
Rating Rationale for Tata Steel Ltd's proposed unsecured subordinated perpetual Securities Issue of ₹ 1500 Crores

NCD Issue Rating: BWR AA

Outlook : Stable

The proposed Issue by Tata Steel is unique in the context of Indian corporate debt market given its perpetual nature. Typically financial institutions like Banks, NBFCs have been the only institutions that have issued perpetual bonds in India for their capital requirement. The perpetual bonds are treated as hybrid in nature from rating perspective and the financial flexibility provided by such security is an important consideration for the ratings.

Brief Terms of the Proposed Issue

The issue is unsecured and junior to all unsubordinated creditors and senior only to share capital. It would have a coupon rate step up option after 10 years from the date of allotment, if not called. The term of the issue permits deferral of interest coupons, unless in 6 months preceding the relevant distribution payment date, the issuer has made any payment for any securities ranking pari passu/junior to the securities. However the unpaid interest coupons would accumulate and the interest would compound on semiannual basis. The proposed securities can be called back by the issuer at the end of 10th year from deemed date of allotment and at end of every year thereafter.

Rating Rationale

Brickwork Ratings has assigned **BWR AA** (Pronounced BWR Double A) with stable outlook for Tata Steel Ltd's (Tata Steel or "the Company") proposed Unsecured Subordinated Perpetual Securities issue of ₹ 1500 Crores. Brickwork Ratings' '**BWR AA**' stands for an instrument that is considered to offer **High** credit quality / safety in terms of timely servicing of principal and interest obligations.

The rating has, inter alia, factored the Company's diversified product portfolio, large market share, on track execution of its expansion plan, turnaround of its UK operations, good management quality and strong group support enjoyed by the Company. The rating is however constrained by the sluggish demand growth in Europe, volatility in prices of raw material and high dependence on imports for European operation.

The rating has also factored the hybrid nature of the instrument. The perpetual nature of the issue and interest deferral option provides the issuer with additional financial flexibility unlike other debt instruments. On the other hand, the accumulation of the interest coupon in case of deferral, call option at end of ten years for the issuer, coupon rate step-up option provides more debt like features to the instrument. Further the company has good track record of dividend payment, which henceforth, if declared would curtail the flexibility of the company to defer

Distribution (coupon) due in six months after the dividend payment. These characteristics of the issue along with the good reputation of the issuer have been considered while assigning the rating.

The proceeds of the NCD issue will be used for general corporate purposes, excluding acquisition or purchase of land, investment in equity/ capital markets.

BWR has essentially relied upon the Tata Steel's audited financial performance up to the financial year ending March 2010, quarterly unaudited published results up to December 2010, projected financials, and information and clarification provided by the company.

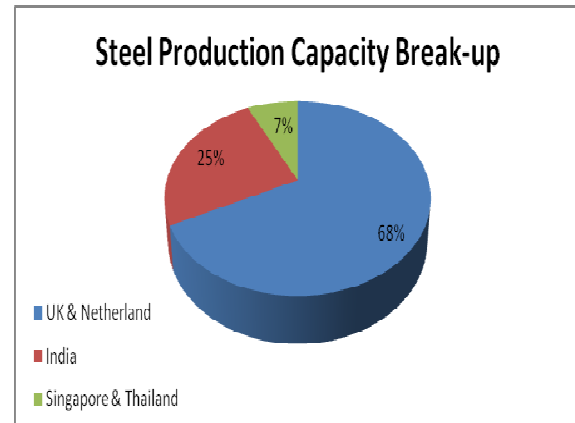
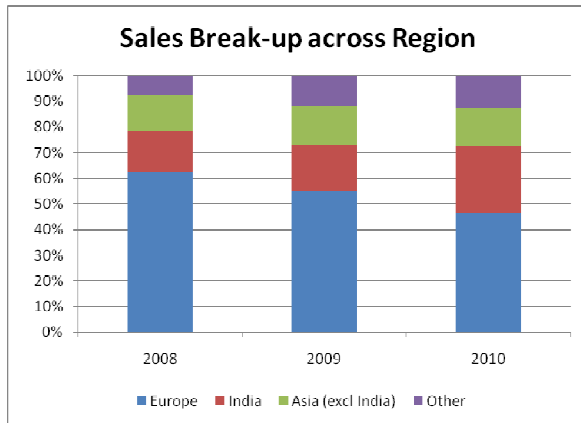
Background

Tata Steel Ltd. (TSL) was established in 1907, as a materialization of its Founder's dream of a prosperous and independent India. Tata Steel Ltd. is one of the flagship companies of Tata Group and is the world's 7th largest steel company in terms of crude steel production volume. It is global company with crude steel production capacity of approximately 27 mtpa. It has commercial presence in over 50 countries and operations in 26 countries across entire value chain of steel manufacturing.

Operational Performance

The company has presence in the entire value chain of steel manufacturing from mining and processing of iron ore & coal to steel production and distribution. The company has diversified product profile ranging from flat products & long products to high value added downstream products including advanced high strength steel, superior automotive steel, packaging steel etc. This has enabled the Company to reduce its reliance from traditional flat and long products and improve margins.

The company's operations are primarily focused in India, Europe and few countries in Asia Pacific. The current steel production capacity is 27 mtpa approximately, 68% of which is in Europe (UK & Netherland) and 25% is in India. On the other hand, Europe accounts for approximately 46% of its net sales compared to India's contribution of 26% for the financial year 2010.



Tata Steel production and sales is concentrated in Europe. The weak demand in Europe has had negative impact on the company's performance in the past couple of years. This is evident from the decrease in the share of Europe in overall sales from 62% in 2008 to 46% in 2010. However it was compensated by the strong demand in India whose contribution to overall sales increased from 15% in 2008 to 26% in 2010. The Company has therefore planned to invest the largest share of additional capital expenditure towards increasing capacity in India.

Project Expansion

Tata Steel, as part of its long-term strategy, aims to secure ownership of assets that will increase its raw materials security and share of value-added products. In the past few years, the Company has taken significant measures to improve its upstream integration, including acquisition of mines, joint ventures etc. As part of its expansion strategy in India Tata Steel Ltd. has undertaken many projects which include Greenfield projects and Brownfield options that are expected to significantly boost future operations. The details of the projects are given below:-

- i. Capacity expansion at Jamshedpur plant by additional 2.9 mtpa is under construction and would be completed by the end of FY 12
- ii. Development of steel plant at Orissa in two modules :-
 - a. First module of the project would have capacity of 3 mtpa and is planned to commence operation on 3 to 4 years.
 - b. Second module of the project would have capacity of 3 mtpa and is planned to commence operation on 5 to 6 years.

Currently the clearances have been received and the company is in process of construction.
- iii. Steel plant with capacity of 5mtpa at Chhattisgarh is planned and currently the company is awaiting final government approval.
- iv. Company is in initial stage of planning for 3 mtpa steel plant at Karnataka.

- v. Company has entered into joint venture with Nippon Steel to construct continuous annealing and processing line for production of automotive cold-rolled flat products with planned capacity of 600,000 tpa is scheduled to be completed for 2013.

The rating has factored timely completion of the Brownfield expansion planned at Jamshedpur and the Greenfield steel plant at Orissa. The Jamshedpur expansion project is on track to completion by the end of financial year 2012. On completion Tata Steel would be able to produce 9.7 mtpa of steel at the Jamshedpur plant. Tata Steel India operation is backward integrated with the Company currently able to meet most of its iron ore requirement, approximately 50% of its coal requirement from its leased captive mines and also significant amount of its ferro alloy requirements internally. This provides cost competitiveness to Tata Steel India operation and also mitigates raw material risk. Further the Company has entered into a joint venture with Larsen & Turbo to develop a sea port near its Orissa plant. The trial operations of the port are underway and would facilitate the Company in transportation of raw materials to both Orissa and Jamshedpur plants.

However similar raw material arrangements are not available with European operation which had to source their entire raw material requirement from open market in FY 2010. Thus it is exposed to volatility in raw material prices and is a significant risk to the company's performance.

Financial Performance

On a consolidated basis, Gross sales of the Company decreased by 30.51% from ₹ 149984.94 Crores in FY09 to ₹ 104229.83 Crores in FY10, the decline being a reflection of the global economic slowdown primarily in the UK and European operations. For FY10, Tata Steel Europe's Turnover was lower by 39% than that of FY09 and it registered a net loss of ₹ 7504 Crores as against a PAT of ₹ 138 Crores in FY09. Consequently EBIDTA of the Company on consolidated basis has also decreased from ₹ 14799.32 Crores in FY09 to ₹ 8017.03 Crores in FY10. The company also incurred significant restructuring cost of ₹ 1683.72 Crores in FY10.

On the other hand, the total borrowings of the Company have decreased from ₹ 59900.50 in FY09 to ₹ 53100.35 Crores in FY10. The debt equity ratio for the company stood at 2.44 and debt service coverage ratio at 1.57 in FY10.

The Company's performance has improved significantly in FY11 as reflected in its financial results. For 9MFY11, on consolidated basis Tata Steel Ltd. registered a net profit of ₹ 12298.93 Crores on net sales of ₹ 84929.33 Crores as compared to net loss of ₹ 4526.06 Crores on net sales of ₹ 74889.36 crores in 9M FY10.

For the Q3 FY11 alone, the net sales have increased by 11.02% from ₹ 26202.01 Crores in Q3 FY10 to ₹ 29089.45 Crores. Net profit for Q3 FY11 stood at ₹ 948.90 Crores as compared to ₹ 432.27 Crores in Q3 FY10.

Abridged balance sheet, P&L, Key financial ratios for the period FY08 – FY10 and the performance for nine month ended December 31, 2010 have been given in Annexure I, II, III and IV respectively.

Recent Event

The company successfully raised ₹ 3,477 Crores through Follow on Public Offer (FPO) in January, 2011. Of the total FPO proceeds, ₹ 1,875 Crores (US\$ 419 Mn) will be used to part-finance the capital expenditure for 2.9 Mtpa Brownfield expansion at Jamshedpur. In addition, Tata Steel will use ₹ 1,090 Crores (US\$ 244 Mn) from the FPO proceeds to pay the redemption amount of some of the maturing redeemable non-convertible debentures.

Outlook

Tata Steel Ltd. is an established player in steel industry with a well diversified commercial and operational presence in various countries. The company has shown ability to adapt to changing environment through strategic decisions in costs reduction; marketing focus with well established client base and dealer network; consistent growth in production and sales and Greenfield expansion plans. Going forward, BWR expects the domestic operations to continue to perform well due to better demand & improving price realizations arising from the backward integration.

The rating could be positively affected if the company is able to sustain profitability in its European operations, improves self sufficiency for its global operations and executes its capital expenditure plans in timely manner. It would be negatively affected in case of delays in execution of expansion plan; increase in raw material price; any regulation adversely affecting mining activities and any deferral of interest payment by the issuer.

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Brickwork Ratings (BWR) has adopted SEBI's standardized Rating Symbols and their definition advised vide SEBI circular CIR/MIRSD/4/2011 dated June 15,2011, with effect from June 21, 2011. While there is no change in the Rating symbol as a consequence to the above, for the amended definition of the Rating, please refer to <http://www.brickworkratings.com/scale.html>. It is clarified that the said change in the definition should not be construed as a change in the Rating.

Key Financials - Tata Steel Ltd

Annexure I: Balance Sheet (Consolidated)

S. No	Particulars (in ₹ Crores)	2009-10	2008-09	2007-08
A	<u>Sources of Funds</u>			
1	Share Capital	886.74	6202.78	6202.63
2	Reserves & Surplus	21927.15	21511.50	27971.35
3	Minority Interest	884.07	894.88	832.70
4	Net Worth	22813.89	27714.28	34173.98
5	Loans			
5.1	Secured Loans	28059.33	34243.88	35414.99
5.2	Unsecured Loans	25051.02	25656.62	18209.75
5.3	Total Loans (5.1 + 5.2)	53100.35	59900.50	53624.74
6	Deferred Tax Liability	1786.96	1785.55	2464.88
7	Total Sources of Funds	79755.35	91355.08	92193.61
B	<u>Application of Funds</u>			
8	Gross Block	106608.43	108389.02	105128.71
9	Depreciation	57902.85	59858.09	59938.92
10	Net Block (8 - 9)	45795.83	45305.86	41966.29
11	Investments	5417.79	6411.10	3367.43
12	<u>Current Assets, Loans & Advances</u>			
12.1	Inventories	16971.53	19815.71	21409.37
12.2	Sundry Debtors	11623.95	13031.63	18697.82
12.3	Cash & Bank Balance	6787.81	6148.36	4231.86
12.4	Loans & Advances	6761.47	12998.73	15459.81
12.5	Sub Total (12.1 to 12.4)	43867.79	53853.95	61462.79
13	Less: Current Liabilities	29982.73	30234.01	32818.75
14	Net Current Assets (12.5-13)	13885.06	23619.94	28644.04
15	Total Application of Funds	79755.35	91355.08	92193.61

Annexure II: Abridged Profit and Loss (Consolidated)

S. No	Particulars (in ₹ Crores)	2009-10	2008-09	2007-08
1	Gross Sales	104229.83	149984.94	134086.77
2	Less: Excise Duty	1836.71	2655.68	2553.14
3	Net Sales (1 - 2)	102393.12	147329.26	131533.63
4	Expenditure:			
4.1	Manufacturing Expenses	44091.53	72937.65	60288.69
4.3	Employee Cost	16462.99	17975.06	16899.57
4.4	Selling, Administration and other Expenses	28222.69	30930.10	32687.45
4.5	Total Expenditure	95177.56	129984.94	114298.96
5	EBIDTA	8017.03	14799.32	25047.38
6	Cost of Borrowings	3022.06	3290.18	4085.41
7	Depreciation	4491.73	4265.39	4136.95
8	Restructuring Costs	1683.72	4094.53	0.00
9	PBT	31.00	6743.24	16371.06
10	Taxes	2151.84	1894.00	4049.30
11	PAT	(2120.84)	4849.24	12321.76

Annexure III: Ratio Analysis* (Consolidated)

S. No	Particulars	2009-10	2008-09	2007-08
1	Debt - Equity Ratio (Times)	2.44	2.24	1.62
2	Interest Coverage Ratio (Times)	1.95	3.84	5.41
3	DSCR (Times)	1.57	3.21	2.90
4	Net Worth (₹ Crore)	22813.89	27714.28	34173.98
5	Profitability Margin (%)	-2.07	3.291	9.00
6	ROCE (%)	4.22	11.73	46.00
7	Net Cash Accruals to total Debt (%)	1.32	13.04	28.00
8	Current Ratio (Times)	1.43	1.74	1.84

*Calculation has been done based on BWR ratio definition

**Annexure IV: Performance for Nine months ended 31st December 2010
(Consolidated)**

S. No	Particulars (in Rs. Crore)	Nine months ended	
		31.12.2010	31.12.2009
1	Net Sales	83,707.12	74,532.37
2	Other operating income	1,222.21	356.99
3	Total Income	84,929.33	74,889.36
4	Expenditure of which:		
4.1	(Increase) / decrease in stock-in-trade	-1,868.87	186.37
	Purchases of finished, semi-finished steel & other products	11,038.83	10,460.12
4.2	Raw materials consumed	27,484.34	23,580.87
4.3	Employee Cost	11,213.32	12,523.21
4.4	Power & Fuel	2,999.39	3,062.28
4.5	Freight and handling	4,647.11	4,062.95
4.6	Other Expenses	17,885.68	17,721.05
4.7	Total Expenditure	76,648.25	74,994.03
5	EBDITA	12,298.93	3,924.27
6	Depreciation	3,248.45	3,397.18
7	Tax	2,369.47	1,365.24
8	PAT	4,707.32	(4,526.06)