Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Steel Authority of India Ltd

Lower steel prices to dent profitability; downgrade to Reduce

Metal & Mining	Sharekhan code: SAIL
Reco/View: Reduce ↓	CMP: **Rs. 82** / Price Target: **Rs. 70** ↓

↑ 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 40.40

Updated Jul 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. 33,681 cr
52-week high/low:	Rs. 138 / 64
NSE volume: (No of shares)	354.2 lakh
BSE code:	500113
NSE code:	SAIL
Free float: (No of shares)	144.6 cr

Shareholding (%)

Promoters	65.0
FII	4.2
DII	8.8
Others	22.0

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	14.8	2.3	-19.8	-39.1
Relative to Sensex	3.7	-10.3	-22.0	-46.4

Sharekhan Research, Bloomberg

Summary

- Q1FY23 operating profit of Rs. 2,302 crore (down 65% y-o-y; down 46.9% q-o-q) was 10% above our estimate of Rs. 2,086 crore due to higher-than-expected blended EBITDA margins of Rs. 7,307/tonne (down 21% q-o-q and 26% above our estimate of Rs. 5,795/tonne). Saleable steel volume of 3.2 million tonnes (down 32% q-o-q) missed estimates.
- Beat in margin was primarily due to higher-than-expected increase of 17% q-o-q in blended steel realization at Rs. 76,281/tonne. However, margins declined sharply q-o-q led by steep rise in coking coal cost.
- Chinese steel exports rose 54% y-o-y in Q1FY23 and thus would put further pressure on domestic steel prices. Thus we expect EBITDA margins to stay stressed. Weak profitability and capex would affect balance sheet deleveraging.
- Weak earnings to impact growth capex, likely increase debt and lower sector valuation and thus, we downgrade SAIL to Reduce (from Hold earlier) with a revised PT of Rs. 70. The stock trades at 6.6x FY24E EV/EBITDA.

Steel Authority of India Limited's (SAIL's) Q1FY23 consolidated operating profit of Rs. 2,302 crore (down 65% y-o-y; down 46.9% q-o-q) was 10% above our estimate of Rs. 2,086 crore, due to higher-than-expected blended EBITDA margin of Rs. 7,307/tonne (down 63% y-o-y; down 21% q-o-q and versus our estimate of Rs. 5,795/tonne). Saleable steel volume of 3.2 million tonne (down 33% q-o-q) was below our estimate of 3.6 million tonnes. Beat in margin was primarily due to higher-than-expected increase of 16.7% q-o-q in blended steel realisation at Rs. 76,281/tonne. PAT at Rs. 804 crore (down 79.4% y-o-y; down 67.4% q-o-q) was 9% above our estimate of Rs. 738 crore led by a beat in margins, a rise in other income partially offset higher depreciation costs.

Key positives

- Beat of 26% in EBITDA margin at Rs. 7,307/tonne led by higher-than-expected steel realization.

Key negatives

- Lower-than-expected saleable steel volume at 3.2 mt; down 33% q-o-q.
- Sharp 58% q-o-q increase in gross debt to Rs. 22,101 crore due to higher working capital requirements.

Management Commentary

- Domestic steel prices corrected by over 20% with June/July steel price at Rs. 58000/Rs. 56700 per tonne. On the other hand, coking cost has also declined to Rs. 33000/tonne in August versus Rs. 38,500/tonne in Q1FY23.
- Management expects sales volume to pick-up from Q2FY23 and has posted strong volume of 1.4 mt in July 2022. It maintained its capex guidance of Rs. 8,000 crore for FY23 and expects it to increase from Q3FY23.
- Working capital increased by Rs. 8000 crore due to high cost coking coal inventories.

Revision in estimates – We have slashed our FY2023E-FY2024E earnings estimates to factor lower margin amid expectation of decline in domestic steel price.

Our Call

Valuation – Downgrade SAIL to Reduce with a revised PT of Rs. 70: The recent government decision to impose 15% export duty on steel is expect to severely affect domestic steel prices and in turn the profitability of steel players. We believe that lower earnings to affect growth capex and drive up debt on the books. Thus, we downgrade SAIL to Reduce (from Hold) with a revised PT of Rs. 70. Likely reversal in export duty remains key to the steel margin/capex outlook. At, CMP the stock trades at 6.6x FY24E EV/EBITDA.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenues	69,114	1,03,477	86,950	88,350
OPM (%)	20.1	20.6	10.2	9.5
Adjusted PAT	5,246	12,597	3,206	2,497
% YoY growth	*81.4*	*140.1*	*-74.5*	*-22.1*
Adjusted EPS (Rs.)	12.7	30.5	7.8	6.0
P/E (x)	6.4	2.7	10.5	13.5
P/B (x)	0.7	0.6	0.6	0.6
EV/EBITDA (x)	4.9	2.2	6.1	6.6
RoNW (%)	12.1	25.3	5.8	4.3
RoCE (%)	11.9	21.8	6.0	4.9

Source: Company; Sharekhan estimates

PAT beat estimate as blended steel realization bettered hopes

Q1FY23 consolidated operating profit of Rs. 2,302 crore (down 65% y-o-y; down 46.9% q-o-q) was 10% above our estimate of Rs. 2,086 crore, due to higher-than-expected blended EBITDA margin of Rs. 7,307/tonne (down 63% y-o-y; down 21% q-o-q and versus our estimate of Rs. 5,795/tonne). Saleable steel volume of 3.2 million tonne (down 33% q-o-q) was below our estimate of 3.6 million tonnes. Beat in margin was primarily due to higher-than-expected increase of 16.7% q-o-q in blended steel realisation at Rs. 76,281/tonne. PAT at Rs. 804 crore (down 79.4% y-o-y; down 67.4% q-o-q) was 9% above our estimate of Rs. 738 crore led by a beat in margins, a rise in other income partially offset higher depreciation costs.

Q1FY23 conference call highlights

- **Steel price outlook:** Average domestic steel prices in Q1FY23 were at Rs. 66,000/tonne (+Rs. 6,000/ton qoq). Steel prices declined to Rs. 58,000/tonne in June 2022 and by further Rs. 1,200-1,300/tonne in July-August 2022.
- **Coking coal price outlook:** Average coking coal costs in Q1FY23 were at Rs. 38,500/tonne versus Rs. 28,500/tonne in Q4FY22. Management expects coking coal costs to decline from August 2022 onwards.
- **Margin forecast:** Company did not give margin guidance, as the prices are volatile. However, near-term margins will be under pressure due to declining steel prices. Volume outlook: The company expects sales volumes to improve from Q2FY23 and has already achieved 1.4 mn tonnes of sales volume in July 2022.
- **Steel export duty impact:** Imposition of export duty on steel negatively impacted export volumes during the quarter. SAIL has requested the government to remove such duties but has not achieved much on this front.
- **Capex guidance:** The management maintained its capex guidance of Rs. 8,000 crores for FY23. However, capex incurred in Q1FY23 was only Rs. 1,000 crore. Company expects capex to pick up from Q3FY23.
- **Debt:** A substantial rise of 58% sequentially in gross debt to Rs. 22,101 crore. This was mainly to fund high working capital requirements due to an increase in coal payments.
- **Employee Cost:** Management expects the quarterly run rate of Rs. 3,000 crore for employee costs to continue in FY23.

Results (Consolidated) **Rs cr**

Particulars	Q1FY23	Q1FY22	Y-o-Y %	Q4FY22	Q-o-Q %
Revenue	**24,029**	**20,643**	**16.4**	**30,759**	**-21.9**
Total Expenditure	21,727	14,075	54.4	26,421	-17.8
Operating profit	**2,302**	**6,568**	**-65.0**	**4,338**	**-46.9**
Other Income	171	112	52.9	416	-59.0
Interest	374	503	-25.6	440	-15.0
Depreciation	1,194	1,026	16.4	1,144	4.4
Exceptional income/(expense)	-	-	NA	11	NA
Share of Profit I (Loss) of Associates/JVs	143	62	132.4	98	45.2
Reported PBT	1,047	5,212	-79.9	3,279	-68.1
Adjusted PBT	**1,047**	**5,212**	**-79.9**	**3,268**	**-68.0**
Tax	243	1,315	-81.5	800	-69.7
Reported PAT	804	3,897	-79.4	2,479	-67.5
Adjusted PAT	**804**	**3,897**	**-79.4**	**2,471**	**-67.4**
Equity Cap (cr)	413	413		413	
Reported EPS (Rs.)	1.9	9.4	-79.4	6.0	-67.5
Adjusted EPS (Rs.)	1.9	9.4	-79.4	6.0	-67.4
Margins (%)			**BPS**		**BPS**
OPM	9.6	31.8	-2224.0	14.1	-452.3
Adjusted NPM	3.3	18.9	-1553.2	8.0	-468.5
Tax rate	23.2	25.2	-204.3	24.4	-121.9

Source: Company; Sharekhan Research

Key operating metrics

Particulars	Q1FY23	Q1FY22	Y-o-Y %	Q4FY22	Q-o-Q %
Crude seel production (mmt)	4.3	3.8	14.9	4.6	-5.7
Saleable steel volume (mmt	3.2	3.3	-5.4	4.7	-33.1
Blended realisation (Rs/tonne)	76,281	61,991	23.1	65,361	16.7
Blended gross spreads (Rs/tonne)	23,651	40,474	-41.6	30,132	-21.5
Blended reported EBITDA margin (Rs/tonne)	7,307	19,724	-63.0	9,217	-20.7

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 to reduce inflation in the country. The duty would mean surplus steel capacity in the domestic market and is expected to put pressure on domestic steel prices (could correct by 10% or Rs. 6500-7500/tonne) in the environment of elevated imported coking coal prices (>$400/tonne). Thus, we margin of steel sector to correct sharply and the same would affect earnings, growth capex and possibly increase debt on books. We believe that change in policies on duties are short-term measure to control inflation and could get reversed as it would impact capex in the steel sector.

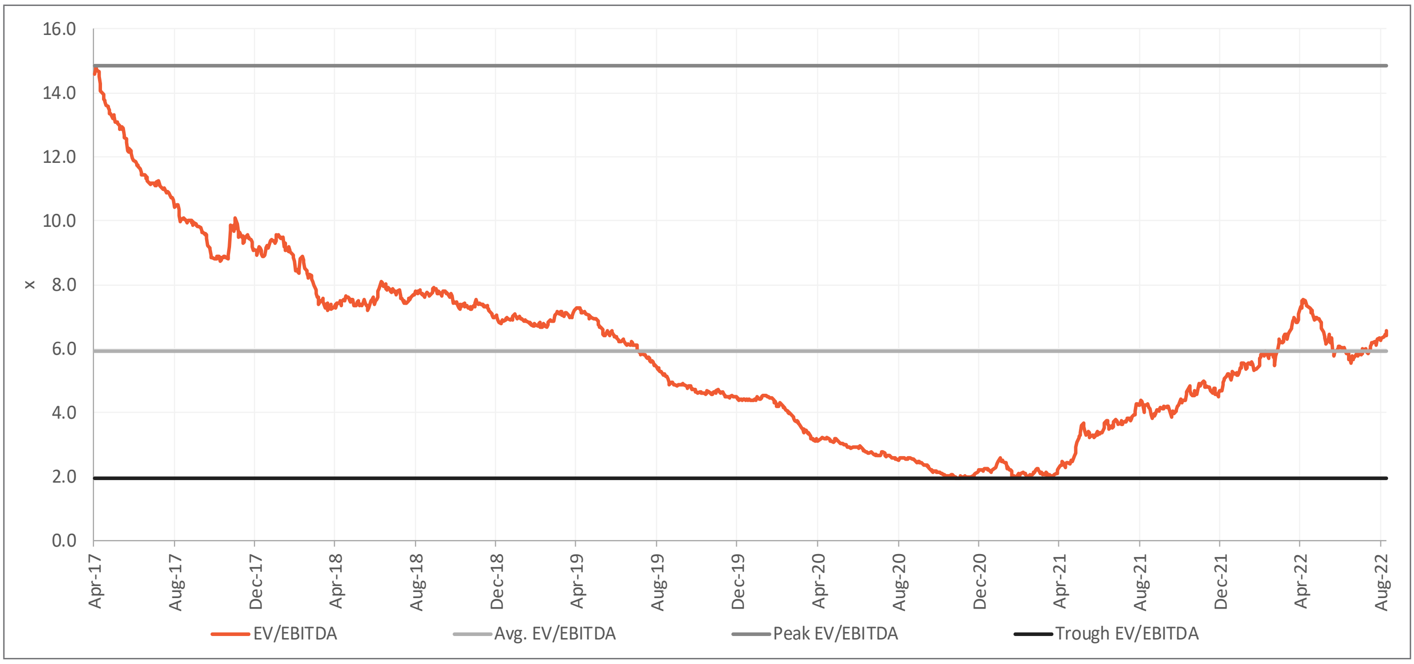
■ Company outlook – Likely weak realisations to hit earnings

We expect SAIL's FY23 EBITDA/PAT to decline sharply by 75%/22% as decline in steel realization to result sharply lower margin of Rs. 4,774/Rs. 4,437 per tonne versus Rs. 21342/tonne in FY22. We expect a decent volume CAGR of 6% over FY22-24E but a surplus domestic capacity amid imposition of the export duty posed a risk to overall volume growth.

■ Valuation – Downgrade SAIL to Reduce with a revised PT of Rs. 70

The recent government decision to impose 15% export duty on steel is expect to severely affect domestic steel prices and in turn the profitability of steel players. We believe that lower earnings to affect growth capex and drive up debt on the books. Thus, we downgrade SAIL to Reduce (from Hold) with a revised PT of Rs. 70. Likely reversal in export duty remains key to the steel margin/capex outlook. At, CMP the stock trades at 6.6x FY24E EV/EBITDA.

One-year forward EV/EBITDA (x) band



Source: Company, 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 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 steel sector. Weak earnings could impact growth capex and could also increase debt on the books.

Key Risks

- Sharp rise in in steel prices and normalization 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 (Old data)

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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