

Tata Steel after Corus Acquisition

Scouting for more Acquisition Options after Corus



Tata Steel has acquired the 5th largest steel producer of the world, Corus, scoring over Brazil's CSN at \$12.15 billion (around Rs 55,000 crore) in cash, making it the largest acquisition by an Indian company and the second largest in the industry after Mittal Steel's \$38.3 billion acquisition of Arcelor. Tata's bid of 608p per share, which beat a price from CSN of 603p, was 33.6 per cent higher than its original bid. By some measures, it exceeded the price paid in other recent industry deals, such as Mittal Steel's acquisition of Arcelor last year.

In its centenary year of 2007, Tata Steel, a subsidiary of Tata Group, India's largest private sector company, was aiming to touch the production figure of 7 million tonnes but the acquisition would bring the total capacity of the group to around 23 million tonnes, making it the fifth largest steel producer in the world. The group was in look out for big overseas acquisitions as the Indian steel producers have limited-to-no options to jeopardize their bright future by offering its stake to competitors, it would be nothing short of firing at ones own toe, especially when the economy is booming and the potential for steel producers is overwhelming. At 8 per cent of GDP growth, Indian steel producers are expecting a bright future ahead and hence leaves little chance for mergers and acquisitions between two giants from within the country. For 2015, the production target is set at 30 million tonnes. Tata Steel produced about 5 million tonnes of steel the last financial year ending March 2006.

Sensing the need, Tata Steel started scouting for overseas presence through greenfield or brownfield projects early this century. The company's global journey began with the announcement of its greenfield ferro chrome plant in South Africa in 2003 at Richards Bay as the possible location. The major aim of this plant was to procure raw material for its India-based stainless steel plant. The plant is set to be completed in two phases, first of which is to begin commercial production by early 2008. The first phase of the ferro chrome plant in South Africa would have a capacity of 0.12 million tonnes with an investment of Rs 3000 million. The company has decided to set up two furnaces with a capacity of 60,000 tonnes. Looking at the success of L N Mittal through mergers and acquisitions, Tata Steel recently announced its interest in overseas acquisition especially in Europe and USA. Timely remark by Corus' officials expressing their interest in China, Brazil and India for cheaper steel induced Tata Steel to cash in on the opportunity and decided to offer a bid for Corus. As Corus was also seen interested in setting up a modern steel distribution network in India, Tata Steel wanted to leave no stone unturned to mark its European presence.

Tata Steel is planning a 50-50 balance between greenfield facilities and acquisitions for future growth. To possess the 100-million tonne capacity by 2015, the company is looking at adding another 29 million tonne through the acquisition route. Tata Steel's acquisitions all of them overseas add up to 21.4 million tonne, with Corus accounting for 18.2 million tonne, Natsteel two million tonne and Millennium Steel 1.2 million tonne. The company would focus on its greenfield projects now. The company has lined up a series of greenfield projects in the country and outside. The projects will add 6 million tonne in Orissa, 12 million tonne in Jharkhand and 5 million tonne in Chhattisgarh. In the international market, the company recently received approval for setting up 3 million tonne plant in Iran and there are plans to set up 2.4 million tonne capacity plant in Bangladesh, which has hit a roadblock. This is besides the expansions at the existing plant in Jamshedpur. It will not be possible to expand at Jamshedpur beyond 10 million tonne. The Corus acquisition would not affect the company's ongoing expansion plans.

Mittal-Arcelor vs Tata-Corus :

The combined entity of Tata-Corus will have a tremendous beneficial reach and scale of 24 million tonne per annum and many synergies, but the market is not willing to wait for the benefits to come through. Besides, at an EV/EBITDA (enterprise value/earnings before interest, tax and depreciation) of more than 8 times CY06 financials on consensus estimates and a replacement value of \$679 per

tonne, analysts believe the transaction valuation is stretched. In the Mittal Steel-Arcelor deal, the EV/EBITDA was 6.2 times. In terms of EV/tonne too, Tata Steel's price, at \$700-710 per

tonne is higher than what Arcelor commanded at \$586 per tonne. Also, in case of Mittal Steel-Arcelor, the deal involved a share swap along with cash. Tata Steel will have to shell out hard cash for Corus. And that means not just more debt on the Tata Steel balance sheet, but also an equity dilution. The company's gearing is low at around 0.26:1, so it is in a position to take on debt of around Rs 8,000 crore, without the debt-equity ratio going for a toss. As for the equity dilution, Tata Steel has issued warrants to Tata Sons in July 2006, Tata Sons was issued 2.7 crore shares of Rs 10 each at a price of Rs 516 per share aggregating Rs 1,393 crore.

The leading steel groups that follow Arcelor Mittal are quite a distance from owning 50 million tonne capacity each. In an industry with a capacity of nearly 1.3 billion tonne, the ideal scene would be half the capacity being owned by not more than ten groups. Tata Steel's audacious, but successful bid for Corus at an enterprise value of £6.7 billion, including debts of £500 million, gives it a capacity of 28 million tonne, including 8.7 mt of its own. But the immediate stock market reaction to Tata Steel running away with the trophy in a head-to-head bidding with Brazil's CSN was negative, as market participants thought Corus at 608 pence, representing a premium of 153 pence on the opening offer, was an expensive buy. Whether the Tatas are paying an inflated price for Corus will remain a subject of debate for some time. Ratan Tata is emphatic that he is not paying anything that is beyond prudence. It may not look so at this point, but the acquisition cost for the Tatas will be justified, as the valuation of steel assets around the world will keep on rising. Corus got sold at 9 times its earnings (EBITDA). Some months ago, Mittal muscled his way into Arcelor by paying 6.2 times the target company's earnings. To put it differently, Corus costs the Tatas \$700 for each tonne of steel against Mittal's payment of \$670 a tonne for Arcelor. But, we know that a recent steel deal in the US was clinched at nearly \$1,000 a tonne.



Beginning of the acquisition journey :

Success on the international front was simply not possible with greenfield plants and therefore, Tata Steel's journey for global recognition started in 2004 with the acquisition of NatSteel Asia, a two-million ton steel firm having facilities across seven countries for \$486.4 million. The fifth largest steel major signed Definitive Agreements with NatSteel Limited of Singapore to acquire all of NatSteel's steel business for cash. NatSteel decided to spin off its entire steel business into a wholly owned subsidiary, NatSteel Asia Pvt Ltd, subsequent to which Tata Steel proposed to acquire 100 per cent of the equity in NatSteel Asia. The enterprise value of the acquisition was fixed at Singapore \$486.4 million. Under the terms of the agreement the enterprise value was subject to certain adjustments including those for any net debt, minority interest, and other liabilities and for working capital variance relative to US\$ 225 million.

NatSteel was the dominant steel producer of Singapore and owns steel mills in China, Thailand, Vietnam, the Philippines

and Australia. The business is focused on long products and has a cumulative capacity to produce about two million tons per annum of rebars, wire rods, pre-stressed concrete wires and strands. The

acquisition also included a 26 per cent equity interest owned by NatSteel in Southern Steel Berhad, a 1.3 million tonne steelmaker in Malaysia. This acquisition was a significant step in Tata Steel's globalization initiative which acted as a beachhead investment for Tata Steel in the high growth geographies of China and South East Asia. Through this transaction, Tata Steel increased its manufacturing footprint to seven countries in Asia.



Thai acquisition :

Tata Steel signed an agreement to buy Thailand's largest steel maker Millennium Steel for \$ 400 million, inclusive of about \$225 million debt Millennium owes. The Thai steel maker has a capacity of 1.7 million ton of steel annually across three manufacturing facilities. Millennium Steel was formed through a merger of three operating companies, the Siam Iron and Steel Company, The Siam Construction Steel Company and NTS Steel Group in 2002 having capacity of producing 1.2 million tonne of steel per annum through the electric arc furnace route and a long products rolling capacity of 1.7 million ton annually. Presently, Thai steel market consumes

11-12 million tonnes per year and hence offer huge potential for the company to set up base in Thailand. "We believe that this acquisition is in line with company's plans of global acquisitions and its rationale of expansion strategy that post our acquisition and feeding semi finished and raw steel products to the plant. Tata Steel would be able to substantially improve the operations and would not rule out the possibility of scaling up operations sometime in the future," Muthuraman had said at the time of acquisition.

Acquisition move in Europe planned in 2004 :

Tata Steel was eyeing acquisition possibilities since 2004 for its presence in European markets. Walking on the footsteps of LNM Group, Tata Steel, too, was scouting for central and eastern European countries to pick up steel mills that might be up for privatization. State-controlled steel making capacities in countries like Czech Republic, Poland, Romania, Ukraine, Slovakia or Serbia were slowly being privatized and Tatas were eyeing penetration into the European market. Scope of consolidation of steel business in domestic market through the acquisition route was a distant reality therefore, Tata Steel started considering some serious takeover options in central and east European countries.

Greenfield plant in Bangladesh :

A way forward in its global strategy, Tata Steel is planning to set up a 2.4 million ton steel unit in Bangladesh which would be completed along with other plans including a urea factory with a one-million ton capacity, a 500-mw coal-fired station and a 1,000-mw gas-fired power plant. The project is scheduled to entail an investment of \$3 billion. A high-level committee, set up by the Dhaka government to study pros and

cons of Tata Steel's proposal, has recently suggested the government to go ahead with the project. Tatas, India's biggest business conglomerate, had recently decided to indefinitely suspend work on its investment plan in Bangladesh citing



frustrating delays in getting government approval for its investment plans. But, the "go-ahead" signal by the Bangla Committee would surely encourage Tata's to commence work on the plant. This is to be the largest ever foreign direct investment in Bangladesh. The Bangladeshi government was supposed to have signed a final agreement with the Tata's in July itself, but now the deal is expected to be finalised in the near future.

Corus bid :

After amassing a strong presence in the Asian region, Tata Steel decided to move beyond Asia with the acquisition

proposal of Corus, the 5th largest steel producer in the world. The company is now set to acquire Corus with an offer of \$12.15 billion (around Rs 34,500 crore) in cash



for buying Corus, the UK's largest steel company. This was the biggest overseas acquisition attempt by an Indian company. The "indicative, non-binding offer" to acquire 100 per cent stake in Corus at 455 pence a share came 12 days after Tata Steel announced its interest in the Anglo-Dutch steel company. There was no time frame within which an offer had to be made. However, Tata Steel had to place the offer documents within 28 days of making a final offer. According to experts of British takeover rules, if it had not made an offer, the Corus board could have approached the takeover panel to impose a "put up or shut up" deadline.

Presently, its total debt and cash balance stood at \$3.1 billion and \$558 million, respectively. Last year, it posted pre-tax profits of nearly \$1 billion on a turnover of \$18.16 billion. However, lower selling prices and higher costs hit operations in the first half of this year. Tata Steel still has the option of selling off Corus' long products business. German steelmaker Salzgitter and Russian producer Evraz are seen as potential buyers for this business which is one of the less profitable parts of Corus. The Tata Steel-Corus combine has now become the fifth largest steel maker in the world with a capacity of 23 million tons a year. Corus has a capacity of 18 million tons a year while Tata Steel producing 5 million tons a year. Corus has no mining interest while Tata Steel has access to cheap iron ore.

Tata Steel's Overseas Acquisitions So Far

Company	Capacity	Investment
NatSteel Asia	2 Million tons	\$486.4 million
Millennium Steel	1.7 million tons	\$ 400 million, inclusive of about \$225 million debt Millennium owes
Corus	18 million tons	\$12.15 billion

Tata Steel with Rs 6000 cr plant in Iran :

Tata Steel's global footprint is spreading at a furious pace. The company has received approval from the Iranian government to set up a three million tonne steel project with an investment of over Rs 6,000 crore. Iran has allotted 500 hectares in the Persian Gulf Special Economic Zone (PGSEZ) at Bandar Abbas for the gas-based steel plant. The Iranian



Mines & Mining Industries Development & Renovation Organisation (IMIDRO) had issued permission for supplying raw material for production. The three-million-tonne plant could be scaled up to five million tonne at a later stage. Once commissioned, it will scale up the combined capacity of Tata Steel-Corus to 28.5 million tonne. The plant would be commissioned within 36 months from date of start of work, which has not yet being announced. Company sources said the work would begin upon receipt of all approvals. The proposed greenfield project in Iran is a part of Tata Steel's strategy to have 100 million tonne capacity by 2015. The company has lined up greenfield projects in Jharkhand, Chhattisgarh, Orissa and Bangladesh as well. The Iran plant would be an export-oriented unit and fully owned subsidiary of Tata Steel.

Conclusion :

Whatever the cost, Corus is in the Tata bag. The important thing to watch out for now is how well the two cultures will blend so as to be able to deliver on the promised \$350 million rise in profits in the next three years, which could only be realized with improved efficiency in production across the board, integrated raw materials procurement and marketing of steel and shipment of low-cost basic steel from Jamshedpur for

finishing and value addition at the Corus mills. In another two years, Corus, known for value-added, differentiated products, will be seeing delivery of at least 60 per cent of steel in that form by the 2008-end, a rise of a third over the delivery in 2003. Corus is also investing a total of £283 million into expansion of its product range in flats and longs. An industry observer said the "whole economic model behind the takeover could unravel" in case there was a big retreat in steel prices. Hopefully, China, which has such a big stake in the industry's well being, will not play spoilsport by becoming an aggressive seller of steel in the world market. The US and the European Union are not taking kindly to arrival of volumes of Chinese steel. In fact, both are planning to take corrective steps to rein in steel imports from China.

Tata Steel owns enormous volumes of high-quality iron ore and other minerals needed for steel-making. Captive raw materials linkages have given the modernising and expanding Jamshedpur mill a competitive edge. Tata Steel is set to build greenfield mills in iron ore-rich states of Orissa, Jharkhand and Chhattisgarh. The rapid progress of the Indian automobile, engineering and construction industries means that the country will need more and more high-quality steel. Access to Corus technology will, in course of time, allow Tata Steel to move up in the value chain.



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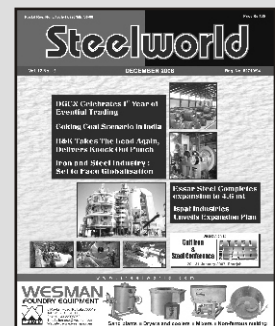
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