



Tata Steel Ltd. - FPO Note

Issue Details	Particulars
Issue Date	January 19, 2011 – January 21, 2011
Issue Size	Rs.33.8- 34.7bn
Price Band	Rs. 594-610
FV	Rs.10
Fresh Issue	57 mn equity shares
QIB	49%
Non Institutional/HNIs	15%
Retail	34%
Employees	2%
Equity shares prior to issue	902.2 mn equity shares
Equity shares post issue	959.2 mn equity shares
Post issue market capitalization	Rs. 570 - 585bn
FPO Rating	-
Lot size	10 equity shares and multiples thereof
Issue Manager	Kotak, Citigroup, Deutsche Bank, HSBC, RBS, SBI Cap and Standard Chartered
Registrar to the issue	Link Intime India Pvt. Ltd.

Objects of the issue

Particulars	FY11	FY12	FY13	Total
Part finance the capex	1,000	15,000	2,750	18,750
Payment of redemption amounts on maturity of certain redeemable non – convertible debentures	-	10,900	-	10,900
General Corporate Expenses	-	-	-	-



About the company

Incorporated in 1907 by Jamsetji N. Tata, the founder of Tata group and is one of the flagship companies of the Tata group. It has a presence across the entire value chain of steel manufacturing, including producing and distributing finished products as well as mining and processing iron ore and coal for its steel production. It is one of the world's largest steel companies with a steel production capacity of ~27.2 mtpa with operations based in India, Europe and other countries in Asia Pacific. India accounted for 62.9% of total steel production whereas the balance accounted 28.8%.

According to WSA, the company was the seventh largest steel company globally in terms of crude steel production volume in 2009. It is also one of the most geographically diversified steel producers, with operations in 26 countries, with a commercial presence in more than 50 countries.

Inorganic growth

The company's capacities have grown at a CAGR of 52.7% over FY06-10 to touch 22.7 mn tons. This was mainly due to the company's acquisition in April 2007 of Corus group plc (Corus), which at the time was estimated by WSA to be the ninth largest steel producer in the world.

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 also has significant operations in Jamshedpur, India, where the Company operates 6.8 mtpa steel production plant and a variety of finishing plants. The company's Indian operations also include captive iron ore and coal mines. The remaining 2.0 mtpa of the company's steel production capacity is located in Singapore and Thailand. It plans to further increase its steel production capacity by an additional 2.9 mtpa through the brownfield expansion of the Jamshedpur facility and is also planning to expand steel production capacity through greenfield investments.

Diversified Product portfolio

Its product range includes steel products including a portfolio of high value – added downstream products such as hot rolled coils, sections, plates and wires. It is also a large producer of ferro chrome in India. Historically, the company's steel products included only flat products and long products. With the acquisition of Corus, the company added a portfolio of high value – added downstream products including advanced high strength steel, superior automotive steel, rods for tyre cord, structural sections of railways and packaging steel. The company's main markets for its products are Europe and India, which accounted for ~72.6% of the company's net sales in FY10, with the remaining sales primarily taking place in other markets in Asia and in North America. The Company's customers primarily comprise the construction, automotive, aerospace, consumer goods and material handling and general engineering industries.

Key drivers

Domestic operations witnessing growth

In India, the company produces flat products used in the automotive, roofing and general engineering industries and long products used in the construction industry, including in the industrial, commercial, infrastructure and housing sectors.

Over the past decade, these industries have been growing and competition from other Indian producers is relatively limited as there are high barriers of entry to the production and commercialization of high-grade steel. In recent years, through continued investment in flat steel technologies, it has established itself as a major supplier of high-grade steel products to certain key markets in India. For example, the company has become a major supplier of steel products to the Indian automotive industry establishing a market



share of ~40%, with imported products representing most of the remaining markets in this industry. In addition, as a member company of the Tata Group, the company also benefits from being identified with the Tata brand, which is a widely recognized brand in India.

In H1FY11, revenue from Indian operations witnessed yoy growth of 21% to touch Rs135bn while PAT registered yoy growth of 115% to touch Rs. 36.4 bn.

European operations stabilizing

Europe, principally the EU, is the most important market for the company's operations, and accounted for 46.4% of its net sales in FY10. Its European operations consist of its principal production facilities in the United Kingdom and the Netherlands, and a sales and trading network, with sales offices, stockholder wholesalers, service centers and joint venture and associate arrangements for distribution and further processing of steel products. The company believes that the Tata Steel Europe brand name and product brands will continue to generate customer loyalty after being rebranded from Corus in September 2010.

Recovery on track.....

Tata Steel Europe which was earlier known as Corus is showing signs of improvement. The company has shut down idle asset – Teeside casting plant and has improved the efficiency of other plants too. It has also taken efforts to tie up raw material supplies of iron ore and coal in Canada and Mozambique. H1FY11 revenue witnessed yoy growth by 13.7% to over Rs. 550bn while profitability registered yoy growth of 115%. Recovery in European operations was mainly on account of increase of production by 26% as compared to decline of 30% in the previous year. With improved capacity utilization, Tata Steel's EBITDA per ton was ~US\$50.

Capex plans to drive growth

It intends to increase the size of its Indian operations, where it maintains a competitive advantage as a low-cost producer, by increasing the capacity of its current production facilities and through greenfield investments. The company completed a brownfield expansion of its Jamshedpur facility in May 2008 that increased capacity by 1.8 mtpa and is implementing an additional brownfield expansion that will increase capacity by an additional 2.9 mtpa, and that is expected to be completed by the end of FY12.

The company is also developing a 6.0 mtpa greenfield steel plant in Orissa and a 5.0 mtpa greenfield steel plant in Chhattisgarh and is in the initial planning phase for the construction of a 3.0 mtpa greenfield steel plant in Karnataka.

The company expects to produce a mix of flat and long products through greenfield expansions. With the increase in size of its Indian operations will enable it to compete more effectively with other steel manufacturers. The Company expects continued growth in steel demand in India, spurred by the increasing local need for steel based products (construction and infrastructure, automobiles, appliances, etc.) and estimated gross domestic product growth rates of 8.4% in 2011 and 8.0% in 2012, according to the World Economic Outlook (October 2010) published by the International Monetary Fund.



Risk and concerns

Uncomfortable level of debt in the books: It currently has Rs.550 bn worth of debt on a consolidated basis. The company is in a high capex mode especially in the greenfield projects space. This would spike up higher debt requirement in the future. As on H1FY11, debt:equity stood at 2.04x. Management has targeted to achieve a debt:equity ratio of 1:1 in next 3-4 years.

External factors may affect margins: Recent event like floods in Queensland, Australia may have an impact on European operations as it is largely dependent for raw material requirement (40% of requirement is catered by Australia). However, the company has sufficient inventory of coal for three months.

Steel industry under pressure: Steel players in the industry have resorted to a series of price hikes due to rising raw material costs. Any slowdown in Europe and inflation concerns in domestic market may make it unviable for further price hikes, thereby affecting the profitability of the company



Financials

Income Statement (Rs. in mn.)

Particulars	FY06	FY07	FY08	FY09	FY10	H1FY11
Total Income	203,182	252,172	1,315,336	1,473,293	1,023,931	558,399
Operating Profit	62,902	72,971	1,77,824	181,277	80,427	81,049
Other Income	1,402	2,146	4,759	2,657	11,859	8,737
EBITDA	64,304	75,117	182,583	183,934	92,286	89,786
Depreciation	(8,604)	(10,110)	(41,370)	(42,654)	(44,917)	(21,220)
Interest	(551)	(1,877)	(40,854)	(32,902)	(30,221)	(12,613)
Excp. items	-	-	63,351	(40,945)	(16,837)	(915)
PBT	55,149	63,130	163,710	67,433	311	55,038
Tax	(17,939)	(21,474)	(40,493)	(18,940)	(21,732)	(17,454)
PAT	37,210	41,656	123,217	48,493	(21,421)	37,584
Adjustments	38	406	(46,969)	(13,876)	1,191	(65)
Minority Interest	(191)	(672)	(1,403)	425	(130)	-
Reported PAT	37,057	41,390	74,845	35,042	(20,360)	37,519
EPS*	38.6	43.2	78	36.5	(21.2)	-
P/E(x)*	16	14	8	17	-	-

Note: EPS is calculated on post FPO equity, P/E taken on upper price band of Rs.610 per share



Balance Sheet (Rs. in mn.)

Particulars	FY06	FY07	FY08	FY09	FY10	H1FY11
Sources of Funds						
Equity Capital	5,530	5,800	62,026	62,028	8,867	9,017
Reserves	97,657	138,938	279,858	215,233	219,334	265,167
Translation diff. account	-	-	-	(4,717)	2,070	1,450
Warrants issued by subsidiary	-	175	175	175	175	175
Warrants issued	-	1,471	-	-	-	1,782
Minority Interest (MI)	1,277	6,021	8,368	8,974	8,843	9,243
Borrowings	33,774	249,254	536,248	599,005	531,004	559,372
Deferred Tax Liability	9,938	7,929	24,841	18,168	18,029	20,979
Total	148,176	409,588	911,516	898,866	786,253	867,185
Application of Funds						
Net Fixed Assets	94,307	108,942	331,187	364,175	365,252	367,251
CWIP	13,574	33,264	88,476	88,883	92,706	122,312
Goodwill	1,140	2,197	180,500	153,649	145,418	150,393
Investments	34,789	164,975	33,674	64,111	54,178	47,156
Def. Tax Assets	16	69	297	1,074	1,488	1,820
Net Current Assets (excl. cash)	(5,978)	(10,836)	233,506	164,435	61,052	106,787
Cash	7,768	108,880	42,319	61,484	68,151	71,466
Misc. Expenditure	2,560	2,098	1,557	-	-	-
Total	148,176	409,588	911,516	898,866	786,253	867,185

Cash Flow Statement (Rs. in mn.)

Particulars	FY06	FY07	FY08	FY09	FY10	H1 FY11
Profit before Tax and after MI	54,722	62,548	111,071	50,809	192.3	54,941
Operating Cash flow	37,355	55,030	135,238	156,959	104,980	34,447
Investing Cash flow	(25,002)	(162,882)	(463,286)	(108,219)	(46,961)	(30,456)
Financing Cash Flow	(9,451)	204,803	205,426	(27,548)	(51,350)	(678)
Net Increase in Cash	2,902	96,951	(122,622)	21,192	6,669	3,314
Opening Cash balance	4,866	11,929	164,941	40,291	61,482	68,152
Closing Cash balance	7,768	108,880	42,319	61,483	68,151	71,466

Ratio Analysis

Particulars	FY06	FY07	FY08	FY09	FY10
OPM (%)	31	29	13.5	12.3	7.9
NPM (%)	18.3	16.6	9.4	3.3	(2.1)
ROE (%)	70	33	24	29.3	-
ROCE (%)	72	23	21	16	-
Debt/Equity(x)	0.3	1.7	1.6	2.2	2.3
Debtor days	22	24	51	32	41
Inventory days	50	56	64	54	67
Creditor days	58	79	73	57	83

Source: RHP, Ajcon Research

Valuation and recommendation

At the upper end of the price band of Rs.610 per share, the stock is valued at 7.8x at H1FY11 annualized EPS on post issue equity. With due consideration to factors like a) cheap valuation as compared to international steel players, b) stabilizing European operations, c)EV/ton<replacement value, c)capex plans to drive growth, we recommend '**SUBSCRIBE**' to the issue.



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