Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Steel Authority of India Ltd

In-line operating profit; zero-debt target delayed to end-FY23

Metal & Mining	Sharekhan code: SAIL
Reco/View: Buy ↔	CMP: Rs. 103
	Price Target: Rs. 150 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 41.5

Updated Jan 08, 2022

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

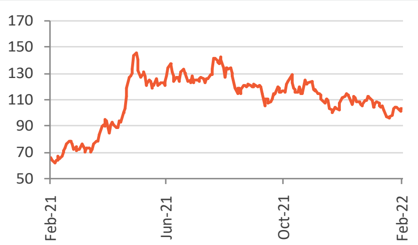
Company details

Market cap:	Rs. 42,705 cr
52-week high/low:	Rs. 151/62
NSE volume: (No of shares)	423.3 lakh
BSE code:	500113
NSE code:	SAIL
Free float: (No of shares)	144.6 cr

Shareholding (%)

Promoters	65.0
FII	4.4
DII	10.5
Others	20.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1	-12	-23	55
Relative to Sensex	2	-10	-31	40

Sharekhan Research, Bloomberg

Summary

- Q3FY22 consolidated adjusted operating profit of Rs. 3,902 crore (down 45% q-o-q) was in line with our estimate as margins and volume met expectations. Reported operated profit of Rs. 3,402 crore is adjusted for a provision of Rs. 500 crore for employee retirement benefit.
- Blended EBITDA margin declined sharply by 38% q-o-q to Rs. 10,161/tonne (in-line) due to a steep Rs. 10,000/tonne q-o-q rise in coking coal prices offsetting a 5% q-o-q improvement in blended realisations (above estimates). Decline of 10% q-o-q in saleable steel sales volumes to 3.8 mmt was on expected lines.
- Management guided for robust 25% q-o-q rise in Q4FY22 sales volume to 4.8 mt and an uptick in steel prices, which would improve profitability in Q4FY22 offsetting further increase in coking coal prices. Further, SAIL slashed debt by 15% q-o-q to Rs. 19,128 crore but now aims to become net debt-free by end of FY23E versus Q1FY23 earlier.
- We maintain a Buy on SAIL with a revised PT of Rs. 150 (reflecting an earnings cut to factor wage cost guidance), noting inexpensive valuation of 2.8x its FY2023E EV/EBITDA and 0.7x FY2023E P/BV.

Steel Authority of India Limited's (SAIL) Q3FY22 consolidated adjusted operating profit of Rs. 3,902 crore (down 23.2% y-o-y; down 44.5% q-o-q) was largely in-line with our estimate of Rs. 3,968 crore but missed the street's estimate by 7%. A steep fall in earnings was on the account of sharp contraction of 38% q-o-q in EBITDA margin to Rs. 10,161/tonne (that was in line with our estimates) primarily on account of Rs. 10,000/tonne q-o-q jump in coking coal price and rise in price of other inputs like ferro alloys. Saleable steel volume also declined by 10.3% q-o-q to 3.8 mmt (in-line) while blended realisation improved by 4.9% q-o-q to Rs. 65,747/tonne (above our estimate by 4%). Average steel realisation increased by 6% q-o-q to Rs. 59,000/tonne in Q3FY2022. We have adjusted reported operated profit of Rs. 3,402 crore (down 33%; down 51.6% q-o-q) for Rs. 500 crore related one-time provision for employee (cost up by 11% q-o-q) retirement benefit. Consolidated adjusted PAT at Rs. 2,187 crore (down 20.6x y-o-y; down 49.6% q-o-q) was above our estimate of Rs. 2,039 crore led by lower interest cost (down 28.1% q-o-q) and higher share of profit share from JVs. SAIL has further lowered its debt by Rs. 3,350 crore q-o-q to Rs. 19,128 crore as on December 31, 2021.

Key positives

- Average steel realisations rose by 6% q-o-q to Rs. 59,000/tonne in Q3FY2022.
- Lowered debt by 15% q-o-q to Rs. 19,128 crore as on December 31, 2021.

Key negatives

- A sharp contraction of 38% q-o-q in EBITDA margin to Rs. 10,161/tonne due steep rise in coking coal price.

Management Commentary

- **Tweaked volume guidance** – The management has marginally tweaked its FY22 sales volume guidance to 16.3mt and expect robust volumes of 4.8 mt in Q4, which implies robust 25% q-o-q increase. SAIL would provide FY23 volume guidance post finalisation of annual business plan.
- **Margin outlook** – Coking coal prices are expected to further rise by Rs. 2000-3000/tonne q-o-q but robust volume growth would help absorb fixed cost and steel prices also expected to improve in Q4. Thus, management expect sequential improvement in profitability in Q4FY22.
- **Debt reduction target/capex guidance** – SAIL's aim to become net debt-free may get pushed to end of FY23 versus earlier guidance of Q1FY23 due to current business environment. FY22/FY23 capex guidance of Rs. 6,500 crore/Rs. 8,000 crore. SAIL has spent Rs. 4,500 on capex in 9MFY22.
- **Other updates** – 1) SAIL has appointed a consultant for product mix configuration for planned capacity expansion by 13-15 mmt in a phased manner remain intact, 2) D/E ratio at 0.42x and net debt/EBITDA at 0.8x in Q3, 3) iron ore sales volume at 22 lakh tonnes in 9MFY22, 4) FY23 normalised wage cost of Rs. 11,500-12,500 crore, 5) flat/long steel price at Rs. 65,000-67,000/Rs. 53,000-54,000 per tonne in Q3FY22

Revision in estimates – We have cut our FY2022E-FY2024E earnings estimates to factor impact of wage hike revision and higher coking coal prices.

Our Call

Valuation – Maintain Buy on SAIL with a revised PT of Rs. 150: SAIL's valuation of 4x its FY23E EPS, 2.8x its FY2023E EV/ EBITDA and 0.7x its FY2023E P/BV is attractive and at a steep discount to domestic peers despite strong earnings growth outlook (expect 42% PAT CAGR over FY2021-FY2023E). Potential debt reduction would boost equity value and drive re-rating of valuation multiples. Hence, we maintain our Buy rating on SAIL with a revised price target (PT) of Rs. 150 (reflects cut in earnings estimates).

Key Risks

A sharp decline in steel prices and sustained higher coking coal prices could impact profitability. Any delay in capacity expansion capacity plan could impact volume growth.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenues	69,114	88,000	94,000	93,600
OPM (%)	20.1	21.6	19.6	16.5
Adjusted PAT	5,246	10,420	10,556	8,656
% YoY growth	81.4	98.6	1.3	-18.0
Adjusted EPS (Rs.)	12.7	25.2	25.6	21.0
P/E (x)	8.1	4.1	4.0	4.9
P/B (x)	0.9	0.8	0.7	0.6
EV/EBITDA (x)	5.6	3.1	2.8	2.9
RoNW (%)	12.1	21.0	18.1	13.1
RoCE (%)	11.9	19.2	19.3	15.2

Source: Company; Sharekhan estimates

In-line Q3 operating profit; debt reduction continues but zero debt target delayed to end-FY23

Q3FY22 consolidated adjusted operating profit of Rs. 3,902 crore (down 23.2% y-o-y; down 44.5% q-o-q) was largely in-line with our estimate of Rs. 3,968 crore but missed the street's estimate by 7%. A steep fall in earnings was on the account of sharp contraction of 38% q-o-q in EBITDA margin to Rs. 10,161/tonne (that was in line with estimates) primarily on account of Rs. 10,000/tonne q-o-q jump in coking coal price and rise in price of other inputs like ferro alloys. Saleable steel volume also declined by 10.3% q-o-q to 3.8 mmt (in-line) while blended realisation improved by 4.9% q-o-q to Rs. 65,747/tonne (above our estimate by 4%). Average steel realisation increased by 6% q-o-q to Rs. 59,000/tonne in Q3FY2022. We have adjusted reported operated profit of Rs. 3,402 crore (down 33%; down 51.6% q-o-q) for Rs. 500 crore related one-time provision for employee (cost up by 11% q-o-q) retirement benefit. Consolidated adjusted PAT at Rs. 2,187 crore (down 20.6x y-o-y; down 49.6% q-o-q) was above our estimate of Rs. 2,039 crore led by lower interest cost (down 28.1% q-o-q) and higher share of profit share from JVs. SAIL has further lowered its debt by Rs. 3,350 crore q-o-q to Rs. 19,128 crore as on December 31, 2021.

Results (Consolidated) Rs cr

Particulars	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)
Revenue	**25,247**	**19,836**	**27.3**	**26,828**	**-5.9**
Total Expenditure	21,845	14,755	48.0	19,794	10.4
Reported operating profit	3,402	5,080	-33.0	7,034	-51.6
Adjusted operating profit	**3,902**	**5,080**	**-23.2**	**7,034**	**-44.5**
Other Income	151	162	-6.3	179	-15.4
Interest	316	670	-52.9	439	-28.1
Depreciation	1,049	981	6.9	1,056	-0.6
Exceptional income/(expense)	-364	2	NA	0	NA
Share of Profit I (Loss) of Associates/ JVs	181	222	-18.2	77	135.9
Reported PBT	2,006	3,815	-47.4	5,795	-65.4
Adjusted PBT	**2,870**	**3,812**	**-24.7**	**5,795**	**-50.5**
Tax	477	2,346	-79.7	1,456	-67.2
Reported PAT	1,529	1,468	4.1	4,339	-64.8
Adjusted PAT	**2,187**	**2,756**	**-20.6**	**4,339**	**-49.6**
Equity Cap (cr)	413	413		413	
Reported EPS (Rs.)	3.7	3.6	4.1	10.5	-64.8
Adjusted EPS (Rs.)	5.3	6.7	-20.6	10.5	-49.6
Margins (%)			**BPS**		**BPS**
Adjusted OPM	15.5	25.6	-1015.7	26.2	-1,076.3
Adjusted NPM	8.7	13.9	-523.2	16.2	-751.0
Tax rate	23.8	61.5	-3771.9	25.1	-133.4

Source: Company, Sharekhan Research

Key operating metrics

Particulars	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)
Crude steel production (mmt)	4.5	4.4	3.7	4.5	1.4
Saleable steel volume (mmt)	3.8	4.2	-7.5	4.3	-10.3
Blended realisation (Rs. /tonne)	65,747	47,762	37.7	62,682	4.9
Blended gross spreads (Rs. /tonne)	36,467	29,616	23.1	41,189	-11.5
Blended reported EBITDA margin (Rs. /tonne)	8,859	12,233	-27.6	16,434	-46.1
Blended adjusted EBITDA margin (Rs. /tonne)	10,161	12,233	-16.9	16,434	-38.2

Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector view - Potential volume recovery and recovery in steel price to sustain steel spreads above historical levels**

We believe steel prices are likely to remain firm in CY2022 as supply cuts by China to curb pollution would keep demand-supply situation tight in Asian markets. Moreover, China has removed the 13% VAT rebate on export of various steel products (including hot rolled coil, wire rods, and rebars) with effect from May 1, 2021. A potential steel price hike to offset elevated coking coal price would help steel makers sustain margins above historical levels and drive earnings growth and continued balance sheet deleveraging for the sector.

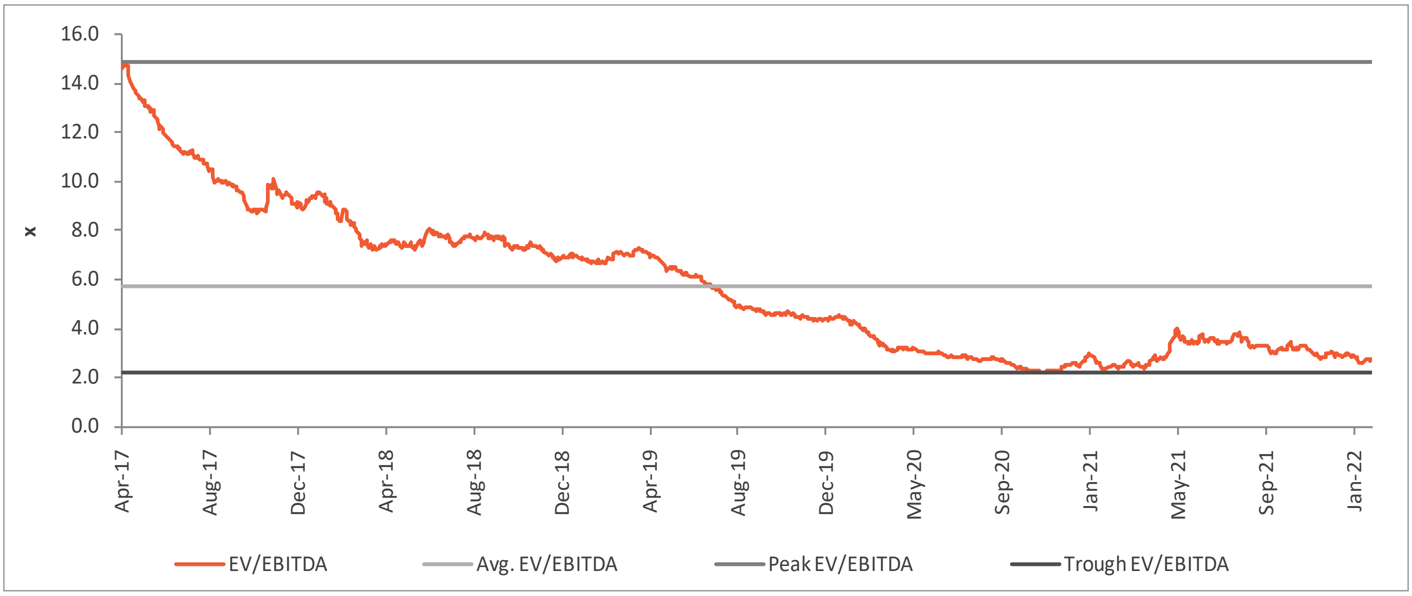
■ **Company outlook - Volume growth, resilient margins and lower interest to drive a 42% PAT CAGR over FY2021-FY2023E**

We expect SAIL's volumes to report a 12% CAGR over FY2021-FY2023E and reach 18.8 mmt by FY2023E, led by strong domestic and exports demand, while margins are expected to remain above previous steel cycles (we model EBITDA margin of Rs. 11.861/Rs. 9,788 per tonne for FY2022E/FY2023E versus Rs. 9,302/tonne in FY2021). This coupled with a sharp decline in interest cost would drive strong 42% PAT CAGR over FY2021-FY2023E

■ **Valuation - Maintain Buy on SAIL with a revised PT of Rs. 150**

SAIL's valuation of 4x its FY23E EPS, 2.8x its FY2023E EV/ EBITDA and 0.7x its FY2023E P/BV is attractive and at a steep discount to domestic peers despite strong earnings growth outlook (expect 42% PAT CAGR over FY2021-FY2023E). Potential debt reduction would boost equity value and drive re-rating of valuation multiples. Hence, we maintain our Buy rating on SAIL with a revised price target (PT) of Rs. 150 (reflects cut in earnings estimates).

One-year forward EV/EBITDA (x) band



Source: Sharekhan Research

About company

SAIL is one of the largest steel-making companies in India and Central Public Sector Enterprises. SAIL produces iron and steel at five integrated plants and three special steel plants, located principally in the eastern and central regions of India and situated close to domestic sources of raw materials. The company's current crude steel production capacity is 16.2 mmt and has largely completed its capex plan to expand capacity to 21.4 mtpa.

Investment theme

We expect steel margin to remain resilient and witness recovery in CY2022 as China's aim to reduce supplies and strong demand environment would aid price hike to mitigate elevated coking coal price. Additionally, SAIL is favourably placed given its entire iron ore requirement is met through its captive iron ore mines. SAIL has one of the best volume growth potential among domestic steel players. Strong earnings growth would drive robust free cash flow (FCF) generation and debt reduction. The company's valuation is also attractive and at a steep discount to domestic peers.

Key Risks

- Sharp fall in steel prices and sustained high coking coal prices could impact earnings outlook.
- Any weakness in steel demand and delay in expansion plan could impact volume growth outlook.

Additional Data

Key management personnel

Soma Mondal	Chairman
Amit Sen	Director (Finance)
Harinand Rai	Director (Technical, projects and Raw materials)

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	8.4
2	Nippon Life India Asset Management Ltd.	1.0
3	Vanguard Group	0.9
4	SBI Funds Management Private Limited	0.8
5	Kotak Mahindra Asset Management Co. Ltd	0.8
6	Aditya Birla Sun Life Asset Management Co. Ltd	0.7
7	ICICI Prudential Asset Management Co. Ltd	0.5
8	Dimensional Fund Advisors LP	0.4
9	DSP Investment Managers Private Limited	0.3
10	IDFC Mutual Fund/India	0.3

Source: Bloomberg Note: Shareholding as of August 6, 2021

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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by BNP PARIBAS

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