

INDIA TAKES ITS PLACE IN THE GLOBAL METALS INDUSTRY.

a sense of national pride was palpable earlier this year when India's Tata Steel acquired the Anglo-Dutch steel major Corus Group plc in a \$12.9 billion deal to become the world's sixth largest steelmaker.

"The Empire Strikes Back" was the headline in *The Times of India*, India's most widely read English language daily, which reminded readers of the scorn the Indian company had endured a century earlier from a skeptical British official who famously vowed to "eat every pound of steel" if Tata ever managed to make any. Not only was the deal the largest acquisition ever made by an Indian company, it was almost 10 times the size of any previous overseas acquisition. Less than a month later, the second-largest deal was struck by another metals company when Hindalco Industries, part of the Aditya Birla Group, bid \$6 billion for Atlanta-based aluminum rolling company Novelis Inc.

a PASSAGE to PROMIN

BY TOM SULLIVAN ~ ILLUSTRATION BY EDEL RODRIGUEZ

Still another big deal followed in April, when Essar Steel Holding Ltd., hot on the heels of Tata in overseas steel acquisitions, announced a \$1.6 billion purchase of Canada's Algoma Steel Inc. and a \$1.6 billion investment in iron ore producer Minnesota Steel LLC. Jindal Steel & Power Ltd., part of the O.P. Jindal Group, in March announced a \$2.1 billion investment in a mining and steel plant in Bolivia.

The takeovers mark the end of the country's time in the economic wilderness. The question is, why are India's metals companies bursting on the world scene now?

For starters, they have a role model in Lakshmi Mittal, the Indian-born industrialist who now controls 10% of world steel production through Arcelor Mittal and is one of the world's five richest people. Moreover, other Indian companies have come of age at a time of rapid economic growth and global consolidation that has put a number of steelmakers into play.

Psychology also played a part, and the high prices paid for Corus and Novelis may be as much about India's new corporate nationalism and will to succeed as it is about corporate strategy, says C.P. Chandrasekhar, professor of economics at Delhi's

venture capitalist based in London. "But this didn't happen overnight. It's been coming for a long time."

Everyone Wants To Be Like Lakshmi

Family ownership defines much of India's corporate world and drives the aspirations and growth of the largest companies. Tata patriarch Ratan Tata is one of India's more popular business tycoons and enjoys latitude and freedom in decision-making due in part to a diverse set of shareholders at its publicly traded companies.

"You have a lot of small, dispersed and passive shareholders, and also a number of financial institutions that tend to take a back seat," Chandrasekhar says.

There's also an element of rivalry. And the considerable influence of Mittal—who fashioned a global empire starting with a single primitive mill in Indonesia—should not be underestimated. Mittal is even afforded rock star-like celebrity status in the Indian media.

"Everyone is trying to copy the Lakshmi Mittal model. Everyone wants to be a big player," says A.S. Firoz, a Delhi-based steel industry consultant and a former chief economist at the Indian Ministry of Steel. "But there are very few in the world who have his sort of expertise for turning mills around."

EVERYONE IS TRYING TO COPY THE LAKSHMI MITTAL MODEL. EVERYONE WANTS TO BE A BIG PLAYER. BUT THERE ARE VERY FEW IN THE WORLD WHO HAVE HIS SORT OF EXPERTISE FOR TURNING MILLS AROUND.

—A.F. FIROZ, STEEL INDUSTRY CONSULTANT, DELHI, INDIA

Jawaharlal Nehru University. "The Tata Group was carried away by the idea that it could do [the takeover]," he says.

For more than a million Indians living in the U.K., news of the Tata/Corus deal evoked feelings of national pride, even among second- and third-generation British Indians, says Vijay Dutt, U.K. correspondent for the Indian daily, *The Hindustan Times*.

The Indian diaspora is used to hearing about India's economic boom. But here was the remnant of British Steel—once a jewel in the crown of the British Empire—in Indian hands. (British Steel in 1999 merged with Dutch producer Koninklijke Hoogovens to form Corus).

"There's a lot of pride now in the Indian community in Europe," says Madhuban Kumar, an Indian-born

Reports of Mittal's plans to invest in India's steel industry have raised fears of hostile takeover bids, possibly acting as a stimulus to increased overseas acquisitions.

"Global business opportunities are being very proactively chased. Companies realize they have to match global size because if they remain small, they can be eaten up," Firoz says. "They would rather go in for quick acquisitions at the moment to be immediately on top. There's huge competition for growth because the space is limited."

Indian Companies Come of Age

The Indian economy has grown at a brisk 8% to 9% during the past few years, and Indian industrial companies have grown at an even faster rate of more than

10%. The Birla and Tata groups have grown steadily during more than a decade of economic reforms and have generated the scale and capital needed to expand overseas. Moreover, the still-fragmented global steel industry presents suitable targets.

“They are applying strategies from India to other markets and are able to leverage their lower costs at home,” says Rajat Bhargava, partner and mining and metals analyst at McKinsey & Co., Mumbai.

Also driving the pace of deal-making is a desire to get bigger. Although steel production is growing at more than 10% per year in India, the steel industry produces a mere 44 million metric tons—one-tenth as much as China with a similar-sized population of 1.2 billion people. A third of the country’s output is produced by the state-owned Steel Authority of India Ltd. (SAIL), which is fully supplied by iron ore from captive state-owned mines.

The development of new facilities in India has been held up by lingering infrastructure problems, such as inadequate roads and power plants, encouraging companies to look overseas. A complication is the social and political unrest over corporate proposals for land acquisition in India, Firoz says.

“If you look at progress in steel projects in India, it has been pathetic,” he says. “They’ve met with huge resistance, which is holding up much of the investment. In underdeveloped [mineral-rich] states, big developments are seen as anti-people and not of benefit to the local population.”

LAYING CLAIM TO A NATIONAL TREASURE

Tata Steel Managing Director Balasubramaniam Muthuraman says the successful integration of Corus is essential to Tata’s global growth strategy.



Tata’s acquisition of Corus and the Hindalco bid for Novelis seemed to signal India’s emergence as a major player in the global metals industry. What has led to this upsurge in India’s global reach?

Opening up of the Indian economy offered Indian companies the opportunity to think on the global scale. The aspirations of industry have risen by leaps and bounds, along with those of the average Indian, contributing significantly to the consistent GDP growth of 7% to 8% in the last few years.

How important is the Corus acquisition to Tata’s growth strategy?

We believe that with the NatSteel [Singapore] and Millennium Steel [Thailand] acquisitions, Tata Steel took the first steps in its global strategy. The Corus acquisition has been another significant step.

Apart from bringing a 19-million-metric-ton capacity all at once to Tata Steel’s basket at roughly a little more than half of the cost of a greenfield site, Corus gives Tata Steel access into the developed and mature markets of Europe. Technology transfer and cross-fertilization of research and development capabilities are added benefits.

Some analysts suggest that Tata paid too much for Corus, but you have said history will say Tata did the right thing. On what do you base your conclusion?

The future will prove that Tata Steel has not overpaid. In terms of numbers, at the price at which Tata Steel is acquiring Corus, the enterprise value per metric ton is little more than \$700.

Today, if you want to create new greenfield capacity, going downstream as much as Corus has in terms of tinplate capacities, galvanizing for automobile applications—and going downstream into construction solutions, service sectors and facilities required for ready-to-use products—such capacity would cost somewhere between \$1,200 and \$1,300 per metric ton.

What are the main challenges you face in integrating the two companies, and how long will it take before synergies begin to bear fruit?

Tata Steel and Corus have very similar work ethics and culture, which is fundamental to the success of any post-acquisition integration process.

We see synergies in procurement of materials, in the marketplace, in shared services and in improvement of operations at all the locations using the know-how of the other.

→continued on page 30

→continued from page 29

It will take a little bit of time; it will start at a lower value for the first one or two years. From the third year onward, we expect to realize the full synergies.

What access does Tata have to raw materials to make Corus more integrated and profitable?

Tata Steel's global strategy is to continuously seek out low-cost production options, backward integration with raw materials and consistently expand its share in the high end of the steel value chain.

At present, Tata Steel's indigenous iron ore mines are sufficient to meet the current requirements of its Indian operations at Jamshedpur [the company's main steel plant in northeast India]. We also have some coking coal. For the balance and to sweeten the mix, we import coal. We have taken strategic initiatives in coal and limestone through equity participation.

Our greenfield projects in India will be backed by captive iron ore mines. We are planning strategic options [overseas, since Tata Steel has a policy of not exporting Indian iron ore] for iron ore and coal to feed some of Corus' requirements.

What is your strategy toward accessing affordable iron ore stocks?

India is rich in iron ore, and the cost of steelmaking here is low compared to resource-starved locations. We intend to create greenfield capacities only in locations where raw materials and energy sources are available. These low-cost steel production facilities would be linked to the most favorable steel-consuming markets to maximize value creation across the entire value chain. We are actively looking at opportunities in countries that have iron ore in good measure.

How important is further consolidation in the steel industry, and what role do you see Tata playing in this process?

A consolidated industry would help extract more value from knowledge and would help remove indiscipline in the marketplace during a downturn. Consolidation will address these issues and will allow the steel industry to serve its customers better with more consistent offerings around the globe and with higher supply chain efficiencies.

The steel industry has been consolidating extensively in the recent past, but it still has to go a long way with the top 10 players accounting for around 30% of the global market share. Industry consolidation is expected to continue, as the enhanced financial strength of companies is providing the means to explore mergers and acquisitions more actively. We will keep looking for opportunities that have a strategic fit.

How important is the North American market to the Tata Steel growth strategy, and what potential ventures would you see as being the most lucrative?

We would like to have a balance between the growing markets of developing countries and the mature markets with high-end products and technology. In fact, that is the fundamental reason why we acquired NatSteel Asia, Millennium Steel and now Corus.

We will look at an opportunity only if it would have a strategic fit with us, be it anywhere in the world. We see American markets as being very important, and we have established a footprint there through Corus' [sales offices and service centers] in the U.S.

Of Tea and Trucks

Tata—a conglomerate that produces tea, cars, software and power plants—is a household name in India. Almost 250,000 people are employed by the group's 96 companies.

Even though Tata is the largest private steel producer in India, steel is a relatively small piece of the Tata empire, accounting for about 23% of the company's revenues of \$21.9 billion in 2005–2006, which represent 3% of India's GDP. Half of the revenues are generated outside India in more than 40 countries, including the United States.

Ratan Tata assumed the chairmanship of the Tata Group from his uncle, J.R.D. Tata, almost two decades ago and streamlined the sprawling conglomerate, sacking inefficient managers and boosting productivity.

The bachelor is a member of one of India's most closely knit religious minorities, the Parsees. Now approaching 70, Tata, it is said, doesn't smoke or drink and avoids the high-flying Mumbai social scene. He tends not to appear on lists of India's wealthiest people, in contrast to competitor Mittal, a more conspicuous consumer, known for his \$105 million London mansion, Armani suits and Gulfstream 550. Tata, notoriously press shy, was unavailable for an interview for this story.

"The Corus deal has been a big come-up for Indian business," says Ranjan Roy, editor of Times News Network, *Times of India*, noting that the Tata/Corus deal was more newsworthy in India than

Mittal's 2006 takeover of Arcelor because Mittal is based in Europe. "Tata is more homegrown."

The acquisition catapults Tata into the big leagues of steel. Tata Steel and its subsidiaries in Thailand and Singapore produce about 9 million metric tons of steel per year—less than half of Corus' 18-million-metric-ton production capacity.

Prior to the Corus acquisition, Tata had extended its presence across Southeast Asia, acquiring Singapore's NatSteel Asia Pte Ltd. for \$211 million in early 2005 and Thailand's Millennium Steel for \$130 million later that year. The company historically has enjoyed access to captive mines to feed its plants in India and acquired a stake in an Australian mine also in 2005. It is looking to acquire its first overseas iron ore mines, says company spokesman Sanjay Choudhry.

The Aditya Birla Group is a \$12 billion conglomerate spanning nearly 20 countries with interests in

industries. Earlier this year, the company won approval for a \$1.76 billion greenfield development in Trinidad and Tobago.

Risky Business

These multinational deals are not without risks for the Indian acquirers, who paid premiums for their assets. For example, some analysts have warned that Tata overpaid for the Corus assets at a premium of nine times earnings. That contrasts with Mittal, which purchased Arcelor at a relative bargain of six times earnings.

Chandrasekhar, for example, argues that it could be difficult for Tata to earn a satisfactory return on its Corus investment. It must quickly integrate the facilities and reduce costs, and at the same time upgrade some of Corus' aging plants.

"They will need to increase sales and utilization of Corus plants," he says. "It's quite a gamble."

TATA STEEL AND ITS SUBSIDIARIES IN THAILAND AND SINGAPORE PRODUCE ABOUT 8 MILLION METRIC TONS OF STEEL PER YEAR—LESS THAN HALF OF CORUS' 18-MILLION-METRIC-TON PRODUCTION CAPACITY.

aluminum, copper, cement, insulators, telecom and life insurance. Its Hindalco unit is the largest aluminum company in India at close to 500,000 metric tons of output per year. With the Novelis acquisition, completed in May, it became the world's largest aluminum rolling company.

Chairman Kumar Birla, who also heads a homegrown family business, became head of the conglomerate when his father passed away 11 years ago. Like Tata, Birla enjoys a virtuous public image. Birla is reported to be a vegetarian and teetotaler, both highly regarded qualities in Indian society.

Aluminum production in India is growing at a rate of 8% to 9% per year, just slightly behind steel, which is currently growing at 10%. Capacity is expected to double in the next five to six years, due largely to the availability of massive reserves of bauxite and low-cost power from captive power plants, Bhargava of McKinsey says.

The Essar Group, another acquisitive company, has revenues in the region of \$4 billion and employs about 20,000 people in the steel, oil and gas, power, communications, shipping, construction and logistics

However, with more than half the \$12.9 billion Tata Steel paid for Corus raised by the company itself—and the other half coming from loan financing from a consortium of banks secured against Tata Steel and Corus assets (which typically involves lower interest payments)—the risk may not be as high as it originally seemed.

Consultant Firoz says Tata will be able to comfortably service its debt as long as steel prices remain in the region of \$500 per metric ton.

"The Tatas have protected themselves through this deal," he says, adding that despite the challenge of Corus' aging plants and diminishing profits, Tata Steel has benefited from the deal.

"By acquiring Corus, they've made it very difficult for another company to take them over, and their leverage in the capital markets has increased considerably."

Should steel prices drop and the investment turn sour, it is widely expected that India's state-owned banks would be instructed to step in with low-cost loans.

Labor issues also will present a challenge with the Indian corporation responsible for a potentially less



ALUMINUM PRODUCTION
IN INDIA IS GROWING AT A
RATE OF 8% TO 9% PER YEAR,
JUST SLIGHTLY BEHIND
STEEL, WHICH IS CURRENTLY
GROWING AT 10%.

flexible, more costly and older workforce than it's accustomed to managing.

There could be Corus job losses, or Tata could consider shipping manpower to Europe. "If they are thinking the labor is cheaper [in India], they may do everything here and basically use the know-how and technology of Corus," says K. Narasimhan, professor of metallurgical engineering and materials science at the Indian Institute of Technology (IIT) Bombay who has collaborated with Tata Steel.

Tata Steel's managing director, Balasubramaniam Muthuraman, says his company paid just over half the enterprise value per metric ton for Corus, compared with the cost of developing a greenfield site. Spokesman Choudhry says the company expects to make savings from synergies in logistics, manufacturing, procurement, marketing and distribution worth \$350 million per year as a result of acquiring Corus, but he declines to be more specific. Essential to

AD TK
1/2 HORIZONTAL BLEED
8.5 X 5.375

achieving those returns will be the ability to source competitive raw materials. Choudhry says the company's policy is not to export Indian iron ore, but rather find steel sources elsewhere globally (see "Laying Claim to a National Treasure," p. 29).

Hindalco arguably faces a more daunting challenge to integrate the Novelis acquisition. The deal was the costliest ever in India at a ratio of 12.4 times earnings, more than twice that of Mittal Steel's Arcelor purchase. Hindalco's share price nosedived following the Novelis announcement.

Firoz says Hindalco may have had little choice because it needed to acquire new factories to fully integrate its production fully, and options were limited. However, he adds, it will take some time before synergies emerge. Novelis last year posted a loss of \$275 million on sales of \$9.8 billion, with the loss due in part to contractual price ceilings on a portion of can sheet sales in North America.

Firoz says contracts, which can't be renegotiated for two years, limit the contribution that Novelis can make to Hindalco at the start. A Novelis spokesman declined to comment on the length of the contracts. A Hindalco spokesman declined to discuss the company's strategy for integrating Novelis.

Despite the risks, Indian companies are bent on joining the fraternity of multinationals. Tata would have closed the Corus deal even if it had to spend more money, says Yezdi Nagporewalla, head of industrial markets at KPMG India.

"It's more about the strategic focus than the size of the investment," he says. The pace of consolidation will rapidly limit the number of targets.

There may be fewer blockbuster deals like those initiated by Tata and Birla, but Indian companies will continue to look for ways to extend their reach.

"We are looking for opportunities to add value and be closer to the markets," says Sajjan Jindal, managing director of JSW Steel Ltd., a unit of the O.P. Jindal Group.

Regardless of whether the deals prove to be lucrative investments, there's no doubt that already they have buoyed the national psyche. The Tata deal, said the Federation of Indian Chambers of Commerce and Industry, "demonstrates the financial muscle of Indian corporates and indicates that Indian companies today have the ability to take over giant-sized companies abroad." 🌐

AD TK
1/3 HORIZONTAL
4.5 X 4.875

AD TK
1/3 HORIZONTAL
4.5 X 4.875