Update
SECTOR: METALS

Tata Steel

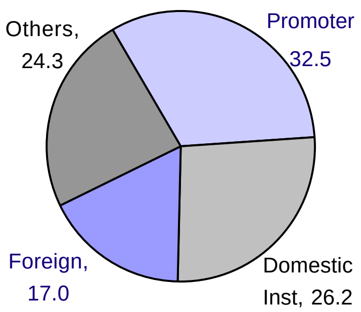
BSE SENSEX	S&P CNX
20,561	6,158

TATA STEEL

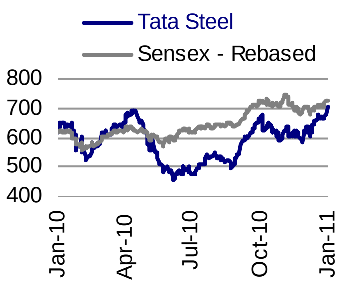
Bloomberg	TATA IN
Equity Shares (m)	914.4
52-Week Range (Rs)	737/449
1,6,12 Rel. Perf. (%)	12/30/-4
M.Cap. (Rs b)	642.8
M.Cap. (US$ b)	14.4

Y/E March	2010	2011E	2012E
Sales (Rs b)	1,024	1,129	1,166
EBITDA (Rs b)	80	159	156
NP (Rs b)	-8	67	69
EPS (Rs)	-9.3	74.4	75.1
EPS Gr. (%)	-109.1	-900.2	0.9
BV/Share (Rs)	95.7	173.4	240.3
P/E (x)	-na-	9.4	9.4
P/BV (x)	7.3	4.1	2.9
EV/Sales (x)	1.0	0.9	0.9
EV/EBITDA (x)	13.3	6.7	6.5
RoE (%)	-9.7	42.9	31.2
RoCE (%)	4.5	13.5	12.3
RoIC (%)	-na-	17.2	17.3

Shareholding pattern % (Sep-10)



Stock performance (1 year)



Rs703 Buy

Embarking on new earnings growth path; upgrade to Buy

- Tata Steel will embark upon a new earnings growth path, with expansion of capacity from 6.8mtpa to 10mtpa at Jamshedpur, start of coking coal production at Benga project, Mozambique, and start of iron ore production at DSO, Canada over 12-15 months.
- Sale of Teesside Cast Products' (TCP) slab plant for nearly USD500m will help to deleverage the balance sheet and reduce earnings volatility for Tata Steel's Europe operations.
- Post the acquisition of Corus and the financial crisis, Tata Steel has made long-term strategic investments (examples: USD3b capex at Jamshedpur, Riversdale (RIV), New Millennium Capital (NML), Dhamra port, JV with Bluescope, JV with NYK) over the last 3-4 years. Over the next 12-15 months, some of these investments will start generating cash flows - Jamshedpur expansion to 10mtpa would be completed by December 2011, and coking coal and iron ore production would start in 2HCY11.
- Tata Steel Europe's (TSE) earnings volatility is likely to reduce on completion of TCP sale and cost-cutting initiatives in the last 2-3 years. TSE margins will remain under pressure until full economic recovery in the European region. Though TSE remains the largest contributor to group crude steel production, its share in consolidated EBITDA and the group's enterprise value is getting diluted. TSE contributes just 1/4th of our target EV of Rs929b.
- Though the earnings contribution from RIV and NML will be marginal in FY13, Rio Tinto group's keen interest in RIV with a firm bid of AUD3.9b and possible counterbid is likely to get reflected in Tata Steel's valuations sooner than expected.
- Tata Steel's focus is now shifting towards high RoE projects rather than pure strategic investments. It has sold ~Rs12b of its investments in group companies like TCS, Tata Power and Tata Motor to unlock value in FY10 and FY11, with further potential of USD873m over 2-3 years.
- Steel prices have recovered by 10-15% across the world over the past one month due to end of de-stocking, supply correction, and raw material cost pressures. HRC prices have risen to USD670/tonne.
- Demand is likely to pick up over the next couple of months, as buyers return to the market post winter vacations in the western world. A strong steel price scenario is expected for 4-5 months.
- We are introducing FY13 estimates and moving our target price to SOTP value of Rs1,017 (upside of 43%) to better reflect the value of its diverse assets across the globe. We expect EPS to grow at a CAGR of 16% to Rs100.2 over FY11- FY13. We have valued Indian operations at EV/EBITDA of 6.5x, TSE at EV/EBITDA of 5x and investments at current market value. We believe that the value of investments will grow, as iron ore and coking coal production ramp up. At our target price, the stock will trade at 10.1x FY13E EPS and an EV of 6.7x FY13E EBITDA. We upgrade the stock to **Buy**.

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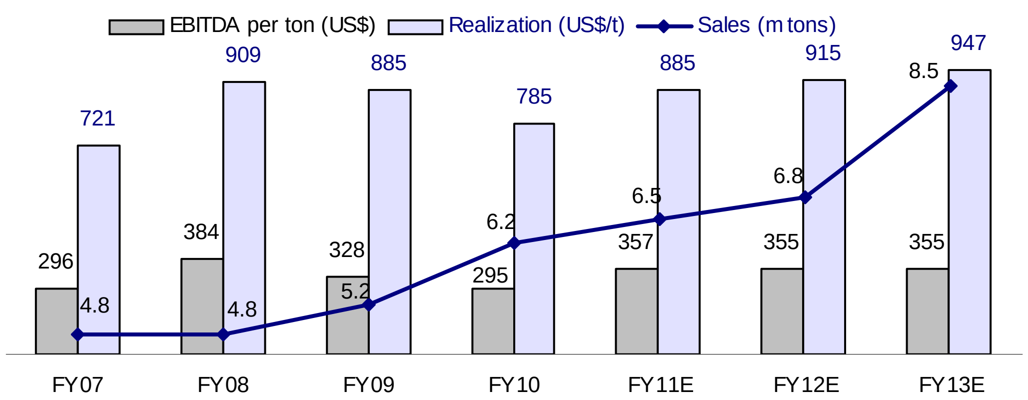
Indian operations: steel and iron ore production growth to drive earnings

- Salable steel from Indian operations is likely to grow at a CAGR of 13.4% to 9.5m tonnes over FY11-FY14. We expect EBITDA for Indian operations to grow at a CAGR of 10% to Rs134.6b by FY13.
- Though steel volumes, operating efficiency and iron ore production growth will drive earnings, declining coking coal integration on account of lack of growth at coal mines and appreciation of Indian currency (Rs43/USD for FY13) will drag margins.

Steel volume growth (m tonnes) to accelerate



Source: Company/MOSL

Raw material investment overseas: sooner than expected value unlocking

- Tata Steel holds 24% in Riversdale (RIV) and 35% stake in its Benga project, which it bought for ~USD500m (including USD100m for 35% stake in Benga). RIV has a small operating mine Zululand with production of ~0.7mtpa, 65% stake in Benga project with total coal reserves of 4b tonnes and 100% stake in Zambeze with total reserves of ~9b tonnes under feasibility study stage.

Riversdale (RIV): Benga Project

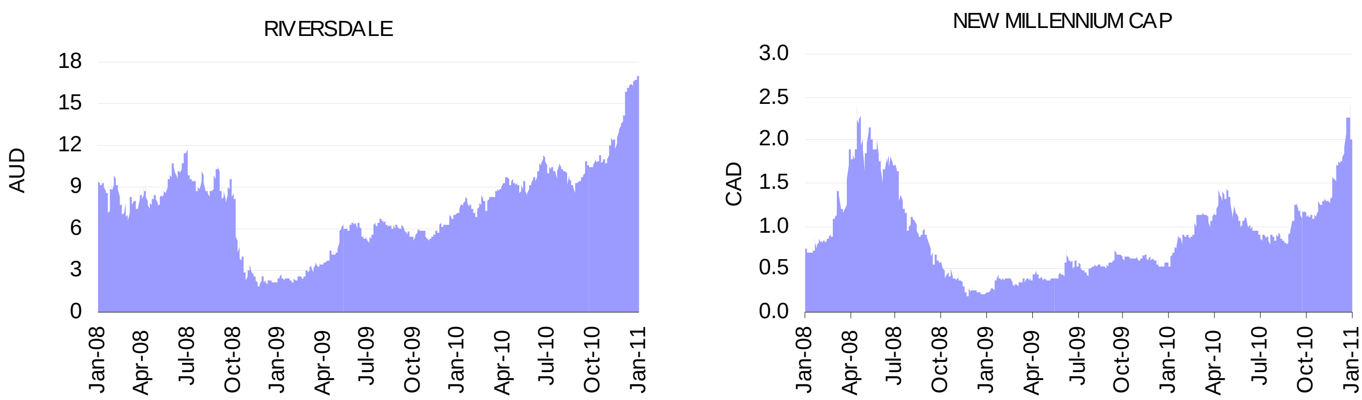
	Coal production					
	RoM (mtpa)	Coking (mtpa)	Thermal (mtpa)	Capex (US$m)	Tata Steel Stake (%)	Remarks
Stage 1	5.3	1.7	0.3	270	35	Production to start in 3QCY11: 40% offtake agreement
Stage 2	10.6	3.3	2.0	150	35	expansion by 2014
Stage 3	20.0	6.0	6.0	-na-	35	Will depend upon market conditions

Source: Company/MOSL

- A non-binding agreement between RIV and WISCO (Chinese steel maker) for 40% stake in Zambeze project for AUD800m has valued 9b tonnes of coal reserves with no near-term production at AUD2b. This implies valuation of AUD1.9b (ignoring Zululand for simplicity) for RIV's 65% stake in Benga project and a valuation of nearly AUD969m for Tata Steel's 35% stake in Benga project. Adding AUD936m for 24% in RIV, Tata Steel's total value in coal assets is AUD1.9b, which will grow with time.

- Though the coal production is expected to be small at ~1m tons (on attributable basis from Benga) in FY13 and logistic bottlenecks remains in evacuating large quantity of coal from Mozambique, the keen interest of Rio Tinto group with a firm bid of A$3.9b for RIV and possible counter bid is likely to get reflected in valuation of Tata steel sooner than expected.

Riversdale valuations have risen sharply, as coking coal has become dear



Source: Company/MOSL

- For iron ore, Tata Steel has invested in New Millennium Capital (NML CN, Mkt Cap: CAD357m, CMP: CAD2.4, Not Rated) by purchasing 27.4% of its equity in the parent company and 80% in DSO (Direct Shipping Ore) project. NML is a mining exploration company, with three main sets of tenements. Feasibility of DSO was completed in February 2010. At an investment of CAD300m, DSO is expected to produce 4mtpa of sinter/pellet feed. Production should begin by 2QFY12. The sinter/pellet feed would be shipped to TSE's Netherlands unit for use in pellet plant and blast furnace.

New Millennium Corp (NML)

		Rererves (m tons)					Tata	Remarks
	Grade (%)	Proven & prob-able	Measure & indi-cated	Infer-red	Total	Capex (C$m)	Steel Stake (%)	
Direct shipping ore	58.8	64	8	7	79	300	80	Haemetite; Sinter feed (80%); Pellet feed(20%) 4mtpa capacity; production start 3QCY11
Labmag	29.6	3,500	1,000	1,200	5,700			Magnetite low grade; feasiblity study underway
Kemag	31.3	2,100	300	1,000	3,400			Magnetite low grade; feasiblity study underway
Total iron content (m tons)	**100.0**	**1,731**	**395**	**672**	**2,798**			

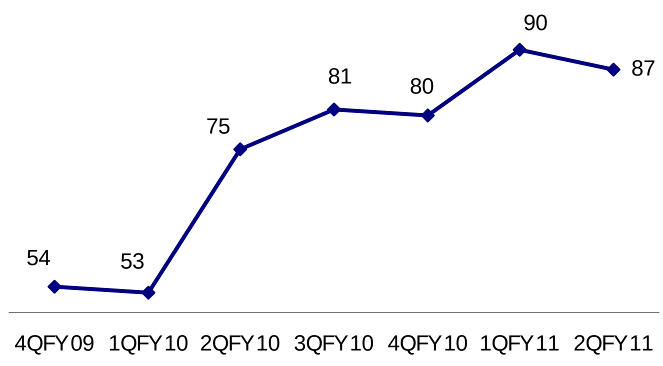
Source: Company/MOSL

- Tata Steel also has an exclusive right to negotiate and settle a proposed transaction in respect of other two projects - LabMag (3.5b tonnes of proven and probable reserves of 29.5% Fe grade) and KeMag (2.1b tonnes of proven and probable reserves of 31.3% Fe grade).

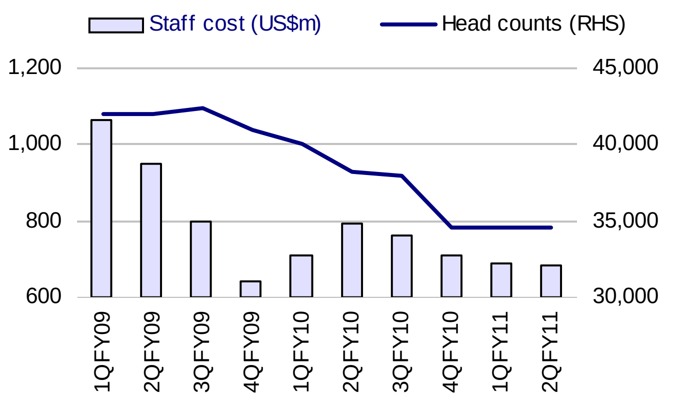
Corus renamed Tata Steel Europe: contribution to EV getting diluted

- Tata Steel Europe (TSE) is likely to reduce earnings volatility due to USD500m investment in improving operating efficiencies over the next 12-15 months, expected sale of 4mtpa Teesside Cast Product (TCP) slab capacity for ~USD500m, various cost cutting measure undertaken over the last 2-3 years under "Fit for Future" program, and re-pricing of raw material more frequently on quarterly basis to better reflect market conditions.
- TSE came under severe stress in 2HFY09 due to demand collapse and crash of commodity prices driven by financial crisis. The financials of TSE took longer to recover, as it chose to consume all of the high cost coking contracted at annual pricing of USD300/tonne for FY09 rather than spreading the deliveries over three years. It undertook a number of cost cutting measures to reduce fixed and variable costs. Weathering the storm resulted in annual savings of USD1.9b.
- TSE reduced headcount by nearly 20%. A corresponding reduction in production levels due to closure of TCP has resulted in specific staff cost remaining constant.
- Also, it reduced purchases of third-party steel to keep the utilization of its mill high. TSE mills (excluding TCP) have regained high level of utilization faster than peers in Europe. TCP was closed as a consortium of 3-4 customers walked out of a 10-year offtake agreement.
- The margins of TSE recovered in 1HFY11. However, subsequent steel price correction and raw material cost inflation are likely to compress margins in 2HFY11.
- Steel prices have started recovering once again thereby raising the expectation of margin expansion in 1HFY12.
- Though TSE remains the largest contributor to group crude steel production, its share in consolidated EBITDA and the group's enterprise value is getting diluted. TSE contributes only 1/4th of our target EV of Rs929b.

TSE: Capacity utilization (%) has improved

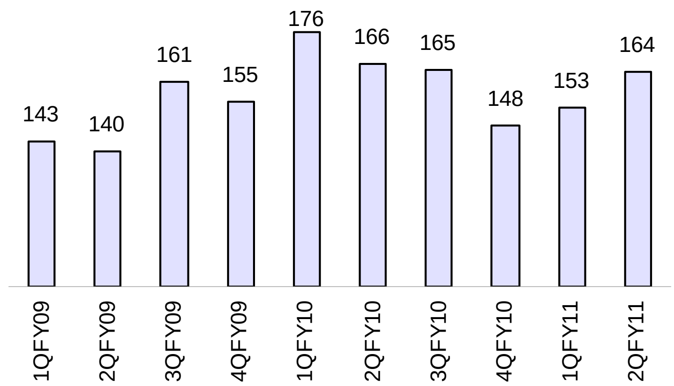


TSE has rationalized staff cost through continuous headcount reduction

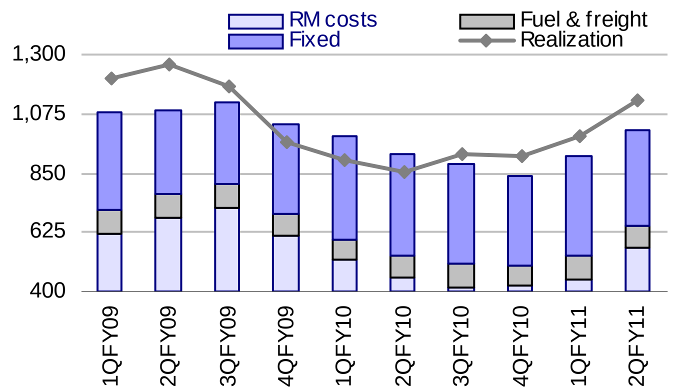


Source: Company/MOSL

Staff cost per ton has remained under check despite production cut (USD/ton)



TSE has turned around on steel price recovery and cost reduction (USD/ton)



Source: Company/MOSL

Strategic investments to drive earnings growth; focus shifting to high RoE projects; upgrade to Buy, with target price of Rs1,017

- Post the acquisition of Corus and the financial crisis, Tata Steel has made long-term strategic investments (examples: USD3b capex at Jamshedpur, RIV, NML, Dhamra port, JV with Bluescope, JV with NYK) over the last 3-4 years. Over the next 12-15 months, some of these investments will start generating cash flows - Jamshedpur expansion to 10mtpa would be completed by December 2011, and coking coal and iron ore production would start in 2HCY11.
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Sum of the parts valuations (SOTP)

Year	2012E	2013E
EBITDA-India	112,912	134,646
Target EBITDA multiple	6.5	6.5
(a) EV- India	733,929	875,202
EBITDA-subsidiaries	38,549	46,315
Target EBITDA multiple	5.0	5.0
(b) EV- Tata steel Europe	192,746	231,574
(d) Target EV (a+b)	926,674	1,106,776
(e) Net Debt (Rs m)	374,342	323,115
(f) Investments	146,098	146,098
Equity value (d+f-e)		
Rs m	698,431	929,759
Rs/share	764	1,017
Target Price (Rs)	764	1,017

Source: MOSL

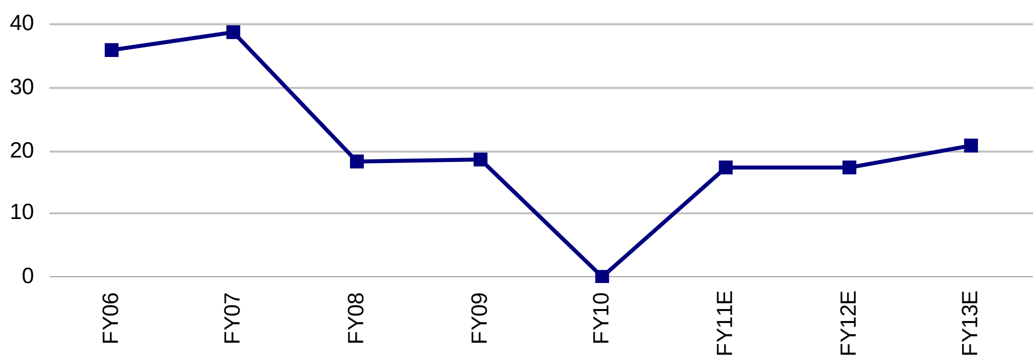
Investments

	Shares	Stake	Purchase		Equity Value		
	(m)	%	US$/sh.	(US$m)	CMP	(US$m)	
New Millenium (C$)	40.4	27.4	1.08	43.5	2.4	97	
DSO project (C$)		80.0		300		300	Valuing it at 2x project cost
Riversdale (A$)	57.1	24.2		500	17	971	
Benga & Tete Project (A$)		35		88.2		1,030	
Tata Motors (US$)	29.6		1.9	57	30	873	
Total (US$m)						**3,237**	

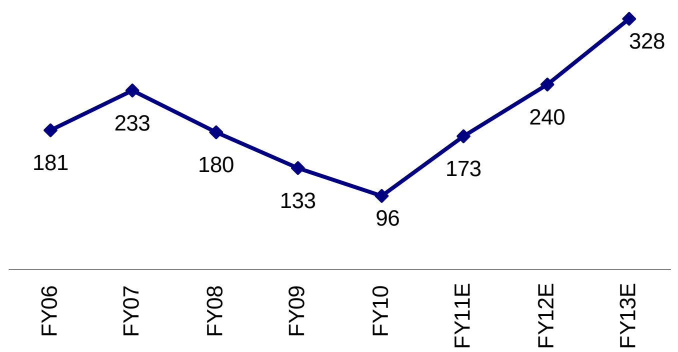
Note: US$/C$ = 1.000 ; US$/A$ = 0.983 ; US$/INR= 44.72

Source: Company/MOSL

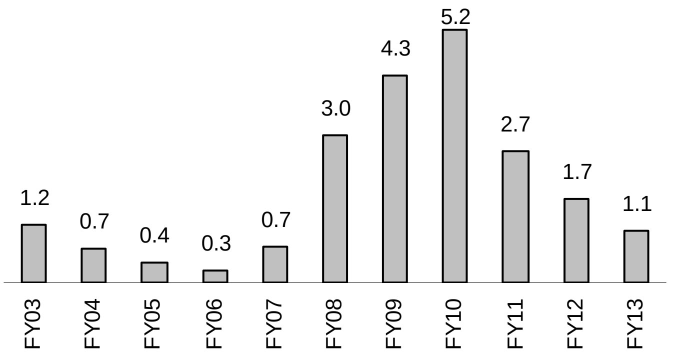
RoIC (%) to start improving in FY13 on start of high return Jamshedpur expansion



Book value (less goodwill) has bottomed out (Rs)



Strong cash flows will reduce debt to equity ratio (x)

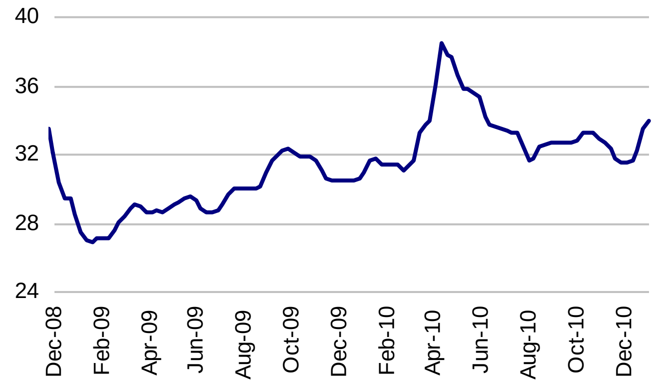


Source: Company/MOSL

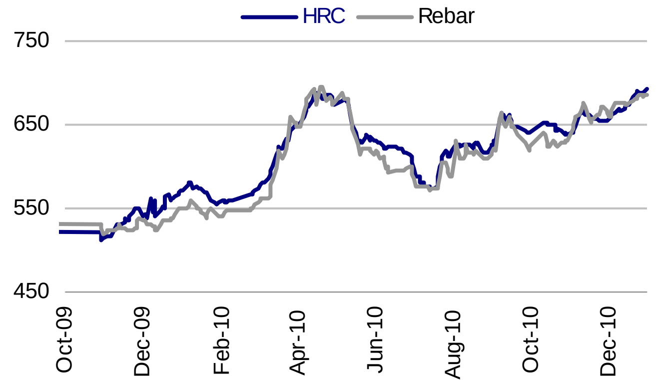
Steel price recovery may provide further upsides

- Steel prices have witnessed a recovery of 10-15% across the world over the past one month due to end of de-stocking, supply correction, and raw material cost pressures. HRC prices have risen to USD670/tonne.
- Demand is expected to pick up over the next couple of months as buyers return to the market post winter vacations in the western world. A strong steel price scenario is expected for 4-5 months.
- Tata Steel tends to gain from steel price increase due to raw material integration. A USD100/tonne increase in steel prices tend to expand the margins of Indian operations by USD50/tonne, thereby driving the equity value by USD425m only on account of Indian operations i.e. Rs21/share addition to target price. Margin expansion for RIV and NML will add further to equity value.

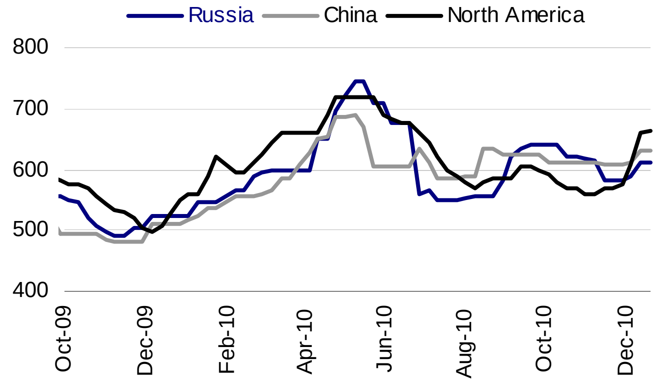
HRC tube grade Mumbai (Rs/tonne)



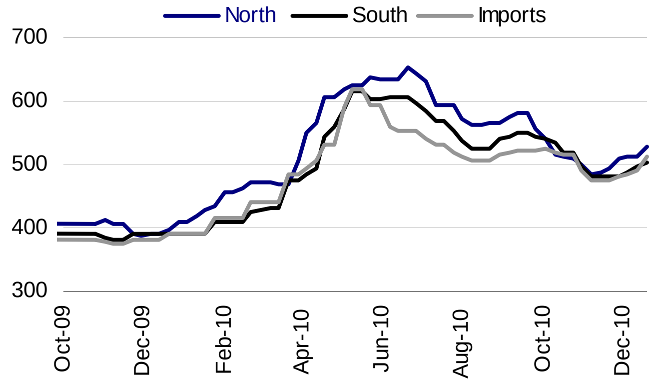
China's domestic steel prices (USD/tonne)



Hot rolled coil export prices (USD/tonne)



Hot rolled coil prices in Europe (EUR/tonne)



Source: Bloomberg/MOSL

Financials and Valuation

INCOME STATEMENT (CONSOLIDATED)				(RS MILLION)
Y/E MARCH	2010	2011E	2012E	2013E
Net Sales	**1,023,931**	**1,129,411**	**1,166,209**	**1,236,040**
Change (%)	-30.5	10.3	3.3	6.0
EBITDA	**80,427**	**158,512**	**155,744**	**186,107**
% of Net Sales	7.9	14.0	13.4	15.1
Depn. & Amortization	44,917	42,938	43,141	42,908
EBIT	**35,509**	**115,574**	**112,604**	**143,199**
Net Interest	30,221	26,512	28,450	27,741
Other income	6,859	6,562	6,834	6,834
PBT before EO	**12,147**	**95,624**	**90,988**	**122,291**
EO income	-11,837	6,086		
PBT after EO	**310**	**101,710**	**90,988**	**122,291**
Tax	21,518	28,910	22,345	30,677
Rate (%)	6,941	28.4	24.6	25.1
Reported PAT	**-21,208**	**72,800**	**68,642**	**91,615**
Minority interests	152	-36	1	1
Share of asso. PAT	1,269	425	13	13
Attributable PAT	**-20,092**	**73,261**	**68,654**	**91,627**
Adjusted PAT	**-8,255**	**67,175**	**68,654**	**91,627**
Change (%)	-109.1	-n/a-	2.2	33.5

BALANCE SHEET (CONSOLIDATED)				(RS MILLION)
Y/E MARCH	2010	2011E	2012E	2013E
Share Capital	8,867	9,017	9,137	9,137
Reserves	221,516	292,859	356,041	435,899
Net Worth	**230,383**	**301,877**	**365,178**	**445,036**
Minority Interest	8,841	8,805	8,806	8,807
Total Loans	531,004	531,004	531,004	531,004
Deferred Tax Liability	16,541	14,742	12,943	11,144
Capital Employed	**786,768**	**856,427**	**917,931**	**995,991**
Gross Block	976,290	1,036,290	1,096,290	1,156,290
Less: Accum. Deprn.	608,126	651,064	694,205	737,113
Net Fixed Assets	**368,164**	**385,225**	**402,084**	**419,176**
Capital WIP	89,795	89,795	89,795	89,795
Investments	34,890	34,890	34,890	34,890
Goodwill on consolidation	145,418	145,418	145,418	145,418
Curr. Assets	**457,965**	**351,866**	**400,782**	**478,548**
Inventory	186,866	78,537	80,501	90,618
Account Receivables	116,240	122,849	117,677	127,393
Cash and Bank Balance	87,166	106,144	156,662	207,888
Others	67,694	44,336	45,942	52,649
Curr. Liability & Prov.	**309,464**	**150,767**	**155,039**	**171,837**
Account Payables	233,886	94,618	97,345	111,049
Provisions & Others	75,578	56,149	57,694	60,788
Net Current Assets	**148,501**	**201,098**	**245,743**	**306,712**
Appl. of Funds	**786,768**	**856,427**	**917,931**	**995,991**

E: MOSL Estimates

RATIOS (CONSOLIDATED)				
Y/E MARCH	2010	2011E	2012E	2013E
Basic (Rs)				
EPS	**(9.3)**	**74.4**	**75.1**	**100.2**
Cash EPS	26.7	128.3	122.2	147.1
BV/Share	95.7	173.4	240.3	327.7
DPS	8.0	9.0	10.0	11.0
Payout (%)	(106.4)	14.1	15.6	12.8
Valuation (x)				
P/E	(75.6)	9.4	9.4	7.0
Cash P/E	26.3	5.5	5.8	4.8
P/BV	7.3	4.1	2.9	2.1
EV/Sales	1.0	0.9	0.9	0.8
EV/EBITDA	13.3	6.7	6.5	5.2
Dividend Yield (%)	1.1	1.3	1.4	1.6
Return Ratios (%)				
RoE	(9.7)	42.9	31.2	30.6
RoCE	4.5	13.5	12.3	14.4
RoIC	-na-	17.2	17.3	20.7
Working Capital Ratios				
Fixed Asset Turnover (x)	1.0	1.1	1.1	1.1
Asset Turnover (x)	1.3	1.3	1.3	1.2
Debtor (Days)	41.4	39.7	36.8	37.6
Inventory (Days)	67	25	25	27
A/c Payables (Days)	83.4	30.6	30.5	32.8
Working Capital Turnover	22	31	28	29
Leverage Ratio (x)				
Current Ratio	1.5	2.3	2.6	2.8
Interest Cover Ratio	1.2	4.4	4.0	5.2
Debt/Equity	5.2	2.7	1.7	1.1

CASHFLOW STATEMENT (CONSOLIDATED)				
	2010	2011E	2012E	2013E
EBITDA	80,427	158,512	155,744	186,107
Non cash exp. (income)	2,404	-402	-1,848	-17,167
(Inc)/Dec in Wkg. Cap.	46,465	-37,547	5,935	-6,130
Tax Paid	-24,586	-28,910	-22,345	-30,677
XO (employee seperation)		-914		
CF from Op. Activity	**104,710**	**90,739**	**137,487**	**132,134**
(Inc)/Dec in FA + CWIP	-69,498	-60,000	-60,000	-60,000
(Pur)/Sale of Investments	8,398	7,000		
Int. & Divident Income	3,054	6,562	6,834	6,834
CF from Inv. Activity	**-61,584**	**-46,438**	**-53,166**	**-53,166**
Equity raised/(repaid)	24,465	10,692	5,346	
Debt raised/(repaid)	-29,944			
Dividend (incl. tax)	-13,209	-9,502	-10,699	
Interest paid	-32,662	-26,512	-28,450	-27,741
CF from Fin. Activity	**-51,350**	**-25,323**	**-33,803**	**-27,741**
(Inc)/Dec in Cash	**-8,224**	**18,979**	**50,518**	**51,226**
Add: opening Balance	95,390	87,166	106,144	156,662
Closing Balance	**87,166**	**106,144**	**156,662**	**207,888**

N O T E S

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Disclosure of Interest Statement	Tata Steel
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	Yes
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No