

Q2FY2012 Review
 Sector: Metals & Mining
 BSE Sensex : 17,482

STEEL AUTHORITY OF INDIA

 Maintain HOLD
 CMP Rs109
 TP Rs101

Cost spiral contracts margins; EBITDA/t at 22-qtr low

SAIL's Q2FY12 revenue grew only 3% YoY to Rs111.9bn despite improved realisations (up 10% YoY) as sales volume declined 7% YoY to 2.83mnt. Operating profit at Rs13.3bn declined 14% YoY mainly on account of higher imported coal, power and royalty cost. Consequently, EBITDA/t at Rs4,690 declined to a 22-qtr low with OPM contracting 229bps YoY to 11.9%. Adj. PAT declined 15% YoY to Rs8.4bn and Reported PAT at Rs4.9bn plummeted 55% YoY due to Rs5.1bn of forex loss (Rs3.5bn adj. for 32% tax) as rupee depreciated 10% QoQ.

Sales volume: Sales volume declined 7%YoY to 2.83mnt due to poor demand off-take. Blended Realisation at Rs39,566/t though up 10%YoY, declined 3% QoQ.

Persistent cost hike contracts margin: SAIL's EBITDA/t at Rs4,690 (22-qtr low) declined 8% YoY and 2% QoQ as cost pressure continued. Operating cost at Rs34,632/t increased 12%YoY on higher coking coal, power and royalty cost. Energy cost has escalated 28% YoY due to increased dependence on Grid (37% in H1FY12 vs. 26% in H1FY11) *ref pg.3*. Despite reduction in manpower, employee cost surged 19% YoY to Rs6,482/t from Rs5,450/t in Q2FY11. However, it declined 12% QoQ as employee cost in Q1FY12 was high due to one-off leave encashment of Rs2.4bn.

Capex update: During Q2FY12, SAIL incurred capex of Rs27.4bn for capacity expansion and modernisation project. The company has revised its capex plan for FY12 to Rs126bn from Rs143bn stated in Q1FY11. The brownfield expansion continues to face delays resulting in significant cost overrun; which has led to ballooning of capex cost. (*ref pg.3*)

Balance sheet: As on 30th Sep'11 SAIL has Rs235bn of debt & Rs157bn of cash.

VALUATIONS AND RECOMMENDATION:

SAIL's Q2 EBITDA at Rs4,690 (22-qtr low) and OPM at 11.9%, in spite of captive iron ore is substandard due to higher cost and operational inefficiencies. High capital cost, worsened by cost and time-overrun further falter our confidence on the stock. Moreover, uncertainty on FPO remains additional overhang on the stock. We have reduced our FY12 and FY13 estimates to factor in higher cost (*ref pg.4*). We estimate EBITDA/t of USD112 for FY12E and USD146 for FY13E. We maintain '**HOLD**' rating on the stock with a revised TP of Rs101 (5.5x FY13E EV/EBITDA + CWIP at 40% disc to BV).

KEY FINANCIALS	(Rs mn)				
	FY09	FY10	FY11	FY12E	FY13E
Revenue	443,031	418,966	441,774	484,143	539,671
YoY Gr. (%)	9.6	(5.4)	5.4	9.6	11.5
Op. Profits	111,127	83,499	78,681	62,356	92,451
OPM (%)	25.1	19.9	17.8	12.9	17.1
Adj. Net Profit	81,877	50,838	50,437	34,678	47,564
YoY Gr. (%)	(9.7)	(37.9)	(0.8)	(31.2)	37.2

KEY RATIOS	FY09	FY10	FY11	FY12E	FY13E
Dil. EPS (Rs)	19.8	12.3	12.2	8.4	11.5
ROCE (%)	27.2	12.5	10.0	6.7	8.2
RoE (%)	32.1	16.6	14.3	9.1	11.6
PER (x)	6.0	14.7	8.9	13.0	9.5
P/BV (x)	1.8	2.2	1.2	1.1	1.0
EV/EBITDA (x)	3.1	7.2	4.4	6.4	5.9

04 November 2011

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QUARTERLY SNAPSHOT (Rs mn)

	Quarter Ended		
	Mar-11	Jun-11	Sep-11
Standalone Net Revenue	123,676	111,896	111,973
YoY Gr. (%)	(0.2)	20.0	2.7
Op.Profit	23,404	13,114	13,271
OPM (%)	18.9	11.7	11.9
Adj.Net Profit	15,071	8,381	8,406
YoY Gr. (%)	(27.7)	(28.8)	(14.8)

STOCK DATA

Market Cap	Rs451bn
Book Value per share	Rs93
Shares O/S (F.V. Rs10)	4,130mn
Free Float	14.2%
Avg Trade Value (6 months)	Rs377mn
52 week High/Low	Rs226/98
Bloomberg Code	SAIL IN
Reuters Code	SAIL.BO

PERFORMANCE (%)

	1M	3M	12M
Absolute	9.0	(9.8)	(43.6)
Relative	(1.2)	(7.3)	(29.0)

RELATIVE PERFORMANCE

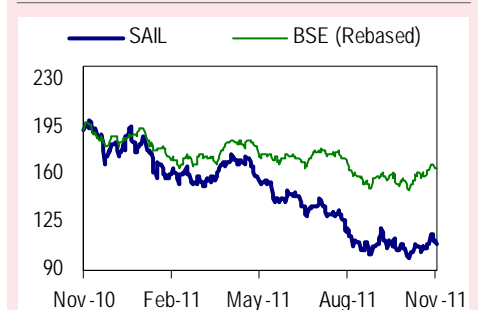
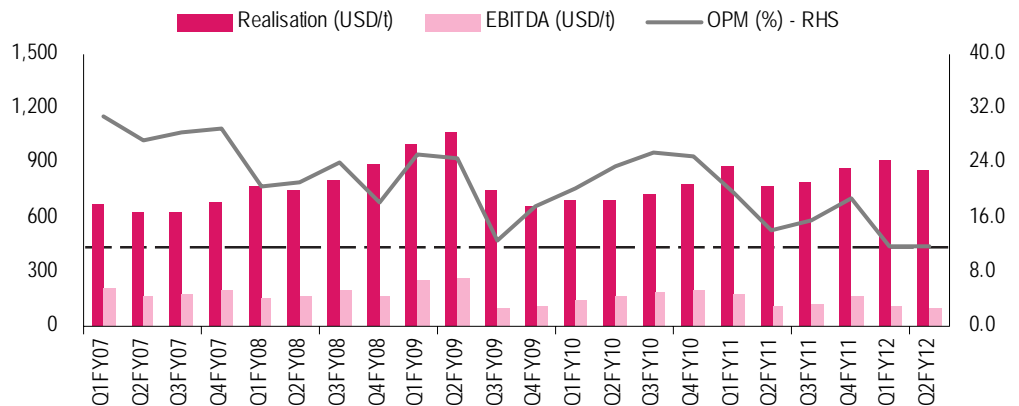


Exhibit 1 - Q2FY12 Quarterly Snapshot

Rs mn	Q2FY12	Q2FY11	%YoY	Q1FY11	%QoQ	FY12E	FY11	%YoY
Net Revenue	111,973	109,023	2.7	111,896	0.1	484,143	441,774	9.6
Operating profit	13,271	15,423	(13.9)	13,114	1.2	62,356	78,681	(20.7)
OPM (%)	11.9	14.1		11.7		12.9	17.8	
Other Income	4,903	3,754	30.6	4,630	5.9	12,235	14,406	(15.1)
EBITDA	18,174	19,176	(5.2)	17,745	2.4	74,591	93,088	(19.9)
Depreciation	3,938	3,688	6.8	3,742	5.2	16,750	14,858	12.7
Interest	2,000	1,090	83.4	1,710	17.0	7,583	4,750	59.7
PBT	12,236	14,398	(15.0)	12,293	(0.5)	50,257	73,480	(31.6)
Provision for tax	3,830	4,535	(15.5)	3,913	(2.1)	15,580	23,043	(32.4)
Effective tax rate (%)	31.3	31.5		31.8		31.0	31.4	
Adjusted Net profit	8,406	9,863	(14.8)	8,381	0.3	34,678	50,437	(31.2)
NPM (%)	7.5	9.0		7.5		7.2	11.4	
E/o income/(loss)	(3,459)	1,037		-		-	(1,389)	
Reported Net profit	4,946	10,900	(54.6)	8,381	(41.0)	34,678	49,047	(29.3)
EPS for the period (Rs)	2.0	2.4	(14.8)	2.0	0.3	8.4	12.2	(31.2)

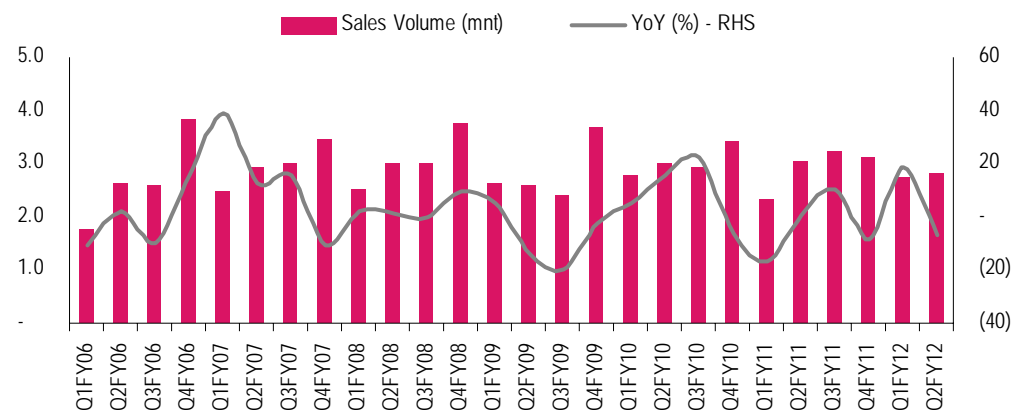
Source: Company, PINC Research

Exhibit 2 - EBITDA/t and OPM remain under pressure



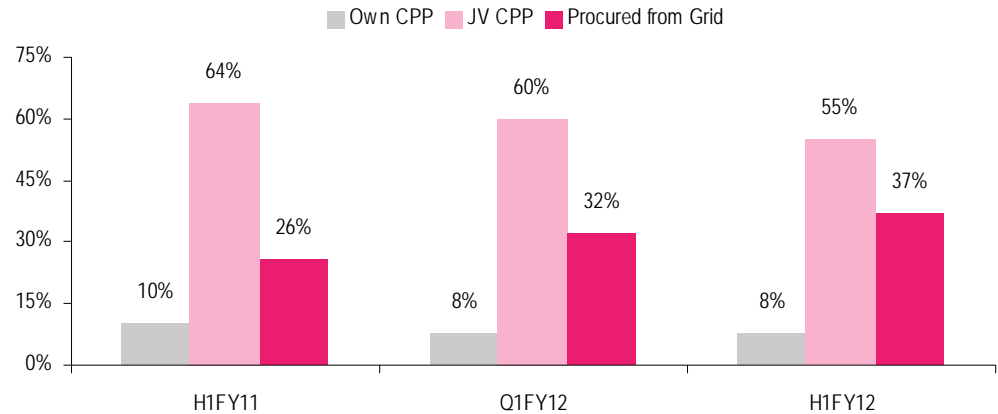
Source: Company, PINC Research

Exhibit 3 - Q2FY12 volume declines YoY



Source: Company, PINC Research

Exhibit 4 - Power cost escalates on increased procurement from grid



Source: Company, PINC Research

Expansion projects to increase capacity by 60% in 3 years; to ~2x in 5 years

The brownfield expansion of capex of Rs721bn continues to face delays, resulting in significant cost and time overrun. The company has indicated that owing to delays, the full benefit of phase-I expansion to 20.2mntpa would come only in FY15E, with no volume growth in FY12E and little growth in FY13E. Current capex cost of ~USD1,150/t for capacity expansion (Rs391bn for ~8.0mntpa) is higher than the benchmark of USD1,000/t.

Exhibit 5 - Capacity Expansion plans

(mn tonnes)	Current capacity	Post expansion by FY13	Post expansion by FY15
Hot Metal	14.50	23.50	26.2
Crude Steel	13.50	21.40	24.6
Saleable steel	12.60	20.20	23.1
Captive Power (MW)	872	1,922	1,922

Source: Company, PINC Research; Note: Ongoing project delays could result in delays in expanding capacity

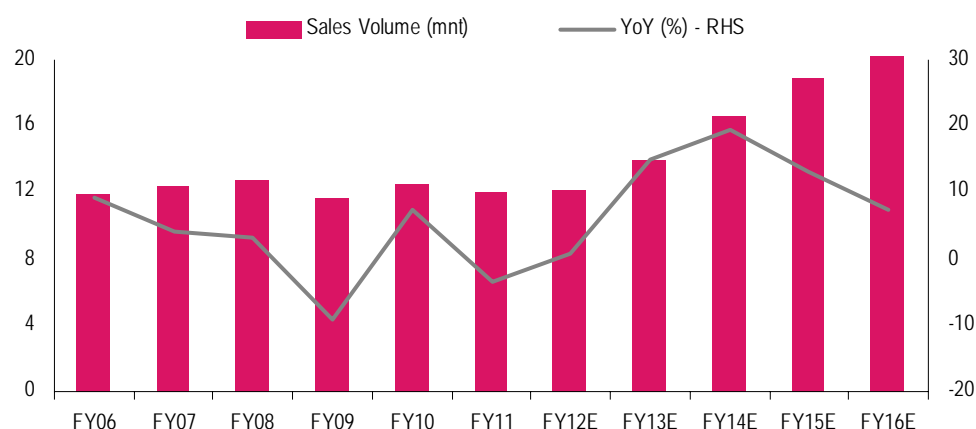
Exhibit 6 - Capex Break up indicating cost over-run

Purpose (Rs bn)	Sep-10	Sep-11
Expansion to 20.2mntpa by 2012	370	391
Additional Capex		
Value addition/product mix improvement	70	70
Technological Upgradation/ Moderanisation	35	35
Sustenance including debottlenecking, AMR and Environment	123	122
Augmenting Raw Material from existing Mines & Development of new mines	100	103
Total	698	721

Source: Company, PINC Research

Out of the above planned capex, Rs47.5bn has already been incurred until Sep'11. The company incurred capex of Rs27.4bn in Q2FY12, with a target of Rs126bn for FY12E.

Exhibit 7 - Expansion to provide volume growth only FY14 onwards



Source: Company, PINC Research

Exhibit 8 - PINC revised assumptions and estimates

	FY12E			FY13E		
	Earlier	Revised	% Chg	Earlier	Revised	% Chg
Benchmark HRC price (USD/t)	780	780	-	735	735	-
Contract coking coal (USD/t)	295	295	-	250	250	-
USD/INR	46.0	46.0	-	45.5	45.5	-
Sales volume (S) - mnt	12.1	12.1	-	13.9	13.9	-
Revenue - Rs mn	492,986	484,143	(1.8)	546,781	539,671	(1.3)
EBITDA - Rs mn	73,189	62,356	(14.8)	99,893	92,451	(7.5)
EBITDA - (Rs/t)	6,037	5,143	(14.8)	7,163	6,630	(7.5)
OPM (%)	14.8	12.9	-197bps	18.3	17.1	-114bps
Adj. PAT - Rs mn	41,946	34,678	(17.3)	52,384	47,564	(9.2)
EPS (Rs)	10.2	8.4	(17.3)	12.7	11.5	(9.2)
EV/EBITDA multiple				5.5	5.5	NA
Target Price (Rs)				109	101	(7.4)

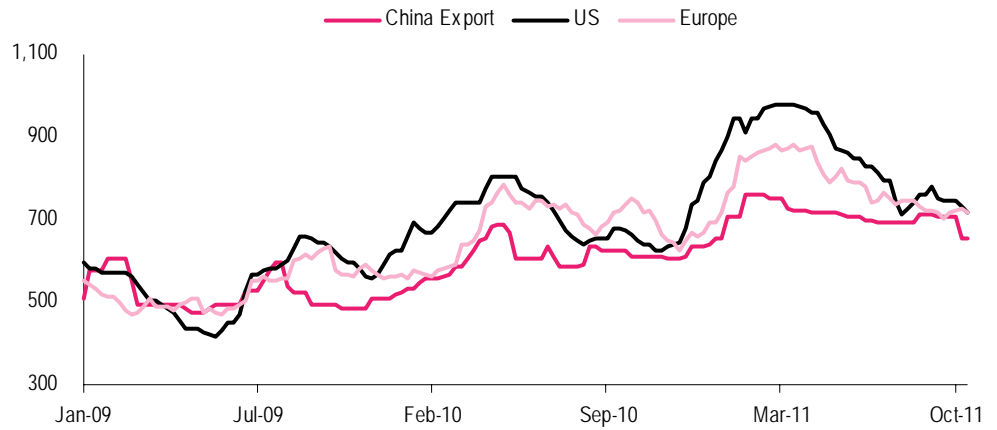
Source: PINC Research

Exhibit 9- Target price sensitivity (Rs)

FY13 EV/EBITDA (x)	FY13E Benchmark HRC price estimate (USD/t)				
	680	730	780	830	880
4.5	(9)	35	79	123	167
5.0	(6)	42	90	138	186
5.5	(4)	49	(101)	154	206
6.0	(1)	56	112	169	226
6.5	1	63	124	185	246

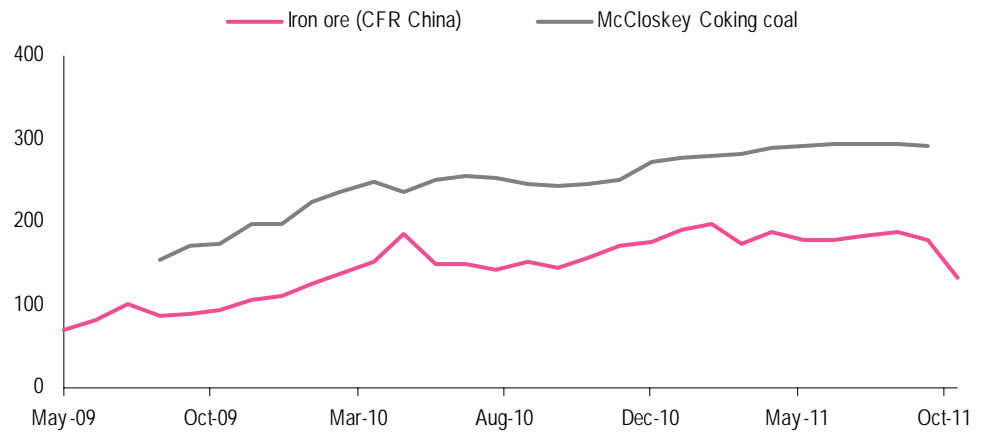
Source: PINC Research

Exhibit 10 - Global HRC price trends (USD/tonne)



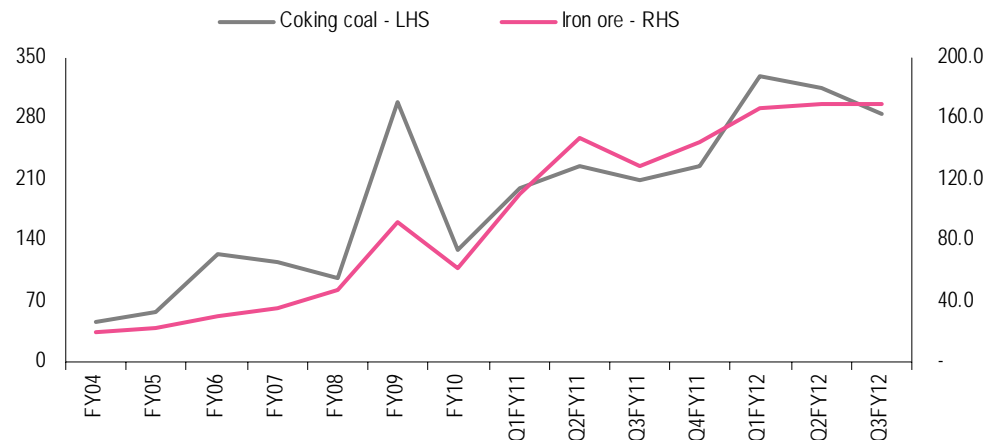
Source: Bloomberg, PINC Research

Exhibit 11 - Raw material spot prices (USD/tonne)



Source: Bloomberg, PINC Research; Iron ore price is for 63.5% grade; Coking coal price is China domestic price as collected by McCloskey

Exhibit 12 - Raw material Contract prices (USD/tonne)



Source: Industry, PINC Research

Income Statement	FY09	FY10	FY11	FY12E	FY13E
Net sales	443,031	418,966	441,774	484,143	539,671
Growth (%)	9.6	(5.4)	5.4	9.6	11.5
Operating Profit	111,127	83,499	78,681	62,356	92,451
Growth (%)	(15.7)	(24.9)	(5.8)	(20.7)	48.3
Other income	19,063	19,261	14,406	12,235	7,933
EBITDA	130,190	102,759	93,088	74,591	100,384
Depreciation	12,878	13,372	14,858	16,750	21,656
EBIT	117,313	89,387	78,230	57,840	78,729
Interest Expense	2,594	4,020	4,750	7,583	10,780
PBT (before E/o items)	114,719	85,367	73,480	50,257	67,949
Tax Provision	32,841	34,529	23,043	15,580	20,385
Adjusted Net Profit	81,877	50,838	50,437	34,678	47,564
Growth (%)	(9.7)	(37.9)	(0.8)	(31.2)	37.2
E/o income/(loss)	(20,173)	16,706	(1,389)	-	-
Reported Net Profit	61,704	67,544	49,047	34,678	47,564
Growth (%)	(18.1)	9.5	(27.4)	(29.3)	37.2
Diluted Adj. EPS (Rs)	19.8	12.3	12.2	8.4	11.5
Diluted EPS Growth (%)	(9.7)	(37.9)	(0.8)	(31.2)	37.2

Cash Flow Statement	FY09	FY10	FY11	FY12E	FY13E
Pre-tax profit	114,719	85,367	73,480	50,257	67,949
Depreciation	12,878	13,372	14,858	16,750	21,656
Total Tax Paid	(32,841)	(38,142)	(23,055)	(15,585)	(20,382)
Chg in working capital	1,987	(2,378)	(34,414)	(1,317)	266
Other operating activities	(17,561)	(12,892)	(9,742)	(4,652)	2,846
Cash flow from oper (a)	79,181	45,327	21,127	45,454	72,335
Capital Expenditure	(59,607)	(110,764)	(101,397)	(130,000)	(150,000)
Chg in investments	(1,145)	(161)	(153)	-	-
Other investing activities	(1,110)	35,960	13,011	12,235	7,933
Cash flow from inv. (b)	(61,862)	(74,965)	(88,539)	(117,765)	(142,067)
Free cash flow (a+b)	17,319	(29,638)	(67,412)	(72,311)	(69,732)
Equity raised/(repaid)	-	-	-	-	-
Debt raised/(repaid)	44,936	89,725	36,542	30,000	50,000
Change in minority interest	-	-	-	-	-
Dividend (incl. Tax)	(14,970)	(13,988)	(13,956)	(11,561)	(11,598)
Other financing activities	(2,594)	(4,020)	(4,750)	(7,583)	(10,780)
Cash flow from fin (c)	27,371	71,717	17,837	10,856	27,622
Net chg in cash (a+b+c)	44,691	42,079	(49,575)	(61,455)	(42,109)

Balance Sheet	FY09	FY10	FY11	FY12E	FY13E
Equity Share Capital	41,304	41,304	41,304	41,304	41,304
Reserves & surplus	238,537	291,863	329,391	352,470	388,436
Shareholders' funds	279,841	333,167	370,695	393,774	429,740
Minority interest	-	-	-	-	-
Total Debt	75,388	165,113	201,655	231,655	281,655
Capital Employed	355,229	498,280	572,350	625,429	711,395
Net fixed assets	188,131	285,684	373,085	486,334	614,679
Cash & Cash Eq.	182,285	224,364	174,789	113,333	71,224
Net Other current assets	(8,393)	(4,307)	32,545	33,829	33,560
Investments	6,527	6,688	6,841	6,841	6,841
Net Deferred tax Assets	(13,322)	(14,149)	(14,911)	(14,910)	(14,910)
Total Assets	355,229	498,280	572,350	625,429	711,395

Key Ratios	FY09	FY10	FY11	FY12E	FY13E
OPM (%)	25.1	19.9	17.8	12.9	17.1
Net Margin (%)	18.5	12.1	11.4	7.2	8.8
Yield (%)	2.2	1.8	2.2	2.2	2.2
Net debt/Equity (x)	(0.4)	(0.2)	0.1	0.3	0.5
Working Capital Days	79	78	75	77	75
RoCE (%)	27.2	12.5	10.0	6.7	8.2
RoE (%)	32.1	16.6	14.3	9.1	11.6
EV/Net Sales (x)	0.8	1.4	0.8	0.8	1.0
EV/EBITDA (x)	3.1	7.2	4.4	6.4	5.9
PER (x)	6.0	14.7	8.9	13.0	9.5
PCE (x)	5.2	11.6	6.9	8.8	6.5
Price/BV (x)	1.8	2.2	1.2	1.1	1.0

Note: EV based valuation multiples calculated valuing CWIP at book value

1-Year rolling forward P/E Band



1-Year rolling forward EV/EBITDA Band



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