

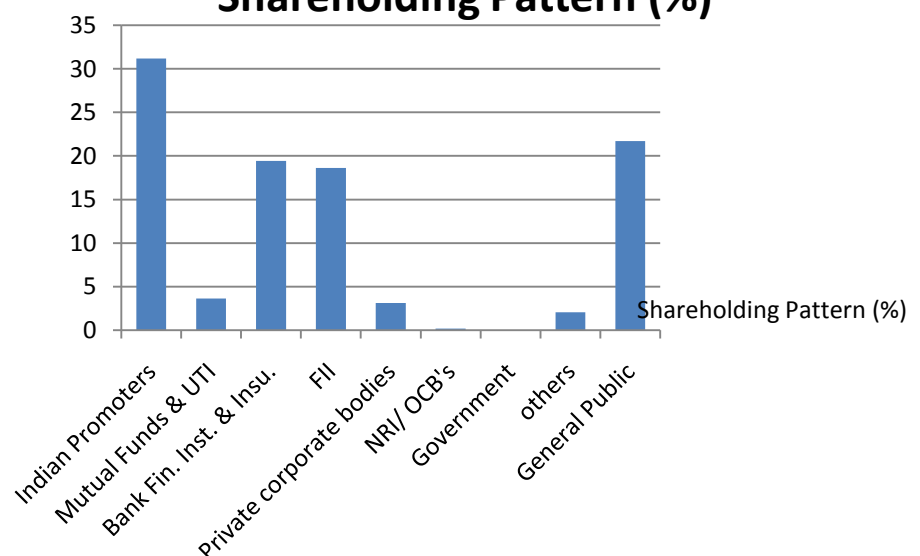
India**Steel****12-month rating** *Buy***12-month Price Target** *Rs 719***Current Market Price** *Rs 550***Upside/Downside (%)** *30.8%***Stock Details****Sector** **Metals & Mining****Reuters** **TISC.BO****Bloomberg** **TATA@IN****52 WK H/L (Rs)** **660.00-148.65****Market Cap (Rs Crores)** **53628****Number of shares* (mn)** **975****Avg. Vol. (3m)** **8446,270*****On fully diluted basis****Research Analyst****Gourav Agrawal****0091 9004659870****gouravagrwal_20@hotmail.com**

On 1st December we initiated our coverage on **Tata Steel** from the Metals & Mining Sector; we hope that with the recent recovery in the global markets it will provide enough stimulus to the markets to embark on the next bull run which will improve considerably the scenario of global steel industry as compared to the gloomy days of recent global turmoil.

Green Shoots

After recent Global turmoil (one of the worst after the Great Depression) green shoots can be seen all over the globe, Leading the rally from the front are BRIC countries with China & to some extent India being the spearheads of the rally, followed by Europe, Japan, U.S.A, and U.K.

In April 2009 global world community decided to pump between 3 to 5 trillions of dollars into collapsing economies which saved the world going into another depression. Stimulus resulted into huge liquidity flowing across the world markets which eased the liquidity crunch faced by the global industries but at the same time it is fueling inflation all over the world. Recovery is at very nascent stage, going forward if everything goes well we might enter into a new phase of Bull Run.

Shareholding Pattern (%)

Key Financial Ratios:

Per Share Data & Key Ratios

	FY 2007A	FY 2008A	FY 2009A	FY 2010E	FY 2011E	FY 2012E	FY 2013E	FY 2014E	FY 2015E
EPS diluted (reported)	64.66	163.21	56.02	21.55	85.48	132.86	239.10	279.22	400.17
EBITDA/sales (%)	29%	14%	12%	9%	13%	16%	22%	23%	26%
EBIT/sales (%)	25%	11%	9%	6%	11%	14%	19%	19%	23%
Net income/sales (%)	15%	9%	3%	2%	5%	7%	11%	12%	14%
ROE				7%	22%	25%	31%	27%	28%
EV/Sales				4.2	0.8	0.7	1.0	0.8	0.7
EV/EBITDA				13.6	5.9	5.9	9.6	5.2	3.7
P/E				25.5	6.4	4.1	2.3	2.0	1.4
P/Sales				0.4	0.3	0.3	0.3	0.2	0.2
P/BV				1.8	1.4	1.0	0.7	0.5	0.4

Sensitivity-Varying WACC and Terminal growth

WACC	PV of FCF	PV of Terminal Value			Intrinsic Value			
		0.25%	1.25%	2.25%	0.25%	1.25%	2.25%	
	104,155	0.25%	1.25%	2.25%				
9.4%	19,307	9.4%	124,828	144,539	169,818	925	1,127	1,386
10.4%	18,409	10.4%	106,574	121,935	141,114	728	886	1,082
11.42%	17,563	11.4%	91,923	104,155	119,104	569	INR 695	848
12.4%	16,767	12.4%	79,965	89,880	101,786	438	540	662
13.4%	16,016	13.4%	70,069	78,225	87,877	329	413	512

Sensitivity - P/E Exit Multiple

Ke	PV of EPS	PV of Terminal Value (P/E)			Intrinsic Value		
		0.75	1.00	1.25	0.75	1.00	1.25
16.6%	583	121	161	202	704	745	785
17.6%	562	115	153	192	677	716	754
18.6%	542	109	146	182	652	INR 688	724
19.6%	523	104	139	173	627	662	696
20.6%	505	99	132	165	604	637	670

Global Steel Industry:

Global Steel production in 2008 was 1330 Mtpa in which India's contribution was a handful of 56 Mtpa while that of china was around 500 Mtpa. In 2008 slowdown world production fell around -1.2% but grew in India & China because of huge domestic demand, worlds production growth rate excluding china was -3.3% which shows dominance of china in global steel industry.

Global steel industry is very fragmented; top 10 producers have only 30% of worlds steel output.

About Tata Steel:

Tata Steel is the 6th largest producer of steel in the world, it is one of the efficient producer of steel in the world on the standalone basis, its plant at Jamshedpur is one of the highest rated & sophisticated steel making facility in the world, its annual crude capacity is at 31 Mtpa (Million tons per annum) and is expected to go up to 56 Mtpa by 2015 it will be combination of both Greenfield as well as Brownfield but majority will be Greenfield projects.

Product Type:

Finished Steel is of two types:

- 1) Long Steel Products: Mainly used in Infrastructure such as Wire, Rods, Pipes, Rebar etc.
- 2) Flat Steel Products: Mainly used in Consumer durables, Autos, and as a raw material for other Products such as Galvanized Sheets/ Coils. Major Flat products are: HR Coils (Hot Rolled Coils), & CR Coils (Cold Rolled Coils).

"Arcelor Mittal is world's No. 1 Steel producer with a total capacity of 118Mtpa", after this the second largest has production capacity of only 34Mtpa.

"India is 10th largest producer of Steel in the World".

"Major Indian Steel players are Sail, Jsw Steel, & Tata Steel".

"Major Products in India are Flat Products".

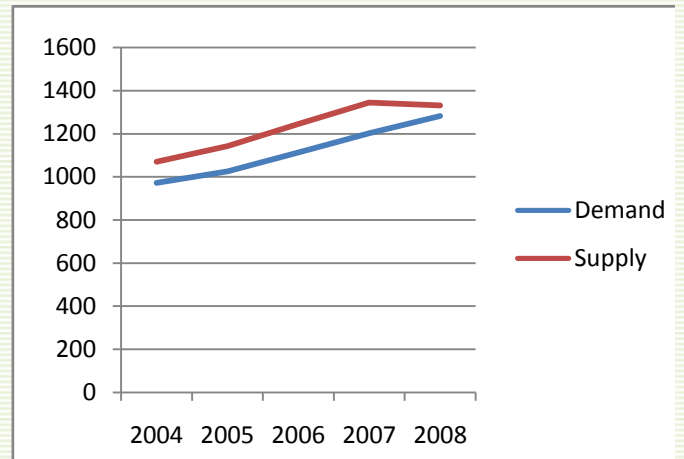
World Demand – Supply Scenario

At global level there is gap between demand and supply of steel which can keep the prices under pressure going forward. At present international flat steel prices are around \$580 – \$600/tonne. We estimated flat steel prices for the financial year 2011 to be around \$620-\$640/tonne..

Indian Demand – supply scenario

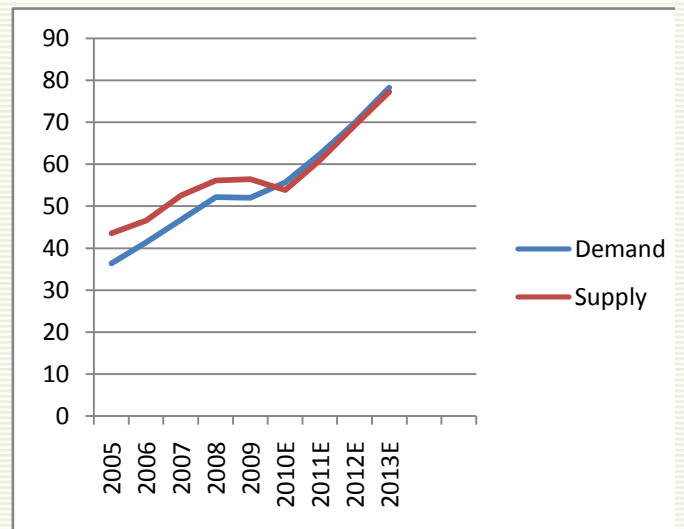
Before 2007 we were steel exporting country but turned net importer in 2007 and are going to continue importing steel for some time to come because we don't expect huge amount of supplies coming up before 2013, as there are land acquisition problems faced by international producers such as Arcelor & Posco for their Greenfield projects in India. At present National Flat Steel prices are around Rs32000-Rs33500/tonne. We estimated National flat steel prices for financial year 2011 to be around Rs32000-Rs34000/tonne.

World Demand & Supply Scenario



Sources: JPC, Crisil, UBS

Indian Demand & Supply Scenario



Sources: JPC, Crisil, UBS

SWOT Analysis

Strengths:

- ✦ Tata Steels one of the biggest strengths is its efficiency in production, its backward integration is one of the best in Indian Steel Clan. It has 100% self sufficiency in Iron Ore and around 70% in Coking coal on a standalone basis. However as a group it has only 22% Self Sufficiency and wants to increase up to 100% in Indian operations and around 50% in European operations. As per management guidance most of the Tata Steels future capacities are coming in India which will help it to maintain higher realizations going forward even if prices come under pressure due to over capacity in international market.
- ✦ It has good management & execution skills and commands respect from others in the industry and has achieved lot of awards for its commitment towards corporate social responsibilities.
- ✦ It has second largest global distribution in the world in over 25 countries.
- ✦ After acquiring Corus plc of U.K. it has strong R&D base and can provide value added and differentiated products to its customer.

Weakness:

- ✦ Tata Steel currently is highly leveraged after acquiring Corus Plc of U.K. in 2007 it has closed to US \$ 10 billion of debt on its books, which makes it vulnerable to the event such as recent global slump.
- ✦ Tata Steels overseas operation have relatively low margin because of its poor raw material integration.

"Per Capita consumption of Steel in India is around 49Kgs while that of China is 318Kgs (6.5 times that of China)".

"Historically it is observed that Steel demand is highly correlated with GDP growth on average 1* GDP".

Opportunities:

- Tata Steel is coming up with handful of Greenfields & Brownfield expansions in near future in India which will help to strengthen its base in low cost steel production capacity thereby improving margins and higher realization in future.

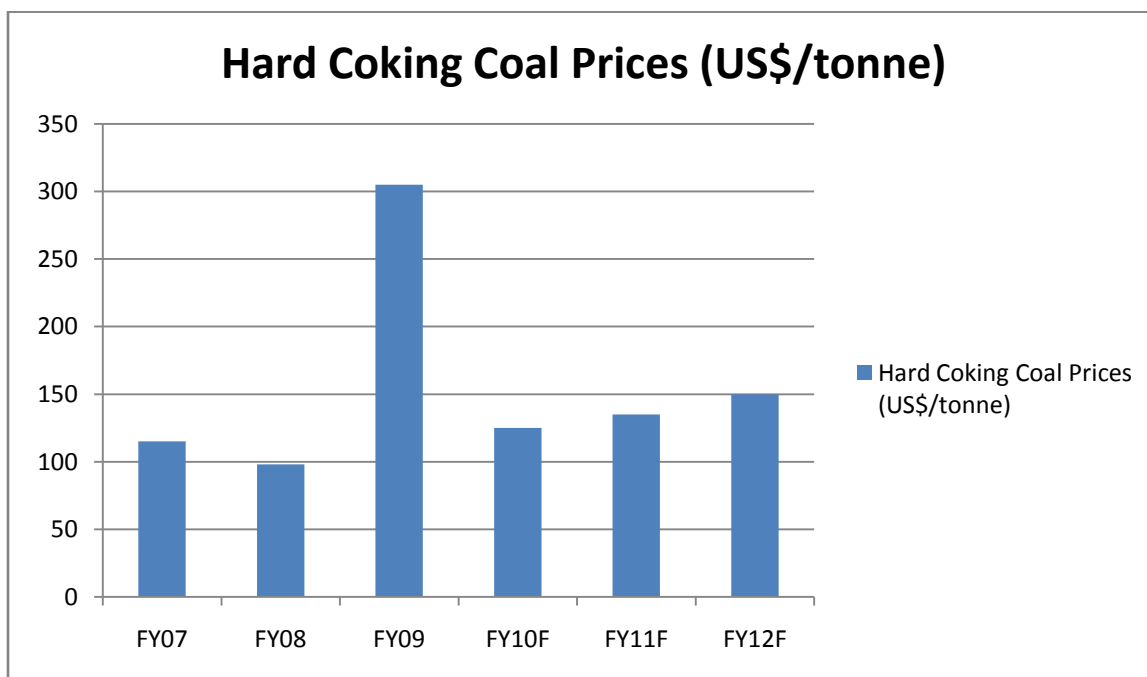
<i>Location</i>	<i>Project Type</i>	<i>Capacity Expansion</i>	<i>Expanded Capacity</i>	<i>Timeline</i>
<i>Jamshedpur</i>	<i>Brownfield</i>	<i>1.8Mtpa</i>	<i>6.8Mtpa</i>	<i>Commissioned</i>
<i>Jamshedpur</i>	<i>Brownfield</i>	<i>2,9Mtpa</i>	<i>9.7Mtpa</i>	<i>Dec 2010</i>
<i>Orissa Phase 1</i>	<i>Greenfield</i>	<i>3.0Mtpa</i>	<i>13.0Mtpa</i>	<i>2012</i>
<i>Orissa Phase 2</i>	<i>Greenfield</i>	<i>3.0Mtpa</i>	<i>16.0Mtpa</i>	<i>2015</i>
<i>Chhattisgarh Phase 1</i>	<i>Greenfield</i>	<i>2.5Mtpa</i>	<i>18.5Mtpa</i>	<i>2013</i>
<i>Chhattisgarh Phase 2</i>	<i>Greenfield</i>	<i>2.5Mtpa</i>	<i>21.0Mtpa</i>	<i>2015</i>
<i>Jharkhand Phase 1</i>	<i>Greenfield</i>	<i>6.0Mtpa</i>	<i>27.0Mtpa</i>	<i>2013</i>
<i>Jharkhand Phase 2</i>	<i>Greenfield</i>	<i>6.0Mtpa</i>	<i>33.0Mtpa</i>	<i>2015</i>

Source: Company

- Government of India in its 11th five year plan (2007-12) has planned expenditure of about 14, 50,000 Crores (USD 320 Billion) in sectors like Irrigation, Urban infra, Power, Roads, Railways, Ports, Airports & Telecom, which will directly and indirectly promote sale of both Long and Flat products.

Threats:

- ✦ Rate at which capacity additions are coming in the world may pose a big risk for demand and supply mismatch which can put pressure on margins and create lot of idle capacity.
- ✦ Fear of China, with major share in world's production around 40%, China has overcapacity of steel. There is always fear of dumping by China in India, although government has helped Indian Steel Industry by Imposing duties on steel import from time to time, prices may remain under pressure going forward with so much of additional capacity.
- ✦ Even though Tata Steel is focusing on Self sufficiency of 100% in raw material procurement for its Indian operation in future, there is always possibility of not achieving the targets; in that case its margin can take a hit going forward. In 2007-08 Steel industry was badly hit by high raw-material prices, Iron ore & Coking Coal prices went up by 85% and 300% respectively & by 400% & 500% respectively since 2004.



Source: TEX, ABN AMRO forecasts

Valuation Methodology:

We believe EV/EBITDA is an appropriate valuation methodology for steel sector companies for following reasons:

- ✚ Capital intensive nature of the industry.
- ✚ Varying capital structures (debt/equity ratios) of the companies.
- ✚ EBITDA is more reflective of a company's operational earnings capability than other measures such as earnings.

Outlook & Valuation:

At the CMP of Rs. 550, the stock is trading at 6.4x FY11E EPS of Rs. 85.48. On EV/EBITDA basis the stock is trading at 13.6x FY10E EV/EBITDA and at 5.9x FY11E EV/EBITDA; while on P/BV basis, the stock is trading at 1.8x FY10E book value and at 1.4x FY11E book value.

We value Tata Steel on a sum-of-the-parts basis with the India business at 7.5x EV/EBITDA, the European business at 6x EV/EBITDA and others at 6.5x EV/EBITDA for normalized FY11E EBITDA.

Target Normalised EBITDA	2010E	2011E	2012E	2013E	2014E	2015E
Tata Steel Standalone	13,070.90	15,381.35	18,412.34	23,788.19	24,316.28	28,106.96
Corus	(3,212.00)	717.52	1,432.69	4,297.09	4,755.83	6,942.66
Natsteel & TST	320.23	17.17	328.15	714.59	934.81	1,216.51
Others	(54.25)	667.84	839.16	946.82	934.76	922.85

Target EV/EBITDA Multiples	2010E	2011E	2012E	2013E	2014E	2015E
Tata Steel Standalone	8.50	7.50	6.50	5.00	5.00	4.25
Corus	6.00	6.00	5.00	4.00	3.50	3.00
Natsteel & TST	6.50	6.50	5.50	4.50	4.50	4.00
Others	6.50	6.50	5.50	4.50	4.50	4.00

Target Enterprise Value	2010E	2011E	2012E	2013E	2014E	2015E
Tata Steel Standalone	111,102.61	115,360.14	119,680.22	118,940.93	121,581.38	119,454.57
Corus	(3,212.00)	4,305.11	7,163.46	17,188.35	16,645.42	20,827.97
Natsteel & TST	2,081.52	111.63	1,804.85	3,215.67	4,206.63	4,866.06
Others	(54.25)	4,340.99	4,615.36	4,260.69	4,206.41	3,691.40

Total EV	109,917.87	124,117.87	133,263.89	143,605.63	146,639.84	148,840.01
Net Debt	53,983.31	53,983.31	53,983.31	53,983.31	53,983.31	53,983.31
Market Capitalisation	55,934.57	70,134.57	79,280.58	89,622.33	92,656.53	94,856.70
Diluted Shares	975,056,802	975,056,802	975,056,802	975,056,802	975,056,802	975,056,802
Target Price	574	719	813	919	950	973

	FY 2010E Mar-10	FY 2011E Mar-11	FY 2012E Mar-12	FY 2013E Mar-13	FY 2014E Mar-14	FY 2015E Mar-15
FUNDS EMPLOYED						
SHARE CAPITAL	6,202.78	6,202.78	6,202.78	6,202.78	6,202.78	6,202.78
SHARE WARRANTS						
RESERVES AND SURPLUS	23,612.27	31,947.44	44,902.29	68,215.56	95,441.08	134,459.96
TOTAL SHAREHOLDERS' FUNDS	29,815.05	38,150.22	51,105.07	74,418.34	101,643.86	140,662.74
WARRANTS ISSUED BY A SUBSIDIARY COMPANY	17.46	17.46	17.46	17.46	17.46	17.46
MINORITY INTEREST	894.88	894.88	894.88	894.88	894.88	894.88
LOANS						
Secured	34,329.26	34,329.26	34,329.26	34,329.26	34,329.26	34,329.26
Unsecured	25,571.24	25,571.24	25,571.24	25,571.24	25,571.24	25,571.24
Additional	-	-	10,000.00	10,000.00	10,000.00	10,000.00
	59,900.50	59,900.50	69,900.50	69,900.50	69,900.50	69,900.50
DEFERRED TAX LIABILITY	1,785.55	1,785.55	1,785.55	1,785.55	1,785.55	1,785.55
PROVISION FOR EMPLOYEE SEPARATION COMPENSA	1,042.41	1,042.41	1,042.41	1,042.41	1,042.41	1,042.41
TOTAL FUNDS EMPLOYED	93,455.85	101,791.02	124,745.87	148,059.14	175,284.66	214,303.54
APPLICATION OF FUNDS						
FIXED ASSETS						
Gross Block	115,822.74	125,734.74	151,753.74	180,250.74	205,030.74	232,288.74
Less — Impairment	(3,225.07)	(3,225.07)	(3,225.07)	(3,225.07)	(3,225.07)	(3,225.07)
Less — Depreciation	(64,010.28)	(68,359.37)	(73,042.25)	(79,005.28)	(86,320.36)	(94,683.33)
Net Block	48,587.39	54,150.30	75,486.42	98,020.39	115,485.31	134,380.34
INVESTMENTS	6,411.10	6,411.10	6,411.10	6,411.10	6,411.10	6,411.10
FOREIGN CURRENCY MONETARY ITEM TRANSLATION DIFFERENCE ACCOUNT	471.66	471.66	471.66	471.66	471.66	471.66
PURCHASED GOODWILL	-	-	-	-	-	-
GOODWILL ON CONSOLIDATION	15,364.92	15,364.92	15,364.92	15,364.92	15,364.92	15,364.92
DEFERRED TAX ASSET	76.12	76.12	76.12	76.12	76.12	76.12
CURRENT ASSETS						
Stores and spare parts						
Stock-in-trade.	1,107.47	1,454.40	2,192.07	17,425.10	21,668.70	14,412.80
Sundry debtors	10,729.96	13,439.14	15,491.04	18,399.78	20,460.74	23,609.41
Interest accrued on investments	6.81	6.81	6.81	6.81	6.81	6.81
Cash and Bank balances	5,917.19	6,003.10	5,618.41	4,490.48	12,469.11	28,967.24
	17,761.44	20,903.45	23,308.33	40,322.16	54,605.35	66,996.26
LOANS AND ADVANCES	13,015.73	13,015.73	13,015.73	13,015.73	13,015.73	13,015.73
CURRENT LIABILITIES AND PROVISIONS						
Current Liabilities	(1,180.28)	(1,550.02)	(2,336.18)	(18,570.71)	(23,093.30)	(15,360.37)
Provisions	(7,157.71)	(7,157.71)	(7,157.71)	(7,157.71)	(7,157.71)	(7,157.71)
	(8,337.99)	(8,707.73)	(9,493.89)	(25,728.42)	(30,251.01)	(22,518.08)
NET CURRENT ASSETS	22,439.17	25,211.45	26,830.16	27,609.48	37,370.07	57,493.92
MISCELLANEOUS EXPENDITURE	105.48	105.48	105.48	105.48	105.48	105.48
TOTAL ASSETS (Net)	93,455.85	101,791.02	124,745.87	148,059.14	175,284.66	214,303.54

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