Management Discussion & Analysis

BUSINESS REVIEW

I. Steel Business Unit

It was another disappointing year for the Indian economy. Despite a host of favourable factors such as lower interest rates, comfortable foreign exchange reserves, low inflation rate and a good monsoon, the economy failed to recover. We are now seeing the first signs of revival around the world which gives us hope that the current year will see better performance of the global economy.

World crude steel production at 824 mil. tonnes in Calendar Year 2001 was marginally lower than that of the previous year *(2000: 830 mil. tonnes)*. Global steel demand slumped and the Industry is now going through a period of gradual adjustment of supply to lower demand. Recessionary conditions pushed steel prices down continuously without any respite. International prices of hot rolled coils plummeted to the lowest levels in recent memory. The Indian steel industry was also adversely affected by the effect of anti-dumping levy imposed by the U.S., effectively blocking the largest market to Indian steel exports, putting further pressure on domestic steel prices. In March this year, the global steel community was awaiting the U.S. decision on imposition of punitive safeguard duties under Section 201 of the U.S. Trade Act. When the additional tariffs and quotas were announced, the Indian steel exporters breathed a sigh of relief after being mostly exempted from these duties. Only exports of carbon flanges have been affected, but exports of this item have been comparatively small. There have been loud protests and threats of retaliation from those affected, including raising the issue with WTO. This will not bring much solace to the Indian steel producers, as the U.S. had earlier levied anti-dumping duties on Indian hot rolled coils ranging from 29 to 43% applicable for a period of five years, which has adversely impacted Indian exports to the U.S. In another instance of rising protectionism, the U.S. has levied, in April 2002, preliminary anti-dumping margins of 153.65% on Indian exports of cold rolled carbon steel flat products.

The Indian economy had its worst year in recent times. Industrial production had a modest growth of 2.5% compared to 5.1% in the previous year, despite an investor friendly budget and a regime of soft interest rates. Services sector growth was reduced by half at 3.2% *(2000-01: 6.3%)*. GDP growth was higher by 5.4% *(2000-01: 4.0%)*, only due to a better performance by the agricultural sector, which is estimated to have grown by 5.7% from a negative growth rate of 0.2% in the previous year. The vulnerability of the domestic steel industry was never more apparent than in the year gone by. The sector was plagued by problems of low prices, over-capacity and rising protectionism overseas. Domestic production was higher by 1% at 26.54 mil. tonnes *(2000-01: 26.17 mil. tonnes)*. Apparent domestic consumption rose by 1% during the year at 25.26 mil. tonnes *(2000-01: 24.92 mil. tonnes)*. Demand for Flat products was stagnant, while Long products grew by 3%. However, prices of Flats were subdued, with Auto (except two wheelers) and Consumer Durables sectors severely impacted by the slowdown. The position of Longs was more encouraging. The Government is in the middle of implementing a few large infrastructural projects, the most ambitious being the National Highway

Development Project (NHDP) and the Delhi and Chennai Metro projects. This is expected to generate demand for construction grade steel.

While the global steel market is showing some nascent signs of improvement in prices, the recovery is bound to be gradual over a period of time. For this to happen, the global economy has to emerge from the current recession. In fact, the days of sharp swings in prices are over, as the producer response to market changes have become faster. There is a broad consensus among nations that excess and uneconomic capacities need to be closed down to bring about a better balance between demand and supply. However, this may not be easy to achieve in practice as individual countries will resist large closures, which brings in wake its own problems.

The Indian economy is expected to do better in the current year. Domestic steel consumption is expected to grow by about 7%. However, production is also expected to keep pace with the increased demand. Unlike the developing trend in the advanced countries, the Indian steel industry continues to be fragmented and shows no sign of consolidation. The excess capacity is likely to ensure that price increases are moderate.

Overall operational performance improved substantially during the year. Gross production of saleable steel of the Company was an all-time record at 3.64 mil. tonnes and was higher by 6% over the previous year. Amongst the Finishing Mills, Wire Rod Mill, Merchant Mill, Hot Strip Mill and the Cold Rolling Mill had their best year. Hot Strip Mill produced 2.43 mil. tonnes *(2000-01: 2.27 mil. tonnes)*, and the Cold Rolling Mill output was better at 0.73 million tonnes of CRCA and galvanised coils *(2000-01: 0.36 mil. tonnes)*. The production departments received excellent support from the Company's Mines and Collieries and other upstream Centres.

The Company's domestic sales was the best ever achieved, increasing by 7% to 3.175 mil. tonnes *(2000-2001: 2.976 mil. tonnes)*. Trade actions by the U.S. pulled steel exports down by 16% to 0.358 mil. tonnes *(2000-2001: 0.425 mil. tonnes)*. Exports of Flats to the U.S. were down to just about 3,300 tonnes from 79,500 tonnes in the previous year. Anti dumping levies are not applicable to Long products. Total steel sales grew by 4% to 3.533 mil. tonnes *(2000-2001: 3.401 mil. tonnes)*. Exports turnover declined by 23% to Rs. 581 crores *(2000-2001: Rs. 757 crores)*, due to substantial reduction in steel and ferro chrome exports. In equivalent US$, exports were lower by 26% at US$ 121 mil. *(2000-2001: US$ 164 mil.)*.

To enhance net realisations, the Company, apart from improving the product mix, is increasingly differentiating its products through 'branding', beginning with 'Tata Tiscon' reinforced bars and 'Tata Shakti' galvanised corrugated sheets. The Company is also actively involved in promotion of use of steel in the large rural market.

II. Non-Steel Businesses Units

Except Ferro Alloys, the production performance of the other two major Profit Centres viz. Tubes and Bearings were satisfactory. Tubes Division's output, including converted products, increased marginally to 0.187 mil.tonnes *(2000-2001: 0.186 mil.tonnes)*. Bearings Division achieved record production at 17.6 mil. nos. *(2000-2001: 16.4 mil. nos.)*. The Bearings plant acquired from Antifriction Bearing Corporation and commissioned in March

2001, produced 2.04 mil. nos. of bearings during the year. Ferro-chrome output was curtailed and was lower by 41% at 64,976 tonnes *(2000-2001: 110,640 tonnes)*. Production of chrome ore/ concentrate was reduced by 16% to 723,337 tonnes from the previous year's level of 859,160 tonnes. Adverse market conditions severely impacted the profitability of Bearings and Ferro Alloys.

Tubes

The Company's Tubes Division operates in two distinct segments - Standard and Precision Tubes markets. The Standard Tubes plant manufactures commercial tubes, which generates approx. 80% of the turnover of the Division. The CR-ERW plant makes tubes for the boiler, auto and general engineering segments. The Commercial tubes segment is extremely competitive and characterised by a large number of units, many of them uneconomic in size and in the unorganised sector. The Precision Tubes segment has units from small to large sizes. Capacities are far in excess of market requirement, resulting in intense price wars. Capacity utilisation in the Commercial and Precision tubes sectors were 41% and 54% respectively in the year under review. The Company's tubes plant, however, operated at over 90%. Overall market is estimated to have shrunk by 1.5% in the past one year. Forecast for the current year is a modest growth of about 3%.

Sales of the Company's Tubes products (included in the total steel sales) were marginally lower at 0.183 mil. tonnes *(2000-2001: 0.184 mil. tonnes)*. The Division is a market leader in the Standard tubes market with its brand 'Tata Pipes' and is one of the leading suppliers of Precision tubes to the domestic boiler/air heater market. The Division achieved the highest profitability in about a decade, through sale of obsolete equipment, better product mix, control on costs and improved labour productivity.

Bearings

Globally, the bearings industry is facing a challenge of over capacity and sluggish demand. The industry is in a consolidation and restructuring mode. Major manufacturers like NSK and Timken have restructured their business and closed their plants in Europe and U.S.

The domestic bearings industry in the organised sector had a negative growth of 1-2% during the year *(2000-01: -4.8%)*. A few large manufacturers dominate the industry. The Auto industry is the largest customer for quality bearings. With the exception of two-wheelers, the Auto market had negligible growth during the year. The Replacement market, which is more profitable as compared to OEMs, witnessed an unprecedented price war resulting in severe squeeze in margins. The large fan market, which mostly uses lower-end bearings and where the unorganised sector has a strong presence, is awash with cheap imported bearings. In fact, bearings from China, Russia and other East European Countries are imported at 40-50% lower prices, leaving very little room for domestic manufacturers.

Sales volume of the Bearings Division increased by 7% to 16.9 mil. nos. *(2000-2001: 15.8 mil. nos.)*. Despite a depressed market, the Division managed to increase its market share from 12% in the previous year to 13%. While operational costs were kept in check, there was a steep increase in wages due to the new wage agreement signed during the year.

The bearings industry is estimated to grow by 5-6% in 2002-03. In the automobile sector, the passenger car market is expected to grow by 5%, two-wheelers by 10-15% and three-wheelers by 5%. However, domestic over capacity and threat of imports would keep prices under pressure.

Ferro-Alloys

Ferro chrome is mostly consumed as an alloying element in production of stainless steel. Global stainless steel production fell by 4.3% to 17.9 million tonnes during 2001 *(2000: 18.7 mil. tonnes)*. Consequently, the ferro chrome industry, already burdened with excess inventory, was constrained to resort to production cuts and global production was down by over 18% to 3.9 mil tonnes in 2001 from 4.8 mil. tonnes in the previous year. With the exception of China, demand for stainless steel worldwide remained weak. Aggressive offers by a few large producers brought down ferro chrome spot prices to historically low levels of US Cents 26/27/lb. Prices were under pressure in the domestic market as well, in line with the international trend. Most of the exporters diverted their attention to the domestic market. The forecast for stainless steel during the current year is positive and it is expected that ferro chrome prices would recover slightly during the second half of the current financial year.

Faced with difficult markets, the Company optimised its product mix by focussing on attractive products/markets. Consequently, sales of chrome ore/concentrate were higher at 600,380 tonnes *(2000-01: 560,770 tonnes)*. Ferro Chrome sales were lower by 20% at 78,590 tonnes *(2000-01: 97,680 tonnes)*. Exports of ferro chrome was deliberately curtailed on account of the unremunerative prices and there was a strategic shift from the international to the domestic market. Stringent cost controls resulted in a reduction in the cost of sales by 18%. The Division also produced 1.66 lakh tonnes of pyroxenite, a new product, to meet the total requirement of the Company's Steel business.

INTERNAL CONTROLS & SYSTEMS

The Company has adequate internal control systems for the business processes across various Profit Centres, in respect of efficiency of operations, financial reporting, compliance with applicable laws and regulations etc. The internal control system is supplemented by extensive audits conducted by the Corporate Audit Division of the Company. The audits are conducted to review the adequacy and effectiveness of internal controls and suggest improvements for strengthening them. Audit plans are made out with due weightage to the risk parameters associated with the business processes. Reviews are carried out to ensure follow up on the audit observations.

The Company has an Audit Sub-Committee which comprises four non-executive Directors: Mr. Mantosh Sondhi - Chairman, Mr. P.K. Kaul, Mr. S.M. Palia and Mr. Ishaat Hussain - Members. The Committee regularly reviews the significant observations of Corporate Audit. The Committee also met the Company's statutory auditors to ascertain their observations on Financial Reports and control concerns. The Audit Sub-Committee's observations are acted upon by the Management.

ERP implementation

During the year, the ERP solution, SAP, was extended to the material management, financial accounting, costing and plant maintenance functions of the Steel Division at Jamshedpur. At the Growth Shop Profit Centre, BaaN was implemented. These were introduced after carrying out re-engineering of the existing systems, bringing about significant organisational and technological changes. Pre-implementation reviews were carried out by Corporate Audit jointly with Consultants.

RISK MANAGEMENT

Industry & Market

In the initial years of the post reform period starting 1992, there was a surge in investments in the steel industry. These were the years of high GDP and industrial growth. However, excess capacity and low profitability have resulted in failure of the new investments in the past 5-6 years. The industry saw a brief spell of rising demand and buoyant prices in 1999-2000. The economic slowdown that started thereafter intensified in the year under review. Steel is a commodity whose fortunes are closely intertwined with the business cycles of the economy.

During the year, apart from stringent cost-cutting measures, the Company adopted a flexible product-mix to suit market conditions, by increasing the production of Longs, which had better demand and price stability. The Company's efforts to differentiate some of its products by 'branding' has met with some success. Sales of 'branded' products, which fetch a premium in the market, have increased to 9% from 5% in the previous year. In view of the trade barriers in some of the existing markets, the Company has developed new markets for its exports.

The global steel market has never been as integrated as now. The domestic market will be more competitive, as import duties on steel are brought down further to 15% during the next three years from the present levels, to conform to WTO requirements. One more step in this direction was taken by the Government, in the last Union Budget, by reducing basic customs duties of cold rolled sheets from 35% to 30%.

Fragmented and over-capacity have been the bane of the Tubes industry. The Company has significantly improved its image in the market as a quality supplier. Since the Division has the advantage of sourcing its main input material viz. hot rolled coils from the Steel Division, quality of tubes can be better calibrated as per market needs. A number of initiatives have been started such as brand building, identification of new markets, development of new products and customer relationship programmes.

A large part of the bearings market is in small sizes, which has a large unorganised sector apart from cheap imports. The industry is characterised by over capacity and uneconomic sizes of units by world standards. In order to improve market share, efforts are on to introduce new symbols to expand the range of bearings specially for automotive applications. Expansion of the range of taper roller bearings is also planned after non-compete agreement with M/s Timken India expires in March 2003. Entry into the export market is also envisaged through M/s Tata International Ltd's network and affiliates of other international majors.

The world ferro chrome market is dependent on the fortunes of the stainless steel industry. Increased pressure on prices has forced most of the marginal producers to shut down their plants.

Production cost of ferro chrome is mainly determined by power tariffs, which are extremely high in India as compared to international standards. While the Ferro Alloys Division is cutting costs on other fronts to achieve some degree of cost competitiveness, the Company is in an advanced stage of planning to set up a ferro chrome plant in South Africa, to take advantage of low power cost and its proximity to the target export markets.

Technology

Though the Steel Works at Jamshedpur is more than 90 years old, substantial capital expenditure has been incurred in rejuvenating the plant and processes. The modernisation process, which started in 1980, has been completed and the Jamshedpur Works has been transformed into a modern technologically efficient and young plant. The Company is today one of the lowest cost steel producers in the world.

Financial

Traditionally, the Company's financial management has been governed by prudent policies, more often than not, even conservative. In fact, the financial strength of the Company today must be seen in the backdrop of this conservatism of the past, which is essential in an industry characterised by its capital intensive and cyclical nature. To illustrate, borrowings have been based not on the capacity to borrow but on the ability to service them. Consequently, leverage has been maintained at a relatively low level. As on 31st March 2002, the long term debt-equity ratio was 0.86:1(before adjusting for provision for deferred tax), as compared to 0.87:1 in the previous year. Foreign currency borrowings are restricted to about 20% of total long term loans to finance capital goods/services. Despite being largely unremunerative, one of the main reasons for promotion of exports by the Company, apart from the Country's need for foreign exchange, has been the fact that the hard currency earnings provides a hedge to its foreign currency liabilities. Derivatives are used to hedge risks and not for any speculative purposes. The Company has a Credit Control Committee which formulates policy guidelines and monitors credit levels. A special Task Force has also been set up to recover overdue credits.

The Company has a Financial Management Information System in place, which involves preparation of a detailed Annual Business plan for the current year and a broad forecast of projections for five years, which is reviewed every year. Capital expenditure commitments and borrowing plans are based on these forecasts.

Contingent Liabilities

Details of contingent liabilities are given in Schedule M of the Notes on Balance Sheet and Profit and Loss Account.

Statutory Compliance

On obtaining confirmation from the various units of the Company of having complied with all the statutory requirements, a declaration regarding compliance of the provisions of the various statutes is made by the Managing Director at each Board Meeting. The Company Secretary, as Compliance Officer, ensures compliance of the SEBI regulations and provisions of the Listing Agreements.

ENVIRONMENT MANAGEMENT

The vision of the Company's Founder, Mr. Jamsetji Nusserwanji Tata, has ensured that Tata Steel is always fully aware of the impact of its activities, products and services on the environment, not only at the local but also at the global scale. Today the world over, sustainable development is at the core of business – the issue of meeting the consumption needs of the people who inhabit our planet now, without sacrificing its capacity to sustain tomorrow. It is this abiding involvement with the environment which has earned the Company recognition for its achievements. The Company was adjudged as one of the top ten Greenest Companies in India in a survey by Tata Energy Research Institute and Business Today. It is now widely accepted that expenditure on environment management, besides providing a healthy place to the employees/residents to live and work, could also bring in significant savings and operational efficiencies.

In the area of resource conservation, a 10% reduction has been achieved during the year in consumption of raw materials. Lubricant consumption is at par with international standards. The continuing efforts on energy management has resulted in the lowest energy consumption of 7.26 Gcal/tonne of crude steel.

Over the years, the Company has phased out a number of pollution prone processes including old top charged coke oven batteries. Air and water quality improved further during the year. Atmospheric pollutants reduced from 1.8 to 1.67 kgs/tonne of crude steel. Total pollutant discharge in the waste water streams was lower at 0.186 kgs/tonne of crude steel from 0.2 kgs in the previous year. Important pollution control and waste utilisation measures taken within the plant premises include installation of dry fog system to bring suspended particle matter of Coke Handling Plant #3 within statutory norms, introduction of use of Hot Strip Mill sludge in sinter making, In house commissioning of tar injection system at 'C' Blast Furnace, introduction of 100% utilisation of oily wastes/sludges through coke making, iron making and power generation process, installation of emission control system for Zero Kiln at Tar Dolo Brick Plant and successful plant scale trial along with M/s Lafarge India for utilisation of LD slag in cement making for the first time in the country.

INDUSTRIAL RELATIONS & HUMAN RESOURCE MANAGEMENT

The year under review saw sweeping changes in the HR policies and processes, necessitated by the need to make the Company a high performing organisation. A new initiative styled as the Performance Ethic Programme (PEP), was launched comprising three essential elements - redesigning the organisation structure, introduction of a flat structure and installing new HR processes. Of these, restructuring of the organisation and delayering the officers' levels from thirteen to five have been completed. The new HR processes are under development. New Wage Agreements were signed with the Company's Unions valid till 2006.

The continuing efforts to rationalise and right size the workforce has resulted in a reduction of employee strength from 48,821 to 46,234 as on 31st March, 2002. While the industrial climate was largely peaceful, there was a one day strike by the Unionised employees in the Company's

Collieries. The Directors wish to acknowledge the efforts of all the employees in helping the Company pull through in this most difficult year. In a recent survey by Hewitt Associates, the Company was placed in 12th position in the Best Employers India 2002 Award.

AWARDS

The Prime Minister, Mr. Atal Behari Vajpayee, conferred on the Company the prestigious Prime Minister's Trophy for the Best Integrated Steel Plant for the year 1999-2000 in New Delhi on 15th February, 2002. The Company has won this award for the third time – 1995-96, 1998-99 and 1999-2000.

CAUTIONARY STATEMENT

Statements in the Management Discussion and Analysis describing the Company's objectives, projections, estimates, expectations may be "forward-looking statements" within the meaning of applicable securities laws and regulations. Actual results could differ materially from those expressed or implied. Important factors that could make a difference to the Company's operations include economic conditions affecting demand/supply and price conditions in the domestic and overseas markets in which the Company operates, changes in the Government regulations, tax laws and other statutes and other incidental factors.