

Market Front Page

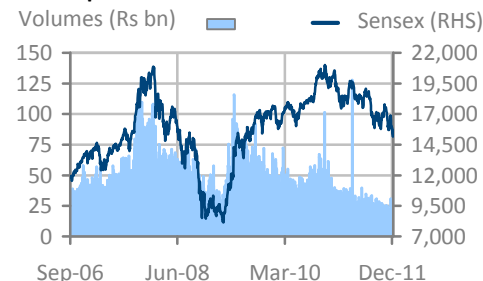
Index Movements	Closing	% Chg	% YTD	ADR/GDR (US\$)	Latest	% Chg	% Prem
Sensex	15,685	3.4	(23.5)	HDFC Bank	25.9	1.2	4.2
Nifty	4,693	3.3	(23.5)	Reliance	28.1	2.8	(1.5)
BSE Smallcap	5,517	0.9	(43.0)	Infosys	49.4	(4.1)	(5.6)
CNX Midcap	6,120	1.4	(30.9)	Satyam	2.3	(1.3)	NA
Nasdaq	2,578	(1.0)	(2.8)	Wipro	9.9	(0.5)	27.1
DJIA	12,108	0.0	4.6	ICICI Bank	25.9	2.7	(3.2)
IBOV	56,653	(0.4)	(18.3)	SBI	60.7	(0.5)	(1.9)
FTSE	5,390	(0.6)	(8.6)	Sterlite	7.0	2.3	0.7
CAC	3,030	(0.8)	(20.4)	Tata Motors	16.6	(0.2)	(1.7)
Turnover	US\$m	% Chg		Commodities	Latest	%Chg	%YTD
BSE	364	1.6		Gold (US\$/ounce)	1,612	(0.2)	13.5
NSE	1,884	3.1		Crude (US\$/bl)	99	1.3	7.8
Derivatives (NSE)	27,985	6.9		Aluminium (US\$/MT)	1,994	(0.4)	(19.3)
FII F&O (US\$m)	Index	Stocks		Copper (US\$/MT)	7,455	0.6	(22.3)
Net buying	265	14		Forex Rates	Closing	% Chg	%YTD
Open interest	11,449	5,139		Rs/US\$	52.7	(0.7)	17.6
Chg in open int.	91	308		Rs/EUR	69.1	0.2	15.6
Equity Flows (US\$m)	Latest	MTD	YTD	Rs/GBP	82.5	0.2	19.1
FII (20/12)	(82)	(37)	(538)	Bond Markets	Closing	bps Chg	
DII (21/12)	(25)	87	5,818	10 yr bond	8.33	2.00	
MF (19/12)	(12)	(60)	1,111	Interbank call	9.65	25.00	

Chart Front Page

Sensex intraday



Sensex price volume trend



Top Research Stories

Tata Steel (ADD); Events

Corporate Front Page

- **Ranbaxy Laboratories** said that it has reached a settlement with USFDA for resuming normal business in the US and has set aside US\$500 mn to cover any potential penalty from an investigation by the US Justice Department. (BL)
- The Berkshire-headquartered BG Group Plc (formerly British Gas) is working towards divesting its little over 65 % stake in India's **Gujarat Gas Co Ltd** (GGCL).(BL)
- Indian lenders are set to restructure loans close to Rs39bn of **Bharati Shipyard**, the country's second-largest private shipyard.
- **United Breweries** is set to increase its manufacturing capacity by about 15 % over the coming months.(BL)
- In view of the global glut, **Shan Solar** has decided to shelve its Rs7.2bn project for manufacturing polysilicon cells.(BL)
- **Cadila Healthcare Ltd** (Zydus Cadila) announced acquisition of 100% stake in the Mumbai-headquartered Biochem Pharmaceutical Industries Ltd for an undisclosed financial consideration.(BL)
- Clinigene International, a clinical research subsidiary of **Biocon**, and Pacific Biomarkers, a Seattle, Washington-based company, has announced a collaborative agreement to address the speciality biomarker and high-end clinical trial laboratory needs of the global pharmaceutical and biotech industry.(BL)
- **United Bank of India** plans to raise about Rs1bn through non-convertible bonds to augment its lower Tier-II capital. (BL)
- **United Spirits Ltd** (USL), has finally decided on foreign currency convertible bonds (FCCBs) to raise as much as US\$225 mn.(BS)
- More than a year after **Mahindra & Mahindra** bought stake in Reva Electric Car Company, the SUV-maker is gearing up to launch its first compact car — it promises nine times the mileage generated by the country's most fuel-efficient petrol-powered car.(BS)

Market Front Page

Top Movers BSE 200

Top Gainers	Price (Rs)	Chg (%)	YTD (%)	Top Losers	Price (Rs)	Chg (%)	YTD (%)
Indiabulls Real Estate Ltd	47	10.4	-66.4	Pantaloon Retail India Ltd	130	-5.1	-64.7
Reliance Communications	68	9.1	-53.4	Indian Hotels Co Ltd	52	-3.9	-45.8
JSW Steel Ltd	510	8.7	-56.7	IRB Infrastructure Develc	139	-3.3	-38.3
Sesa Goa Ltd	162	8.3	-50.7	Nestle India Ltd	3984	-3.2	4.5
Titan Industries Ltd	169	8.3	-5.9	Apollo Tyres Ltd	56	-3.0	-16.8

Volume spurts

Company	CMP	M.Cap (US\$ m)	Vol. (in '000)	10D A.Vol (in '000)	Vol % Chg
Mahindra & Mahindra Financial Services	614.8	1,214	766	116	559
Godrej Consumer Products Ltd	391.3	2,404	1,509	284	432
Jain Irrigation Systems Ltd	81.4	596	12,970	3,916	231
IRB Infrastructure Developers Ltd	138.9	876	2,888	999	189
Shriram Transport Finance Co Ltd	461.4	1,981	1,694	620	173
Apollo Tyres Ltd	55.5	531	8,365	3,095	170
Ashok Leyland Ltd	21.0	1,061	12,908	5,529	133
Hindustan Oil Exploration Co Ltd	91.7	227	3,575	1,588	125
Hero Motocorp Ltd	1,845.6	6,997	1,161	521	123
Nestle India Ltd	3,983.9	7,292	52	25	106

FII – FII trades

Scrip	20/12/2011			21/12/2011		
	Volume '000	Price	Prem %	Volume '000	Price	Prem %
Bob	37	654	0.2	24	665	0.7
Grasim	0.100	2,450	3.2	6	2,455	3.4
Pnb	202	808	2.6	3	805	2.5
Pantaloon	208	137	3.0	292	135	1.2
Gppl	158	50	0.5	151	55	1.8
Indusind bank	608	240	2.2	63	244	3.5

Corporate Front Page

- **IVRCL Infra** is planning to sell as much as 1,600 acres out of the land bank that it had secured for its real estate development.(BS)
- **SKS Microfinance** said that its shareholders have approved raising the investment limit of foreign institutional investors in the company to 74 % from 24 %.(ET)
- Madura Fashion & Lifestyle Retail, **Aditya Birla Group** company has launched a new retail format, Planet Fashion Grande, which will focus on style-conscious consumers.(ET)
- **ONGC** said it will buy 10 % stake of **Cairn India** in a gas-discovery block that sits next to Reliance Industries' prolific KG-D6 area in the Bay of Bengal.(ET)
- Abu Dhabi Gas Industries (GASCO) announced that it has given a US\$189mn contract to **Larsen & Toubro** Limited (L&T) for engineering, procurement, construction and commissioning of the new Habshan-Ruwais- Shuweihat gas pipeline.(ET)
- **Mahindra Holidays & Resorts** said it has acquired a 106-rooms property in Goa for an undisclosed sum as part of its expansion at popular holiday destinations in India.(ET)

Economy Front Page

- Public sector banks need capital infusion of Rs 100bn a year, if they are to grow their credit portfolio and market share as per Dr C. Rangarajan, Chairman, Prime Minister's Economic Advisory Council.(BL)
- Global rating agency Moody's upgraded Indian governments long-term rupee bonds rating to investment grade (Baa3) from speculative grade (Ba1) despite the fiscal slippage and mounting growth concerns.(ET)
- Lok Sabha passed a bill to regulate the factoring business and help the micro, small and medium enterprises in dealing with liquidity problems.(FE)

Insider Trading

Company	Name of Acquirer / Seller	Transaction Date	Buy /Sale	Quantity	Price (Rs)	Deal Size (Rs m)	Shares Transaction (%)	Holding after Transaction (%)
Apollo Tyres	Sunrays Properties & Investment	19/12/2011 - 20/12/2011	Buy	545,605	59.0	32	0.1	8.8
Dalmia Bharat Enterprises	Keshav Power	19/12/2011	Buy	123,207	116.0	14	0.0	1.8
Dr Reddys Laboratories Ltd	Dr K Anji Reddy	14/11/2011	Buy	600,956	1,645.0	989	0.0	-
Dr Reddys Laboratories Ltd	Dr Reddys Holdings Ltd	14/11/2011	Buy	600,956	1,645.0	989	0.4	23.4
EIH Ltd	Oberoi Hotels Pvt Ltd	19/12/2011	Buy	91,310	83.0	8	0.0	14.3
Everonn Education	Varkey Group	16/12/2011	Buy	2,618,120	356.0	932	13.6	-
Gitanjali Gems Ltd	Mehul C Choksi	22/11/2011	Buy	450,000	337.0	152	0.0	46.6
Gitanjali Gems Ltd	Mehul C Choksi	19/12/2011	Buy	150,000	325.0	49	0.0	46.8
Hinduja Global Solutions Ltd	Aasia Mgmt & Consul / Aasia Prop Dev	29/11/2011 - 30/11/2011	Buy	600,000	324.0	194	2.9	3.1
Maharaja Shree Umaid Mills Ltd	Lakshmi Niwas Bangur (HUF)	05/12/2011	Buy	518,000	570.0	295	6.0	0.0
Maharaja Shree Umaid Mills Ltd	Shreeyash Bangur	05/12/2011	Buy	499,000	570.0	284	5.8	0.0
Maharaja Shree Umaid Mills Ltd	Yogesh Bangur	05/12/2011	Buy	498,000	570.0	284	5.8	0.0
Siyaram Silks	Rajiv A Poddar	15/12/2011	Buy	222,892	273.0	61	2.4	6.8
Siyaram Silks	Rajiv A Poddar	15/12/2011	Sell	222,892	273.0	61	2.4	-
Sonata Software Ltd	Bhupati Investment & Finance Pvt Ltd	--	Buy	2,360,000	21.0	50	2.2	17.5
Sujana Tower	Sujana Finance	15/12/2011	Sell	3,476,000	7.0	24	0.7	1.2

Deal size worth more than Rs5m considered. The exchange does not report transaction prices, so we have assumed them to be closing prices for the respective days. Hence, actual deal sizes may vary from the figures above.

BSE/NSE – Bulk Deals

Company	Name of Acquirer / Seller	Transaction Date	Buy /Sale	Quantity	Price (Rs)	Deal Size (Rs m)
Godrej Cons	Godrej Industries Ltd	21/12/2011	Buy	970,000	392.0	380
Godrej Cons	Godrej N Boyce Mfg Co Ltd	21/12/2011	Sell	970,000	392.0	380

Tata Steel – ADD

22 December 2011

Earnings downgrade



IIFL
Institutional Equities

Value overshadowed by uncertainty

Tata Steel's stock price, after correcting more than 50%, is trading close to our bear-case valuation. Our detailed analysis suggests that Tata Steel's domestic operations could deliver much higher profitability compared with the previous cycles even if steel prices remain low. Although investors' concerns on deteriorating outlook for Tata Steel Europe (TSE) are valid, we believe that the probability of sustained Ebitda losses is low. Valuations are attractive. However, weakness in steel prices and deteriorating outlook for Europe may weigh on near-term stock performance. Commissioning of 3mtpa steel plant and improvement in TSE's earnings visibility led by an expected drop in bulk prices would act as triggers. Retain ADD.

Domestic operations better placed to weather downturn:

Earnings power of the domestic operations has improved significantly compared with the past down-cycle, largely due to: 1) improvement in product mix; 2) operational efficiencies; and 3) increased cost advantage due to higher raw-material prices. We believe that collectively, these factors would enable the domestic operations to deliver per tonne Ebitda of US\$275-300/tonne compared with a bottom of US\$78/tonne in FY02.

TSE unlikely to report sustained Ebitda losses: We share the market's concern that outlook for TSE has significantly deteriorated. However, we see a low probability of sustained Ebitda losses. Shorter duration of raw-material contracts means that profitability of TSE would be restored as the high-cost inventory is consumed. Note that more than 75% of global steel producers depend on third-party metallic and the impact of lower realisations would be mitigated by a drop in prices of bulk commodities. Realignment of capex is critical to restore the market's confidence in TSE's ability to fund its operations.

Valuations attractive but earnings visibility holds the key: We cut our earnings estimates for FY12 by 41% and FY13 by 44% as we build in lower volumes, pressure on profitability and higher tax rate. We expect earnings visibility to improve in coming quarters as steel prices stabilise and reduced raw-material costs flow through TSE's P&L.

Company update

CMP	Rs349
12-mth TP (Rs)	442 (26%)
Market cap (US\$m)	6,370
Enterprise value(US\$m)	15,465
Bloomberg	TATA IN
Sector	METALS

Shareholding pattern (%)

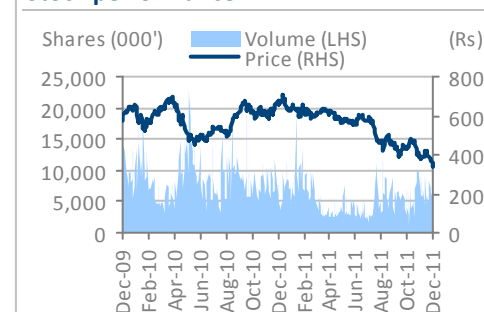
Promoter	30.7
FII	14.6
DII	27.7
Others	27.0

52Wk High/Low (Rs)	737/341
Shares o/s (m)	959
Daily volume (US\$ m)	46.7
Dividend yield FY12ii (%)	3.4
Free float (%)	69.3

Price performance (%)

	1M	3M	1Y
Absolute (Rs)	-8.0	-23.8	-48.3
Absolute (US\$)	-8.7	-29.9	-55.5
Cagr (%)	3 yrs	5 yrs	
EPS	-5.5	0.6	
DPS	-9.2	-1.6	

Stock performance



Financial summary (Rs m)

Y/e 31 Mar, Consolidated	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Revenues (Rs m)	1,023,931	1,187,530	1,227,078	1,204,712	1,298,646
EBITDA margins (%)	7.9	13.5	11.9	13.5	14.9
Pre-exceptional PAT (Rs m)	(3,255)	66,679	36,037	42,667	65,363
Reported PAT (Rs m)	(20,092)	89,781	70,807	42,667	65,363
Pre-exceptional EPS (Rs)	(3.7)	69.6	37.1	44.0	67.3
Growth (%)	(103.0)	(1994.8)	(46.6)	18.4	53.2
IIFL vs consensus (%)			(29.5)	(30.8)	(15.4)
PER (x)	(95.2)	5.0	9.4	7.9	5.2
ROE (%)	(1.3)	22.8	9.3	9.8	13.8
Net debt/equity (x)	1.9	1.3	1.1	1.0	1.0
EV/EBITDA (x)	10.3	5.2	5.7	5.1	4.3
Price/book (x)	1.4	0.9	0.8	0.8	0.7

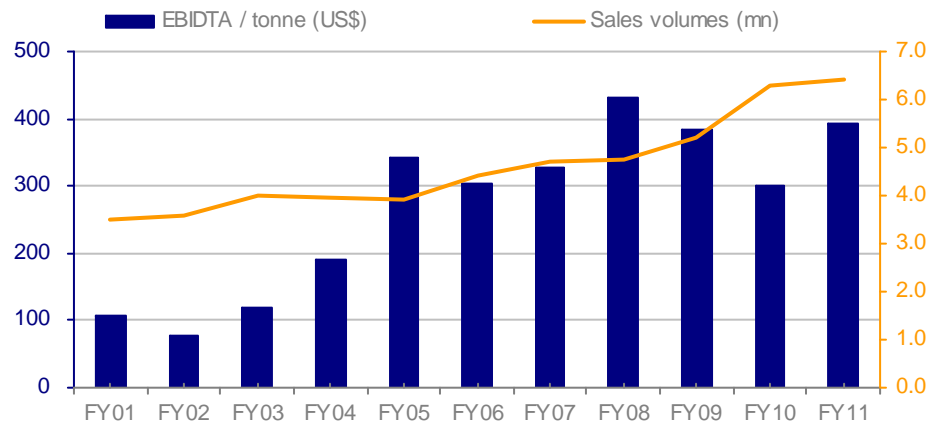
Source: Company, IIFL Research. Priced as on 21 December 2011

Domestic operations better placed to weather downturn

Standalone operations – trying to gauge worst-case profitability

Ebitda / tonne for the domestic operations increased from a low of US\$78 at the bottom of the previous steel cycle in FY02 to a high of US\$431/tonne in FY08. Over FY01-11, per tonne Ebitda averaged at US\$270. This sharp improvement in profitability is attributable to: 1) improvement in product mix; 2) cost reduction and 3) increasing advantage arising from backward integration as a result of increase in iron ore and coking coal prices in the sea-borne market.

Figure 1: Tata Steel reports a sharp improvement in profitability over the past cycle



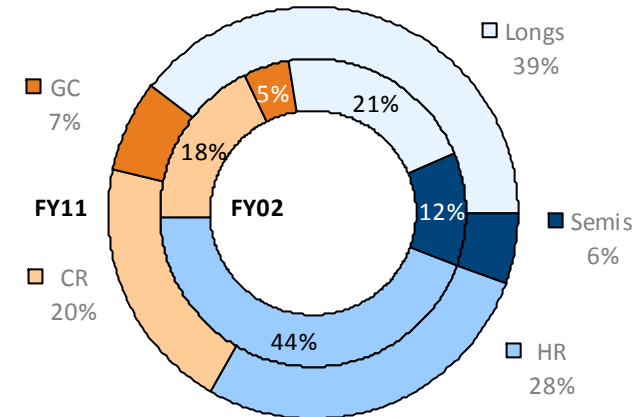
Source: Company, IIFL Research

As fears of a downturn are gaining momentum, the investor community is raising questions on where Tata Steel's profitability would settle. The recent drop of bulk prices adds to the concerns that the improvement in profitability over the past 10 years due to increase in benefit of backward integration on the back of rise in bulk prices would reverse. Earnings visibility for Tata Steel is dwindling due to these factors. Our analysis, based on profitability

achieved during the bottom of the previous cycle and improvements over the past years, indicates that Tata Steel's domestic operations could deliver Ebitda / tonne of US\$275-300 in a bear-case scenario.

- 1. Significant improvement in product mix:** Tata Steel has focused on improving its product mix over the past several years. The proportion of semis in shipments has decreased from 13% in FY01 to 6% in FY11. Even as production capacity expands to 10mtpa, the proportion of semis would go down. Besides this easier matrix to gauge improvement in product mix, Tata Steel has significantly increased the proportion of value-added steel. For example, its shipments to the auto segment increased from less than 100,000tonnes in FY02 to more than 1mtonnes in FY11.

Figure 2: Tata Steel's product mix has seen continuous improvement in the past 10 years

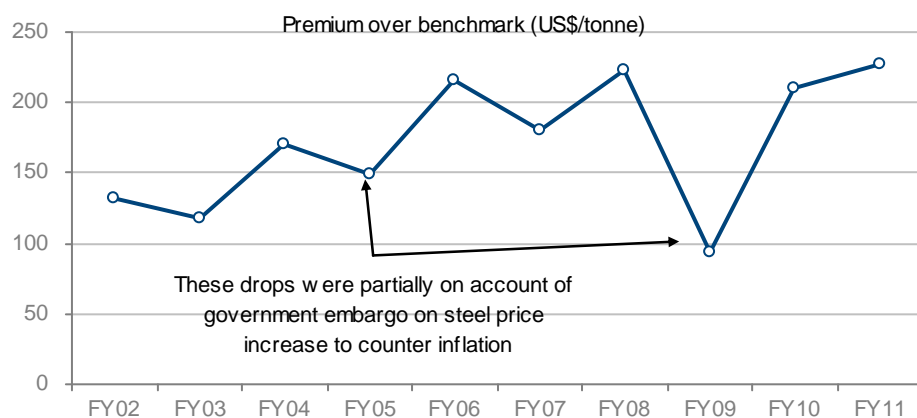


Source: Company, IIFL Research

Improvement in product mix could add ~US\$50 to Ebitda / tonne

A simple comparison of product-wise sales break-down is unlikely to provide an indication of the magnitude of improvement in product mix. This is because even within each product segment, the company has been increasing the proportion of value-added products. Lack of details on product-wise sales revenue makes it difficult to quantify the improvement in product mix. Hence, we use the increase in blended premium realised by Tata Steel's over-benchmark steel price as a proxy to gauge the benefit of product mix improvement. Our analysis suggests that over the past 10 years improvement in product mix has led to ~US\$100 increase in Tata Steel's blended realisation. As margins on value additions are higher, this improvement itself could add ~US\$50/tonne to Ebitda/tonne.

Figure 3: Improvement in product mix adding ~US\$100 to realisations



Source: Company, IIFL Research

2. Reduction in cost: Over the past several years, apart from improving its product mix, the company has been able to trim costs. Reduction in operating cost has primarily come from reduction in headcount and a simultaneous increase in sales volumes. Additionally, modernisation of the company's steel plant

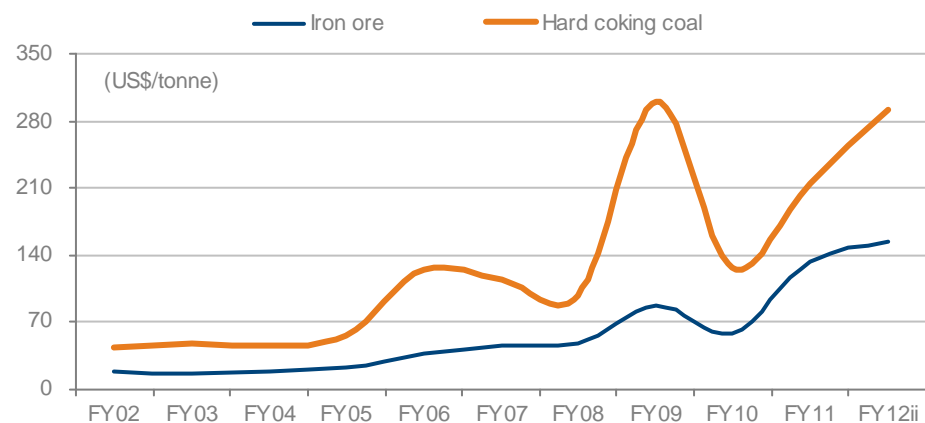
has led to considerable improvement in operating parameters. For instance, over the past 10 years, the company's combined energy intake (coke + PCI) has dropped and proportion of PCI has increased. Several improvements in the production process, such as complete elimination of open heath furnaces, have also contributed to reduction in production cost. Our analysis suggests that these cost reduction initiatives to ~40/tonne are largely coming from reduction in fuel rates.

Figure 4: Efficiency improvement could lead add US\$45/tonne to profitability

Consumption (kgs) / tonne of steel	FY02	FY11	Reduction
Coal (PCI)	288	187	101
Coke	639	557	82
Rs / tonne (FY11)			
Coal (PCI)			9,457
Coke			9,968
Savings (Rs/tonne of steel)			
Coal (PCI)			956
Coke			819
Total			1,775
Other efficiency gains (Rs/tonne)			
Total			2,275
Exchange rate			50
Ebitda improvement due to lower costs (US\$/tonne)			45

Source: Company, IIFL Research

3. Widening cost advantage: Tata Steel's backward integration for iron ore and coking coal has been an immense source of competitive advantage. As prices of these bulk commodities increased over the past several years, so has Tata Steel's cost advantage over non-backward integrated steel producers (over 75% of total production). The increase in steel price can be largely attributed to higher bulk commodity prices. Admittedly, bulk prices would come down as global steel demand cools off. However, prices are unlikely to fall to levels prevailing in FY02.

Figure 5: Coking coal and iron ore prices unlikely to fall to FY02 levels


Source: Company, IIFL Research

As a result of the increase in bulk commodities prices, Tata Steel's raw-material cost advantage has increased from a meagre US\$9/tonne in FY02 to ~US\$290/tonne in FY11. We do not expect iron ore and coking coal prices to drop below US\$100/tonne and US\$185/tonne respectively. At these prices, we expect that Tata Steel would have raw-material cost advantage of ~US\$140/tonne.

Figure 6: Tata Steel's backward integration

Particulars	US \$/tonne steel
In FY02 (US\$/tonne)	
For Tata Steel	54
For non-integrated player	63
Tata Steel's raw material advantage	9
In FY12 (US\$/tonne)	
For Tata Steel	191
For non-integrated player	385
Tata Steel's raw material advantage	193
Assuming a drop in bulk prices (US\$/tonne)	
For Tata Steel	164
For non-integrated player	304
Tata Steel's raw material advantage	140

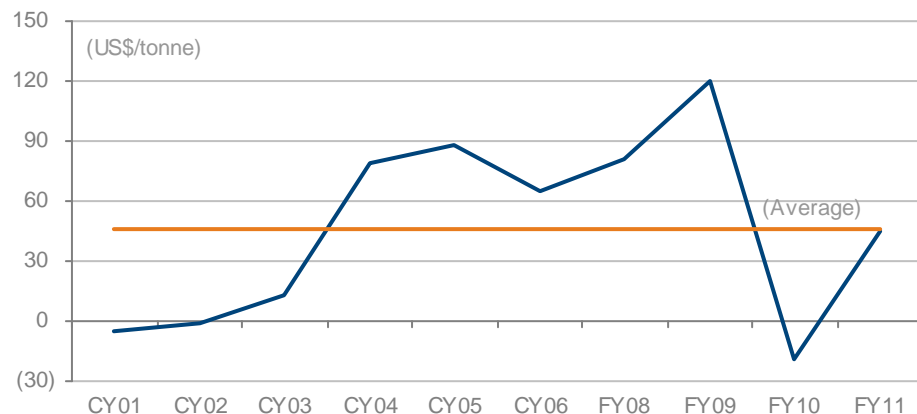
Source: Company, IIFL Research

We estimate bottom-cycle Ebitda for Tata Steel at US\$300

To arrive at bottom-cycle Ebitda for Tata Steel, we need to reduce the cost inflation experienced by the company over the same period. On an aggregate basis, the improved operations coupled with an increased cost advantage, imply that compared with the previous bottom cycle, Tata Steel's domestic Ebitda would be significantly higher. These improvements add up to a minimum of US\$230/tonne. Further, note that the soon-to-be-commissioned 3mtpa brownfield expansion would reduce overhead per tonne, boosting profitability. Depending on bulk prices and even assuming a bear-case scenario, per tonne Ebitda of the domestic operations would be US\$275-325/tonne.

TSE – sustained losses at Ebitda levels unlikely

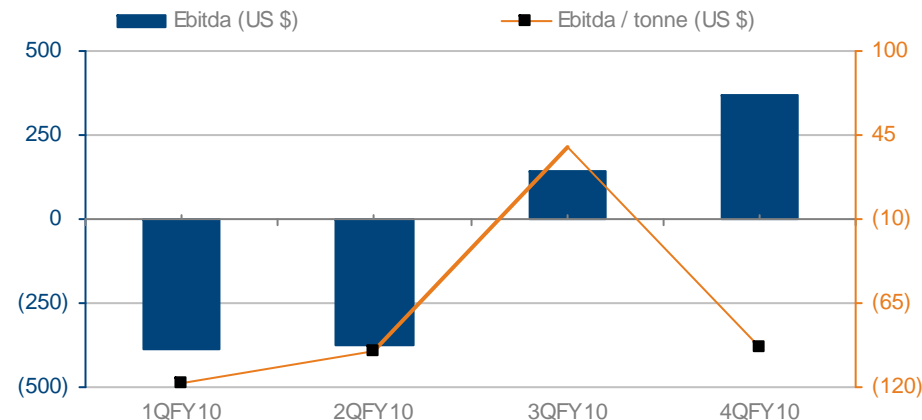
Deterioration of business outlook for Tata Steel Europe (TSE) has raised questions on whether the Ebitda loss is a new normal. We try to answer this by looking into the history and reasons for large losses. TSE's average Ebitda over the past 11 years stood at US\$46/tonne. During this period, Ebitda / tonne has seen wide swings of loss of US\$19/tonne to profit of US\$120/tonne. As evident from the graph below, TSE incurred a meaningful loss at Ebitda levels only in FY10. Losses in the previous cycle in 2000 and 2001 were miniscule.

Figure 7: TSE's profitability over the past couple of cycles


Source: Company, IIFL Research

Shorter duration for raw-material contract reduces possibility of a repeat of FY10

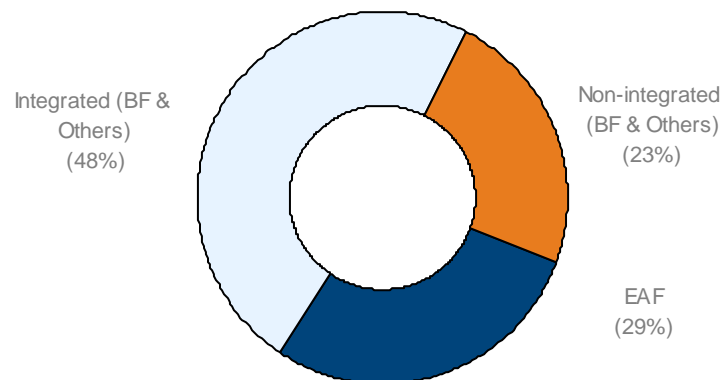
In FY10, TSE reported Ebitda loss of US\$170m for the full year. The performance of FY10 was like a tale to two halves - during 1HFY10 TSE reported Ebitda loss of US\$540m, which was largely due to carry forward of high cost inventory of coking coal and iron ore. TSE's Ebitda loss in 1HFY10 stood at US\$540m while in 2HFY10 it reported Ebitda profit of US\$370m. This huge loss in 1HFY11 was largely due to high cost inventory coking coal and iron ore.

Figure 8: Losses in 1HFY10 were primarily on account of high cost inventory


Source: Company, IIFL Research

Until FY11, steel companies and bulk producers used to enter into annual contracts for raw materials. In the past couple of years, the contract duration has been revised from annual to quarterly. As iron ore spot market price is currently below the formula-based price, for the coming quarter's contract, there is possibility that iron ore contract duration may further reduce to a month. The key benefit of these shorter-duration contracts is the fact that time lag between the movement of bulk prices and steel price would considerably shorten. Accordingly, probability of losses owing to high-priced inventory has significantly reduced.

Figure 9: Steel producers with total capacity of over 80% rely on third party metallic



Source: Company, IIFL Research

Weakness in steel price imply lower bulk prices

TSE's performance would be negatively impacted if weakness in global steel demand persists and consequently steel prices remain soft. In such a scenario, we expect bulk prices to drop as demand for bulk would also come off. Note that ~75% of the steel making capacity globally depends on third-party metallic (iron ore and coking coal or scrap). Accordingly, a rise or drop in steel prices would be compensated by similar movement in bulk prices. We see little probability of sustained high bulk prices and weak steel prices as this would mean a large part of the non-integrated 75% capacity can incur loss or make low profit. Historically, a period of strong steel prices is associated with high bulk prices and vice versa.

TSE's profitability to remain around 10-year average

Over the past 11 years TSE's Ebitda / tonne has averaged US\$/45 while for good years for steel business it averaged over US\$70. As the European steel demand is expected to remain subdued, TSE's profitability would remain under pressure. The company would step its restructuring initiatives in the near term to mitigate the tough external environment. We expect TSE's to deliver Ebitda / tonne

around US\$40 in the medium term. That said, its profitability every quarter could see significant fluctuations.

TSE will cover interest cost

We expect in the medium term TSE to deliver Ebitda in the range of ~US\$350-500m based on annual sales volumes assumption of ~12mtonnes and Ebitda per tonne of ~US\$30-40. In FY11, TSE's finance cost amounted to US\$270. In the medium term, we expect TSE would be able to meet its interest obligation; however there is a possibility of Ebitda falling short of interest outgo in a particular quarter or year.

Capex needs to be realigned

In the beginning of FY11, Tata Steel announced that it is increasing capital expenditure in Europe to ~US\$500m-600m given there has been miniscule investments in these facilities for several years. Since this announcement outlook for financial performance of TSE has significantly deteriorated. In the medium term, we do not expect TSE to generate sufficient cash to meet this increased capital expenditure number. Given expected weakness in financial performance, we believe it is imperative for Tata Steel to cut its capital expenditure. We believe in absence of significant improvement in operating environment TSE's capex would be cut down to maintenance levels.

Valuations attractive but earnings visibility hold the key

Tata Steel has corrected ~48% from its peak (Dec-2010) on the back of deterioration in global steel demand outlook. At current market price valuations look inexpensive based on our forecast of its long term sustainable earnings capacity. As evident, from the table below even factoring in a bear case scenario there is very limited downside to the stock price. Note that, in this valuation we have not given any value for its investments in group companies and raw-material assets.

Figure 10: Bear case scenario indicate limited downside

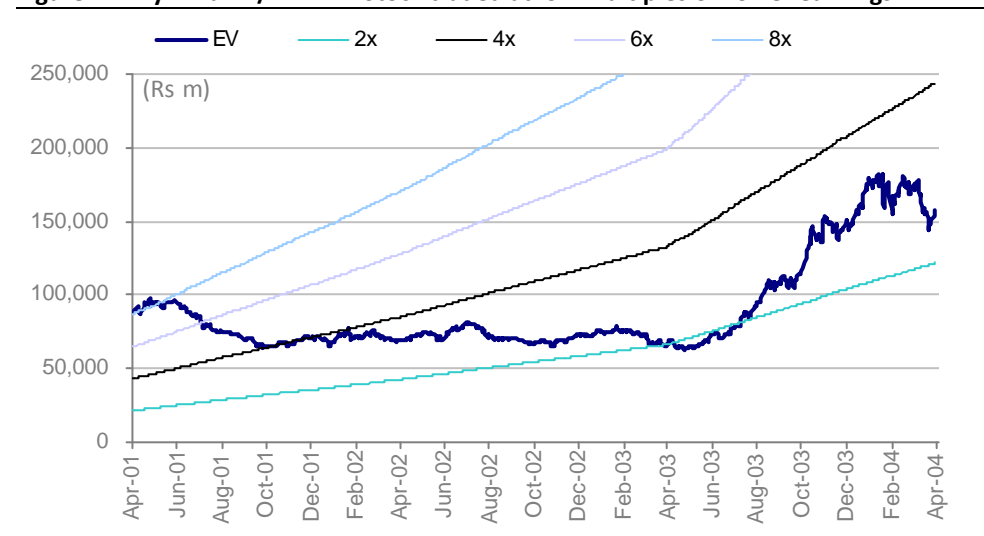
Business (FY13) Bear case	Volumes	Ebitda/tonne	Multiple	Value
Tata Steel (standalone) (US\$ m)	8.2	290	5.5	13,079
Corus (FY12) (US\$ m)	12.5	25	4.5	1,406
South-east Asia operations (FY12) (US\$ m)	3.0	15	5.0	225
Total (US\$ m)				14,710
Less: Current debt (end 1QFY12) (US\$ m)				9,500
Equity value (US\$ m)				5,210
Value of investments in Bengal (US\$ m)				600
Value of investments in DSO				
Total equity value (US\$ m)				5,810
Total equity value (Rs m)				302,133
No. of share outstanding				971
Per share value (Rs)				311

Source: Company, IIFL Research

Improvement in outlook critical for stock performance

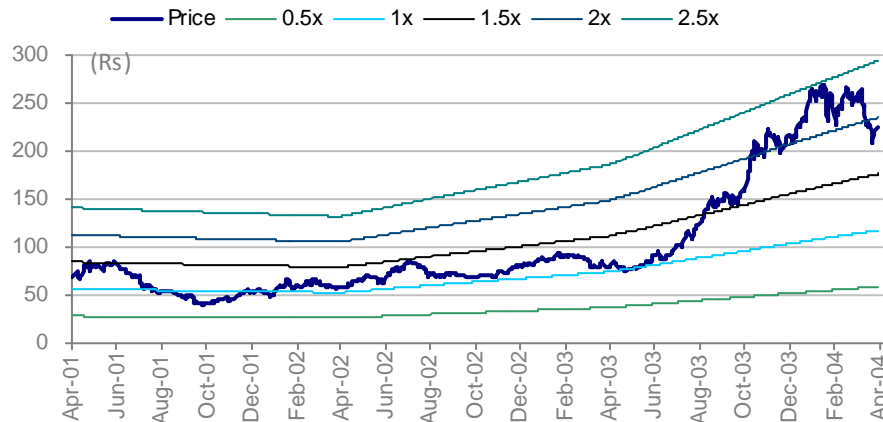
Tata Steel's stock look attractively prices on several conventional parameters like price to book, replacement cost and Ebitda multiple. Cheap valuations have provided limited support to the stock price in recent months. Our analysis of Tata Steel's trading multiple for over 15 years leads us to believe that cheap valuations may not be enough for stock to perform. At present, Tata Steel is trading at an EV/Ebitda of 5.1x FY13ii:

- During previous bottom of the cycle (CY01-03) Tata Steel traded at an EV/Ebitda ~2.5x. Note that at this point in time entire steel industry was in doldrums and profitability at nadir. Tata Steel reported lowest profitability during this period. This implies that the market was ascribing low multiple to bottom of the cycle earnings.

Figure 11: 1 yr fwd EV/EBITDA: Stock traded at low multiples on lower earnings


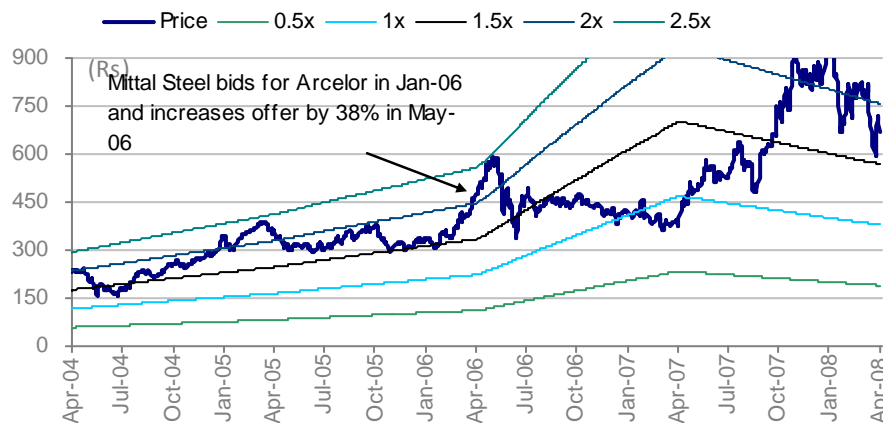
Source: Company, IIFL Research

- Even as steel moved into an up-cycle in calendar year 2003, initially valuation remained low. Admittedly, earnings surprises have a role to play in bringing down the valuation multiple. However, even adjusted earnings surprises valuation multiples during period of steel price recovery remained much lower present multiple.

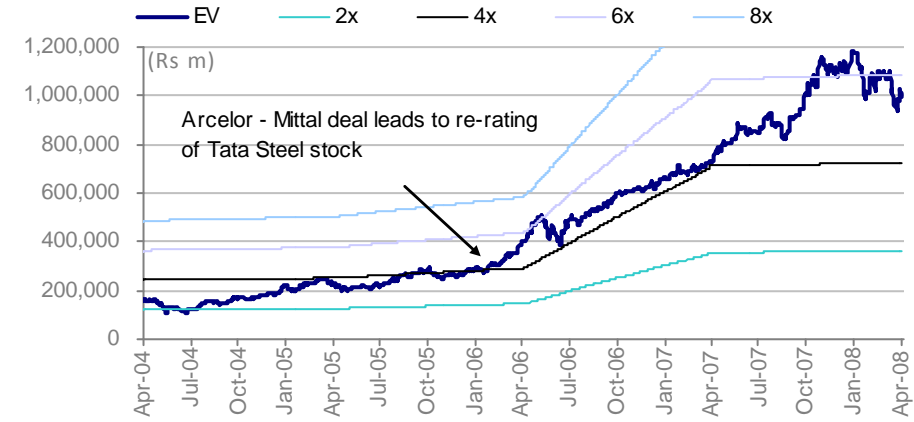
Figure 12: Stock traded at 1x 1 yr fwd P/B multiple for nearly 2 years


Source: Company, IIFL Research

- Decisive re-rating of Tata Steel and steel sector in general happened post announcement of acquisition of Arcelor by Mittal Steel. During the same time, investors' confidence in sustained strong global growth and resultant higher steel demand increased.

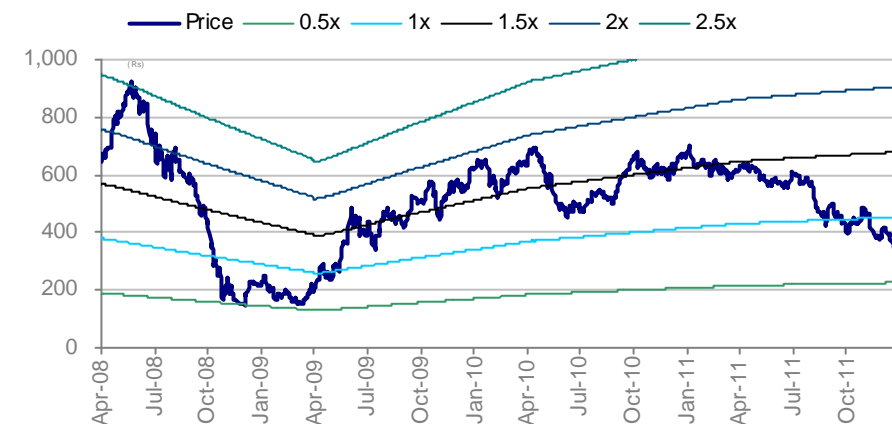
Figure 13: 1 yr fwd P/B: Arcelor-Mittal deal triggered re-rating of steel sector


Source: Company, IIFL Research

Figure 14: Sharp expansion on 1 yr fwd EV/EBITDA multiples from 4x to 6x


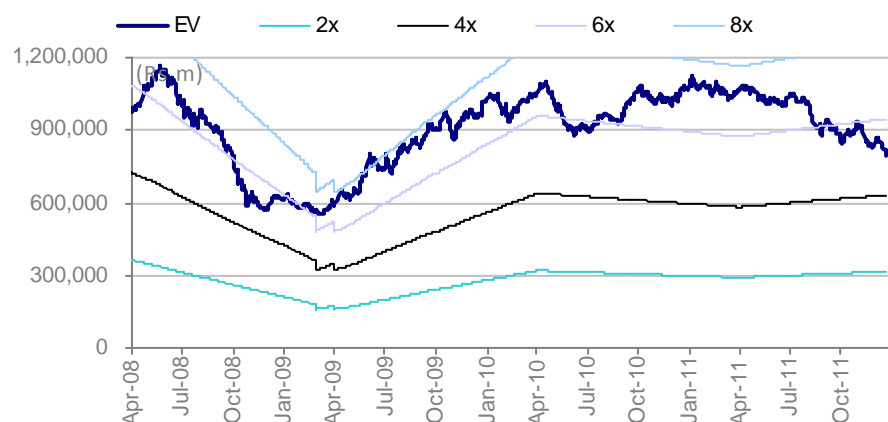
Source: Company, IIFL Research

- During the financial crisis, Tata Steel's valuation multiple dropped to an all-time low. At the bottom it traded at a PBV of 0.5x as uncertainty over its earnings increased culminating into concerns on debt servicing.

Figure 15: Stock traded at an all time low 1 yr fwd P/B multiple of 0.5x at the bottom of 2009-10 financial crises


Source: Company, IIFL Research

Figure 16: Stock was trading at much lower 1 yr fwd EV / EBITDA multiple on expectations



Source: Company, IIFL Research

Stock performance hinges on earnings visibility

This analysis of trading history of Tata Steel suggests that attractive valuations are not enough for the stock to perform. Despite the cheap valuations, the stock may languish if newsflow on steel price remaining negative. An improvement in outlook for global steel industry is needed for meaningful re-rating of Tata Steel, which in our view is some time away.

Lower bulk price - near-term trigger

Given uncertainty of global and Indian economy, an immediate improvement in outlook for steel demand looks very unlikely. However, at present Tata Steel's earnings outlook is clouded by expectation of near-term losses at Tata Steel Europe. We believe potential Ebitda losses at TSE is largely on account of high cost raw-material inventory, which will get consumed over the next two quarters. We expect bulk prices to drop in line with steel prices, which will ease the cost pressure on TSE. Accordingly, TSE earnings outlook could improve over the next couple of quarters acting as a positive trigger for stock price.

Figure 17: SoTP based target price

(Rs m)	FY13 Ebitda	Multiple	Enterprise value
Tata Steel	142,330	5.5	782,817
Tata Steel Europe	19,798	4.0	79,191
South-east Asia	3,326	5.0	16,632
Total			878,640
Add: value of Bengal project			25,000
Total			903,640
Less: Debt FY12 end			474,254
Equity value			429,386
Equity shares			971
Target price (Rs)			442

Source: Company, IIFL Research

Lowering volume and profitability estimates for both TSI and TSE

We have cut our volume estimates and are building in lower profitability for both TSI and TSE due to softening of steel prices. Additionally, the effective tax rate will be higher as higher losses from TSE (no tax breaks on TSE losses) would erode standalone profits.

Figure 18: Estimate revision

	Earlier		Now		Change	
	FY12ii	FY13ii	FY12ii	FY13ii	FY12ii	FY13ii
Revenues	1,265,661	1,384,737	1,227,078	1,204,712	-3	-13
EBITDA	150,482	180,446	145,739	163,130	-3	-10
Adj PAT	60,886	76,245	36,037	42,667	-41	-44
EPS	62.7	78.6	37.1	44.0	-41	-44

Source: Company, IIFL Research

Assumptions

Y/e 31 Mar, Consolidated	FY10A	FY11A	FY12ii	FY13ii	FY14ii
TSI volumes (mn t)	6.3	6.4	6.7	8.2	9.3
TSI EBITDA/tonne (Rs)	14,240.9	17,862.8	18,820.6	17,357.4	17,756.4
TSE volumes (mn t)	14.4	14.9	13.6	12.5	14.0
TSE EBITDA/tonne (US \$)	(18.9)	44.5	28.7	32.5	40.1

Source: Company data, IIFL Research

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar, Consolidated	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Revenues	1,023,931	1,187,530	1,227,078	1,204,712	1,298,646
EBITDA	80,427	159,956	145,739	163,130	194,057
Depreciation and amortisation	(44,917)	(44,148)	(44,259)	(54,935)	(58,115)
Ebit	35,510	115,808	101,480	108,195	135,942
Non-operating income	11,859	9,810	1,500	1,500	1,500
Financial expense	(30,221)	(27,701)	(27,807)	(29,622)	(26,250)
PBT	17,147	97,917	75,173	80,073	111,193
Exceptionals	(16,837)	23,102	34,770	0	0
Reported PBT	310	121,019	109,943	80,073	111,193
Tax expense	(21,518)	(32,459)	(37,236)	(38,006)	(46,429)
PAT	(21,208)	88,560	72,707	42,067	64,763
Minorities, Associates etc.	1,116	1,221	(1,900)	600	600
Attributable PAT	(20,092)	89,781	70,807	42,667	65,363

Ratio analysis

Y/e 31 Mar, Consolidated	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Per share data (Rs)					
Pre-exceptional EPS	(3.7)	69.6	37.1	44.0	67.3
DPS	8.0	12.0	12.0	12.0	12.0
BVPS	257.5	371.2	431.4	461.6	515.3
Growth ratios (%)					
Revenues	(30.5)	16.0	3.3	(1.8)	7.8
Ebitda	(55.6)	98.9	(8.9)	11.9	19.0
EPS	(103.0)	(1994.8)	(46.6)	18.4	53.2
Profitability ratios (%)					
Ebitda margin	7.9	13.5	11.9	13.5	14.9
Ebit margin	3.5	9.8	8.3	9.0	10.5
Tax rate	6936.0	26.8	33.9	47.5	41.8
Net profit margin	(2.1)	7.5	5.9	3.5	5.0
Return ratios (%)					
ROE	(1.3)	22.8	9.3	9.8	13.8
ROCE	5.5	13.8	9.8	10.2	12.8
Solvency ratios (x)					
Net debt-equity	1.9	1.3	1.1	1.0	1.0
Net debt to EBITDA	5.5	3.0	3.2	2.9	2.5
Interest coverage	1.2	4.2	3.6	3.7	5.2

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Y/e 31 Mar, Consolidated	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Cash & cash equivalents	88,206	141,604	157,027	119,581	50,796
Inventories	186,866	240,552	262,292	240,739	262,298
Receivables	116,240	148,163	151,284	148,526	160,107
Other current assets	67,694	100,045	100,047	102,047	104,047
Creditors	233,886	266,711	275,519	265,389	281,443
Other current liabilities	65,942	70,899	73,899	76,899	79,899
Net current assets	159,178	292,754	321,231	268,604	215,906
Fixed assets	457,958	523,934	580,566	621,960	674,374
Intangibles	145,418	152,982	152,982	152,982	152,982
Investments	33,851	45,796	28,096	28,396	28,696
Other long-term assets	1,149	1,756	1,756	1,756	1,756
Total net assets	797,553	1,017,222	1,084,630	1,073,698	1,073,713
Borrowings	531,004	621,843	626,698	586,698	534,950
Other long-term liabilities	38,237	39,565	39,265	38,965	38,665
Shareholders equity	228,313	355,814	418,667	448,035	500,099
Total liabilities	797,553	1,017,222	1,084,630	1,073,698	1,073,713

Cash flow summary (Rs m)

Y/e 31 Mar, Consolidated	FY10A	FY11A	FY12ii	FY13ii	FY14ii
EBIT	35,510	115,808	101,480	108,195	135,942
Tax paid	(24,631)	(32,351)	(37,236)	(38,006)	(46,429)
Depreciation and amortization	44,917	44,148	44,259	54,935	58,115
Net working capital change	103,746	(80,178)	(13,054)	15,181	(16,086)
Other operating items	(94,913)	57,594	0	0	0
Operating cash flow before interest	64,629	105,022	95,449	140,305	131,542
Financial expense	(30,221)	(27,701)	(30,307)	(29,622)	(26,250)
Non-operating income	11,859	9,810	1,500	1,500	1,500
Operating cash flow after interest	46,267	87,131	66,642	112,182	106,792
Capital expenditure	(49,820)	(110,124)	(100,891)	(96,329)	(110,529)
Long-term investments	(3,516)	(11,282)	18,000	0	0
Others	55,742	(41,483)	34,770	0	0
Free cash flow	48,673	(75,758)	18,521	15,853	(3,737)
Equity raising	24,215	45,462	5,346	0	0
Borrowings	(68,002)	90,840	4,855	(40,000)	(51,749)
Dividend	(13,209)	(7,146)	(13,299)	(13,299)	(13,299)
Net chg in cash and equivalents	(8,323)	53,399	15,423	(37,446)	(68,785)

Source: Company data, IIFL Research

Events Calendar

Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
DECEMBER - 2011					
5	6	7	8	9	10
12	13	14	15	16	17
Oct IIP- -5.10%		Nov WPI- 9.11%			
19	20	21	22	23	24
	Nov CPI- AL/RL				
26	27	28	29	30	31
				Nov CPI- IW	Indusind Bank – 10 Jan HDFC – 12 Jan Bajaj Finance – 18 Jan Bajaj FinServe – 18 Jan Bajaj Auto – 19 Jan Bajaj Holding – 19 Jan

Black: Quarterly results, Blue: Economic data, Red: India Holiday

	Oct-Dec 11	Jan-Mar 12	Apr-Jun 12
Economics / Politics	<ul style="list-style-type: none"> RBI's Monetary Policy meeting (end Oct) 2QFY12 Quarterly GDP 	<ul style="list-style-type: none"> RBI's Monetary Policy meeting (end Jan) 3QFY12 Quarterly GDP 	<ul style="list-style-type: none"> RBI's Monetary Policy meeting (end Apr) 4QFY12 Quarterly GDP
Cement	<ul style="list-style-type: none"> Jaiprakash Associate's 3.5mtpa expansion at Nalgonda, AP JSW 4.0mtpa plant at AP, Karnataka 	<ul style="list-style-type: none"> Chettinad Cement 2.0mtpa plant in Gulbarga 	
Metals		<ul style="list-style-type: none"> Tata Steel's 3MT expansion to be commissioned Commissioning of 358ktpa Mahan smelter 	<ul style="list-style-type: none"> Commissioning of 1.5mtpa utkal refinery
Oil & Gas	<ul style="list-style-type: none"> FPO of ONGC BPCL: Bina refinery stabilization and ramp up to 6.0mtpa 	<ul style="list-style-type: none"> HPCL: HMEL Bhatinda refinery stabilization and ramp up to 9.0mtpa 	
Pharma	<ul style="list-style-type: none"> Dr Reddy's: Generic olanzapine launch in US under 180-day exclusivity Sun Pharma: partial resolution of Caraco manufacturing quality issues in US Cipla: Capacity utilization ramp up at the Indore manufacturing facility Ranbaxy: partial resolution of FDA manufacturing quality at Paonta Sahib / Dewas Ranbaxy: launch of generic Lipitor in US under 180-day exclusivity IPCA: US FDA approval of Indore facility 	<ul style="list-style-type: none"> Dr Reddy's: generic Avandia launch in US 	
Telecom	<ul style="list-style-type: none"> MTNL expected to decide on 3G roaming with bidders Aircel, Tata New Telecom Policy expected to be announced 	<ul style="list-style-type: none"> RIL's 4G launch in 2-3 cities RCOM FCCB redemption US\$1.1b 	<ul style="list-style-type: none"> 2G/3G/4G spectrum auctions; expecting at least 40MHz over the next 36 months 3G revenues start kicking in

	Oct-Dec 11	Jan-Mar 12	Apr-Jun 12
Utilities	<ul style="list-style-type: none"> Commissioning of Tata Power – Maithon Unit-2 – 525MW (plate mill) at Angul Commissioning of JSPL captive units – 270MW (2 units) NTPC's Sipat-1 U2 (660MW) to commission in 3QFY12 NTPC's Simhadri (1000MW) to commission in 3QFY12 Adani Power's Mundra-III U3 (660MW) to commission in 3QFY12 Adani Power's Tiroda-III U1&2 (1320MW) to commission in 3QFY12 NHPC's Chamera III (231MW) to commission in 3QFY12 Shunglu committee report on power sector (Nov-11) 	<ul style="list-style-type: none"> Commissioning of Tata Power – Mundra UMPP Unit-1 – 800MW JSPL expected to add 2mtpa of steel capacity (DRI) at Angul Commissioning of JSPL captive units – 405MW (3 units) Commissioning of PTC's 360MW tolling projects in Andhra Pradesh – Meenakshi and Simhapuri NTPC's Sipat-1 U3 (660MW) to commission in 4QFY12 NTPC's Vallur U1 (500MW) to commission in 4QFY12 NTPC's Vallur U2 (500MW) to commission in 4QFY12 NHPC's Uri II (240MW) to commission in 4QFY12 	<ul style="list-style-type: none"> Commissioning of Tata Power – Mundra UMPP Unit-2 – 800MW

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.

SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.

Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.

Published in 2011. © India Infoline Ltd 2011

This report is published by IIFL's Institutional Equities Research desk. IIFL has other business units with independent research teams separated by Chinese walls, and therefore may, at times, have different or contrary views on stocks and markets. This report is for the personal information of the authorised recipient and is not for public distribution. This should not be reproduced or redistributed to any other person or in any form. This report is for the general information of the clients of IIFL, a division of India Infoline, and should not be construed as an offer or solicitation of an offer to buy/sell any securities.

We have exercised due diligence in checking the correctness and authenticity of the information contained herein, so far as it relates to current and historical information, but do not guarantee its accuracy or completeness. The opinions expressed are our current opinions as of the date appearing in the material and may be subject to change from time to time without notice.

India Infoline or any persons connected with it do not accept any liability arising from the use of this document. The recipients of this material should rely on their own judgment and take their own professional advice before acting on this information.

India Infoline or any of its connected persons including its directors or subsidiaries or associates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained, views and opinions expressed in this publication.

India Infoline and/or its affiliate companies may deal in the securities mentioned herein as a broker or for any other transaction as a Market Maker, Investment Advisor, etc. to the issuer company or its connected persons. India Infoline generally prohibits its analysts from having financial interest in the securities of any of the companies that the analysts cover. In addition, the company prohibits its employees from conducting F&O transactions or holding any shares for a period of less than 30 days.