Indiabulls

**TATA STEEL**
**RESEARCH**

**EQUITY RESEARCH** — **September 30, 2009**

## RESULTS REVIEW

**Share Data**

| | |
|---|---|
| Market Cap | Rs. 372.9 bn |
| Price | Rs. 510.35 |
| BSE Sensex | 17,126.84 |
| Reuters | TISC.BO |
| Bloomberg | TATA IN |
| Avg. Volume (52 Week) | 4.0 mn |
| 52-Week High/Low | Rs. 545/146.35 |
| Shares Outstanding | 730.6 mn |

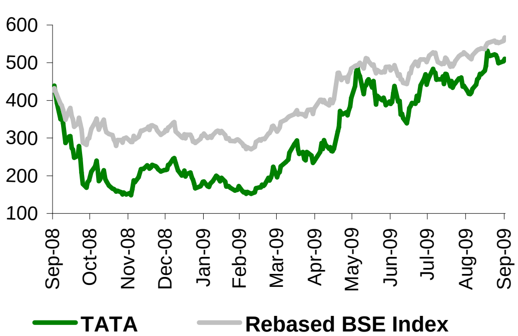
**Valuation Ratios (Consolidated)**

| Year to 31 March | 2010E | 2011E |
|---|---|---|
| EPS (Rs.) | 41.2 | 55.6 |
| +/- (%) | (60.4%) | 35.0% |
| PER (x) | 12.4x | 9.2x |
| EV/ Sales (x) | 0.8x | 0.8x |
| EV/ EBITDA (x) | 7.7x | 6.5x |

**Shareholding Pattern (%)**

| | |
|---|---|
| Promoters | 34 |
| FIIs | 15 |
| Institutions | 23 |
| Public & Others | 28 |

**Relative Performance**




## Tata Steel Limited — Sell

***Lower utilisation remains a concern***

For Q1'10, Tata Steel Limited (TSL) reported a weak set of numbers. Net sales declined by 46.7% yoy to Rs. 231.8 bn, mainly due to 36.8% yoy decline in sales volumes and a 15.8% yoy decline in average sales realisations. During the quarter, TSL reported a negative EBITDA of Rs. 1.4 bn, as against EBITDA of Rs. 69.9 bn in Q1'09. In the near-to-medium term, we expect TSL's sales volumes to remain under pressure, given a slow recovery in steel demand in Europe, which contributes ~60% of the Company's sales volumes. Moreover, with the excess idle capacity across the world (because of production cuts announced by the major steel companies), and a sluggish demand, we expect steel prices to remain under pressure in the near term.

***Corus continues to drag volumes, despite recovery*:** The demand scenario of the Steel sector has improved in the past few months. In July 2009, steel production in the European region increased by ~25%, as compared with the December 2008 lows. With the recovery in steel demand, TSL-Europe (TSE) has restarted some of its idle capacities. However, in the coming quarters, we expect the production cuts at TSE to continue, given a weak demand outlook in the developed countries and the available idle capacities of other major steel companies across the world. Accordingly, we expect 70% utilisation at TSE in FY10. On the other hand, we believe that an improvement in the domestic demand, on account of the recovery in the core sectors should moderate the drop in the Company's sales volumes.

***Margins to remain under pressure*:** The steep decline in steel prices and the expected fall in the Company's sales volumes (~21% decline in FY10), should drag the EBITDA margin of the Company. However, the fall will be

**Key Figures (Consolidated)**

| Quarterly Data | Q1'09 | Q4'09 | Q1'10 | YoY% | QoQ% |
|---|---|---|---|---|---|
| (Figures in Rs. mn, except per share data) | | | | | |
| Net Sales | 435,083 | 264,310 | 231,805 | (46.7)% | (12.3)% |
| EBITDA | 69,876 | 330 | (1,417) | NM | NM |
| Adj. Net Profit | 41,480 | (18,466) | (19,899) | NM | NM |
| **Margins(%)** | | | | | |
| EBITDA | 16.1% | 0.1% | (0.6)% | | |
| NPM | 9.5% | (7.0)% | NM | | |
| **Per Share Data (Rs.)** | | | | | |
| Adj. EPS | 56.8 | (25.3) | (27.7) | NM | NM |

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moderated by the decline in input costs, which is a result of the dip in coking coal and iron ore prices. We expect the Company's EBITDA margin to decline to ~10.8% in FY10, as compared to 12.3% in FY09.

### Valuation

At the current market price (CMP) of Rs. 510.35, the stock is trading at a forward P/E of 12.4x and 9.2x the FY10 and FY11 earnings, respectively. Based on our DCF valuation, we have arrived at a target price of Rs. 465 (assuming 13% WACC and a 5% terminal growth). Since, our target price provides a 10% downside potential from the CMP, we have given a Sell rating to the stock.

As DCF valuation is sensitive to the changes in WACC and the terminal growth rate, we have performed a sensitivity analysis of the same.

| Terminal growth (in %) | WACC (in %) | | | | | | |
|---|---|---|---|---|---|---|---|
| | 11.5 | 12.0 | 12.5 | **13.0** | 13.5 | 14.0 | 14.5 |
| 4.0 | 602 | 528 | 463 | 405 | 353 | 306 | 264 |
| 4.5 | 649 | 567 | 496 | 433 | 377 | 327 | 282 |
| **5.0** | 703 | 612 | 534 | **465** | 405 | 351 | 303 |
| 5.5 | 765 | 664 | 577 | 501 | 435 | 377 | 325 |
| 6.0 | 840 | 724 | 626 | 542 | 470 | 406 | 350 |

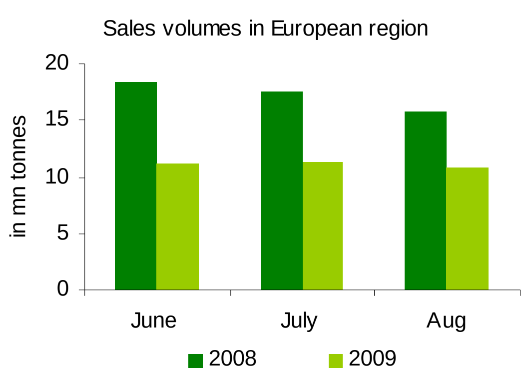
### Result Highlights

In Q1'10, TSL's net sales declined by 46.7% yoy to Rs. 231.8 bn, mainly on account of a steep decline in sales volumes and average sales realisations of the Company. During the quarter, the saleable steel sales volumes declined to 5.5 mn tonnes, as against 8.6 mn tonnes in Q1'09, and the average sales realisation of the Company declined by 15.8% yoy to Rs. 42,588 per tonne.

| Q1'10-Result summery | TSL-India | Corus | Nat steel | TSL-Thailand | Group |
|---|---|---|---|---|---|
| Deliveries (mn t) | 1.4 | 3.3 | 0.5 | 0.3 | 5.5 |
| Sales (USD mn) | 1,172 | 3,179 | 507 | 133 | 4,991.0 |
| EBITDA (USD mn) | 373 | (387) | 9 | 1 | (4) |
| EBITDA Margin (in %) | 31.8% | NM | 1.8% | 0.8% | NM |
| Sales realisation (USD/t) | 837 | 963 | 1,014 | 512 | 914 |

During Q1'10, TSL's Indian operations registered a robust 20.8% yoy growth in its sales volumes. However, the global operations of the Company eventually dragged it down. Sales volumes of TSE registered a sharp decline of 47.6% yoy, mainly on account of lower utilisation (~56% in Q1'10). Sales volumes of Nat Steel and TSL-Thailand also registered declines and thus, overall sales volumes for the group declined by 36.8% yoy.

| | Production Volume | | | Sales Volume | | |
|---|---|---|---|---|---|---|
| **Sales Volume** | **Q1'09** | **Q1'10** | **YoY%** | **Q1'09** | **Q1'10** | **YoY%** |
| **(Figures in mn tonnes)** | | | | | | |
| Tata Steel India | 1.2 | 1.5 | 29.9% | 1.2 | 1.4 | 20.8% |
| Tata Steele Europe | 5.2 | 2.8 | (46.2%) | 6.3 | 3.3 | (47.6%) |
| Nat Steel | 0.4 | 0.4 | (7.1%) | 0.8 | 0.5 | (39.5%) |
| Tata steel Thailand | 0.4 | 0.3 | (29.1%) | 0.4 | 0.3 | (25.9%) |
| Group | 7.2 | 5.0 | (30.4%) | 8.6 | 5.5 | (36.8%) |




In the recent months, the European steel sector has witnessed a recovery in the demand. In July 2009, the steel production in the European region increased by ~25% as compared with the December 2008 lows. In line with the recent recovery in demand, TSE has restarted some of its idle capacities, which is likely to improve its utilisation rates. Accordingly, we expect TSE utilisation rates to be at ~70%. On the other hand, TSL India's operation is expected to register a robust volume growth on the back of the strong domestic demand, which should moderate the fall in the total sales volumes. Accordingly, we expect TSL's sales volumes to be ~22.5 mn tonnes in FY10, as against 28.5 mn tonnes in FY09.

On the realisation front, in FY09, average steel products realisation of the Company have declined by ~7%. After the sharp fall in 2008, steel prices stabilised in the first half of 2009; however, we expect prices to remain under pressure given the excess idle capacities at major steel companies across the globe. Thus, we expect TSL's net sales to decline ~29% in FY10.

### Margin to remain under pressure

During Q1'10, the Company reported negative EBITDA of Rs. 1.4 bn, versus Rs. 69.9 bn in Q1'09, mainly due to lower capacity utilisation and the higher raw material costs.

Going forward, we believe that the expected lower realisations, falling sales volumes, and higher average fixed costs per unit will overshadow the benefit resulting from the fall in the prices of raw material such as coking coal and iron ore. While coking coal prices have plummeted from ~USD 300 per tonne in CY08 to ~USD 115-125 in CY09, iron ore prices have declined from ~USD 140 per tonne in CY08 to USD 50–60 per tonne in CY09. Thus, we believe that the EBITDA margin of the Company will remain under pressure in the near-to-medium term, and expect them to be ~10.8% in FY10, as compared with 12.3% in FY09.

**Key Figures (Consolidated)**

| Year to March | FY07 | FY08* | FY09E* | FY10E* | FY11E* | CAGR (%) |
|---|---|---|---|---|---|---|
| (Figures in Rs. mn, except per share data) | | | | | | (FY09-11E) |
| Net Sales | 252,124 | 1,315,359 | 1,473,293 | 1,045,650 | 1,138,438 | (12.1)% |
| EBITDA | 78,882 | 179,931 | 181,277 | 112,467 | 133,294 | (14.2)% |
| Adj. Net Profit | 42,795 | 86,458 | 83,299 | 33,009 | 44,559 | (26.9)% |
| **Margins(%)** | | | | | | |
| EBITDA | 30.8% | 13.7% | 12.3% | 10.8% | 11.7% | |
| NPM | 16.7% | 6.6% | 5.7% | 3.2% | 3.9% | |
| **Per Share Data (Rs.)** | | | | | | |
| Adj. EPS | 74.8 | 107.9 | 103.9 | 41.2 | 55.6 | (26.9)% |
| PER (x) | 6.0x | 4.7x | 4.9x | 12.4x | 9.2x | |

**Includes Corus results*

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