SAIL

BSE SENSEX	S&P CNX
50,051	14,815

सेल SAIL

Bloomberg	SAIL IN
Equity Shares (m)	4,130
M.Cap.(INRb)/(USDb)	298.4 / 4.1
52-Week Range (INR)	82 / 20
1, 6, 12 Rel. Per (%)	2/75/122
12M Avg Val (INR M)	2271

Financials & Valuations (INR b)

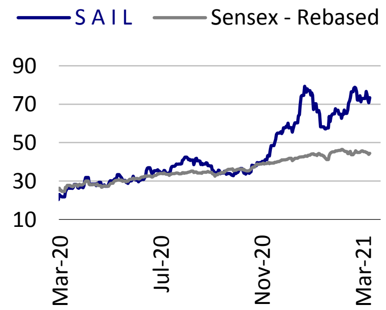
Y/E March	2021E	2022E	2023E
Sales	695.1	809.8	823.8
EBITDA	137.7	157.8	145.1
Adj. PAT	59.6	76.6	70.0
Adj. EPS (INR)	14.4	18.5	17.0
EPS Gr. (%)	-3,167.0	28.5	-8.6
BV/Sh. (INR)	110.7	124.8	136.2
RoE (%)	13.7	15.8	13.0
RoCE (%)	11.6	13.6	12.0
Payout (%)	10.5	25.9	35.5
Valuations			
P/E (x)	5.0	3.9	4.3
P/BV	0.7	0.6	0.5
EV/EBITDA (x)	5.1	4.2	4.2
Div. Yield (%)	4.2	5.5	6.9

Shareholding pattern (%)

As on	Dec-20	Sep-20	Dec-19
Promoter	75.0	75.0	75.0
DII	13.0	13.7	14.8
FII	4.2	3.2	3.6
Others	7.9	8.1	6.7

FII Includes depository receipts

Stock performance (one-year)



CMP: INR72 TP: INR104 (+44%) Buy

Best play on higher steel prices

Strong FCF to drive deleveraging and higher dividend yield

We see Steel Authority of India (SAIL) as the best play on higher steel prices as it: 1) is backward integrated with captive iron ore, 2) has a higher operating leverage due to high conversion cost, and 3) has a higher financial leverage. With limited capex, higher pricing should drive significant deleveraging and boost equity value. We estimate net debt to decline by INR232b (INR56/sh, 76% of CMP) over FY20-23E to INR305b. We also expect higher dividend payouts going forward (implying ~5% yield), supported by strong FCF of INR19/sh (25% yield). We are raising our FY22E/FY23E EBITDA estimate by 34%/37% and TP by 28% on expectation of higher realization and volumes. The stock trades at 4.2x FY22E EV/EBITDA, a 25-30% discount to peers TATA and JSTL.

Higher realization and volume growth to drive earnings

- Given a strong steel cycle, we expect realization to remain high in the medium term, which, coupled with an inefficient cost structure (higher conversion cost), should provide disproportionate margin gains to SAIL. Every INR1,000/t of higher steel price improves SAIL's FY22E EBITDA by 11%.
- Supported by under-utilized capacities, volume growth is expected to be strong at 9% CAGR over FY21-23E. There is also a likelihood of product mix improvement (higher finished steel sales).
- We estimate 36% EBITDA CAGR over FY20-23E.

Strong FCF to drive deleveraging and higher dividend yield

- With robust EBITDA and limited capex, we estimate FCF to be strong at INR78b/INR86b in FY22E/FY23E, implying a FCF yield of 25-28%.
- Higher FCF should drive significant deleveraging, which should boost its equity value. We estimate net debt to decline by INR232b (INR56/share, 76% of CMP) over FY20-23E to INR305b (2.1x of FY23E EBITDA). Net debt has already declined by INR94b (INR23/share) to INR443b in 9MFY21.
- As SAIL swings to profit and has limited capex needs, we expect a higher dividend payout going forward. As against an inconsistent dividend of INR1-2/sh (nil in FY16-18), we expect a consistent higher payout of INR4-5/sh, implying a yield of 5-7%.

Valuation is attractive, lower steel price the key risk

- At the CMP, the stock is trading at 4.2x FY22E EV/EBITDA, which is at a 25-30% discount to peers TATA and JSTL. Even on FY22E P/BV, it is trading at an attractive 0.6x, despite an expected strong RoE of 16%.
- We value the stock at 5x FY22E EV/EBITDA at INR104/share, implying a target P/B of 0.8x (historical average of 0.7x).
- Key risks are lower steel price and higher capex.

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Best play on higher steel prices

Captive iron ore and high opex provide higher sensitivity to steel prices

Our steel price outlook remains strong as demand is on an upsurge led by a recovery from COVID-19 lows and higher sea-borne iron ore prices. We see SAIL as the best play in India on higher steel prices as it:
1) is backward integrated with captive iron ore, which cushions raw material cost,
2) has a higher operating leverage due to high conversion cost, which provides disproportionate margin gains from rising steel prices, and
3) has a higher financial leverage, which amplifies EPS growth.

We are raising our FY21-23E realization and volume assumption, which is driving an increase in our EBITDA estimate by 7-37% and EPS by an even higher 12-89% (due to financial leverage gains). At the same time, we have raised our target price by 28%. Our volume expectation now factors in a consistent ramp-up in SAIL's volumes as the demand outlook is strong, which should help sweat its expanded capacities.

Exhibit 1: Change in estimates

INR b	Revised			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Sales (mt)	14.8	16.6	17.5	14.8	16.0	17.0	0.0	3.9	3.1
Realization/t (INR)	47,011	48,778	47,071	46,116	45,974	45,000	1.9	6.1	4.6
EBITDA/t (INR)	9,300	9,499	8,283	8,704	7,377	6,233	6.9	28.8	32.9
Revenue	695.1	809.8	823.8	681.8	734.7	764.1	1.9	10.2	7.8
EBITDA	137.7	157.8	145.1	128.8	118.1	106.0	6.8	33.7	36.9
PAT	59.6	76.6	70.0	53.2	46.4	37.0	12.1	65.2	89.1
Net debt	403.3	358.3	304.8	402.3	372.0	333.3	0.2	-3.7	-8.5
Target price (INR)		104			81			29	

Source: MOFSL

Estimate 36% EBITDA CAGR over FY20-23E

- Supported by 7% volume CAGR over FY20-23E and better realization, we estimate revenue/EBITDA to grow at 10%/36% CAGR over FY20-23E.
- Due to financial leverage benefit and lower interest cost from deleveraging, we estimate SAIL to swing to profit in FY21E (from a loss in FY20) and sustain an 8% EPS CAGR over FY21-23E.

Exhibit 2: Key operating metrics and financials

Y/E March	Unit of measurement	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E	FY20-23E CAGR (%)
Production	mt	11.85	13.30	13.23	14.32	14.43	14.37	16.60	17.50	6.6
Sales	mt	12.10	13.15	14.08	14.12	14.23	14.78	16.60	17.50	7.1
Realization/t	INR	32,290	33,814	40,877	47,444	43,328	47,011	48,778	47,071	2.8
EBITDA/t	INR	-2,773	29	3,693	6,896	4,000	9,300	9,499	8,283	27.5
Revenue	INR b	391.0	445.0	575.6	669.7	616.6	695.1	809.8	823.8	10.1
EBITDA	INR b	-29.0	0.7	52.2	97.6	57.1	137.7	157.8	145.1	36.5
Other income	INR b	24.0	26.8	30.7	33.9	37.6	39.3	40.6	41.2	3.2
Depreciation	INR b	24.0	26.8	30.7	33.9	37.6	39.3	40.6	41.2	3.2
Finance cost	INR b	23.0	25.3	28.2	31.5	34.9	29.2	24.1	20.5	-16.2
PBT	INR b	-70.8	-49.1	-8.1	33.3	31.1	79.7	100.9	92.0	43.6
Adjusted PAT	INR b	-41.8	-26.3	1.1	26.0	-1.9	59.6	76.6	70.0	
Adjusted EPS	INR	-10.1	-6.4	0.3	6.3	-0.5	14.4	18.5	17.0	

Source: Company, MOFSL

Higher sensitivity to steel prices, spot price implying significant upside

- Every INR1,000/t of higher steel prices improves SAIL's FY22E EBITDA by 11% and EPS by 17%. At the same time, valuation rises by 22%.
- If we assume spot steel prices to sustain in FY22E, it would imply an upside of 63% to our base case EBITDA and a 130% upside to our valuation of INR240 per share.

Exhibit 3: Every INR1000/t higher realization raises EBITDA by 11% and EPS by 17%

	Base case		INR1,000/t sensitivity		Bull case - spot	
INR b	FY21E	FY22E	FY22E	Change (%)	FY22E	Change (%)
Revenue	695.1	809.8	826.4	2	909.8	12
EBITDA	137.7	157.8	174.4	11	257.8	63
PAT	59.6	76.6	89.4	17	153.5	100
Net debt	403.3	358.3	348.6	-3	299.9	-16
Volume - mt	14.8	16.6	16.6	0	16.6	0
Realization/t	47,011	48,778	49,778	2	54,802	12
EBITDA/t	9,300	9,499	10,499	11	15,523	63
TP (5x EV/EBITDA)		104	127	22	240	130

Source: MOFSL

Captive raw material advantage

SAIL has captive iron ore mines that meet its entire raw material requirement for steel production. It has nine iron ore mines and seven flux mines (limestone, dolomite, etc.), which provides captive raw materials. The iron ore mines have a capacity of 37.5mtpa and produced 29.3mt of ore in FY20. Being a PSU, its mines will get auto-renewed as per the MMDR Act when the leases come up for expiry in CY30. Backward raw material integration protects the company in a rising raw material environment, while at the same time benefitting from higher steel prices.

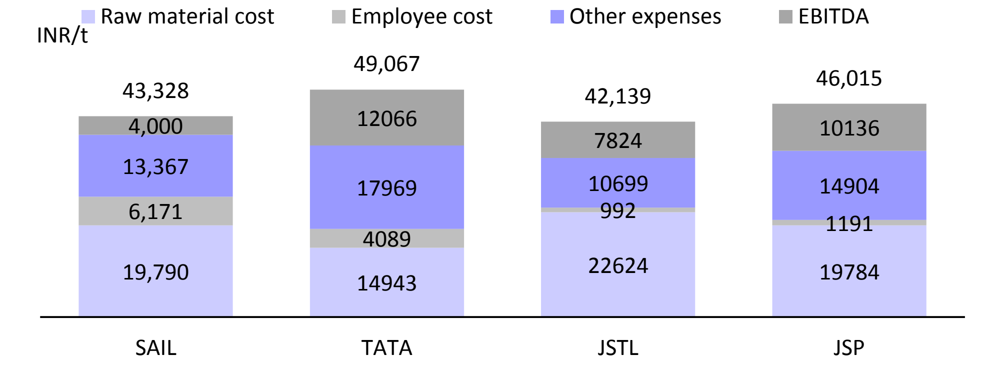
Exhibit 4: SAIL's iron ore mines have a production capacity of 37.5mtpa

Name of the mine	Capacity (mtpa)
Kiriburu	5.5
Meghahatuburu	5.0
Bolani	7.5
Gua	4.0
Rajhara, Dalli	8.7
Barsua, Kalta, Taldih	6.0
Chiria	0.8
Total	**37.5**

Source: MOFSL, Company

SAIL, however, is vulnerable to increase in coking coal prices due to its dependence on imported coal and higher coal consumption rate. It consumes ~0.9mt of coking coal per tonne of crude steel as against the industry benchmark of ~0.7mt. This is due to likely lower coke yield from coking coal. Despite captive iron ore and fluxes, its raw material cost is higher compared to TATA and at par with JSP, but lower compared to JSTL in FY20.

Exhibit 5: Comparative cost structure of steel companies in FY20



Source: Company, MOFSL

Expansion phase nearly complete….

SAIL's capacity expansion and modernization plan, which started in CY09, has seen significant delays in completion as well as cost overruns. The original plan, which was expected to get completed in FY13, entailed a capex of INR391b on expansion of crude steel capacity (to 21mtpa from 14mtpa), INR122b on sustenance (including debottlenecking), and INR35b on modernization/technological upgradation. Against that, it has spent a much higher total capex of INR880b over FY09-20.

With most projects having been completed or nearing completion (like slab caster at Bhilai), we expect incremental capex to be low over the next two years as the management's focus shifts to ramp-up of these capacities. The expansion provides an opportunity for potential volume growth of 34% over FY20 production levels.

Exhibit 6: See potential to grow production by 34% over FY20 levels

mt	Hot Metal		Crude Steel		Finished Steel	
Plant	**FY20**	**Capacity**	**FY20**	**Capacity**	**FY20**	**Capacity**
BSP	4.8	7.5	4.5	7.0	4.0	6.6
DSP	2.4	2.5	2.2	2.2	2.1	2.1
RSP	3.6	4.5	3.5	4.2	3.2	4.0
BSL	4.1	5.8	3.7	4.6	3.4	4.2
ISP	2.5	2.9	2.1	2.5	2.1	2.4
VISL	0.0	0.3	0.0	0.2	0.0	0.2
ASP	0.0	0.0	0.1	0.5	0.1	0.4
SSP	0.0	0.0	0.1	0.2	0.2	0.3
Total	**17.5**	**23.5**	**16.2**	**21.4**	**15.1**	**20.2**
Potential growth (%)		34.7		32.4		33.9

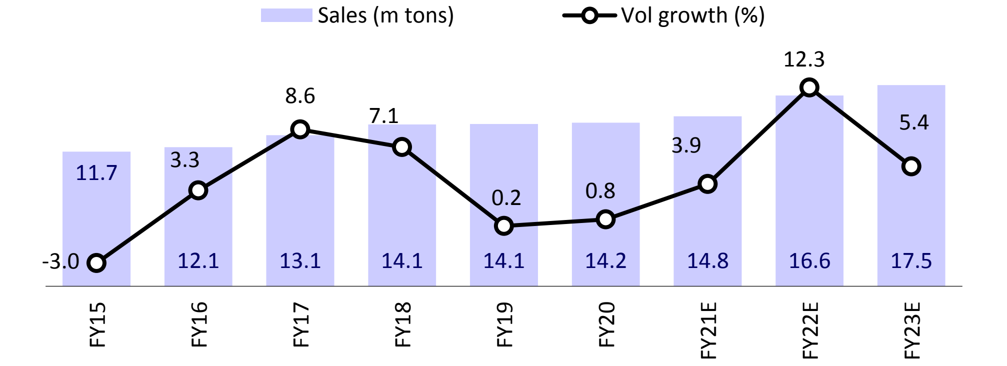
Source: Company

…which should drive 9% volume CAGR over FY21-23E…

Supported by improving demand and spare capacity, we expect SAIL to register 9% volume CAGR in FY21-23E – a growth of 12%/5% YoY to 16.6mt/17.5mt in FY22E/FY23E. Growth is likely to continue in coming years as it would have saleable steel capacity of 20.2mtpa (19.3mtpa excluding special steel plants). The management has guided at 17mt of sales in FY22E, ~2% above our estimate.

SAIL has shown strong resilience in 9MFY21, despite challenges posed by the COVID-19 pandemic, and has achieved 1% YoY volume growth to 10.6mt (supported by inventory liquidation). In 3QFY21, it achieved saleable production of 4.15mt, implying a run-rate of 16.6mtpa.

Exhibit 7: Sales volumes to grow by ~9% CAGR over FY21-23E



Source: Company, MOFSL

…as well as improve product mix

With the completion of modernization projects and finished steel capacities, we expect operating costs to stay under control and product mix to improve, which should be supportive of margin. At rated steel capacity, the share of semis is expected to decline to 12% v/s 20%/27% in FY20/9MFY21. The share of value added products like CRC and GP sheets is likely to improve. In long steel product mix, we expect the share of structural and TMT rods/bar in volumes to improve at the expense of semis (billets etc.).

Exhibit 8: Flats contribute ~50% of volumes, share of semis to fall post completion of its expansion plans

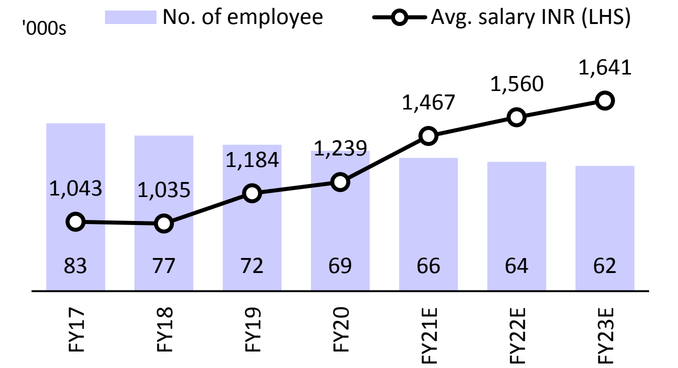
Share (%)	FY14	FY15	FY16	FY17	FY18	FY19	FY20	9MFY21	Capacity mix*
Flats	58	60	48	51	53	51	50	46	46
Longs	33	28	25	25	28	28	30	27	42
Semis	9	12	26	24	19	22	20	27	12
Products									
HRC	33	32	26	30	28	28	28	27	16
CRC	4	4	4	5	7	6	6	5	11
GP/GC	2	2	2	2	2	2	1	1	3
Plates	14	15	16	15	17	16	15	14	16
TMT, rods	13	12	15	18	18	18	17	15	19
Structurals	4	3	3	6	7	7	6	6	14
Rail	7	6	7	6	8	9	10	10	8
PET	1	1	1	1	1	1	1	1	1
Semis	22	25	26	17	12	13	16	21	12

Source: Company, MOFSL; *potential mix on rated capacity

Operating leverage to offset higher employee costs

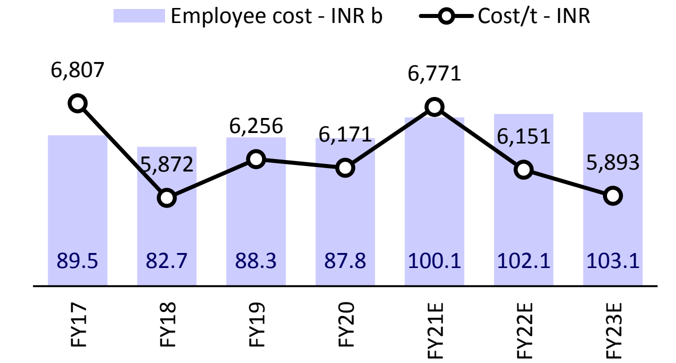
Despite ~16% reduction in its employee count over FY18-20, employee cost has fallen by just 2% to INR87.8b due to higher retirement costs. Its employee cost of INR6,171/t of steel volumes is the highest in the industry. Employee cost is likely to rise by 12-15% YoY in FY21 as SAIL plans to retrospectively (from 1st Apr'20) implement the impending wage revision under the 7th Pay Commission, 2017 in 4QFY21. This implementation is happening at an opportune time as higher steel price at present would help absorb the entire wage hike. Given the 9% volume CAGR over FY21-23E, we expect operating leverage benefits to result in lower employee cost per tonne at INR5,893 in FY23E (v/s INR6,771 in FY21E).

Exhibit 9: Employee count reducing



Source: Company, MOFSL

Exhibit 10: Employee cost/t to decline on higher volumes



Source: Company, MOFSL

Pricing strength to drive strong FCF

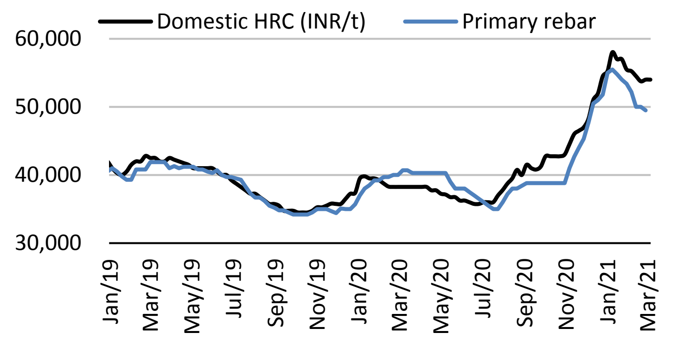
Elevated steel prices to keep profitability high in the near term

Regional steel demand-supply situation looks strong. While demand continues to be on an upsurge from the pandemic lows, supply is getting disrupted in China due to output cuts being implemented to control pollution. We expect this supply shortfall to continue to support regional steel prices.

Even in India, we have seen a strong rebound in demand which is now growing at 8-10% YoY. Given the thrust on infrastructure expenditure in the Union Budget for FY22, we expect steel demand to remain strong which coupled with strong regional prices to support steel prices in India. Currently, India HRC price is at a ~10% discount to imports from Korea. Moreover, India primary rebar price is now only at a ~INR3,000/t discount to secondary rebar (v/s historical average of INR4,800/t).

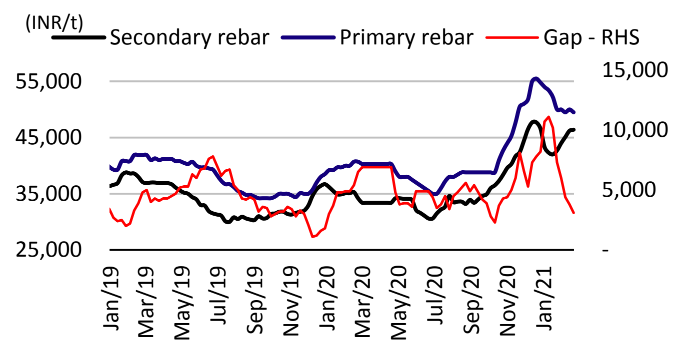
We however conservatively factor in FY22 realization at a ~12% discount to spot price. We also assume higher coking coal prices (USD160/t CNF India) in FY22E and FY23E. Even with these conservative assumptions, we estimate SAIL's EBITDA to grow by 36% CAGR to INR145b over FY20-23E.

Exhibit 11: Spot HRC/rebar prices 17%/13% above 3QFY21 average



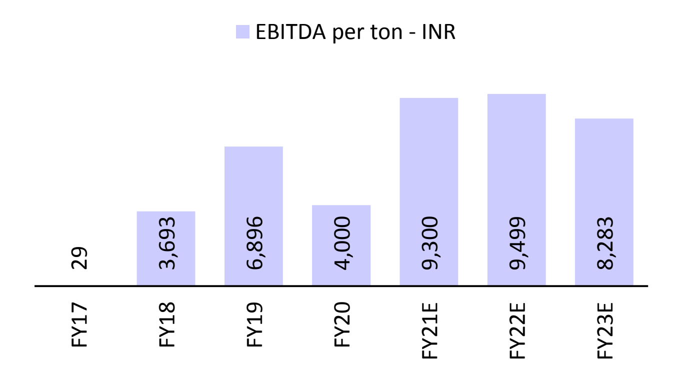
Source: Steelmint, MOFSL

Exhibit 12: Gap between primary and secondary rebar down to INR3,000/t, below the average of INR4,800/t



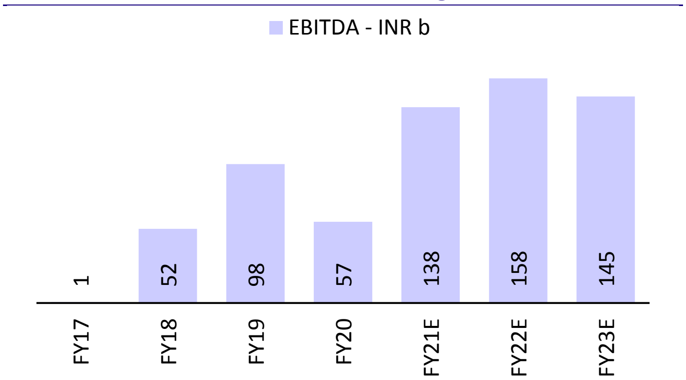
Source: Steelmint, MOFSL

Exhibit 13: Even on conservative estimates, we expect SAIL's EBITDA/t and…



Source: Company, MOFSL

Exhibit 14: …EBITDA to remain strong in FY22-23E



Source: Company, MOFSL

Iron ore sales – another stream of cash flows

SAIL has sub-grade iron ore inventory of 43mt lying in its mines in Odisha, Jharkhand, and Chhattisgarh at the end of FY20. Since sub-grade ore could not be consumed internally and the company was not allowed to sell this inventory, the same was valued at nil. In FY20, the Central Govt allowed the company to sell this inventory. Accordingly, it valued the same at INR38b as of FY20-end, valuing it at average prices for the past three-years. In addition to this, it is also allowed to sell ~25% of its iron ore production. While it has been selling sub-grade ore from Odisha mines, it is in the process of obtaining clearances from Chhattisgarh and Jharkhand for moving the material for sale.

In 3QFY21, it sold 1.3mt of iron ore at INR4.8b, implying a realization of INR3,750/t. This contributed an EBITDA of INR3.5b. We expect SAIL to record sales of 2.4mt in 4QFY21, leading to a revenue of INR8.3b and contributing EBITDA of INR4.5b. While iron ore realization is expected to decline in line with domestic iron ore prices, assuming 4mt of sales at INR2,500/t, iron ore sales should still contribute ~INR10b to FY22E cash flows.

Exhibit 15: Iron ore auction data for SAIL

Month	Quantity offered (t)	Quantity booked (t)	Bid price/t	INR m
Apr'20	0	0		0
May'20	1,00,000	40,000	1,300	52
Jun'20	2,00,000	60,000	1,473	88
Jul'20	2,00,000	0		0
Aug'20	4,04,000	3,56,000	2,033	724
Sep'20	5,76,000	5,48,000	3,004	1,646
Oct'20	7,40,000	7,12,000	2,561	1,823
Nov'20	2,56,000	2,56,000	4,388	1,123
Dec'20	9,76,000	8,12,000	4,031	3,273
Jan'21	10,72,000	7,76,000	3,389	2,630
Feb'21	10,92,000	7,80,000	2,771	2,161
Mar'21 (up to the 10th)	1,88,000	1,04,000	2,250	234
YTD total	58,04,000	44,44,000	3,095	13,756

Source: Steelmint

Exhibit 16: Iron ore sales contribute ~7% to EBITDA in 3QFY21

INR m	2QFY21	3QFY21	4QFY21E	FY22E	FY23E
Sales (mt)	0.5	1.3	2.5	4.0	4.0
Revenue	1,520	4,760	8,250	10,000	10,000
EBITDA	1,030	3,450	4,500	4,000	4,000
Realization/t	3,167	3,748	3,300	2,500	2,500
EBITDA/t	2,146	2,717	1,800	1,000	1,000
Contribution to total EBITDA (%)	5.4	6.8	6.4	2.5	2.8

Source: Company, MOFSL

Higher cash flows to deleverage the Balance Sheet to comfortable levels

SAIL's debt woes started with delays in its capacity expansion and modernization plan to 21mtpa from 14mtpa, which started in FY09 and lasted a decade. A major part of its expansion is complete, with some modernization projects still continuing. SAIL has spent ~INR880b towards capital expenditure over FY09-20, of which a large part has been spent towards growth capex. In FY08, SAIL reported a net cash balance of ~INR100b. However, due to delays in capacity expansion, declining profitability on weak pricing cycles, and higher fixed cost structure, SAIL saw a massive debt addition of INR630b over FY08-20, resulting in a net debt position of INR533b at the end of FY20. Returns ratios too depleted with SAIL reporting a RoE of -10% in FY16 v/s 24% in FY09. Weaker earnings and higher debt led net debt/EBITDA to rise to 9.3x in FY20, with an interest coverage ratio of 0.8x.

During 9MFY21, SAIL deleveraged its balance sheet by INR94.5b (INR23/share) to INR443b (INR107/share) on the back of higher free cash flow generation. We expect it to further deleverage by INR40b (INR9/share) in 4QFY21. Massive deleveraging of INR134b in FY21 has been supported by higher free cash flow generation, which in turn has been due to: a) higher EBITDA (INR158b), and b) working capital release of INR58b, supported by inventory destocking.

We expect FCF generation to remain strong in FY22E/FY23E at INR78b/INR86b. However, the same should normalize from higher levels achieved in FY21E due to working capital normalization. This should drive a further debt reduction of INR99b to INR305b over FY21-23E. We expect SAIL to reduce its debt by INR233b over FY20-FY23E on the back of: a) strong EBITDA growth (36% CAGR) over FY20-23E to INR145b, b) working capital release through liquidation of iron ore inventory and realization of Railways' debtors (~INR69b in 3QFY21), d) lower finance costs, and e) limited annual capex of INR50b.

Exhibit 17: EBITDA back at FY08 levels; interest coverage ratios and net leverage seen improving

INR b	FY08	FY09	FY12	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E
EBITDA	125.9	86.8	64.0	49.0	-29.0	0.7	52.2	97.6	57.1	137.7	157.8	145.1
Net debt	-100.5	-98.2	107.0	279.7	348.0	410.2	450.6	448.8	533.6	403.3	358.3	304.8
Net debt/EBITDA (x)	-0.80	-1.13	1.67	5.71	-11.99	-	8.64	4.60	9.35	2.93	2.27	2.10
Interest paid	3.4	2.8	7.2	15.0	23.0	25.3	28.5	33.1	36.5	29.2	24.1	20.5
Interest coverage ratio (x)	55.7	43.1	10.3	3.8	-1.0	0.2	2.0	3.3	1.9	5.0	6.9	7.5
RoE (%)	41.7	24.2	9.7	4.9	-9.9	-7.1	0.3	6.8	-0.5	13.7	15.8	13.0

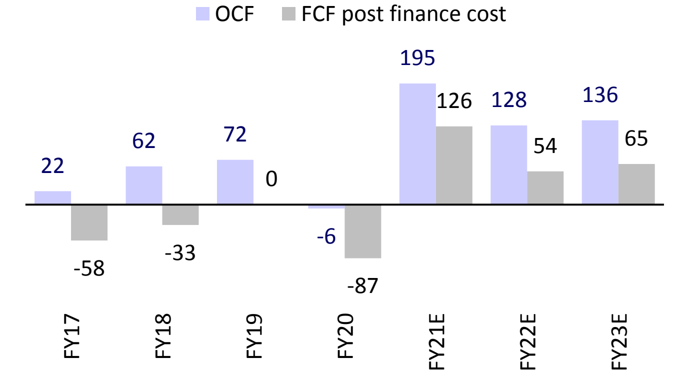
Source: Company, MOFSL; Int. coverage ratio (Int. cost/EBITDA including other income)

Exhibit 18: SAIL to see cumulative equity addition of INR56/share over FY20-23E

INR b	4QFY20	1QFY21	2QFY21	3QFY21	4QFY21E	FY22E	FY23E
Net debt at the end of	537.6	540.4	504.2	443.1	403	358	305
Per share (INR)	130.2	130.9	122.1	107.3	97.7	86.8	73.8
Debt reduction		-2.8	36.2	61.1	39.8	45.0	53.5
Debt reduction per share (INR)		-0.7	8.8	14.8	9.6	10.9	12.9
Cumulative equity addition (per share)		**-0.7**	**8.1**	**22.9**	**32.5**	**43.4**	**56.4**

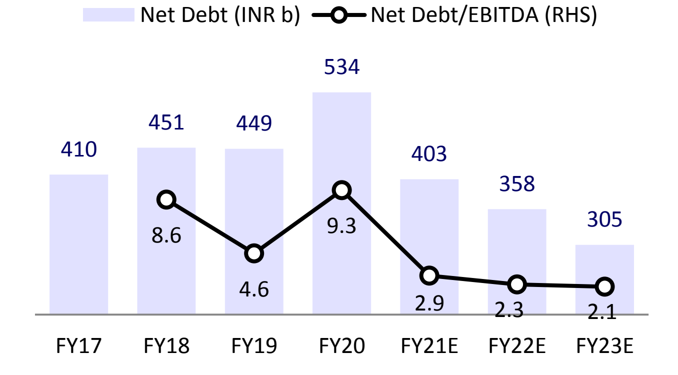
Source: Company, MOFSL

Exhibit 19: FCF to remain strong on higher EBITDA and limited capex



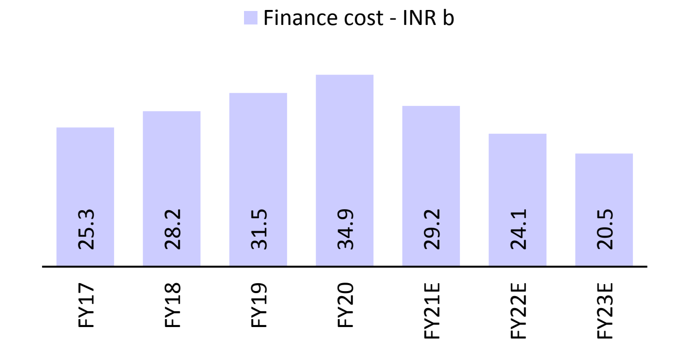
Source: Company, MOFSL

Exhibit 20: Net debt/EBITDA to decline significantly (below 2.5x) in FY22E



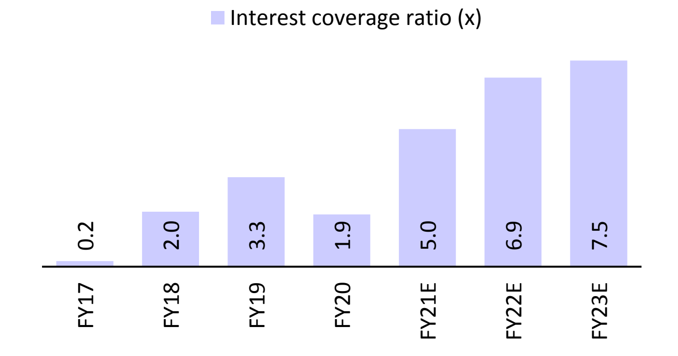
Source: Company, MOFSL

Exhibit 21: Finance cost to fall on declining debt



Source: Company, MOFSL

Exhibit 22: Interest coverage ratio to improve significantly



Source: Company, MOFSL

Dividend likely to rise sharply…

…implying a 6% dividend yield

Due to weak profitability in the past five years (FY16-20), SAIL has had a patchy record of dividend payouts. It paid dividend only once in these five years (FY19) and that too a measly INR0.5/share. As per its Dividend Distribution Policy, 2017, it may not declare dividend or declare one at a lower rate if:

a) the company is making losses or profits are inadequate,

b) the company requires funds for meeting higher capex, working capital, or repayment of loans taken in the past,

c) there is inadequate cash, and

d) cost of raising funds from alternate sources is high.

As PAT outlook is much stronger over FY21-23E, which should support deleveraging, we expect a dividend payout ratio of 25-30%. We expect a FY22E/FY23E dividend of INR4/INR5 per share. This would imply an attractive 6-7% dividend yield on its CMP.

Exhibit 23: SAIL's dividend history

Year	Dividend	EPS	Payout (%)
FY07	1.5	15.2	9.9
FY08	3.7	20.5	18.1
FY09	2.6	15.1	17.2
FY10	3.3	16.5	20.0
FY11	2.4	11.9	20.1
FY12	2.0	9.1	21.9
FY13	2.0	6.0	33.3
FY14	2.0	4.6	44.0
FY15	2.0	5.2	38.3
FY19	0.5	6.3	8.0

Source: Company, MOFSL

Valuation and view

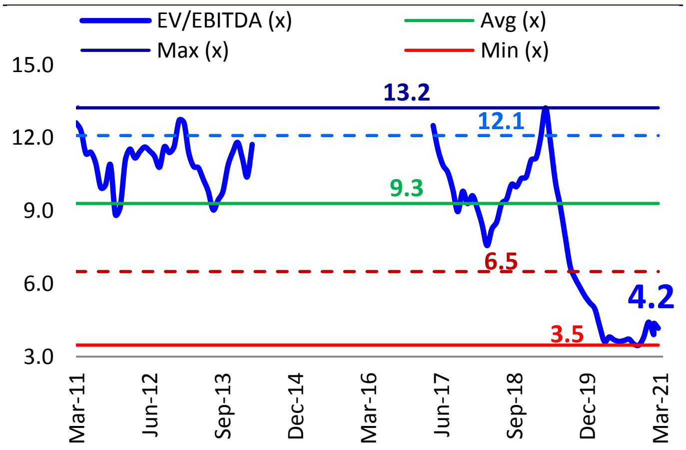
- **Volume growth to take care of higher fixed cost:** While employee cost is expected to rise by over 12% on account of wage revisions, we expect the impact to be absorbed by volume growth and higher realization. We have factored in a hike of ~14% in staff cost over FY20.
- **Expect 36% EBITDA CAGR over FY20-23E even on a conservative basis:** Despite factoring in conservative realization (~12% discount to spot) and higher coking coal prices (USD160/t CNF India) in FY22-23E, we estimate SAIL's EBITDA to grow at 36% CAGR to INR145b over FY20-22E.
- **Net leverage to remain comfortable:** We estimate a net debt reduction of INR233b (INR56/share) to INR305b (INR74/share) over FY20-23E on the back of higher operating cash flows. Realization of Railways' debtors would lead to further deleveraging (not fully factored in). With a significant debt reduction and higher earnings, net debt/EBITDA should decline to ~2.3x by Mar'22.
- **Valuations remain comfortable:** At the CMP, the stock is trading at 4.2x FY22E EV/EBITDA and 0.5x P/B. We value the stock at 5x FY22E EV/EBITDA at INR104/share, implying a target P/B of 0.8x (historical average of 0.7x). Reiterate **Buy**.

Exhibit 24: Target price calculation

Year	FY17	FY18	FY19	FY20	FY21E	FY22E
Sales (mt)	13.1	14.1	14.1	14.2	14.8	16.6
EBITDA (INR per tonne)	51	3,705	6,916	4,012	9,311	9,509
EBITDA – INR m	671	52,176	97,615	57,097	1,37,660	1,57,849
Target EV/EBITDA (x)						5.0
Target EV						7,89,243
Less: Net debt (INR m)	4,10,168	4,50,632	4,48,823	5,33,576	4,03,299	3,58,308
Equity value						4,30,934
Target price (INR/share)						**104**

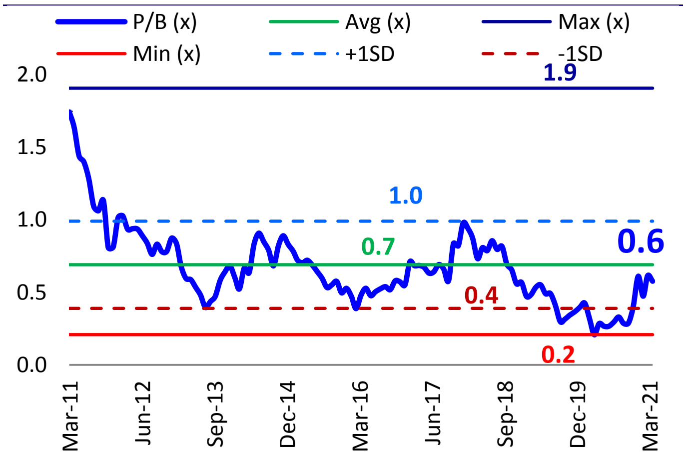
Source: MOFSL, Company

Exhibit 25: SAIL trading at 4.2x one-year forward EV/EBITDA



Source: MOFSL

Exhibit 26: SAIL trading at 0.6x P/B



Source: MOFSL

Risks

- **Risk of higher capex on government push:** While SAIL's original capex plan for FY22 stands at INR40b, the Center has budgeted higher capex (INR80b) to support its post-pandemic economic recovery. We have factored in a capex of INR50b for FY22. While we see a lower likelihood of higher capex as there are no projects on the anvil, any potential capex increase would pose a risk to our free cash flow projection and debt reduction.
- **Decline in demand and steel prices:** We have factored in a 12% discount to spot prices. However, a sharp slump in demand and prices beyond our estimate poses a risk to our estimates.
- **Contingent liabilities materializing into demands:** SAIL has contingent liabilities of INR373b, ~90% of net worth, as of FY20-end. While these matters are sub judice, materialization of contingent liabilities into liabilities could pose a serious risk to Balance Sheet health.

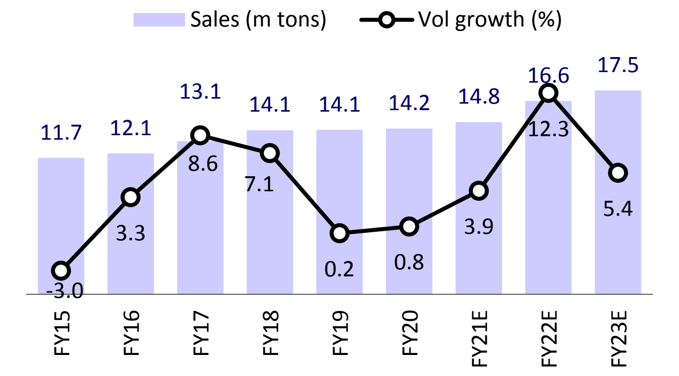
Exhibit 27: Contingent liabilities are ~90% of net worth

	Contingent liabilities (INR b)	FY20	FY19
	In respect of SAIL:		
(i)	Claims against the SAIL pending for appellate/judicial decisions	298.4	247.3
(ii)	Other claims against SAIL not acknowledged as debt	49.6	33.1
(iii)	Disputed income tax/service tax/other demands of joint venture company	0.4	0.4
(iv)	Bills drawn on customers and discounted with banks.	0.8	1.9
(v)	Price escalation claims by contractors/suppliers and claims by employees.	3.6	4.0
	In respect of subsidiaries/jointly controlled entities:		
(i)	Claims pending for appellate/judicial decisions	0.0	0.1
(ii)	Other claims not acknowledged as debt	20.4	12.4
		373.3	**299.2**
	Net worth	**415.1**	**396.5**
	Contingent liabilities as a percentage of net worth	89.9	75.5

Source: Company, MOFSL

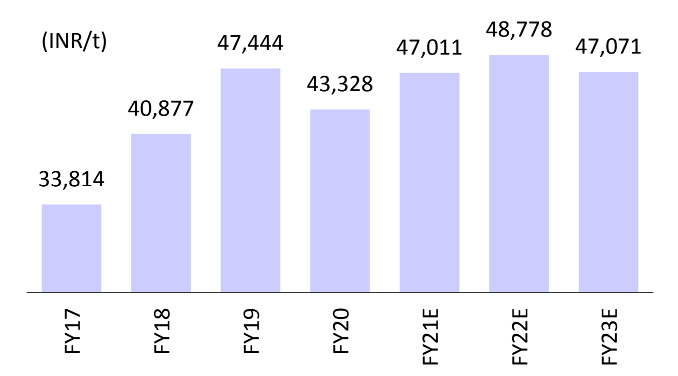
Story in charts

Exhibit 28: Volumes to grow ~9% CAGR over FY21-23E



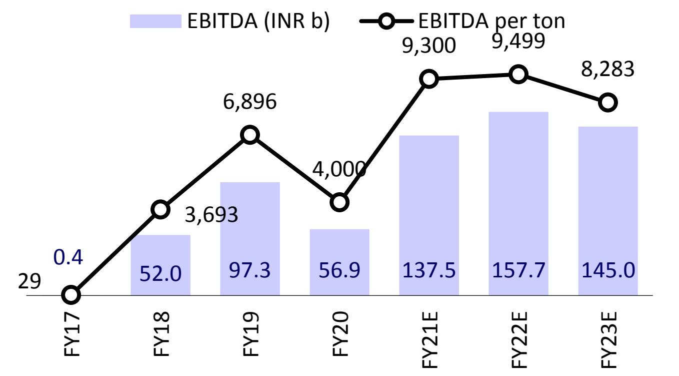
Source: Company, MOFSL

Exhibit 29: Realization to remain strong in FY22E



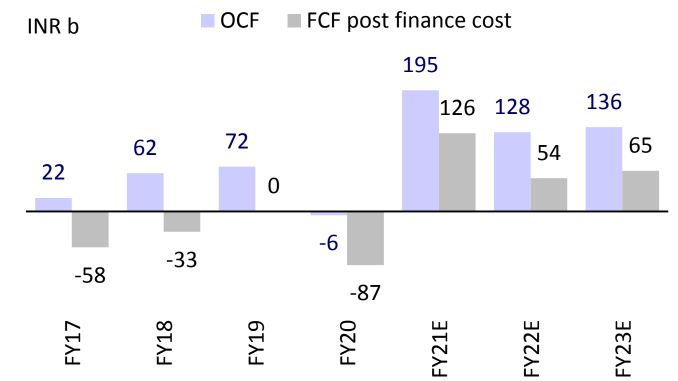
Source: Company, MOFSL

Exhibit 30: EBITDA to grow ~36% CAGR over FY20-23E



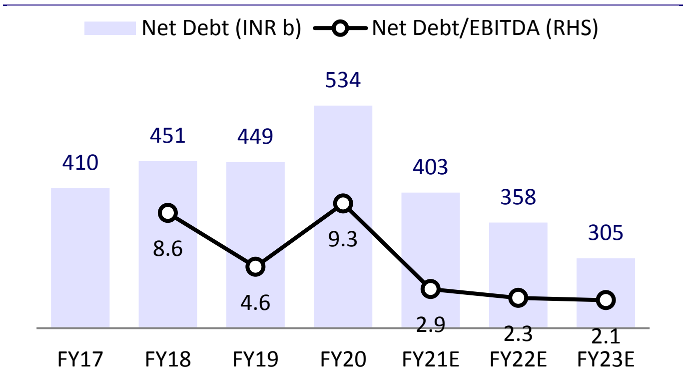
Source: Company, MOFSL

Exhibit 31: Operating cash flows to remain strong



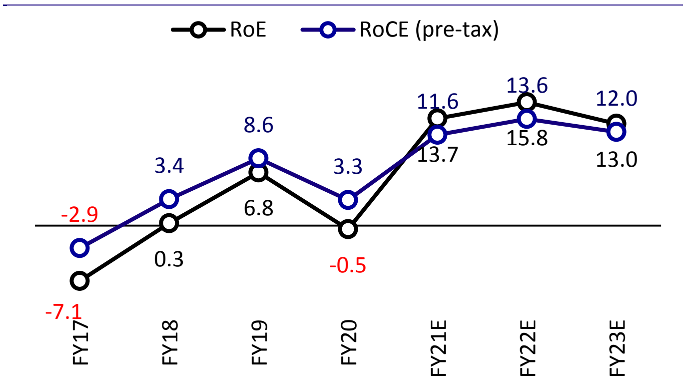
Source: Company, MOFSL

Exhibit 32: Net debt to decline to comfortable levels



Source: Company, MOFSL

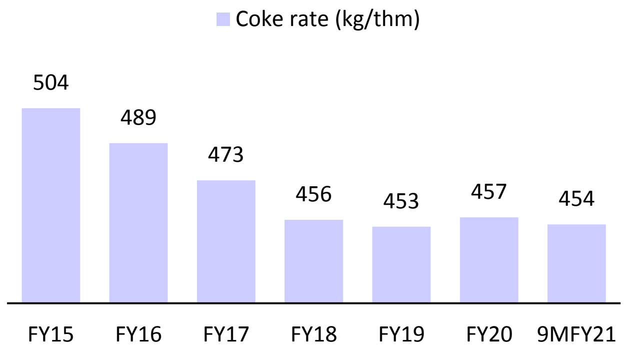
Exhibit 33: Return ratios to improve over FY21-23E



Source: Company, MOFSL

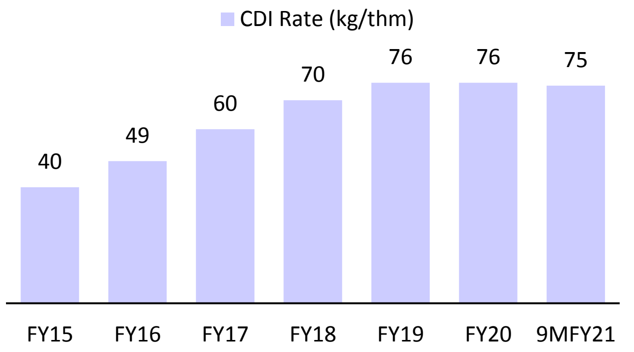
Annexure: Improvement in efficiency parameters

Exhibit 34: Coke rate reduced by ~10% as over last 5 years…



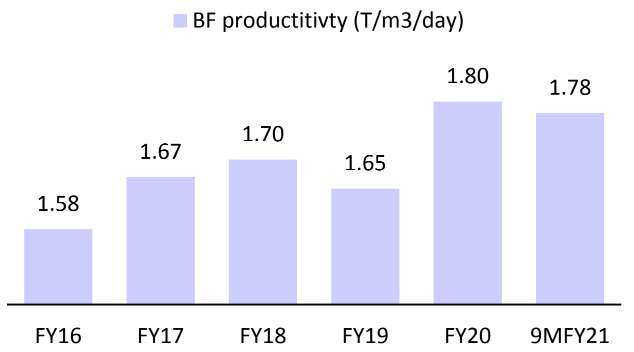
Source: Company, MOFSL

Exhibit 35: …as coal dust injection rate has improved



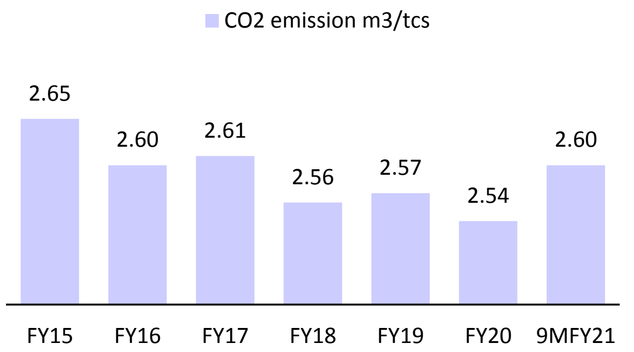
Source: Company, MOFSL

Exhibit 36: Productivity has improveed over the years



Source: Company, MOFSL

Exhibit 37: CO2 emissions remain high



Source: Company, MOFSL

Exhibit 38: Plant-wise quarterly performance

INR b	1QFY20	2QFY20	3QFY20	4QFY20*	1QFY21	2QFY21	3QFY21
Segment revenue							
Bhilai Steel Plant	40.2	47.1	53.2	54.3	31.3	45.0	56.7
Durgapur Steel Plant	18.9	17.0	20.8	20.6	12.8	21.9	25.6
Rourkela Steel Plant	32.7	29.1	31.8	31.8	15.3	37.0	45.8
Bokaro Steel Plant	35.4	28.2	36.3	34.2	16.1	41.3	49.2
IISCO Steel plant	18.1	17.7	21.7	20.0	14.7	20.0	21.5
Special Steel plants	19.5	17.7	16.6	17.4	12.3	18.9	23.3
Alloy Steel Plant	2.0	2.1	1.7	1.4	0.6	1.4	1.6
Salem Steel Plant	4.4	3.8	4.2	3.3	1.9	4.4	5.4
Visvesvaraya	0.2	0.2	0.3	0.2	0.2	0.3	0.4
Others	12.9	11.6	10.4	12.5	9.6	12.7	15.9
Total segment revenue	**164.9**	**156.9**	**180.3**	**178.4**	**102.5**	**184.0**	**222.1**
Less: Inter-segment revenue	16.7	15.6	14.9	16.6	11.8	14.8	23.8
Sales/income from operations	**148.2**	**141.3**	**165.4**	**161.7**	**90.7**	**169.2**	**198.3**
Segment results							
Bhilai Steel Plant	1.6	8.6	7.1	16.7	-1.6	5.4	7.7
Durgapur Steel Plant	0.5	-1.2	-0.8	0.5	-0.6	0.8	4.5
Rourkela Steel Plant	2.4	-1.9	-2.1	4.7	-4.0	3.3	10.7
Bokaro Steel Plant	2.9	-0.3	-0.7	2.7	-3.4	2.1	10.6
IISCO Steel plant	-0.6	-1.9	-1.5	-0.3	-2.8	-2.1	1.5
Special Steel plants	2.1	0.9	0.5	33.6	1.5	1.5	8.2
Alloy Steel Plant	-0.1	0.0	-0.2	-0.2	-0.3	-0.2	-0.1
Salem Steel Plant	-0.8	-0.6	-0.6	-0.3	-0.6	-0.4	0.1
Visvesvaraya	-0.2	-0.2	-0.2	-0.1	-0.2	-0.2	-0.1
Others	3.2	1.8	1.5	34.2	2.6	2.2	8.3
	8.9	**4.2**	**2.6**	**57.8**	**-11.0**	**11.1**	**43.1**
Less: Interest expenses	7.9	9.4	8.5	9.1	8.9	7.2	6.7
Less: Exceptional item				7.7		-2.2	0.0
Total profit (+)/Loss (-) before Tax	**1.0**	**-5.2**	**-5.9**	**41.0**	**-19.8**	**6.1**	**36.4**

Source: Company, MOFSL, *higher profitability due to recognition of iron ore inventories

Financials and valuations

Income Statement (Consolidated)							(INR b)
Y/E March	**FY17**	**FY18**	**FY19**	**FY20**	**FY21E**	**FY22E**	**FY23E**
Net Sales	**445.0**	**575.6**	**669.7**	**616.6**	**695.1**	**809.8**	**823.8**
Change (%)	13.8	29.3	16.4	-7.9	12.7	16.5	1.7
EBITDA	**0.7**	**52.2**	**97.6**	**57.1**	**137.7**	**157.8**	**145.1**
Change (%)	-102.3	7,677.0	87.1	-41.5	141.1	14.7	-8.1
EBITDA per tonne (INR)	51	3,705	6,916	4,012	9,311	9,509	8,293
Depreciation	26.8	30.7	33.9	37.6	39.3	40.6	41.2
EBIT	**-26.1**	**21.5**	**63.8**	**19.5**	**98.4**	**117.2**	**103.9**
Interest	25.3	28.2	31.5	34.9	29.2	24.1	20.5
Other income	4.5	4.2	4.9	9.1	8.3	7.8	8.7
PBT before EO	**-46.9**	**-2.6**	**37.2**	**-6.3**	**77.4**	**100.9**	**92.0**
Extraordinary Item	-2.2	-5.6	-3.9	37.3	2.2	0.0	0.0
PBT	**-49.1**	**-8.1**	**33.3**	**31.1**	**79.7**	**100.9**	**92.0**
Total Tax	-19.6	-2.5	12.0	11.8	33.5	26.2	23.9
Effective Rate (%)	39.9	30.2	36.1	38.0	42.0	26.0	26.0
Reported PAT	**-29.5**	**-5.7**	**21.3**	**19.3**	**46.2**	**74.7**	**68.1**
Change (%)	-28.8	-80.8	-475.4	-9.4	139.9	61.5	-8.8
Share of Associates/JV	1.9	2.8	2.2	1.9	1.9	1.9	1.9
Minority Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjusted PAT	**-26.3**	**1.1**	**26.0**	**-1.9**	**59.6**	**76.6**	**70.0**
Change (%)	-37.1	-104.0	2344.1	-107.5	-3167.0	28.5	-8.6

Balance Sheet (Consolidated)							(INR b)
Y/E March	**FY17**	**FY18**	**FY19**	**FY20**	**FY21E**	**FY22E**	**FY23E**
Sources of Funds							
Share Capital	41.3	41.3	41.3	41.3	41.3	41.3	41.3
Reserves and Surplus	329.1	328.2	355.2	373.8	415.9	474.0	521.5
Shareholders' funds	**370.4**	**369.5**	**396.5**	**415.1**	**457.2**	**515.3**	**562.8**
Loans	414.0	454.1	451.7	538.0	438.0	388.0	358.0
Deferred Tax Liability	-38.5	-41.6	-28.7	-20.2	13.2	24.2	34.3
Minority Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital Employed	**745.9**	**781.9**	**819.5**	**932.9**	**908.4**	**927.6**	**955.1**
Application of Funds							
Gross Fixed Assets	841.9	955.8	1,017.2	1,131.3	1,191.3	1,261.3	1,311.3
Less: Depreciation	338.9	369.6	403.4	441.0	480.3	520.9	562.1
Net Fixed Assets	**503.0**	**586.3**	**613.7**	**690.3**	**711.0**	**740.4**	**749.2**
Capital WIP	232.8	184.0	160.1	87.5	67.5	47.5	47.5
Investments	24.8	26.3	29.7	32.4	32.4	32.4	32.4
Curr. Assets							
Inventory	157.4	170.2	195.1	238.4	209.5	232.9	237.0
Sundry Debtors	29.3	38.7	45.0	88.4	76.2	77.6	67.7
Cash and Bank Balances	3.8	3.5	2.9	4.5	34.7	29.7	53.2
Other assets	81.4	98.7	98.1	100.4	100.4	100.4	100.4
Loans and Advances	5.3	5.2	6.2	7.1	9.5	12.6	15.3
Current Liabilities							
Sundry Creditors	52.3	75.3	72.3	63.3	80.0	93.2	94.8
Other Current Liabilities	174.3	192.7	192.9	188.1	188.1	188.1	188.1
Provisions	65.2	62.9	66.1	64.7	64.7	64.7	64.7
Net Current Assets	**-14.6**	**-14.6**	**15.9**	**122.6**	**97.5**	**107.2**	**126.0**
Application of Funds	**745.9**	**781.9**	**819.5**	**932.9**	**908.4**	**927.6**	**955.1**

Financials and valuations

Ratios							
Y/E March	**FY17**	**FY18**	**FY19**	**FY20**	**FY21E**	**FY22E**	**FY23E**
Basic (INR)							
EPS	**-6.4**	**0.3**	**6.3**	**-0.5**	**14.4**	**18.5**	**17.0**
Cash EPS	-0.6	6.1	13.3	13.8	20.7	27.9	26.5
Book Value per Share	89.7	89.4	96.0	100.5	110.7	124.8	136.2
Dividend Per Share	0.0	0.0	0.5	0.0	3.0	4.0	5.0
Valuation (x)							
P/E					5.0	3.9	4.3
Cash PE					3.5	2.6	2.7
EV/EBITDA					5.1	4.2	4.2
EV/Sales					1.0	0.8	0.7
EV (USD/tonne)					1,158	965	841
Price-to-Book Value					0.7	0.6	0.5
Profitability Ratios (%)							
EBITDA Margin	0.2	9.1	14.6	9.3	19.8	19.5	17.6
RoE	-7.1	0.3	6.8	-0.5	13.7	15.8	13.0
RoCE (pre-tax)	-2.9	3.4	8.6	3.3	11.6	13.6	12.0
RoIC (pre-tax)	-5.3	4.1	10.7	2.7	12.4	14.7	12.7
Turnover Ratios	110	80	85	152	108	98	93
Debtors (Days)	24	25	25	52	40	35	30
Inventory (Days)	129	108	106	141	110	105	105
Creditors (Days)	43	53	46	41	42	42	42
Asset Turnover (x)	0.6	0.7	0.8	0.7	0.8	0.9	0.9
Leverage Ratio							
Debt/Equity (x)	1.1	1.2	1.1	1.3	0.9	0.7	0.5

Cash Flow Statement							(INR b)
Y/E March	**FY17**	**FY18**	**FY19**	**FY20**	**FY21E**	**FY22E**	**FY23E**
EBITDA	0.7	52.2	97.6	57.1	137.7	157.8	145.1
(Inc.)/Dec. in WC	17.5	11.2	-26.6	-106.6	57.8	-11.8	7.5
Direct Taxes Paid	0.1	-1.4	0.0	-0.9	-2.4	-18.3	-16.7
Other Items	3.3	-0.4	1.2	44.2	2.2	0.0	0.0
CF from Oper. Activity	**21.6**	**61.6**	**72.2**	**-6.2**	**195.3**	**127.8**	**136.0**
(Inc.)/Dec. in FA & CWIP	-54.3	-66.0	-38.8	-43.8	-40.0	-50.0	-50.0
Free Cash Flows to Firm	**-32.7**	**-4.4**	**33.3**	**-50.0**	**155.3**	**77.8**	**86.0**
Interest and Dividend	0.0	0.1	1.3	1.5	8.3	7.8	8.7
(Pur.)/Sale ofInvest.	0.0	1.3	0.3	0.1	0.0	0.0	0.0
CF from Inv. Activity	**-54.3**	**-64.7**	**-37.2**	**-42.3**	**-31.7**	**-42.2**	**-41.3**
Issue of Shares							
Inc./(Dec.) in Debt	58.3	31.2	-2.4	89.1	-100.0	-50.0	-30.0
Interest Paid	-25.3	-28.5	-33.1	-36.5	-29.2	-24.1	-20.5
Dividends Paid	0.0	0.0	0.0	-2.5	-4.1	-16.5	-20.7
CF from Finan. Activity	**33.0**	**2.7**	**-35.5**	**50.0**	**-133.3**	**-90.7**	**-71.2**
Inc./(Dec.) in Cash	**0.3**	**-0.3**	**-0.6**	**1.6**	**30.3**	**-5.0**	**23.5**
Add: Opening Balance	3.5	3.8	3.5	2.9	4.5	34.7	29.7
Closing Balance	**3.8**	**3.5**	**2.9**	**4.5**	**34.7**	**29.7**	**53.2**

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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