FPO Note — Tata Steel Limited

Recommendation	SUBSCRIBE	
Issue Price	Rs. 594 - 610	
Bidding Date	19th – 21st January 2011	
Sector	Steel	
Financials (Rs in mn)	FY11E	FY12E
Revenue	1128957	1159174
EBIDTA	151568	162415
PAT	62630	64910
EPS	65.3	66.9
EBIDTA Margin	13.3%	13.9%
PE Ratio	9.3	9.1

No of Equity Shares Offered	57 million
Post Issue Promoter Holding	90%
Offer structure for different categories	
QIB	50%
Non-Institutional	15%
Retail	35%
Post issue Equity (Rs. in mn)	959.21
Issue Size (Rs. in mn)	33858 to 34770
Face Value	Rs.10
Bid Lot	10 Equity Shares

Retail Application – Detail at cut-off Price

Number of shares	320
Application Money	195200
Amount Payable	195200

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Investment rationale:

- **Expansion Projects to enhance Capacity:** Tata Steel is planning to increase its capacity from the current 6.8mtpa to 9.7mtpa in Jamshedpur. The company is increasing its capacity of 2.9mtpa by brown-field expansion which is expected to get completed by the end of FY12. The volume growth will be seen in FY13 onwards. We believe that with the lowest production cost amongst its peers, and the timely capacity expansion, the company is ready to capitalize on India's growth story.

- **Fund raising will help in de-leveraging Balance Sheet:** Tata Steel has taken several initiatives to de-leverage its balance sheet of debt / equity of 2.33x in FY10. The company has issued preferential shares, warrants, etc. to de-leverage its balance sheet. The proposed FPO of Rs. 35000 mn (on upper band) out of which Rs. 10900 mn will be used to set-off the debt as well as expected US$ 500mn from the sale of Teesside should help reduce net debt / equity to 1.21x by FY12E.

- **Improve visibility in raw-material availability:** Tata Steel has increased its stake from 19.9% to 27.4% in (New Millennium Capital Corporation, Canada), NML's Direct Shipping Ore (DSO) Project. The company has a 35% stake in a Mozambique Coal Mine with a 40% off-take rights, is expected to commence from end CY11 once the feasibility study is completed. The mine is expected to produce 2mn tons of coking coal. Tata Steel also enjoys 24% stake in Riversdale Mining Ltd. Rio Tinto has emerged as a possible bidder for Riversdale mine and has evaluated the company for US$3.8 bn. We believe that recent positive developments on Tata Steel's international resource projects improve its raw-material security which will improve the operating margins going forward.

Valuation & Recommendation

At Rs. 610 (upper band), Tata Steel is trading at an EV/EBIDTA of 6.3x in FY11E and 5.6 in FY12E; whereas; PE of 9.3x in FY11E and 9.1 in FY12E. We have valued the company on an EV/EBIDTA of 6.5x (FY12E), arriving at a target price of Rs. 804 per share. We recommend a "SUBSCRIBE" rating on the stock.

Investment Rationale

Expansion Projects to enhance capacity:

Jamshedpur facility: Expansion on track

Tata Steel has completed a 1.8 mtpa capacity expansion of the Jamshedpur facility in May 2008. The company has aggressively expanded its Jamshedpur facility to meet out the increase in domestic demand and had a total steel capacity of 6.8 mtpa out of which 3.5 mtpa for flat products and 3.3 mtpa for long products. Tata Steel is planning to increase its capacity from the current 6.8mtpa to 9.7mtpa in Jamshedpur. The company is increasing its capacity of 2.9mtpa by brown-field expansion which is expected to get completed by the end of FY12. The volume growth will be seen post FY13 onwards. The total capex for the project is Rs. 163720mn and the company has incurred Rs. 67400mn till November 2010. The product mix of 2.9 mtpa will comprise of 2.54 mtpa HR coil and 0.3mtpa Slabs.

The facility will also comprise of blast furnace with a capacity of 3.1 mtpa, pellet plant with a capacity of 6 mtpa, steel melting shop for crude steel, thin slab caster and rolling mill, coke oven battery with a capacity of 700,000 tpa and two lime kilns. The expansion program also includes the construction of an additional coke oven battery with a capacity of 700,000 tpa, which will service the facility's existing production.

We believe that with the lowest production cost amongst its peers, and the timely capacity expansion, the company is ready to capitalize on India's growth story. Tata Steel's Indian operation is 100% integrated on the iron ore front and around 50% captive coking coal act as a cushion against the high volatility in the prices.

The company is also planning to increase its capacity through green-filed projects.

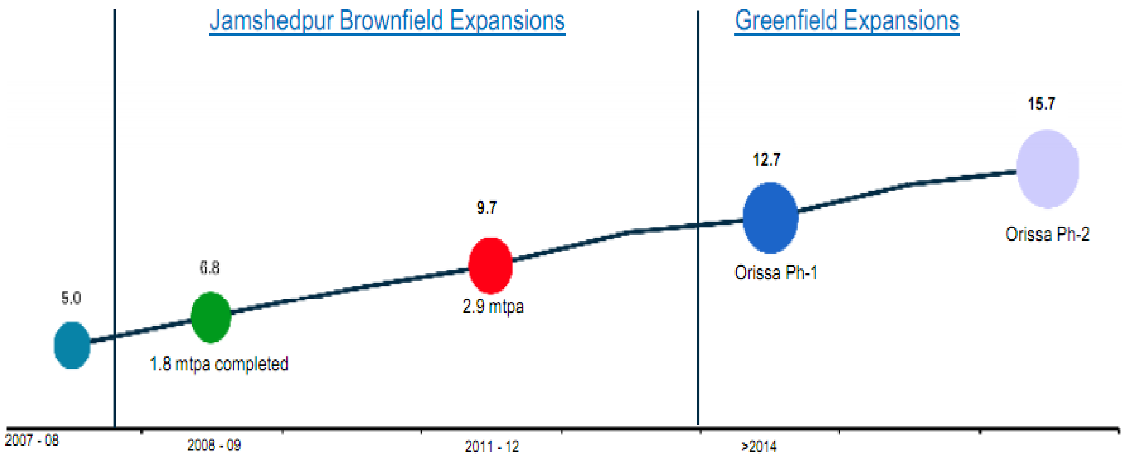
Orissa Project	➢ 6mtpa of flat products integrated steel plant in two phase of 3mtpa each ➢ The facilities will consist of a blast furnace, coke ovens, a sinter plant, a caster and a hot strip mill. ➢ The first module has an estimated total construction cost of Rs. 167,500 million and is expected to commence operation in three to four years.

Chhattisgarh Project	➢ 5mtpa integrated steel plant will consist solely of long products ➢ MoU with the Government of Chhattisgarh extended till June'12 ➢ Prospecting License for Baladila 1 granted by Government of Chhattisgarh ➢ The coal requirements for the new plant would have to be met either through the acquisition or lease of new mines, an increase in coal sourced from third parties or a combination of these sources. ➢ State Government has recommended to MoEF for final environmental clearance ➢ Land acquisition underway

Karnataka Project	➢ 3 Mtpa integrated steel plant ➢ MoU with Government of Karnataka and Tata Metallics signed on June 2010 ➢ Iron ore mining concessions under active consideration by the Karnataka State Government ➢ Karnataka State High level clearance committee has cleared 2,500 acres of land and land acquisition underway

Source: Company & Nirmal Bang Research

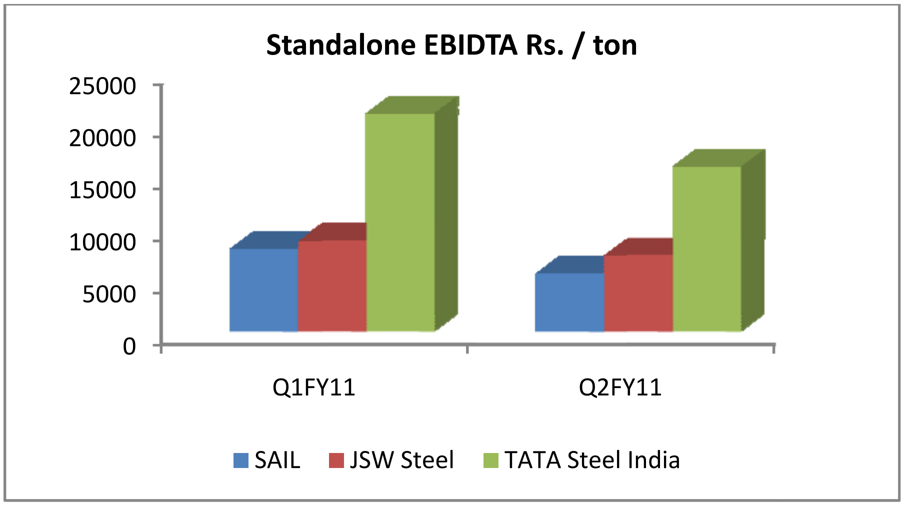
Expansion Projects currently ongoing:



Source: Company & Nirmal Bang Research

Un-interrupted Raw-material supply

Tata Steel is 100% fully integrated on iron ore front and 50% captive coking coal. The company has iron ore mines in Orissa and Jharkhand have combined reserves of 597m tons, and would be further developed along with steel-capacity expansion at Jamshedpur. Tata Steel has also got clearance to explore Ankua mine in Jharkhand with a total reserve of 400mn tons of iron ore. The company has coal mines at West Bokaro and Jharia with a combined reserves of 482mn tons and is beneficiated to lower its high ash content. As Tata Steel India is highly integrated on raw-material front compared to its Indian peers, the company due to its cost advantage has highest EBIDTA/ton.



Source: Company & Nirmal Bang Research

Fund raising will help in de-leveraging Balance Sheet

Tata Steel has taken several initiatives to de-leverage its balance sheet of debt / equity of 2.33x in FY10. The company has issued preferential shares, warrants, etc. to de-leverage its balance sheet. The proposed FPO of Rs. 35000 mn (on upper band) out of which Rs. 10900 mn will be used to set-off the debt as well as expected US$ 500mn from the sale of Teesside should help reduce net debt / equity to 1.21x by FY12E.

Tata Steel has taken several restructuring measures to de-risk its balance sheet, including raising funds through equity and repaying the high-cost debt. The company had come out with a GDR issue of US$500m in Jul '09.

Tata Steel has also issued 15 million shares and 12 million warrants to Tata Sons at a price of Rs. 594 each amounting to Rs. 16038 mn. Tata Steel will further raise Rs. 70bn via issue of securities, including ordinary shares, equity shares with differential voting rights, Global Depositary Receipts, debentures and foreign currency bonds.

Tata Steel has a gross debt of US$ 12.9bn out of which net debt stood at US$ 10.9bn with cash equivalents of US$ 2bn. We believe that with the equity raising and increase in profitability, the net debt / equity ratio will decrease significantly in the coming years. We expect net debt / equity to be 1.62x in FY11E and 1.21x in FY12E.

Improve visibility in raw-material availability

Tata Steel Europe is a non-integrated steel maker which imports iron ore and coking coal to meet out its raw-material requirement. The increase in raw-material prices eats the profitability of the company. We believe that recent positive developments on Tata Steel's international resource projects improve its raw-material security which will improve the operating margins going forward.

Joint Venture with New Millennium Capital Corporation

Tata Steel has increased its stake from 19.9% to 27.4% in (New Millennium Capital Corporation, Canada), NML's Direct Shipping Ore (DSO) Project. Tata Steel has made a positive investment decision by exercising its option to acquire an 80% interest in the DSO Project in exchange of covering expenses of C$300m (Canadian dollar), to be funded by TSL. The project has proven and probable direct shipping quality iron ore reserves of ~64m tons and TSL has 100% off-take rights. A feasibility study of this project is underway and production of iron ore is expected in 2012.

Mozambique Coal Mine Joint Venture

The Benga Project is a joint venture between Riversdale (65%) and Tata Steel Limited (35% with 40% off-take rights) and is located in the Tete Province of Mozambique. Identified on the Benga Licence are Coal Resources of 4.0 billion tonnes and a Coal Reserve of 502 million tonnes. Construction of Stage 1 (production of 5.3 Mt per year) has commenced and is expected to be completed in the second half of 2011.

Rio Tinto bidding Riversdale Mining – positive for Tata Steel

Tata Steel enjoys 24% stake in Riversdale Mining Ltd. Rio Tinto has emerged as a possible bidder for Riversdale mine and has evaluated the company for US$ 3.9bn which translates into US$ 940mn for Tata Steel. We believe that the counter bidding Rio Tinto's offer is not a desirable strategy as the company's cost of borrowing is increasing. We believe that Tata Steel investments in Riversdale mining will increase if the Rio Tinto's offer is accepted which is a positive sign for Tata Steel.

Risk Factors:

- Slower than expected growth in European operations would lead to lower than expected earnings in Tata Steel Europe
- Tata Steel Europe's inability to pass on the higher than expected raw-material prices to its customers as Tata Steel Europe is just a converter.
- Significant risk of equity dilution

Key Catalysts:

- Completion on 2.9mtpa capacity at Jamshedpur ahead of schedule
- Stake sale in Riversdale at higher than expected price
- Increase in Steel prices
- Acquisition of coking coal and iron ore mines
- Faster recovery growth in European operations

Objects of the Issue:

Particulars	Amount (Rs. in mn)
Part finances the Company's share of capital expenditure for expansion of existing works at Jamshedpur.	18750
Payment of redemption amounts on maturity of certain redeemable non-convertible debentures issued by the Company on a private placement basis.	10900
General corporate purposes.	x
Total Net Proceeds	**x**

Source: Company & Nirmal Bang Research

Valuation & Recommendation

Tata Steel Indian operation is best placed amongst its peers. The company is expected to post robust volume growth on account of capacity expansion, increase domestic demand and highest level of raw-material integration. It's fund raising, de-leveraging of balance sheet and its international raw-material project gives a competitive advantage.

At Rs. 610 (upper band), Tata Steel is trading at an EV/EBIDTA of 6.3x in FY11E and 5.6 in FY12E; whereas; PE of 9.3x in FY11E and 9.1 in FY12E. We have valued the company on EV/EBIDTA of 6.5x (FY12E), arriving at a target price of Rs. 804 per share. We recommend a "SUBSCRIBE" rating on the stock.

Rs. in mn

Valuation	FY12E
EV/EBITDA	6.5
EBITDA	162,414.9
EV	1,055,696.6
Cash	59,068.1
CWIP	36,770.4
Term Loan	371,122.5
Market Cap	780,412.6
Equity Cap	9,707.4
Target Price (Rs. per share)	**803.9**

Company Background

Tata Steel excluding Europe operations has a steel production capacity of 6.8 mtpa in FY10 which will increase to 9.7 mtpa by the end of FY12. Tata Steel's steel manufacturing capacity in India will increase three-fold at 21 mtpa from the present 6.8 mtpa following the completion of its expansion project at Jamshedpur and its two green-field plants at Orissa and Chattisgarh becoming operational.

With acquisition of TSE (Tata Steel Europe) in '07, TSL became the tenth-largest steel company in the world, with group capacity of ~27.2mtpa. TSE is Europe's second-largest steel producer. As a result of this acquisition, the majority of the Company's steel production capacity is currently located in the United Kingdom and the Netherlands where the Company has four facilities with a total steel production capacity of 18.4 mtpa.

The Company offers a broad range of steel products including a portfolio of high value-added downstream products such as hot rolled coils, sections, plates and wires.

The Group's South-East Asian operations comprise Tata Steel Thailand, in which TSL has 67.1% stake, and Nat Steel Holdings, which is one of the largest steel producers in Asia Pacific, operating in seven countries.

Consolidated Profit & Loss (Rs. in mn)

Particulars	FY2009	FY2010	FY2011E	FY2012E
Net Sales	**1,457,046**	**1,017,578**	**1,128,957**	**1,159,174**
Other Operating Income	16,247	6,354	10,600	7,200
Total Income	**1,473,293**	**1,023,931**	**1,139,557**	**1,166,374**
Total Expenditure				
Raw Materials consumed	748,111	447,516	479,685	489,885
Staff Cost	178,777	164,630	154,926	163,000
Purchase of Power	59,603	40,517	40,261	41,653
Freight and handling	60,419	55,491	60,559	59,222
Other Expenditure	241,420	235,350	252,559	250,200
Total Expenditure	**1,288,330**	**943,505**	**987,989**	**1,003,960**
EBITDA	**184,962**	**80,427**	**151,568**	**162,415**
EBITDA Margin	**12.6%**	**7.9%**	**13.3%**	**13.9%**
Depreciation	42,654	44,917	42,974	44,808
PBIT	**142,309**	**35,509**	**108,593**	**117,607**
Other Income	2,593	11,859	12,037	6,822
Interest (net)	32,903	30,221	26,917	26,628
PBT	**111,999**	**17,147**	**93,714**	**97,800**
Total of Exceptional items	-53,347	-16,837	-915	0
Profit before tax	**58,652**	**310**	**92,799**	**97,800**
Total Tax	18,940	21,518	31,226	34,090
Net Profit (+) / Loss (-)	**39,712**	**-21,208**	**61,573**	**63,710**
Minority Interest	-1,017	-1,116	-1,057	-1,200
PAT after MI	**40,728**	**-20,092**	**62,630**	**64,910**
Equity Share Capital	7,308	8,867	9,587	9,707
EPS	**55.7**	**-22.7**	**65.3**	**66.9**

Consolidated Balance Sheet (Rs. in mn)

Particulars	FY2009	FY2010	FY2011E	FY2012E
Sources of Funds				
Shareholders' Funds				
Equity Capital	7,301	8,867	9,587	9,707
Warrants	-	-	1,782.00	-
Convertible preference share	54,727	-	-	-
Reserves	215,115	219,272	272,928	328,752
Securities premium	-	0	42,960	49,968
Reserves & Surplus	215,115	219,272	315,888	378,720
Net worth	**277,143**	**228,139**	**327,257**	**388,427**
Warrants issued by Subsidiary Co	175	175	175	175
Loans				
Secured	343,293	280,593	279,368	220,712
Unsecured	255,712	250,410	250,410	250,410
Total Borrowings	**599,005**	**531,004**	**529,779**	**471,123**
Minority Interest	8,188	7,692	7,655	7,655
Deferred tax	17,856	17,690	18,351	19,082
Provision for Employee Seperation	10,424	9,637	9,637	9,637
FOREIGN CURRENCY MONETARY ITEM TRANSLATION DIFFERENCE	-4,717	2,070	2,070	2,070
Total Liabilities	**908,073**	**796,405**	**894,922**	**898,167**
Application of Funds				
Fixed Assets				
Gross block	**994,587**	**972,890**	**1,013,314**	**1,133,314**
Less: depreciation	630,832	608,126	651,100	695,908
Net block	363,755	364,764	362,214	437,406
Capital work in progress	89,301	93,194	106,770	36,770
Total Fixed Assets	**453,056**	**457,958**	**468,984**	**474,176**
Investments	64,111	54,178	54,178	54,178
Goodwill	153,649	145,418	145,418	145,418
Current assets				
Inventories	216,687	186,866	214,494	208,586
Debtors	130,316	116,240	126,939	128,957
Cash	61,484	67,878	62,909	59,068
Loans and advances	130,225	67,694	73,307	71,494
Total Current Assets	**538,712**	**438,678**	**477,648**	**468,106**
Current liabilities & provisions				
Current liabilities	230,933	233,886	184,691	176,982
Provisions	71,577	65,942	66,615	66,728
Total Current liabilities	**302,510**	**299,827**	**251,306**	**243,710**
Net Current Assets	**236,202**	**138,851**	**226,342**	**224,395**
Miscellaneous Expenses	1,055	0	0	0
Total Assets	**908,073**	**796,405**	**894,922**	**898,167**

Ratios

	FY2009	FY2010	FY2011E	FY2012E
Key Ratios				
EPS (Rs.)	55.7	(22.7)	65.3	66.9
CEPS (Rs.)	114.1	28.0	110.1	113.0
Book Value (Rs.)	304.4	257.3	339.5	400.1
Dividend	16.00	8.00	8.00	8.00
Debt-equity (x)	2.16	2.33	1.62	1.21
Valuations				
P/E (x)	10.9	(26.9)	9.3	9.1
P/CEPS (x)	5.3	21.8	5.5	5.4
Price/BV (x)	2.0	2.4	1.8	1.5
Market cap/sales (x)	0.3	0.5	0.5	0.5
EV (Rs. Million)	883,297	904,038	951,701	904,206
EV/EBITDA (x)	4.8	11.2	6.3	5.6
EV/Sales (x)	0.6	0.9	0.8	0.8
Profitability Ratios				
EBITDA Margin	12.6%	7.9%	13.3%	13.9%
NP Margin	2.8%	-2.0%	5.5%	5.6%
ROCE	10.9%	4.2%	9.4%	9.5%
ROE	14.7%	-8.8%	19.1%	16.7%
	1100.6%	54.5%	50.2%	43.2%
Growth Ratios				
Net Sales Growth	11.1%	-30.2%	10.9%	2.7%
EBITDA Growth	4.0%	-56.5%	88.5%	7.2%
PBIT Growth	11.6%	-84.7%	446.5%	4.4%
PAT Growth	-67.0%	-149.3%	-411.7%	3.6%
EPS Growth	-67.0%	-140.7%	-388.3%	2.4%
Book Value Growth	-22.5%	-15.5%	32.0%	17.9%

NOTE