

## Company Flash

12 May 2009 | 6 pages

# Tata Steel (TISC.BO)

## Sell: A Setback for Corus

- Shutdown of Teesside likely** — Tata Steel has announced that its Teesside Cast Products (TCP) plant faced the risk of closure, as a consortium of four buyers had terminated the 10-year (from 2004) Offtake Framework Agreement (OFA) to buy ~78% of the plant's production. This comes soon after news that the proposed plant sale to some consortium members may not be completed.
- Impact of shutdown** — While the proposed closure would not have a major impact on profits (plant sales were at cash cost), this is a setback as it will be more difficult to cover fixed costs and is likely to involve a shutdown cost.
- Corus restructuring hits roadblock** — Tata Steel has closed service centres in UK; plans to sell aluminium smelters in Europe, and also an 80% stake in TCP in order to restructure Corus' operations. The TCP stake sale was expected to raise US\$480m but is unlikely to go through as the buyers have cited financial difficulties. Tata Steel has to repay US\$795m in FY10 and US\$1.3bn in FY11. While cash as of Dec 2008 was US\$1.1 bn, planned FY10 capex is US\$1.2bn.
- Covenant reset sought** — Tata Steel UK has reportedly asked its banks to ease terms of £3bn loan for Corus' acquisition in exchange for a £200m repayment.
- Safeguard duty deferred** — The Indian government has deferred the industry request to impose a safeguard duty (likely 25%) to slow down HRC imports.
- Difficult outlook in Europe** — Demand continues to be 35-50% down. £600m savings hinge on hedging gains and plant closures, only the latter is recurring.

Sell/High Risk		3H
Price (12 May 09)		Rs260.75
Target price		Rs125.00
Expected share price return		-52.1%
Expected dividend yield		3.8%
<b>Expected total return</b>		<b>-48.2%</b>
Market Cap		Rs190,500M
		US\$3,854M

### Price Performance (RIC: TISC.BO, BB: TATA IN)



Figure 1. Tata Steel (Consolidated) – Statistical Abstract

YE 31 Mar	PAT (Rs bn)	PAT growth (%)	EPS (Rs)	EPS growth (%)	P/E (x)	EV/EBITDA (x)	ROE (%)
FY06	37.3	4%	67.5	4%	4.1	2.4	36%
FY07	41.8	12%	71.9	7%	3.8	3.8	29%
FY08	75.1	80%	102.4	42%	2.7	4.0	26%
FY09E	94.6	26%	127.8	25%	2.2	3.8	31%
FY10E	38.3	-60%	45.9	-64%	6.0	5.2	11%
FY11E	30.5	-20%	37.1	-19%	7.4	6.1	8%

Source: Company Reports and Citi Investment Research and Analysis. Price as on 12 May 2009. Note - All figures are on a consolidated basis.

See Appendix A-1 for Analyst Certification and important disclosures.

### Pradeep Mahtani<sup>1</sup>

+91-22-6631-9882  
pradeep.mahtani@citi.com

### Thomas P Wrigglesworth<sup>2</sup>

+852-2501-2747  
thomas.wrigglesworth@citi.com

### Raashi Chopra<sup>1</sup>

raashi.chopra@citi.com

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<sup>1</sup>Citigroup Global Markets India Private Limited; <sup>2</sup>Citigroup Global Markets Asia

## Tata Steel

### Company description

Tata Steel Ltd (TSL) is the world's sixth-largest steel company. In India, it has raised its crude-steel capacity from 5mtpa to 6.8mtpa, of which ~60% is rolled into flat products and the rest sold as long products. It sells ferro alloys, tubes, bearings and some mineral products. Corus, TSL's 100% subsidiary, is a Northern European Steel long and flat steel producer with around 20m tpa of crude steel capacity and production bases in the UK and Holland. TSL has a presence in Asia through NatSteel (100%-owned) and Tata Steel Thailand (67%-owned). Adding the Asia-based capacities takes its total crude-steel capacity to 30mtpa and finishing capacity to 33mtpa. Of its crude steel capacity, 23% is in India, 71% in the UK/Europe and the rest in SE Asia. The crude steel capacity in India will likely be hiked further to 10mtpa by 2011.

### Investment strategy

We rate TSL Sell/High Risk (3H) to factor in an extended global slowdown, weaker steel prices in Europe and India, lower volumes and weaker margins. Our earnings estimates for TSL are largely based on our European steel price forecasts. For HRC we expect an average price of US\$740/t, +15% YoY for FY09, but a decline of 26% YoY to US\$550/t for FY10 and 18% YoY to US\$450/t for FY11. India's steel demand growth which was between 11-14% p.a. in the past three years has slowed. Demand ytd (April 2008-January 2009) showed a 3.2% decline yoy. We take into account volume cuts announced by Corus given weakening demand in its key markets of Europe and UK. The sharp price cuts have an adverse impact on TSL's consolidated EBITDA margins, which could fall from 14% in FY08 to 11% in FY10 and 10% in FY11. TSL's more profitable operations in India do not get a proportionate benefit from declining raw material prices as 100% of iron ore and 60% of coking coal is available from captive sources. We expect declining earnings in FY10 and FY11. TSL should end FY09 with a high debt-equity ratio of 1.7x. This is likely to fall to around 1.1x by FY11 as we anticipate debt repayments by Corus due to lower working capital needs. With falling profitability, we expect Tata Steel's interest coverage to fall from 3.6x in FY09 to 1.8x by FY11.

### Valuation

We use EV/EBITDA as our preferred valuation metric for TSL largely due to its high leverage. Our target multiple is based on the stock's five year average forward EV/EBITDA of 4x, which incorporates a full steel cycle. As we assume near-trough domestic prices, we no longer apply a 5% discount to the average EV/EBITDA. Our 12-month forward consolidated EV/EBITDA is 4x. At our target price of Rs125, the stock would trade at a consolidated FY10E P/E of 2.7x.

### Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, assigns a High Risk rating to TSL. Key upside risks are: 1) upside in steel prices in Europe or India driven by better demand or plant shutdowns; 2) increase in steel import duties in India; 3) a better global credit outlook; and 4) weaker raw material prices than we expect which would benefit Corus.

# Appendix A-1

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#### Fundamental Research

Analyst: Pradeep Mahtani

Covered since May 30 2008

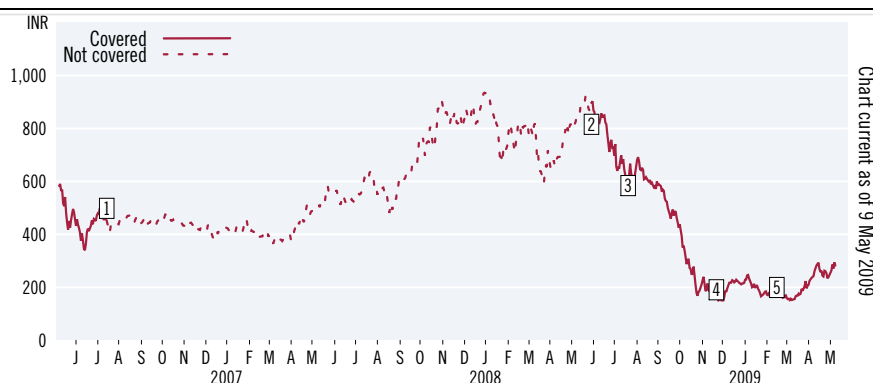


Chart current as of 9 May 2009

Date	Rating	Target Price	Closing Price
1 14-Jul-06	Coverage suspended		
2 29-May-08	*1M	*1,286.00	896.05

Date	Rating	Target Price	Closing Price
3 21-Jul-08	1M	*933.00	598.50
4 21-Nov-08	*3H	*130.00	160.05

Date	Rating	Target Price	Closing Price
5 16-Feb-09	3H	*125.00	184.05

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 31 Mar 2009

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