Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Steel Authority of India Ltd

Decent Q4; Steel export duty to dent earnings

Metal & Mining	Sharekhan code: SAIL
Reco/View: Hold ↓	CMP: **Rs. 74** / Price Target: **Rs. 80** ↓

↑ 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 40.94

Updated Apr 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. 30,687 cr
52-week high/low:	Rs. 146 / 72
NSE volume: (No of shares)	600.6 lakh
BSE code:	500113
NSE code:	SAIL
Free float: (No of shares)	144.6 cr

Shareholding (%)

Promoters	65.0
FII	4.6
DII	10.2
Others	20.2

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-23.2	-18.9	-32.4	-40.1
Relative to Sensex	-18.7	-15.7	-24.4	-46.8

Sharekhan Research, Bloomberg

Summary

- SAIL's Q4FY2022 consolidated operating profit of Rs. 4,338 crore slightly missed our estimate on lower-than-expected EBITDA margin. PAT of Rs. 2,471 crore beat estimates on higher other income.
- Miss in EBITDA margin at Rs. 9,217/tonne was on account of lower-than-expected blended realisation at Rs. 65,361/tonne. The company reported in-line saleable steel sales volumes of 4.7 mt.
- Recent imposition of 15% export duty on steel would result in a sharp decline in domestic steel price, while benefit of cut in coking coal import duty to nil (from 2.5% earlier) would be small at Rs. 750/tonne. Thus, we expect severe impact on margin and earnings of the steel sector and cut our FY2023E/FY2024E EBITDA by 47%/39% for SAIL.
- Weak earnings to impact growth capex, likely increase in debt and could lower sector valuation. Thus, we downgrade SAIL to Hold (from Buy earlier) with a lower PT of Rs. 80. The stock trades at 5.4x its FY2024E EV/EBITDA.

Steel Authority of India Limited's (SAIL) Q4FY2022 consolidated adjusted operating profit stood at Rs. 4,338 crore (down 29.5% y-o-y; up 11.2% q-o-q), marginally below our estimate of Rs. 4,451 crore due to miss in EBITDA margin at Rs. 9,217/tonne (down 34.9% y-o-y and 9.3% q-o-q versus estimate of Rs. 9,500/tonne). Saleable steel sales volume of 4.7 million tonne was in-line with our estimate. The margin miss can be attributed to a 0.6% q-o-q decline (versus expectation of 3.4% q-o-q increase) in blended realisation at Rs. 65,361/tonne. Average steel realisation stood at Rs. 60,000/tonne versus Rs. 59,000/tonne in Q3FY2022. Consolidated adjusted PAT at Rs. 2,471 crore (down 31.2% y-o-y; up 13% q-o-q) was marginally above our estimate of Rs. 2,410 crore, led by higher other income (up 68% y-o-y; up 175% q-o-q) and lower tax rate of 24.4% (versus assumption of 25.2%).

Key positives

- Sharp volume recovery of 22.6% q-o-q to 4.7mt.
- Further lowered debt to Rs. 13,386 crore in Q4FY2022 versus Rs. 19,128 crore in Q3FY2022.

Key negatives

- Lower-than-expected EBITDA margin to Rs. 9,217/tonne, down 35% y-o-y.

Management Commentary

- Steel export duty of 15% would result in lower domestic steel price. Exports accounted for only 8.6% of FY2022 sales volume of SAIL.
- Coking coal prices are expected to increase by 10-15% in Q1FY2023, while steel prices are expected to remain volatile and, thus, margin pressure is expected to remain under pressure Q1FY2023.
- Management expects production to be close to its full capacity and endeavors to maximise production.
- Capex guidance of ~Rs. 8,000 crore for FY2023 versus Rs. 3,500 crore in FY2022. Near-term focus will be on capacity debottlenecking.
- Further lowered debt to Rs. 13,400 crore versus Rs. 19,128 crore as of Q3FY2022. However, further balance sheet deleveraging would depend upon profitability in the coming quarters.

Revision in estimates – We have sharply cut our FY2023E-FY2024E earnings estimates to factor lower margin amid expectation of a decline in domestic steel price and higher coking coal price.

Our Call

Valuation – Downgrade SAIL to Hold with a revised PT of Rs. 80: The recent government decision to impose 15% export duty on steel is expected to severely impact domestic steel price and in turn profitability of steel players, given elevated coking coal prices. We believe lower earnings would impact growth capex, increase debt on the books and lower steel sector valuation. Thus, we downgrade SAIL to Hold (from Buy earlier) with a revised PT of Rs. 80. Reversal in export duty remains key to steel margin/capex outlook. At the CMP, the stock trades at 5.4x its FY2024E EV/EBITDA.

Key Risks

A sharp increase in steel price, reversal of steel export tax, and normalisation of coking coal prices are key upside risks and vice versa.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenues	69,114	1,03,477	87,875	89,300
OPM (%)	20.1	20.6	11.1	10.5
Adjusted PAT	5,246	12,597	3,898	3,208
% YoY growth	*81.4*	*140.1*	*-69.1*	*-17.7*
Adjusted EPS (Rs.)	12.7	30.5	9.4	7.8
P/E (x)	5.9	2.4	7.9	9.6
P/B (x)	0.7	0.6	0.5	0.5
EV/EBITDA (x)	4.7	2.0	5.2	5.4
RoNW (%)	12.1	25.3	7.0	5.5
RoCE (%)	11.9	21.8	7.0	5.8

Source: Company; Sharekhan estimates

Q4 operating profit slightly below estimates on lower margins

SAIL's Q4FY2022 consolidated adjusted operating profit of Rs. 4,338 crore (down 29.5% y-o-y; up 11.2% q-o-q) was marginally below our estimate of Rs. 4,451 crore due to miss in EBITDA margin at Rs. 9,217/tonne (down 34.9% y-o-y and 9.3% q-o-q versus estimate of Rs. 9,500/tonne), while saleable steel sales volume of 4.7 million tonne was in line with our estimate. The margin miss can be attributed a 0.6% q-o-q decline (versus expectation of a 3.4% q-o-q increase) in blended realisation at Rs. 65,361/tonne. Average steel realisation stood at Rs. 60,000/tonne in Q4FY2022 versus Rs. 59,000/tonne in Q3FY2022. Consolidated adjusted PAT at Rs. 2,471 crore (down 31.2% y-o-y; up 13% q-o-q) was marginally above our estimate of Rs. 2,410 crore, led by higher other income (up 68% y-o-y; up 175% q-o-q) and lower tax rate of 24.4% (versus assumption of 25.2%).

Q4FY22 conference call highlights

- **Steel export duty impact –** Management hinted that the recent 15% export duty on steel would result in a decline in domestic steel price due to potential increase in domestic supply. Exports accounted for only 8.6% of FY2022 sales volume.
- **Margin outlook –** Coking coal prices are expected to increase by 10-15% in Q1FY2023, while steel are prices expected to remain volatile (improved in April but declined in May). This would put further pressure on steel spreads.
- **Optimistic volume guidance –** Management expects production to be close to its full capacity and endeavors to maximise production. This seems optimistic in our view, given the likelihood of higher domestic supply on expectation of decline in exports due to export duty.
- **Capex guidance –** Management has guided for capex of ~Rs. 8,000 crore for FY2023 as compared to capex of Rs. 3,500 crore in FY2022. Near-term focus will be on capacity debottlenecking, but we would take a call on long-term capacity expansion in some time and have a neutral view currently.
- **Debt reduction –** The company has lowered its debt to Rs. 13,400 crore versus Rs. 19,128 crore as of Q3FY2022. However, further balance sheet deleveraging would depend upon profitability in the coming quarters.
- **Employee Cost –** Wage bill to remain stable or slightly decline in FY2023 as the impact of higher provisions has already been taken into account in FY22.
- **Other updates –** 1) Coking coal inventory of 35 days, 2) coal supplies from Russia started on trial basis, 3) WC capital was lower due high credit cycle and realisation of money from railways, and 4) flat steel price stood at Rs. 64,000-65,000/tonne in Q4FY2022.

Results (Consolidated) Rs cr

Particulars	Q4FY22	Q4FY21	Y-o-Y %	Q3FY22	Q-o-Q %
Net Sales	**30,759**	**23,285**	**32.1**	**25,247**	**21.8**
Total Expenditure	26,421	17,131	54.2	21,845	20.9
Reported operating profit	4,338	6,154	-29.5	3,402	27.5
Adjusted operating profit	**4,338**	**6,154**	**-29.5**	**3,902**	**11.2**
Other Income	416	248	67.7	151	175.1
Interest	440	540	-18.6	316	39.4
Depreciation	1,144	1,158	-1.2	1,049	9.0
Exceptional income/(expense)	11	-166	-106.3	-364	-102.9
Share of Profit l (Loss) of Associates/JVs	98	123	-20.2	181	-45.7
Reported PBT	3,279	4,661	-29.7	2,006	63.5
Adjusted PBT	**3,268**	**4,827**	**-32.3**	**2,870**	**13.9**
Tax	800	1,191	-32.8	477	67.7
Reported PAT	2,479	3,470	-28.6	1,529	62.2
Adjusted PAT	**2,471**	**3,594**	**-31.2**	**2,187**	**13.0**
Equity Cap (cr)	413	413		413	
Reported EPS (Rs.)	6.0	8.4	-28.6	3.7	62.2
Adjusted EPS (Rs.)	6.0	8.7	-31.2	5.3	13.0
Margins (%)			**BPS**		**BPS**
Adjusted OPM	14.1	26.4	-1232.7	15.5	-135.4
Adjusted NPM	8.0	15.4	-740.1	8.7	-62.9
Tax rate	24.4	25.6	-115.2	23.8	60.9

Source: Company; Sharekhan Research

Key operating metrics

Particulars	Q4FY22	Q4FY21	Y-o-Y %	Q3FY22	Q-o-Q %
Crude steel production (mmt)	4.6	4.6	0.9	4.5	1.4
Saleable steel volume (mmt	4.7	4.3	8.3	3.8	22.6
Blended realisation (Rs./tonne)	65,361	53,590	22.0	65,747	-0.6
Blended gross spreads (Rs./tonne)	30,132	37,099	-18.8	36,467	-17.4
Blended reported EBITDA margin (Rs./tonne)	9,217	14,163	-34.9	8,859	4.0
Blended adjusted EBITDA margin (Rs./tonne)	9,217	14,163	-34.9	10,161	-9.3

Source: Company; Sharekhan Research

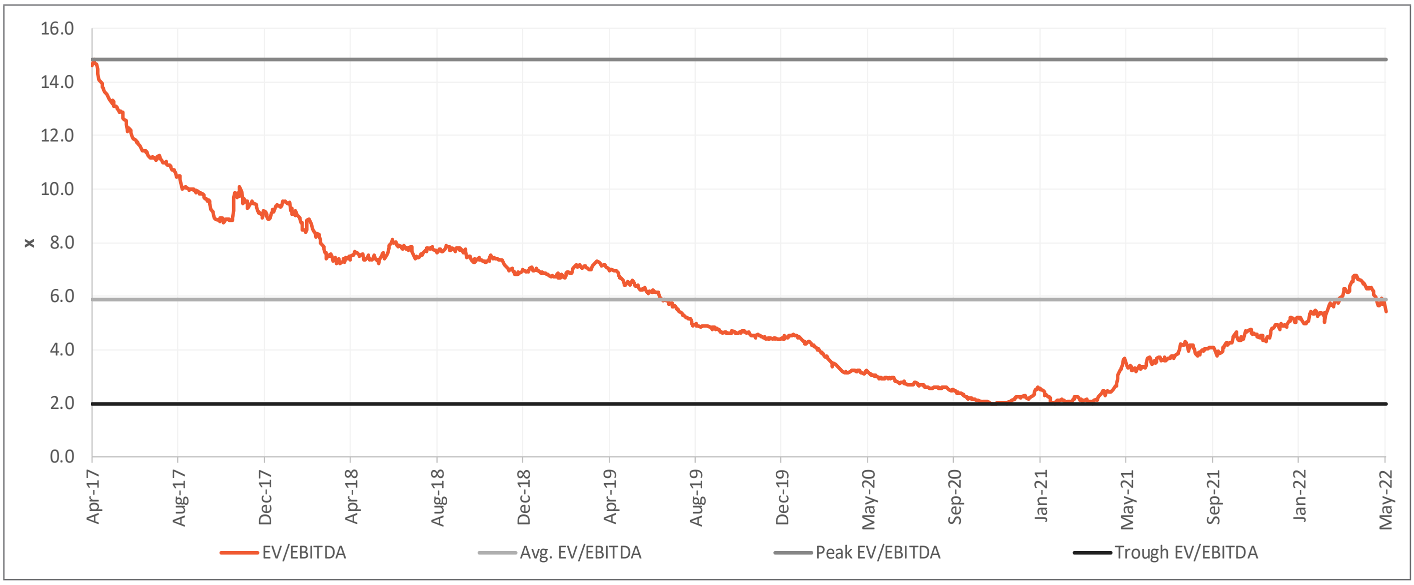
Outlook and Valuation

■ **Sector view – Steel export duty to dent sector profitability:** The government has recently imposed 15% export duty on steel with the aim to reduce inflation in the country. Export duty would mean surplus steel capacity in the domestic market and is expected to put pressure on domestic steel price (could correct by 10% or Rs. 6,500-7,500/tonne) in the environment of elevated imported coking coal price (>$400/tonne). Thus, we expect margin of the steel sector to correct sharply and the same would impact earnings, growth capex, and possibly increase debt on books. We believe change in policies on duties are short-term measures to control inflation and could get reversed as it would impact capex in the steel sector.

■ **Company outlook – Likely weak realisation to impact earnings:** We expect SAIL's FY2023 EBITDA/PAT to decline sharply by 54%/69% as reduced steel realisation is expected to result in sharply lower margin of Rs. 5,274/Rs. 4,937 per tonne versus Rs. 21,342/tonne in FY2022. We expect a decent volume CAGR of 6% over FY2022-FY2024E, but surplus capacity in the domestic market amid export duty poses risk to overall volume growth.

■ **Valuation – Downgrade to Hold with a revised PT of Rs. 80:** The recent government decision to impose 15% export duty on steel is expected to severely impact domestic steel price and in turn profitability of steel players, given elevated coking coal prices. We believe lower earnings would impact growth capex and increase debt on the books. Thus, we downgrade SAIL to Hold (from Buy earlier) with a revised PT of Rs. 80. Reversal in export duty remains key to steel margin/capex outlook. At the CMP, the stock trades at 5.4x its FY2024E EV/EBITDA.

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 domestic steel margin to decline, given the recent government decision to impose 15% export duty on steel products to control inflation. Additionally, elevated imported coking coal price remains a cause of concern for the steel sector. Weak earnings could impact growth capex and could increase debt on books.

Key Risks

- Sharp rise in steel prices and normalisation of coking coal prices could improve earnings outlook.
- Removal of export tax on steel could improve sector valuation.

Additional Data

Key management personnel

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

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corporation of India	5.73
2	Nippon India Life Asset Management Ltd	1.24
3	Vanguard Group Inc	0.75
4	Kotak Mahindra Asset Management Co Ltd	0.62
5	ICICI Prudential Asset Management Co Ltd	0.58
6	Dimensional Fund Advisors LP	0.49
7	Edelweiss Asset Management Ltd	0.42
8	Power Corp of Canada	0.30
9	Aditya Birla Sun Life Asset Management Co Ltd	0.27
10	PGIM India Asset Management Pvt Ltd	0.27

Source: Bloomberg

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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