing statutory clearances thereafter.

Valuation

At the CMP of Rs659 the stock is trading at 6.1x FY09E FDEPS of Rs108.5 and at 5.4x EV/EBITDA. We believe that with the recent hikes in steel prices and expected hikes in the prices the company will pass on the incremental costs. The hikes in prices were primarily on account of high demand and increasing raw material costs, with contract iron ore prices settled with a hike of 65% yoy. Post settlement of the coking coal contracts, the steel prices are expected to increase further. We have factored in a hike of 65% for iron ore in FY09 and a 100% hike in coking coal prices for FY09.

We have fine tuned the target price to Rs1,085 to account for the hike in iron ore and steel prices and expected hike in coking coal and scrap prices. We maintain a BUY on the stock with a target price of Rs 1,085 which is 10x FY09 FDEPS of Rs108.5.

Consolidated quarterly result

	3QFY08	2QFY08	(%) qoq	1QFY08	9MFY08
Net Sales	318,985	324,249	-1.6%	311,633	954,867
Expenditure					
Raw Material Cost	142,559	146,271	-3%	145,884	434,714
Change in stock	1,901	0		-8,771	-6,870
Net Raw material cost	144,459	146,271	-1%	137,113	427,844
Gross profit	174,526	177,978	-2%	174,520	527,024
Gross margin	54.7%	54.9%	-18bps	56.0%	55.2%
Power Cost	12,233	11,552	6%	11,259	35,044
Employee Cost	41,667	39,494	6%	40,006	121,167
Freight	16,722	14,617	14%	14,088	45,427
Other Expenses	64,476	65,089	-1%	60,326	189,891
Total operating exp	135,098	130,751	3%	125,679	391,528
EBITDA	39,428	47,227	-16.5%	48,840	135,496
Ebitda margin	12.4%	14.6%	-220bps	15.7%	14.2%
Depreciation & amortization	10,113	11,014	-8%	10,298	31,425
EBIT	29,315	36,213	-19%	38,542	104,071
EBIT margin	9.2%	11.2%	-198bps	12.4%	10.9%
Interest	10,809	13,847	-22%	8,921	33,577
Other income	1,975	1,102	79%	1,742	4,819
Empl separation compensation	662	565	17%	539	1,766
Contribution for sports infra	0	0		1,500	1,500
Forex gain (loss)	448	1,059	-58%	5,379	6,887
Actuarial gain/(loss) on funds for employee benefits	1,451	18,503	-92%	41,211	61,165
PBT	21,719	42,465	-49%	75,916	140,100
Provision for tax	7,707	9,389	-18%	12,526	29,622
ETR (%)	35%	22%	1337bps	16%	21%
Share of profits of Associates	520	393	32%	392	1305
Minority interest	387	45	758%	168	600
Attributable PAT	14,145	33,424	-58%	63,614	111,183
Net margin	4.4%	10.3%	-587bps	20.4%	11.6%
less: E/o Items adjusted for Tax	-1,451	-18,503	-92%	-41,211	-61,165
Adjusted PAT	12,694	14,921	-14.9%	22,402	50,018
Adjusted net margin	4.0%	4.6%	-62bps	7.2%	5.2%
Equity capital	6,089	6,089	0%	6,089	6,089
Diluted capital	8,717	8,717	0%	8,717	8,717
Reported EPS					
- Basic	23.23	54.89	-58%	104.47	182.60
- Diluted	14.56	17.12	-14.9%	25.70	57.38
Adj EPS					
- Basic	20.85	24.51	-15%	36.79	82.14
- Diluted	14.56	17.12	-14.9%	25.70	57.38

All fig in Rs mn except percentage and per sh data

Common Size ratios

	3QFY08	2QFY08	(%) qoq	1QFY08	9MFY08
Net Sales	100%	100%	-	100%	100%
Raw material cost	44%	45%	-115 bps	47%	139%
Change in stock	1%	0%	59 bps	-3%	-2%
Net Raw Material Cost	45%	45%	-56 bps	44%	137%
Personal expenses	13%	12%	67 bps	13%	39%
Power cost	4%	4%	21 bps	4%	11%
Frieght	5%	5%	65 bps	5%	15%
Other expenses	20%	20%	-19 bps	19%	61%
EBITDA	12%	15%	-241 bps	16%	43%
Depreciation	3%	3%	-28 bps	3%	10%
Interest expense	3%	4%	-94 bps	3%	11%
Other income	1%	0%	27 bps	1%	2%
PAT	4%	10%	-595 bps	20%	36%

Financials

Income Statement					Balance Sheet				
Rs bn					Rs bn				
	FY07	FY08E	FY09E	FY10E		FY07	FY08E	FY09E	FY10E
Gross Sales	274	1,058	1,264	1,291	Equity Capital	6	7	7	8
Excise Duty	22	24	26	26	Reserves & Surplus	141	255	333	404
Net Revenue	252	1,034	1,238	1,264	Less: Misc Exp	-2	-2	-2	-2
Other Income	4	2	1	2	Minorities	6	6	6	6
Total Income	257	1,036	1,239	1,266	Networth	150	266	344	416
Raw Material consumed	92	431	589	644	Total Debts	249	636	606	606
Employee Exp	19	146	150	145	Preference Shares	0	60	60	0
Other Expenses	67	297	292	281	Long Term Liabilities	19	57	57	56
Total Operating Expenses	178	875	1,032	1,070	Capital Employed	419	1,019	1,067	1,078
EBITDA	79	161	208	196	Gross Block	201	898	942	952
Depreciation	10	32	33	35	Less Depreciation	-92	-558	-592	-627
EBIT	69	130	174	161	CWIP	33	33	78	138
Net Interest Cost	4	36	34	34	Net Fixed Assets	142	373	428	463
Other E/o and VRS exp	2	2	2	2	Investments	165	178	178	178
PBT	63	92	139	126	Goodwill	2	217	217	217
Tax	21	26	46	42	Ret benefit assets	0	38	38	38
PAT	42	66	93	84	Other Non current Assets	0	15	15	15
Minority Interest/Associate	0	0	0	1	Inventory	39	191	246	298
Preference Div	0	1	1	0	Debtors	17	156	187	191
Net Income available to SH	42	66	92	85	Cash and Bank	109	60	30	-23
Basic Wtd Shares o/s (mn)	580	731	731	831	Loans & Advances	20	20	20	20
Basic EPS	72.0	89.7	125.8	102.5	Other Current Assets	0	1	1	1
Net Income for FDEPS cal:					Total Current Assets	184	428	484	487
Add: Int on CARS(net of Tax)	0	1	1	1	Current Liabilities	60	212	271	299
Add: Div on Pref Shares	0	1	1	0	Provisions	15	17	21	21
Net Income for FDEPS cal:	42	67	95	86	Total Curr. Liabi. & Prov.	75	229	292	319
Fully Diluted Shares o/s (mn)	580	872	872	872	Net Current Assets	109	199	192	168
FDEPS	72.0	77.0	108.5	99.1	Total Assets	419	1,019	1,067	1,078
Cash Flow Statement					Ratios				
Rs bn									
	FY07	FY08E	FY09E	FY10E		FY07	FY08E	FY09E	FY10E
PBT	63	92	139	126	EBIDTA margin (Core) (%)	29.5	15.4	16.7	15.4
Depreciation	10	32	33	35	EBIT margin (%)	25.5	12.3	14.0	12.6
Net Chg in WC	3	-156	-27	-28	NPM (%)	16.5	6.4	7.5	6.7
Others	1	34	33	32	Adj ROCE (%)	15.8	14.2	12.2	11.0
Tax Paid	-21	-29	-44	-45	Adj ROE (%)	33.2	31.4	30.1	22.4
CFO	55	-27	134	120	ROIC (%)	26.9	21.9	13.9	10.1
Assets Purchased/Capex	-29	-262	-89	-70	Adj EPS	72.0	77.0	108.5	99.1
Net Investments made	-132	-13	0	0	Cash EPS	89.4	113.5	146.7	139.4
GW / Intangibles / Sub acq	-7	-214	0	0	Book Value	258.9	305.7	394.8	477.0
Others Investing Activities	5	2	1	2	DPS	16.2	13.3	14.0	14.3
CFI	-163	-487	-88	-68	Payout (%)	22.6	17.6	13.2	14.6
Change in Share capital	15	64	0	1	Net Debt to Equity (x)	0.9	2.4	1.8	1.5
Change in Borrowings	202	387	-30	0	PE (x)	6.2	8.5	6.1	6.6
Issues/Red of Pref Sh Cap	0	60	0	-60	P/BV (x)	1.7	1.8	1.4	1.3
Interest and Dividend Paid	-13	-46	-45	-46	EV/Sales (x)	1.6	1.1	0.9	0.9
Others	1	0	0	0	EV/EBITDA (x)	5.4	7.0	5.4	6.0
CFF	205	465	-75	-105					
Total Cash Generated	97	-49	-30	-53					
Cash Opening Balance	12	109	60	30					
Cash Closing Balance	109	60	30	-23					

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